Standardising Responsible Islamic Finance
A Review of Green, Social and Sustainability Sukuk

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1. Introduction

Sustainability and responsibility have become prominent themes in the contemporary finance industry. The rapid spread of Covid-19 infections in 2020 has further focused the attention of governments and other market participants on the relevance of raising capital with a targeted societal purpose. As a result, while financial activity categorised as ‘responsible’ may not yet challenge mainstream value-neutral finance in terms of scale or geographic spread, reframing financial transactions through a lens of responsibility is now a viable option for a growing number of financial market participants. Covering financial activity targeting a non-exhaustive range of sectors that fit pre-determined ethical, environmental, social and/or governance criteria, ‘responsible finance’ combines societal goals with value creation. In doing so, responsible finance transactions aim to provide both financial returns for transaction participants and a positive impact on society based on benchmarks applied by those transaction participants.

Like responsible finance, the contemporary Islamic finance industry is a comparatively niche, but growing, sector in the global finance markets. This industry is arranged around financial activity structured to adhere to the financial principles of Islamic law and intertwines principles derived from religious teaching with financial objectives. In the context of Islamic finance as it operates today, structural compliance with the Islamic legal prohibitions of *riba*

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4 There are many terms used to describe this sector, but for consistency this article adopts the term ‘responsible finance’ to describe financial transactions that are structured to consider both financial and non-financial criteria. M. O’Brien Hylton, ‘Socially Responsible Investing: Doing Good Versus Doing Well in an Inefficient Market’ *The American University Law Review* 42 (1992) 1–52, pp. 6–10; J.M. Puauchonder, ‘On the emergence, current state, and future perspectives of Socially Responsible Investment (SRI)’, *Consilience* 16 (2016) 38–63, p. 41.
5 Baker and Nofsinger, supra (n 3) at 3.
6 The terms ‘Islamic law’ and ‘shari’ah’ are often used interchangeably. This article will use the term Islamic law unless quoting directly or where the context requires otherwise. There is no single correct means of expressing Arabic terms and sounds in the Latin alphabet. Throughout this chapter, quotations and the official names of products and organisations, which contain a transliteration of Arabic terms and use of italicisation which are different from that used in this chapter, will be reproduced without adjustment.
(unjustified gain in a financial transaction, frequently translated today simply as interest), gharar (excessive risk), maysir (gambling) and haram (forbidden) activities demonstrates an Islamic finance product’s visible adherence to rules of Islamic law. Concurrently with these structural characteristics, the ethical framework that is seen by some as already embedded within Islamic finance is highlighted as underpinning a natural compatibility between Islamic finance and responsible finance. However, while the responsible finance and Islamic finance market sectors may be seen as similar in their approach to financial activity and in their thematic goals, overlap between the two sectors has been relatively limited. Despite suggestions of Islamic finance’s ingrained ethical nature, the current practice of this financial sector has more commonly been to comply with the legal requirements of Islamic law through the structural avoidance of prohibited activities, rather than to positively promote and implement any ethical framework. Islamic finance transactions to date have, therefore, generally been ones in which any wider societal benefits arising from a transaction have been incidental to, rather than being considered equally important as, financial returns. The currently modest interaction between responsible finance and Islamic finance can be seen in the sukuk market, where the majority of issuances

8 Frank Vogel and Samuel Hayes, Islamic Law and Finance Religion, Risk, and Return (Brill, 1998), Chapter 4.
11 Moghul and Safar-Aly, supra (n 10) at 26.
13 Activity based on charity and philanthropy (such as qard hasan (interest free loan), zakat (compulsory alms giving), sadaqah (voluntary alms giving) and waqf (Islamic endowment)) exists within the Islamic social finance sector in the same way that charitable activity within conventional finance is possible (World Bank and the Islamic Development Bank Group, Global Report on Islamic Finance 2016: A Catalyst for Shared Prosperity? (World Bank, 2016), xi. See also, Islamic Commercial Law Report 2018, supra (n 9)). However, this article focuses on activity in which sustainability, social impact and other extra-financial goals are combined with profit making goals, rather than being acts of charity. Outside of the mainstream Islamic finance market, the Islamic microfinance sector has seen some grassroots development, see generally, Atif Hanif and Edana Richardson, ‘Sharia-Compliant Microfinance’ in Ranajoy Basu (ed), Microfinance: A Practitioner’s Handbook (Globe Law and Business 2013), 63.
to date have structurally complied with rules of Islamic law, but have been value-neutral with respect to their impact on society more generally.\textsuperscript{15}

\textit{Sukuk} are Islamic capital markets instruments that evidence the proportionate interest of holders (referred to in this article as ‘certificateholder’) in underlying assets, revenues or services.\textsuperscript{16} In economic effect, \textit{sukuk} share characteristics with conventional bonds, but are structured to adhere to the financial principles of Islamic law. As the conventional responsible finance bond industry has expanded, issuances of \textit{sukuk} promoted as being ‘responsible’ still constitute only a tiny portion of the \textit{sukuk} certificates issued to date.\textsuperscript{17} Nevertheless, within the last five years, and most noticeably since 2017, there has been a perceptible increase in the number of green, social and sustainability \textit{sukuk} issuances. These transactions represent innovative financial products through which transaction participants can pursue financial and extra-financial objectives, while also complying with structural requirements of Islamic law.

With growth in the global responsible finance sector has come calls for increased standardisation across responsible finance transactions and for the development of common metrics and a unified set of standards as to what constitutes a responsible finance transaction.\textsuperscript{18} In the conventional responsible finance bond market, steps towards greater standardisation have come largely from the financial market itself, with some political intervention. In the responsible finance \textit{sukuk} market, the development of responsible finance standards has more often been government-led. The evolution of responsible finance \textit{sukuk} standards, and their application in practice, remains under-researched in an academic context. This article will, therefore, consider the evolving parameters and standardisation of responsible finance \textit{sukuk}. It will begin by exploring the nature of responsible Islamic finance today and the priorities of those within the sector. To provide context and a point of comparison, it will then discuss the conventional responsible finance sector and its increased standardisation. It will also analyse the contemporary responsible finance \textit{sukuk} market and the development of relevant standards. Using the issuance of responsible finance \textit{sukuk} certificates by the Republic of Indonesia as a case study, this article will analyse how concepts of responsibility have been reflected in contemporary Islamic finance \textit{sukuk} issuances and the measures that issuers have put in place to verify the responsible credentials of an issuance. This article will conclude by considering whether common responsible finance \textit{sukuk} standards should now be developed.

\textsuperscript{15} Danial Idraki, ‘Green Sukuk: Slow progress in a sector with incredible potential’ (March 2016) 13(13) Islamic Finance News, 15 at 15.

\textsuperscript{16} AAOIFI, Shari‘a Standard No. (17), ‘Investment Sukuk’.

\textsuperscript{17} Idraki, supra (n 15) at 15.

\textsuperscript{18} See, for example, EU High-Level Expert Group on Sustainable Finance, Financing a Sustainable European Economy (European Commission, 2018), 30 online at: https://ec.europa.eu/info/sites/info/files/180131-sustainable-finance-final-report_en.pdf, accessed 24 May 2020, noting that ‘the EU should introduce an official EU Green Bond Standard’.
2. Combining Ethics and Finance – against what standards must responsible finance sukuk be benchmarked?

