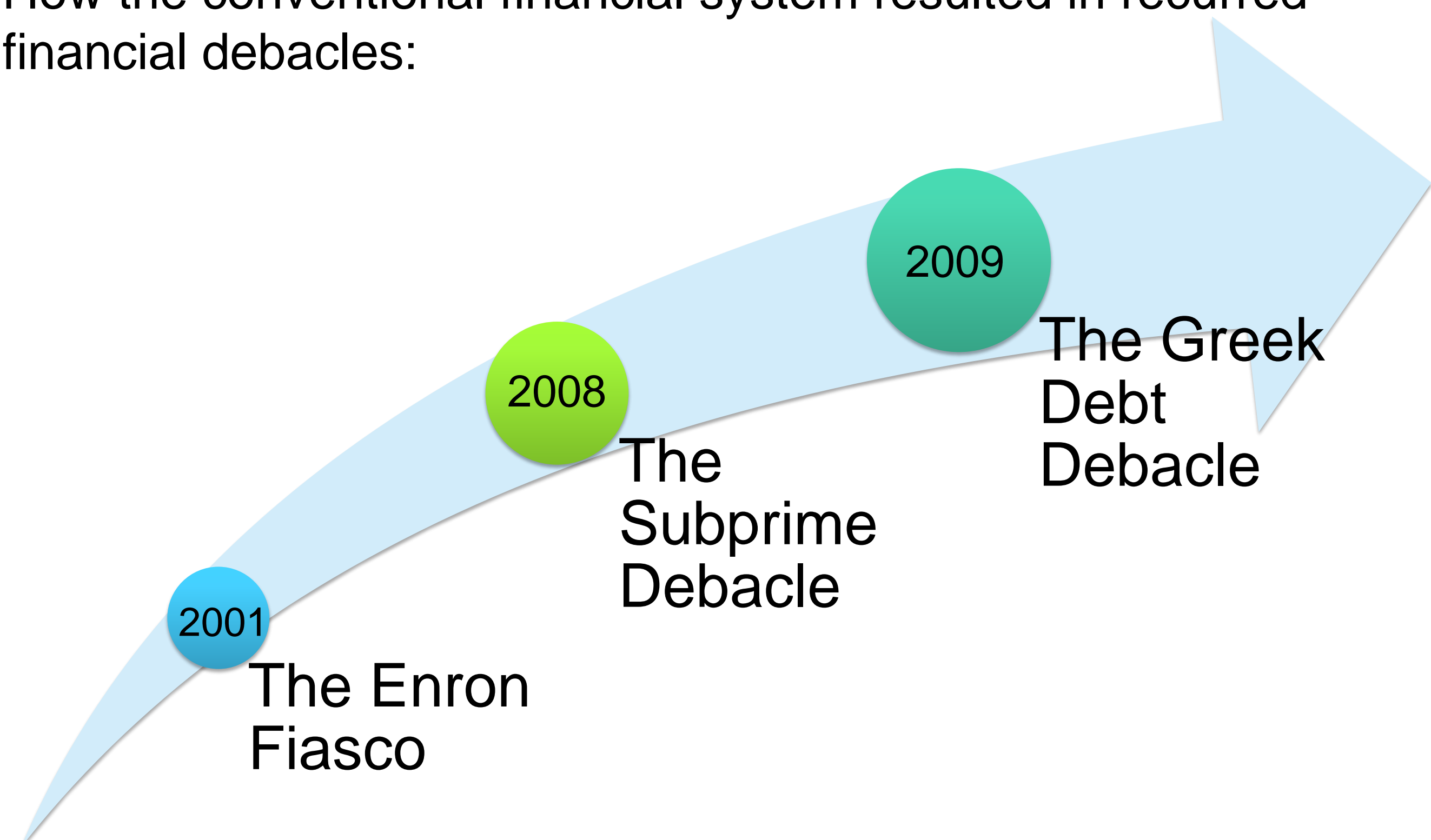


The Interconnections between Islamic Finance and Sustainable Finance

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Background

How the conventional financial system resulted in recurrent financial debacles:



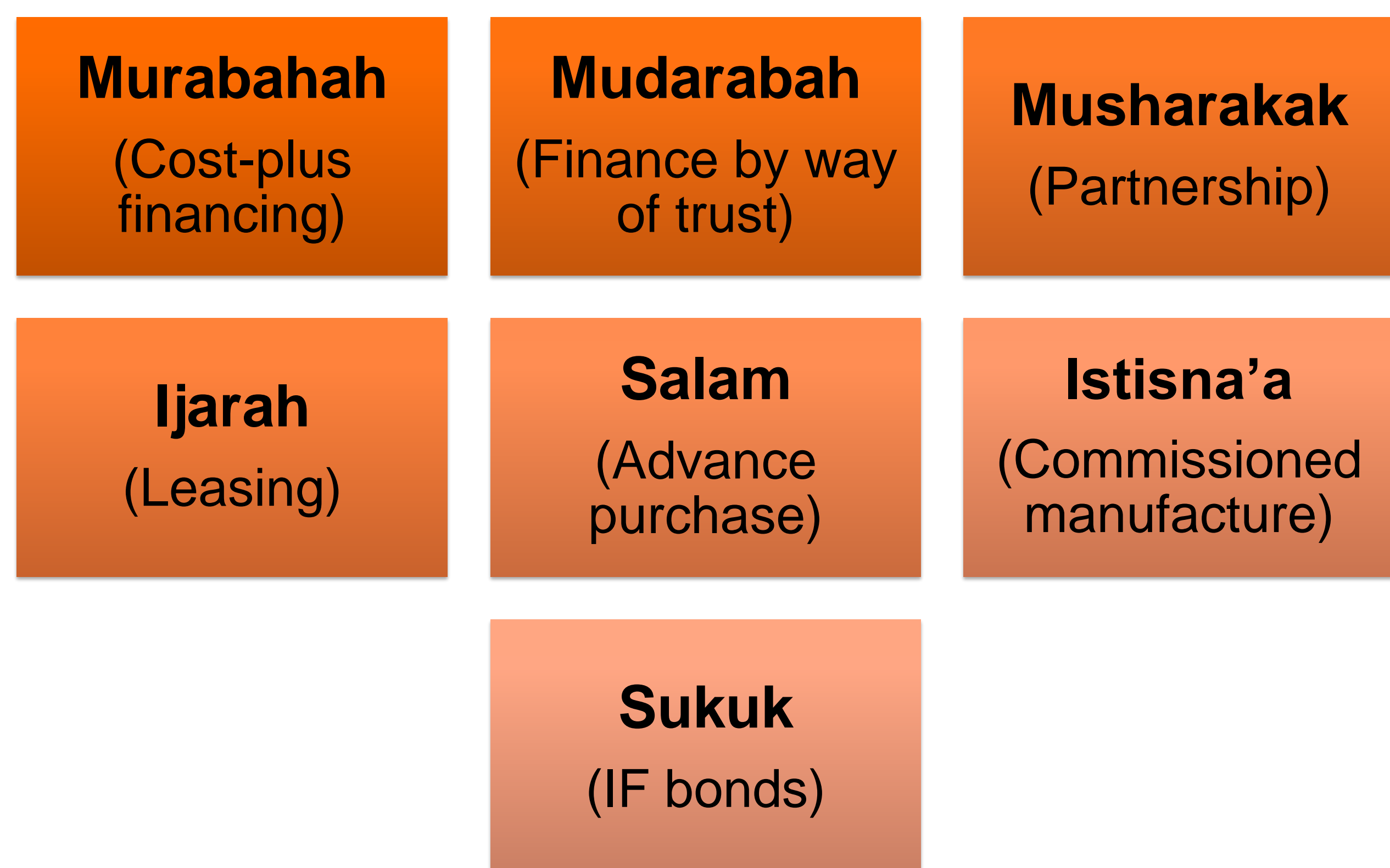
Islamic Finance Tenets

Existing since the 1970s, Islamic or Shariah-compliant finance has experienced unprecedented growth, with expected assets valued at \$1.8 trillion in 2013 (Ernst & Young, 2012). Islamic finance is seen as a promising alternative for more stable financial markets.

- **Riba:** Usually described as usury/interest, Riba may be referred to as excessive interest; however, to many scholars the whole concept of interest is regarded as Riba.
- **Gharar:** Literally means to deceive, cheat, delude, lure, entice, and so on. Gharar is usually linked to uncertainty presented in contracts when, for example, the contract is executed without known variables (price, interest rates, parties, etc.).
- **Maisir:** A concept closely related to gambling, where an easy profit may be achieved without any productive activity.

Islamic Financial Products

Asset-backed financing instruments under Islamic Finance:



How IF Generates Sustainability

Based on a fundamental set of rules and moral values, Shariah-compliant finance plays a fiduciary duty for the society as a whole. Islamic Finance promotes equality and is less profit-motivated.