In a conventional context, ethics and notions of responsibility are, today, more often seen as fluctuating and personal to the individual, than as being prescribed by an external, universal source. In contrast, within Islamic law, ethics and responsibility remain predicated on Islamic belief and are inseparable from it. For those participating in the Islamic finance sector, ethics and responsibility derive from a common and enduring foundation of religious teachings. As Moghul has noted, ‘Islamic spirituality, in its norms as well as its practices, establishes a methodological framework and impetus to establish businesses and markets that support sustainability and social and environmental well-being.’ The existence of an ethical code in Islamic finance, therefore, does not come from the individual, but rather applies to every individual as a stable authoritative reference. Yet despite these differences in the reference frameworks for responsible finance and Islamic finance, it is the duality of concern that is common to both - the notion that societal well-being should be considered in pursuit of financial returns - that is presented as linking the two. As a result, ‘if you were to draw a circle representing ethical finance, a separate Islamic finance circle would overlap the ethical finance circle to a very great degree.’ Like conventional responsible finance then, Islamic finance is highlighted as inherentlysubjecting financial activity to qualitative benchmarks beyond just monetary gain.

Notwithstanding Islamic finance’s connection with religious principles, however, in order for an Islamic finance transaction to be classified as responsible in a contemporary financial context, transaction participants must actively strive to make the overlap between Islamic finance and responsible finance happen.

19 Moghul and Safar-Aly, supra (n 10) at 26. Rodney Wilson, ‘Parallels Between Islamic and Ethical Banking’ (2002) 11 Review of Islamic Economics 51 at 53 noting that ‘[t]hose involved in Islamic finance would regard their ethics as being enduring, as ultimately they are based on holy revelation, whereas ethics derived from social values are inevitably more transitory’.
20 The Emerging Convergence of SRI, ESG and Islamic Finance (Thomson Reuters – RFI Responsible Finance Report, 2015) at 60.
21 Wilson, supra (n 19) at 53.
23 Islamic Commercial Law Report 2018, supra (n 9) at 7.
25 de Belder, supra (n 14).
This positive step involves structuring financial products that intentionally fulfil prescribed ethical benchmarks, while also complying with the structural requirements of Islamic law. Without this additional layer of intentionality in an Islamic finance transaction to pursue goals beyond profit maximisation, any such transaction may simply be one that is neutral as to its wider societal impact.

Recent growth in the number of specifically designated responsible Islamic finance transactions could be attributed to mounting calls from religious leaders and those within the Islamic finance sector for greater adherence to the substance and spirit of Islamic law. However, rising global awareness of environmental, social and sustainability concerns have, arguably, been more influential in encouraging a greater willingness amongst Islamic finance market participants to engage with concerns beyond the financial impact of a transaction. While Islamic law’s ethical framework may be immutable and enduring, it is ultimately the individual’s role to apply and fulfil the tenets prescribed by that framework. This means that the societal impact of an individual Islamic finance transaction will be influenced and shaped by the ambitions and priorities of transaction participants. In the same way that conceptions of ethics and responsibility in conventional responsible finance reflect perceived contemporary societal needs, therefore, the application of Islamic law’s teachings today will be seen through the specific lens of modern societal needs and will depend on the context in which they are raised. Reflecting this, the evolution of responsible Islamic finance has, like that of conventional responsible finance, been one that has followed changing values amongst governments and market participants. With the shift in global interest towards responsible finance, the Islamic finance industry has similarly begun to consider environmental, social and sustainability issues of contemporary relevance. It is, therefore, against these contemporary benchmarks - which align with those used in the conventional responsible finance sector - that responsible finance sukuk today are measured and standardised.

3. Responsible Finance Bonds – moving towards some sort of standardisation?

Conventional responsible finance bonds are contractually similar to standard bonds. However, rather than directing proceeds generated by the issue of the bond certificates towards the funding of value-neutral activities such as ‘general corporate purposes’, responsible finance bonds ring-fence and then direct these proceeds towards projects meeting environmental, social or other ethical

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29 The term ‘project’ is used here to cover enterprises, activities and projects that may be invested in.
criteria. Responsible finance bonds, therefore, provide holders (referred to in this article as ‘bondholders’) with an opportunity to finance activities meeting particular societal objectives while also receiving a financial return on their investment.

In May 2020, the International Capital Markets Association (the ‘ICMA’), a capital markets trade association, noted the need ‘for convergence on terminology among markets participants, wider stakeholders, as well as policy makers and regulators’ in the context of responsible finance. Reflecting efforts to standardise the language of responsible finance bond issuances, the responsible finance bond market uses broad labels to describe issuances of responsible finance bonds. These issuances are classified as either green, social, sustainable or social impact. ‘Green bonds’ are instruments whose issue proceeds will be used to finance or refinance environmentally-beneficial projects. ‘Social bonds’ earmark funding for projects that seek to address social issues or to achieve positive social outcomes. ‘Sustainability bonds’ fund projects having both green and social objectives. Finally, social impact bonds (also known as ‘pay-for-success’ bonds) are not strictly debt instruments and are structured so that payments made to bondholders are contingent on the ability of a service provider to achieve targeted outcomes from a funded social project.

To support these labels and to encourage integrity amongst responsible finance bond participants, trade associations, industry bodies and, most recently, political entities, have sought to establish a framework of common responsible finance bond standards within which market participants can operate. These standards have, to date, largely focused on green bonds, but industry best practice standards have also been developed for social and sustainability bonds.

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30 See, for example, HSBC Holdings plc’s sustainability bond whose use of proceeds aligned with the International Capital Markets Association’s Sustainability Bond Guidelines (discussed below), while its eligible projects were classified based on specified United Nations Sustainable Development Goals, including good health and well-being, education, affordable and clean energy and climate action HSBC Holdings plc Sustainable Development Goal (SDG) Framework November 2017 at 8. See also, Sustainalytics, HSBC Sustainable Development Goals (SDG) Bond, Second-Party Opinion by Sustainalytics, 14 November 2017.


32 The ICMA referred to it as ‘sustainable finance’, which it defined as incorporating ‘s climate, green and social finance while also adding wider considerations concerning the longer-term economic sustainability of the organisations that are being funded, as well as the role and stability of the overall financial system in which they operate’, ibid., at 5.


34 ICMA, Social Bond Principles (ICMA, 2018).

35 Clifford Chance, ‘Make our Planet Great Again’ – Green, Social and Sustainability Bonds (June 2017), at 2, online at: https://www.cliffordchance.com/briefings/2017/06_make_our_planetgreatagain-greensocialan.html, accessed 24 May 2020.

36 Ranajoy Basu and Aaron Bourke, ‘Social impact investing: the growing trend of financing for good’ (2016) 8 Journal of International Banking and Financial Law 483A at 484B.

As parameters of ‘greenness’ vary between individual issuers and investors, whether a project to be funded is and remains ‘green’ is subjective. It is important, therefore, that market participants are provided with adequate information about a green bond issuance and the relevant project(s) that will be invested in. This information will allow investors to make an informed investment decision. In order to increase transparency and standardisation across the green bond market, two sets of voluntary guidelines have been developed for the green bond market: the Green Bond Principles (the ‘GBPs’) issued by the ICMA, and the Climate Bonds Standard issued by the Climate Bond Initiative (the ‘CBI’), a non-governmental organisation. These guidelines are aligned, with the Climate Bonds Standards building on the GBPs to provide a more detailed set of requirements to be implemented by a green bond issuer. Both sets of guidelines, therefore, place strong emphasis on transparency and issuer disclosure with respect to the projects that are eligible to be financed using bond issue proceeds. While neither standard sets out a complete list of eligible green projects, they do set out non-exhaustive categories of such projects, including those linked to renewable energy, clean transportation and water distribution infrastructure. Both the GBPs and the Climate Bonds Standards also encourage an issuance’s green credentials to be independently verified. This external review process can take the form of an independent consultant’s review (which includes a second-party opinion on the ‘greenness’ of the proposed use of proceeds), verification by a qualified party, certification by an external green assessment standard or a third party rating.

From a political perspective, steps towards harmonisation of green bond standards have also been taken. In March 2018, the European Commission

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40 CBI, Climate Bonds Standard, Version 3.0 (CBI, 2019).
41 ICMA, Green Bond Principles, supra note 39 at Section 1 – Use of Proceeds, CBI, supra note 40 at Part A, Section 4 – Reporting Prior to Issuance.
42 The CBI’s list of eligible projects is more prescriptive than the corresponding list in the ICMA’s Green Bond Principles. See, for example, the issue of USD587,000,000 3.00% green bonds by National Bank of Abu Dhabi P.J.S.C. (now First Abu Dhabi Bank P.J.S.C.) the proceeds from the issue of which are to be used to finance, in whole or in part, projects falling within one or more eligible categories, which include renewable energy, energy efficiency, pollution prevention and control, sustainable water management and climate change adaptation. An external review ‘second party opinion’ was provided by Vigeo Eiris, which confirmed that the bonds aligned with the ICMA GBPs, Vigeo Eiris Enterprise, Second Party Opinion on Sustainability of NBAD’s ‘Green Bond’, issued March 2017.
43 External review to confirm alignment with the Green Bond Principles is recommended by the ICMA, ICMA, Green Bond Principles, supra note 39, External Review and is required by certain stock exchanges, such as the London Stock Exchange plc, before a green bond issuance that is listed on the exchange’s dedicated green bond segments.
45 For example, the Climate Bond Initiative Climate Bond Certified stamp of approval (which also requires the appointment of a third party approved verifier).
46 See for example the Moody’s Investor Service, Green Bonds Assessment (GBA) methodology. ICMA, Green Bond Principles, supra note 39, External Review.
published an Action Plan on Financing Sustainable Growth (the ‘Action Plan’). This Action Plan sets a strategy to ‘further connect finance with sustainability’, including through the creation of standards and labels for green finance products. A Technical Expert Group established as part of this Action Plan recommended that the European Commission establish a framework for determining when economic activity is considered to be environmentally sustainable. This led to the development of a proposed Regulation on the Establishment of a Framework to Facilitate Sustainable Investment (the ‘Taxonomy Regulation’). This Taxonomy Regulation sets out a classification system that the EU and Member States can use when setting out legislative measures or standards in respect of green bonds and to which market participants can refer in order to determine whether economic activity is environmentally sustainable. The taxonomy will enter into force in a phased manner until 31 December 2022 and represents a move towards the adoption of more prescriptive and exhaustive criteria for determining a project’s suitability for green financing.

In parallel with the Taxonomy Regulation, the Technical Expert Group also recommended that the European Commission create a non-legislative, voluntary standard to ‘enhance the effectiveness, transparency, accountability, comparability and credibility of the green bond market without disrupting the market, and to encourage bond issuers to issue their bonds as “EU Green Bonds”’. In June 2019, an updated draft of the Technical Expert Group’s report on the European Union Green Bond Standard (EU-GBS) was published. Though not yet reflected in legislation, the EU-GBS provides an indication of the framework within which issuers of green bonds may have to operate in order

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49 ibid.


55 ibid.
for bond issuances to be classified as ‘EU Green Bonds’.

The EU-GBS builds on, and is aligned to, market best practices, most notably the ICMA’s GBPs. Like the GBPs, therefore, the EU-GBS are voluntary, but, once an issuer chooses to follow the EU-GBS, the framework is more prescriptive and less discretionary than the GBPs. As part of the EU-GBS, the Technical Expert Group recommended linking the use of proceeds from EU Green Bonds to the Taxonomy Regulation. As such, each eligible project should align with the Environmental Objectives within the Taxonomy Regulation. Proceeds from the issue of EU Green Bonds should, therefore, contribute to (i) climate change mitigation, (ii) climate change adaptation, (iii) sustainable use and protection of water and marine resources, (iv) transition to a circular economy, waste prevention and recycling; (v) pollution prevention and control and (vi) protection of healthy ecosystems’ while not ‘significantly harming any of the other objectives’ but while complying with certain ‘minimum social safeguards’ and technical screening criteria. The Technical Expert Group also recommended that issuers of EU Green Bonds prepare a green bond framework in which they provide details on ‘all key aspects of the proposed use-of-proceeds, and [the issuer’s] green bond strategy and processes at issuance’, that the use of proceeds and impact of a green bond issuance be reported, and that an issuance’s alignment with the EU-GBS be verified by an accredited external verifier. Complementing the GBPs, therefore, the EU-GBS seek to provide market participants with a common language and framework that encourages transparency and builds investor confidence in the green bond market.

Reflecting their smaller share of the responsible finance bond market, social and sustainability bonds have been the subject of less extensive standardisation efforts. Nevertheless, what constitutes a suitably positive ‘social’ project is, like notions of greenness, subjective. As is the case for green bonds, issuers of social bonds can voluntarily align the structure of a social bond issuance with market-led standards, most notably, the ICMA’s Social Bond Principles (‘SBPs’). The SBPs closely follow the GBPs and aim to encourage transparency and standardisation in the market for financing projects meeting social objectives. Like the GBPs, the SBPs do not comprehensively set out eligible social bond projects. Instead, social project categories within the SBPs include, but are not limited to, those providing affordable basic infrastructure, access to healthcare, education, vocational training, financing and financial services, affordable housing, employment generation, food security and socioeconomic advancement.

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58 EU Technical Expert Group on Sustainable Finance, Taxonomy, supra (n 52) at 43.
59 EU Technical Expert Group on Sustainable Finance, Report on EU Green Bond Standard, supra (n 53) at 32.
60 ibid.
and empowerment.\textsuperscript{62} The SBPs also outline suggestions as to target populations who can benefit from the relevant social projects.\textsuperscript{63} Like the GBPs, the SBPs recommend external review to verify the social objectives of a social bond issuance.\textsuperscript{64}

With respect to sustainability bonds that direct financing towards projects that are both green and social without falling clearly within one specific category, the ICMA published its Sustainability Bond Guidelines (the Sustainability Bond Guidelines, together with the GBPs and the SBPs, the ‘ICMA Responsible Finance Bond Principles’). These voluntary guidelines provide that a bond can be classified as a sustainability bond if it complies with the core components of both the GBPs and the SBPs.\textsuperscript{65} The guidelines do not themselves set out specific structural recommendations for sustainability bonds, but rather direct market participants to the GBPs and the SBPs.\textsuperscript{66}

Finally, unlike green, social and sustainability bonds, social impact bonds are not subject to specific market or industry-led guidelines. As a result, the legitimacy of a social outcome in social impact bonds, or procedures for independent verification of a project’s social credentials, have not yet been standardised.

The ICMA Responsible Finance Bond Principles continue to represent market best practice in the responsible finance bond market. These frameworks are voluntary, and their core elements are recommendations for responsible finance bond issuers. External review as standard in responsible finance bond issuances reflects this voluntariness as well as the ability of issuers to self-label bonds as green, social or sustainable. It also reflects the market’s need for assurances beyond those of the issuer that a bond issuance is responsible in substance. While the Climate Bonds Standards and the EU-GBS are also voluntary, in order to be certified as a green bond under the Climate Bonds Standards or to be classified as an ‘EU Green Bond’ under the EU-GBS (once adopted), issuances are required to fulfil certain more prescriptive criteria set out by the relevant framework. Across the board, these frameworks complement rather than contradict each other. In each case, they focus primarily on encouraging transparency and consistent issuer disclosure. This works to provide investors with information that will assist them in determining whether the use of proceeds of an individual issuance of responsible finance bonds aligns with that investor’s own ethical benchmarks.

4. Responsible Finance Sukuk – Types and Standardisation

\textsuperscript{62} ibid., at section 1 – Use of Proceeds.
\textsuperscript{63} ibid., at section 1 – Use of Proceeds.
\textsuperscript{64} ibid., External Review.
\textsuperscript{65} ICMA, Sustainability Bond Guidelines (ICMA, 2018), Sustainability Bond Definition.
\textsuperscript{66} ibid.
Responsible finance sukuk are structured using a combination of classical Islamic contracts. These contracts operate to create a financial instrument that complies with the prohibitions of Islamic law. At the same time, they also provide a mechanism for an entity to raise finance in the capital markets and for certificateholders to receive periodic payments. While the responsible finance sukuk market has, to date, shown a preference for sukuk structures based on, or incorporating, murabaha arrangements (a sales agreement where the purchase price of assets is payable on a deferred and marked-up basis), the combination of contracts used in individual responsible finance sukuk issuances will vary between transactions. This is because the contractual structure chosen by the parties will depend on jurisdiction-specific regulatory requirements, the underlying assets in which the certificateholders receive an undivided ownership interest, and the extent to which transaction parties want the responsible finance sukuk to replicate the economic substance of a conventional bond. Nevertheless, like responsible finance bonds, the defining characteristic of responsible finance sukuk is the deliberate ring-fencing of issue proceeds and the application of those proceeds to fund green, social or sustainable projects.

Until the Technical Expert Group’s call for the European Commission to adopt the EU-GBS, the push for harmonisation across the conventional responsible finance bond sector was primarily market-driven. In contrast, within the Islamic finance market measures designed to standardise and encourage responsible finance sukuk have come from government or intergovernmental authorities. This ‘top-down’ approach to encouraging responsible finance sukuk is reflected in the development of relevant standards. These standards specify the characteristics that an issuance of sukuk certificates should display in order to be categorised as responsible.

In 2019, the Shariah Advisory Council of the Securities Commission of Malaysia (the ‘SC’, a statutory body with authority to oversee, regulate and develop the Malaysian capital markets) noted that the purpose of issuing responsible finance sukuk is to ‘promote the investment and funding of activities related to social responsibility’. This promotion of socially responsible finance and investment has become a key aspect of Malaysia’s capital markets regulatory infrastructure. Reflecting this, in 2014 the SC published the first responsible finance sukuk standards to facilitate the issuance of these instruments within Malaysia. These standards are built into Malaysia’s existing regulatory framework for sukuk and are mandatory for issuers who want to issue responsible finance sukuk within Malaysia. In the 2014 revised edition of the SC’s

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68 This goal was initially set out in SC, Capital Market Masterplan 2 (Securities Commission Malaysia, 2011) at 3.1.4.
69 See SC, Guidelines on Issuance of Corporate Bonds and Sukuk to Retail Investors, SC-GL/5-2015 (R5-2019), first issued 15 June 2015; revised 26 November 2019 (‘SC Retail Guidelines’), Section 1.07, which provides that
Guidelines on Sukuk, therefore, a new Part D was added to address the additional requirements to be met for the issue, offering and invitation to subscribe or purchase ‘sustainable and responsible investment (SRI) sukuk’. The Guidelines on Sukuk have since been superseded by the Guidelines on Unlisted Capital Market Products under the Lodge and Launch Framework and the Guidelines on Issuance of Corporate Bonds and Sukuk to Retail Investors, each of which has a separate chapter dedicated to responsible finance sukuk (these chapters together, the ‘SC’s SRI Sukuk Standards’). As a result, responsible finance sukuk issued in Malaysia must comply with the SC’s broader sukuk standards as well as the more specific SC’s SRI Sukuk Standards.

As is the case with responsible finance bonds, the threshold requirement for classification as a sukuk complying with the SC’s SRI Sukuk Standards is that the proceeds from the issue of the sukuk certificates are directed towards funding eligible projects. These projects should aim to preserve and protect the environment and natural resources, to conserve the use of energy, to promote use of renewable energy or the reduction of greenhouse gas emissions, to address or mitigate specific social issues or to improve quality of life within society. When the SC’s SRI Sukuk Standards were initially published, the list of eligible projects that could be funded was specific and finite. Bringing the SC’s SRI Sukuk Standards more closely in line with international best practice, the standards have since been amended so that the list of eligible projects referred to in the SC’s SRI Sukuk Standards is now non-exhaustive. These eligible projects include (but are not limited to) ‘green projects’ that relate to renewable energy, pollution prevention and control, or climate change adaptation, ‘social projects’ that relate to affordable basic infrastructure, access to essential services or food security, or projects that combine green and social projects. It is the issuer’s responsibility

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[a]All issuances of sukuk must comply with the requirements set out in Part D of these Guidelines. In addition to the requirements in Part D, issuances of Sustainable and Responsible Investment (SRI) sukuk must also comply with the requirements under Part E of these Guidelines.

71 SC, Guidelines on Unlisted Capital Market Products under the Lodge and Launch Framework, SC-GL/4-2015 (R4-2019), first issued 9 March 2015, revised 26 November 2019 (‘SC LOLA Guidelines’). While these Guidelines refer to ‘unlisted capital market products’, they go on to clarify that this includes ‘corporate bonds or sukuk under the Exempt Regime’, which is the regime implemented under the Bursa Malaysia Main Market Listing Requirements which allows for the listing of sukuk or bonds on the Malaysian Stock Exchange without those sukuk or bonds being quoted or traded on the Malaysian Stock Exchange. This regime allows issuers who intend to list sukuk or bonds on the Malaysian Stock Exchange for the listing purposes and where these securities are not offered to retail investors but rather to sophisticated investors.

72 SC Retail Guidelines.
73 SC LOLA Guidelines, para. 7.02 and SC Retail Guidelines, para. 20.02.
74 SC LOLA Guidelines, supra (n 71), para. 7.04(c) and SC Retail Guidelines, supra (n 69) at para. 20.04(c).
75 Para 20.04, SC Retail Guidelines when originally published on 15 June 2015 set out a finite list of eligible projects, noting that: ‘[o]nly 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: Natural resources..., Renewable energy and energy efficiency..., Community and economic development..., or Waqf properties / assets....’
76 SC LOLA Guidelines, supra (n 71) para. 7.08 and SC Retail Guidelines, supra (n 69) at para. 20.08.
77 SC Retail Guidelines, supra (n 69) at para 20.08.
to establish internal processes to evaluate and select eligible projects based on these criteria.\footnote{SC LOLA Guidelines, \textit{supra} (n 71) para. 7.12 and SC Retail Guidelines, \textit{supra} (n 69) at para. 20.12.}

The focus in the SC’s SRI Sukuk Standards on both environmentally-friendly projects and projects with a positive social objective shares characteristics with the ICMA’s Sustainability Bond Guidelines and approves a more diverse range of projects than the GBPs, the SBPs or the CBI’s Climate Bond Standards individually. Recent amendments to the SC’s SRI Sukuk Standards have also brought the disclosure requirements imposed on issuers in line with those set out in the ICMA Responsible Finance Bond Principles. Like these principles, therefore, disclosure under the SC’s SRI Sukuk Standards now focuses on the four core components of use of proceeds, process for project evaluation and selection, management of proceeds, and reporting.\footnote{SC LOLA Guidelines, \textit{supra} (n 71) para. 7.14 et seq and SC Retail Guidelines, \textit{supra} (n 69) at para. 20.09 et seq.} As a result, issuers of responsible finance sukuk within the SC’s SRI Sukuk Standards must disclose information about the overall socially responsible investment objectives that the issuer intends to achieve, the use of proceeds and management of those funds, and details of the eligible project(s). It must also report annually to investors on the utilisation of the issue proceeds.\footnote{SC LOLA Guidelines, \textit{supra} (n 71) para. 7.14 and SC Retail Guidelines, \textit{supra} (n 69) at para. 20.14.}

The SC’s SRI Sukuk Standards are binding domestic measures to encourage harmonisation across Malaysian responsible finance sukuk. In 2017, the Association of Southeast Asian Nations (ASEAN) Capital Markets Forum, an intergovernmental forum for regulatory authorities from ASEAN countries, sought to achieve a similar harmonisation across the ASEAN region. It did so by publishing standards aimed at creating a common framework for ASEAN-linked responsible finance bonds and sukuk. These standards have sought to facilitate the development of specifically designated ASEAN green, social or sustainability bonds and sukuk.\footnote{ASEAN Capital Markets Forum, Development of a sustainable asset class in ASEAN, online at: https://www.theacmf.org/initiatives/sustainable-finance/development-of-a-sustainable-asset-class-in-asean, accessed 24 May 2020.} The first such standards were the ASEAN Green Bond Standards.\footnote{ASEAN Green Bond Standards (2018), \textit{supra} (n 82) at para. 2.0.} These standards are based on the GBPs and seek to ‘enhance transparency, consistency and uniformity of ASEAN Green Bonds.’\footnote{ASEAN Green Bond Standards (2018), \textit{supra} (n 82) at para. 2.0.} The ASEAN Green Bond Standards were updated and republished in 2018, together with the ASEAN Social Bond Standards\footnote{ASEAN Capital Markets Forum, ASEAN Social Bond Standards (ACMF, 2018), online at: https://www.theacmf.org/images/downloads/pdf/ASBS2018.pdf, accessed 24 May 2020.} (which are based on the SBPs) and the ASEAN Sustainability Bond Standards (which are based on the Sustainability
Bond Guidelines) (the three standards together, the ‘ASEAN Responsible Finance Bond Standards’). Like the ICMA Responsible Finance Bond Principles, the ASEAN Responsible Finance Bond Standards detail the process to be followed by issuers with respect to project evaluation and selection how the proceeds from the issue of responsible finance bonds or sukuk are to be managed and the level of disclosure expected of issuers before and following an issue of green bonds or sukuk. The ASEAN Responsible Finance Bond Standards also recommend external verification.

Although aligned with the corresponding ICMA Responsible Finance Bond Principles, the ASEAN Responsible Finance Bond Standards include a number of distinguishing features. Both the ASEAN Green Bond Standards and the ASEAN Social Bond Standards set out non-exhaustive lists of categories of eligible projects that align with the corresponding list of eligibility categories in the GBPs and SBPs, respectively. However, the ASEAN Responsible Finance Bond Standards also specifically confirm that certain categories of projects are ineligible for funding. These projects cover fossil fuel power generation projects and projects involving activities that ‘pose a negative social impact related to alcohol, gambling, tobacco and weaponry’. In addition to this, while the ICMA Responsible Finance Bond Principles can be used by issuers in any country, the ASEAN Responsible Finance Bond Standards are designed only for issuers or issuances of bonds and sukuk that have a geographic or economic connection to the ASEAN region. The standards also require that any external reviewer ‘have the relevant expertise and experience in the area which they are reviewing’ and that such credentials are made publicly available. Finally, continuous publicly available access to information on the use of proceeds, the

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86 ASEAN Green Bond Standards (2018), supra (n 82) at para. 4.2. ASEAN Social Bond Standards (2018), supra (n 84) at para. 4.2
87 ASEAN Green Bond Standards (2018), supra (n 82) at para. 4.3. ASEAN Social Bond Standards (2018), supra (n 84) at para. 4.3.
88 ASEAN Green Bond Standards (2018), supra (n 82) at para. 4.4. ASEAN Social Bond Standards (2018), supra (n 84) at para. 4.4.
89 ibid.
90 ASEAN Green Bond Standards (2018), supra (n 82) at para. 5.0. ASEAN Social Bond Standards (2018), supra (n 84) at para. 5.0.
91 ASEAN Green Bond Standards (2018), supra (n 82) at para. 4.1.5. ASEAN Social Bond Standards (2018), supra (n 84) at para. 4.1.5.
92 ibid.
93 ASEAN Green Bond Standards (2018), supra (n 82) at para. 4.1.7. ASEAN Social Bond Standards (2018), supra (n 84) at para. 4.1.7.
94 The ASEAN Green Bond Standards and the ASEAN Social Bond Standards define ‘ASEAN Green Bonds’ and ‘ASEAN Social Bonds’, respectively, as meaning bonds and sukuk that comply with the relevant standards.
95 This connection can either come through the issuer, the funded project or the origination of the origination of the issuance, ASEAN Green Bond Standards (2018), supra (n 82) at paras. 3.1 and 3.2. ASEAN Social Bond Standards (2018), supra (n 84) at paras. 3.1 and 3.2.
96 ASEAN Green Bond Standards (2018), supra (n 82) at para. 5.0. ASEAN Social Bond Standards (2018), supra (n 84) at para. 5.0.
process for project evaluation and selection, and management of proceeds, as well as more frequent periodic reporting to investors than that advocated by the ICMA Responsible Finance Bond Principles is encouraged under the ASEAN Responsible Finance Bond Standards.\(^{97}\)

Following publication of the ASEAN Responsible Finance Bond Standards, Malaysia’s SC revised its capital markets guidelines to provide for additional types of security, categorised as ‘ASEAN Green Bonds or Sukuk’, ‘ASEAN Social Bonds or Sukuk’ and ‘ASEAN Sustainability Bonds or Sukuk’. Rather than following the SC’s SRI Sukuk Standards, ASEAN responsible finance bonds or Sukuk issued within the regulatory oversight of the SC must align with the ‘prescribed standards’ set out in the relevant ASEAN Responsible Finance Bond Standards.\(^{98}\)

In the responsible finance sukuk market, then, the lead with respect to developing tailored standards has been assumed by national or intergovernmental authorities. However, through various amendments since their initial publication, these standards have increasingly been brought in line with market best practice set out primarily in the ICMA Responsible Finance Bond Principles. As a result, in both the responsible finance bond market and the responsible finance sukuk market, the push towards harmonisation is now based on transparency and guidance on eligible project categories, the management of issue proceeds, periodic reporting and independent assessment. This growing conformity across standards has allowed a number of responsible finance sukuk issuances to be structured to comply with the SC’s SRI Sukuk Standards and/or the ASEAN Responsible Finance Bond Standards while also being assessed by independent assessors as compliant with the ICMA Responsible Finance Bond Principles. This benchmarking against a number of standards is something reflected in the recent Indonesian Green Sukuk (defined below).

### 5. Case Study – Indonesian Green Sukuk

Since 2017, Malaysian issuers have dominated the responsible finance sukuk market.\(^{99}\) However, gradually issuers from other jurisdictions have begun to issue responsible finance sukuk, with issuers from Indonesia, the United Arab Emirates\(^ {100}\) and Saudi Arabia\(^ {101}\) recently accessing this market. Reflecting this

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\(^{97}\) ASEAN Green Bond Standards (2018), supra (n 82) at para. 4.4. ASEAN Social Bond Standards (2018), supra (n 84) at para. 4.4.

\(^{98}\) SC LOLA Guidelines, supra (n 71), Chapter 8 and SC Retail Guidelines, supra (n 69), Chapter 21.

\(^{99}\) Including the Tadau Energy Sdn Bhd issue of RM250,000,000 (ca. USD60,000,000) worth of green sukuk in July 2017, the PNB Merdeka Ventures Sdn Berhad’s issue of RM690,000,000 (ca. USD170,000,000) worth of green sukuk certificates in December 2017, and the HSBC Amanah Malaysia Berhad’s issue of RM500,000,000 (ca. USD120,000,000) worth of sustainability sukuk in October 2018.

\(^{100}\) The May and October 2019 issuances of USD1,200,000,000 green sukuk by MAF Sukuk Ltd guaranteed by the UAE incorporated Majid Al Futtaim Holding LLC.

\(^{101}\) The December 2019 issue of EUR1,000,000,000 worth of green sukuk by IDB Trust Services Ltd, which was guaranteed by the Islamic Development Bank.
geographic spreading of responsible finance sukuk issuances, in March 2018 and again in February 2019, the Republic of Indonesia (the ‘Republic’) became the first sovereign to issue responsible finance sukuk certificates. These certificates, the USD1,250,000,000 green sukuk due 2023 (the ‘2018 Indonesian Green Sukuk’) and the USD750,000,000 green sukuk due 2024 (the ‘2019 Indonesian Green Sukuk’ and, together with the 2018 Indonesian Green Sukuk, the ‘Indonesian Green Sukuk’) were aligned with domestic, regional and international best practice standards. This issuance reflects the trend in the responsible finance sukuk market for transparency, engagement with investors and ongoing disclosure.

The Indonesian Green Sukuk certificates were issued through an SPV (Perusahaan Penerbit SBSN Indonesia III or ‘PPSI-III’) under a USD25,000,000,000 trust certificate programme (the ‘Indonesian Sukuk Programme’). The sukuk certificates in each series of Indonesian Green Sukuk were issued for a period of five years and were listed on Nasdaq Dubai and the Singapore stock exchange.\(^{102}\)

The Indonesian Sukuk Programme comprises a base prospectus that provides for the issue of sukuk based on either an ijarah (Islamic lease) or a wakalah (Islamic agency) contractual structure.\(^{103}\) The wakalah structure was used for both series of Indonesian Green Sukuk.\(^{104}\) Pursuant to this structure, on the issue date of the Indonesian Green Sukuk, PPSI-III issued sukuk certificates to certificateholders. At least 51% of the proceeds generated by this issuance were then used by PPSI-III to purchase beneficial rights in and to certain properties from the Republic (the ‘Ijarah Assets’).\(^{105}\) The remaining 49% of the issue proceeds were used to purchase beneficial rights in and to certain assets from the Republic and to procure their construction and delivery (the ‘Project Assets’ and, together with the Ijarah Assets, the ‘Indonesian Sukuk Assets’).\(^{106}\) PPSI-III declared a trust in favour of certificateholders over all of its rights, title, interest and benefit in, to and under the Indonesian Sukuk Assets, the related transaction documents, all monies standing to the credit of a specified account and all connected proceeds.\(^{107}\) As a result, PPSI-III will hold the Indonesian Sukuk Assets on trust for certificateholders in proportion to their holding of Indonesian Green

\(^{102}\) Pricing Supplement, Issue by Perusahaan Penerbit SBSN Indonesia III of U.S.$1,250,000,000 3.75% Trust Certificates due 2023 Under the U.S.$25,000,000,000 Trust Certificate Issuance Program (the ‘Indonesian Green Sukuk’) at Part B Item 1.

\(^{103}\) Offering Memorandum, Indonesian Sukuk Programme, at 2 – Structure Diagram and Cash Flows.

\(^{104}\) Pricing Supplement, Indonesian Green Sukuk at Part A Item 18.

\(^{105}\) The total Ijarah Assets that were invested in were valued on the date of issuance of the Indonesian Green Sukuk at Indonesian Rupiah (IDR) 8,547,793,088,667 (converted at the average IDR/USD exchange rate for January 2018, as set out on page v of the Offering Memorandum, Indonesian Sukuk Programme, this represented a value equivalent to USD636,849,433 or 51% of the proceeds from the issue of the Indonesian Green Sukuk).

\(^{106}\) The total Project Assets that were invested in were valued on the date of issuance of the Indonesian Green Sukuk at IDR8,207,526,467,700 (converted at the average IDR/USD exchange rate for January 2018, as set out on page v of the Offering Memorandum, Indonesian Sukuk Programme, this represented a value equivalent to USD611,498,023 or 49% of the proceeds from the issue of the Indonesian Green Sukuk).

\(^{107}\) Offering Memorandum, Indonesian Sukuk Programme, at Condition 4.1 – Summary of the Trust.
Sukuk.\textsuperscript{108} PPSI-III (as lessor) then leased the *Ijarah* Assets to the Republic. Following completion and delivery of the Project Assets, PPSI-III also agreed to lease these Project Assets to the Republic.\textsuperscript{109} The rent payable periodically from the lease of the *Ijarah* Assets will be an amount equal to the pre-agreed periodic distributions payable to certificateholders during the tenor of the Indonesian Green Sukuk.\textsuperscript{110} Pursuant to a *wakalah* agreement, the Republic was delegated responsibility for collecting all rental payments due under the lease agreement, as well as insuring the properties making up the Indonesian Sukuk Assets, paying property taxes and performing major maintenance and structural repairs to those properties, in each case on PPSI-III’s (as owner) behalf.\textsuperscript{111}

The Indonesian Green Sukuk were the first two series of sukuk issued under Indonesia’s Green Bond and Green Sukuk Framework.\textsuperscript{112} This framework was established to align with both the domestic Regulation on the Issuance and the Terms of Green Bond\textsuperscript{113} published by the Republic’s Financial Services Authority and the ICMA’s GBPs.\textsuperscript{114} The Republic’s Green Bond and Green Sukuk Framework is, therefore, built around the four core components of use of proceeds, process for project evaluation and selection, management of proceeds, and reporting. As a result, using the money received from the purchase of the Indonesian Sukuk Assets by PPSI-III, and ‘[w]ith reference to the [ICMA’s] Green Bond Principles’\textsuperscript{115}, the Republic will finance or re-finance expenditure relating directly to eligible projects.\textsuperscript{116} As part of the offering documents for the Indonesian Green Sukuk, no specific eligible projects were disclosed. Projects to be funded are, instead, to be determined following the issue of the Indonesian Green Sukuk with reference to the requirements of the Republic’s Green Bond and Green Sukuk Framework. In order to be an eligible green project within this framework, a project must be identified for budget allocation based on its ability to address climate change mitigation and adaptation.\textsuperscript{117} The project must then fall

\begin{itemize}
  \item \textsuperscript{108}ibid.
  \item \textsuperscript{109}ibid., at 63 - Summary of the Principal Transaction Documents – Lease Agreement.
  \item \textsuperscript{110}ibid.
  \item \textsuperscript{111}ibid., at 65 - Summary of the Principal Transaction Documents – Wakala Agreement.
  \item \textsuperscript{112}ibid., Appendix A-1 (The Green Bond and Green Sukuk Framework).
  \item \textsuperscript{113}Financial Services Authority of the Republic of Indonesia, Regulation on the Issuance and the Terms of Green Bond (No. 60/POJK.04/2017). However, this regulation refers to ‘green bonds’ and ‘debt securities’ rather than referring to sukuk and there is no indication in the regulation that the reference to ‘bond’ is to be given a broader meaning of also including sukuk.
  \item \textsuperscript{114}Offering Memorandum, Indonesian Sukuk Programme, Appendix A-1 (The Green Bond and Green Sukuk Framework) at II.
  \item \textsuperscript{115}Republic’s Green Bond and Green Sukuk Framework (2018), para II(1).
  \item \textsuperscript{116}Pricing Supplement dated 22 February 2018 for the issue by Perusahaan Penerbit SBSN Indonesia III of USD1,250,000,000 3.75\% Trust Certificates due 2023 under the USD25,000,000,000 Trust Certificate Issuance Program (the ‘2018 Indonesian Green Sukuk Pricing Supplement’), Use of Proceeds. Pricing Supplement dated 12 February 2019 for the issue by Perusahaan Penerbit SBSN Indonesia III of USD750,000,000 3.90\% Trust Certificates due 2024 under the USD25,000,000,000 Trust Certificate Issuance Program (the ‘2019 Indonesian Green Sukuk Pricing Supplement’), Use of Proceeds.
  \item \textsuperscript{117}Offering Memorandum dated 23 January 2018, Indonesian Sukuk Programme, Appendix, The Green Bond and Green Sukuk Framework, s II(2) and Offering Memorandum dated 31 January 2019, Indonesian Sukuk Programme, Appendix, The Green Bond and Green Sukuk Framework, s II(2).
\end{itemize}
within at least one of a number of specified sectors. These eligible sectors include renewable energy, energy efficiency, sustainable transport, green tourism, green buildings and sustainable agriculture. Projects related to new fossil fuel-based electric power generation, improving the efficiency of fossil fuel-based electricity power generation, large-scale hydropower plants, and nuclear or nuclear-related assets are not eligible under the framework. Once the proceeds have been allocated, the allocations are registered and individual ministries within the government will be responsible for managing and tracking the use of the issue proceeds and reporting to the Ministry of Finance on the environmental benefits of any funded project. The Republic, acting through the Ministry of Finance, has also undertaken to report annually on the use of the issue proceeds and the estimated beneficial impact of the funded projects. This annual report and the continued compliance of the Indonesian Green Sukuk with the Republic’s Green Bond and Green Sukuk Framework will be verified by an independent third party.

Pursuant to a unilateral purchase undertaking entered into by the Republic, at maturity or upon early redemption of the Indonesian Green Sukuk, the Republic will purchase all of PPSI-III’s rights, title, benefits and entitlements in, to and under the Indonesian Sukuk Assets at a price equal to the outstanding principal amount of the Indonesian Green Sukuk, plus any accrued but unpaid periodic distributions. Once the Indonesian Sukuk Assets have been repurchased from PPSI-III, the money received will be used to redeem the Indonesian Green Sukuk from certificateholders. The trust declared by PPSI-III over the Indonesian Sukuk Assets in favour of certificateholders will then be dissolved.

Prior to the issue of the Indonesian Green Sukuk, the Center for International Climate Research (CICERO) provided an independent third party report (in the form of a ‘second opinion’) on the Republic’s Green Bond and Green Sukuk Framework underpinning the Indonesian Green Sukuk. This independent verification is in line with international best practice in responsible finance bond and sukuk issuances. Although the offering memorandum for the Indonesian

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118 ibid., Appendix, The Green Bond and Green Sukuk Framework, at II(1).
120 ibid., at II(1).
121 ibid., at II(3).
122 ibid., at II(4).
123 ibid., at III.
124 Upon the occurrence of a dissolution event, Offering Memorandum, Indonesian Sukuk Programme, at Condition 9.2 - Dissolution Following a Dissolution Event and Condition 9.3 – No Other Dissolution. In the case of a total loss with respect to the properties underlying the Indonesian Sukuk Assets the amount payable to investors will be funded using insurance proceeds. Offering Memorandum, Indonesian Sukuk Programme, at Condition 9.3 - Dissolution Following a Total Loss Event.
125 Offering Memorandum, Indonesian Sukuk Programme, at Condition 9 – Capital Distributions of the Trust.
126 ibid.
Sukuk Programme itself only refers to the ICMA’s GBPs, and the Indonesian Green Sukuk are not classified as ‘ASEAN Green Sukuk’ in the transaction documents. CICERO’s second opinion confirms that the Republic’s Green Bond and Green Sukuk Framework aligns with the GBPs, the ASEAN Green Bond Standards and the Regulation on the Issuance and the Terms of Green Bond published by the Republic’s Financial Services Authority. This arguably reflects the growing convergence and increased harmonisation across responsible finance bond and sukuk standards. CICERO assigned the Green Bond and Green Sukuk Framework a rating of medium green reflecting ‘projects and solutions that represent steps towards the long-term vision, but are not quite there yet.’

As part of its second opinion, CICERO noted that the Republic’s Green Bond and Green Sukuk Framework ‘provides a sound framework for climate-friendly investments.’ CICERO did, however, also highlighted the possibility that some eligible projects may include an element of deforestation. The Republic noted that there would be no deforestation in the context of sustainable agriculture. However in practice, a failure of the Republic to comply with any such assurance would not result in the early redemption of the Indonesian Green Sukuk certificates and the Green Bond and Green Sukuk Framework may be revised by the Republic at any time.

A year after the issuance of the 2018 Indonesian Green Sukuk and ‘in compliance with the [ICMA]’s Green Bonds Principles and their transparency and disclosure rules’, Indonesia published its first annual Green Sukuk Issuance Allocation and Impact Report (the ‘Impact Report’). This Impact Report only covers the allocation of proceeds from the 2018 Indonesian Green Sukuk and confirms that USD637,600,000 of the issue proceeds from the 2018 Indonesian Green Sukuk were used to refinance projects launched in 2016 in the sustainable projects sector.

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128 As noted above, the Regulation on the Issuance and the Terms of Green Bond would appear to be relevant only to conventional green bonds issued by the Republic, not to green sukuk. Nevertheless, CICERO benchmarked the second opinion on The Republic of Indonesia’s Green Bond and Green Sukuk Framework (3 January 2018) at 2.

129 ibid., at 5.

130 ibid., at 12.

131 ibid., at 16 and 17.

132 ibid., at 17.

133 ibid., at 17.

134 Offering Memorandum dated 23 January 2018, Indonesian Sukuk Programme, 19 Investment Considerations - Where the proceeds of a Series are specified as being used to finance or refinance Eligible Green Projects, as defined under the Green Bond and Green Sukuk Framework, such Certificates may not be suitable for environmentally focused prospective investors and Offering Memorandum dated 31 January 2019, Indonesian Sukuk Programme, 18 Investment Considerations - Where the proceeds of a Series are specified as being used to finance or refinance Eligible Green Projects, as defined under the Green Bond and Green Sukuk Framework, such Certificates may not be suitable for environmentally focused prospective investors. Concern over the ultimate use of proceeds from the issue of the Indonesian Green Sukuk has been highlighted by some commentators. See, for example, Morgan Davis, ‘Indonesia’s green sukuk needs a harder look’ (27 February 2018) Global Capital Asia, online at: www.globalcapital.com/article/b173hzfxfhv8p0i/indonesias-green-sukuk-needs-a-harder-look, accessed 24 May 2020.

transport sector, the waste to energy and waste management sector, the renewable energy sector and the energy efficiency sector.\(^{136}\) The remaining issue proceeds were used to finance new projects in sectors covering sustainable transport, renewable energy, energy efficiency and resilience to climate change for highly vulnerable sectors and disaster risk reduction.\(^{137}\) In assessing the impact of this allocation of the 2018 Indonesian Green Sukuk issue proceeds, the Impact Report notes that the primary indicator for mitigation projects is greenhouse gas emissions reduction, while also recognising that the 2018 Indonesian Green Sukuk may have impacts ‘beyond climate and environmental’ impacts,\(^{138}\) including in furtherance of the United Nations’ Sustainable Development Goals.\(^{139}\) The accounting firm KPMG provided an independent limited assurance report on the processes relating to the allocation of the 2018 Indonesian Green Sukuk issue proceeds and on the amounts of those issue proceeds allocated to eligible green projects.\(^{140}\)

Though designed using classical Islamic contracts and structured to be compliant with principles of Islamic law,\(^{141}\) the nature of the Indonesian Green Sukuk was heavily influenced by market best practice as reflected in international, regional and domestic standards. While the GBPs provided a focal point in terms of guidance, the ASEAN Green Bond Standards and the Regulation on the Issuance and the Terms of Green Bond draw on these industry norms and mould them to fit with regional and domestic requirements. Reflecting this, the Republic’s Green Bond and Green Sukuk Framework underpinning the Indonesian Green Sukuk details project categories, proceeds management, reporting and independent advice requirements that are comparable with those applied in conventional sovereign responsible finance bond issuances.\(^{142}\) This, it is submitted, is a positive step. It reflects the current expectations of investors and indicates the potential continued homogenisation of responsible finance standards around the world. The reality is that unlike mainstream sukuk, where investors are often unconcerned with an issuance’s use of proceeds, investors in responsible finance sukuk are investing with the expectation that their capital will be used in a specific way. In order to access these investors and to avoid the reputational

\(^{136}\) ibid., at 11.

\(^{137}\) ibid., at 12.

\(^{138}\) ibid., at 13

\(^{139}\) ibid.

\(^{140}\) ibid., at 36–40.

\(^{141}\) The structure and mechanism of sukuk issued under the Indonesian Sukuk Programme were approved as compliant with Islamic law by a selection of shari’ah scholars acting on behalf of some of the programme’s arrangers / dealer banks – these scholars were composed of those from CIMB Islamic Bank Berhad, the Shariah Advisory Board of Citi Islamic Investment Bank, the Executive Committee of the Fatwa and Sharia Supervisory Board of Dubai Islamic Bank PJSC and the Central Shariah Committee of HSBC Bank Middle East Limited. Offering Memorandum, Indonesian Sukuk Programme at 21 – Investment Considerations - There is no assurance that the Certificates will be deemed Sharia compliant by all Sharia scholars.

risk of not providing investors with full and accurate information, it was inevitable that the standards followed by responsible finance sukuk issuers would come broadly into line with those applied in the more established conventional responsible finance bond market.

6. Conclusion and Steps for the Future

The responsible finance sukuk market is still in the early stages of development. As this market has gradually become more international in its issuer and investor base, it has shown a capacity to align with a variety of different standards, including those designed for conventional responsible finance bonds. This is reflected in the Indonesian Green Sukuk and highlights the current expectations of the market with respect to transparency and disclosure.

Increasingly, then, responsible finance sukuk issuers are adhering to international best practice standards, and regional and national responsible finance sukuk standards are themselves evolving to align more closely with these standards. As issuances of responsible finance sukuk steadily increase, however, it may now be time for the development of a common framework for responsible finance sukuk. This would apply across regions and provide a common reference point for investors in, and issuers of, responsible finance sukuk regardless of the location of the issuer. In order for responsible finance sukuk to appeal to a wide investor base, the framework should be explicitly aligned to the ICMA Responsible Finance Bond Principles and reflect the four core components of these principles. However, it could also then be tailored to reflect the specific nuances of Islamic capital markets instruments – such as setting out what categories of projects are ineligible for funding due to their incompatibility with Islamic legal principles. Like the GBPs, SBPs and Sustainability Bond Guidelines, a set of common responsible finance sukuk standards would be most effective if issued by a cross-jurisdictional Islamic finance standards setting body (such as the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) or the Islamic Financial Services Board (IFSB)). This would provide a central authority to oversee the development and dissemination of these standards and to allow for the coordinated updating of these standards in line with market developments. A set of responsible finance sukuk standards would then give responsible finance sukuk issuers a common framework to apply when structuring issuances. This could simplify the external review process and bring increased harmonisation across the market, something that could encourage market efficiency and bolster investor confidence.

As countries around the world look to encourage a transition towards a more sustainable domestic economy, it seems likely that the number of responsible finance bond and sukuk issuances will increase. The responsible finance bond market already benefits from market-led cross-jurisdictional standards whose use has become the industry norm. Within the Islamic finance market, steps have
been taken to bring about an increased harmonisation of responsible finance sukuk issuances. However, the standards implemented to date remain country and/or region specific, something that could potentially slow the growth of the global responsible finance sukuk market. The recent growth in the geographic spread of the responsible finance sukuk market makes the formulation of common standards something that should now be considered. Structured and reactive standards for responsible finance sukuk that are accessible to issuers and investors could, it is submitted, be the catalyst needed to bring momentum to the global responsible finance sukuk market.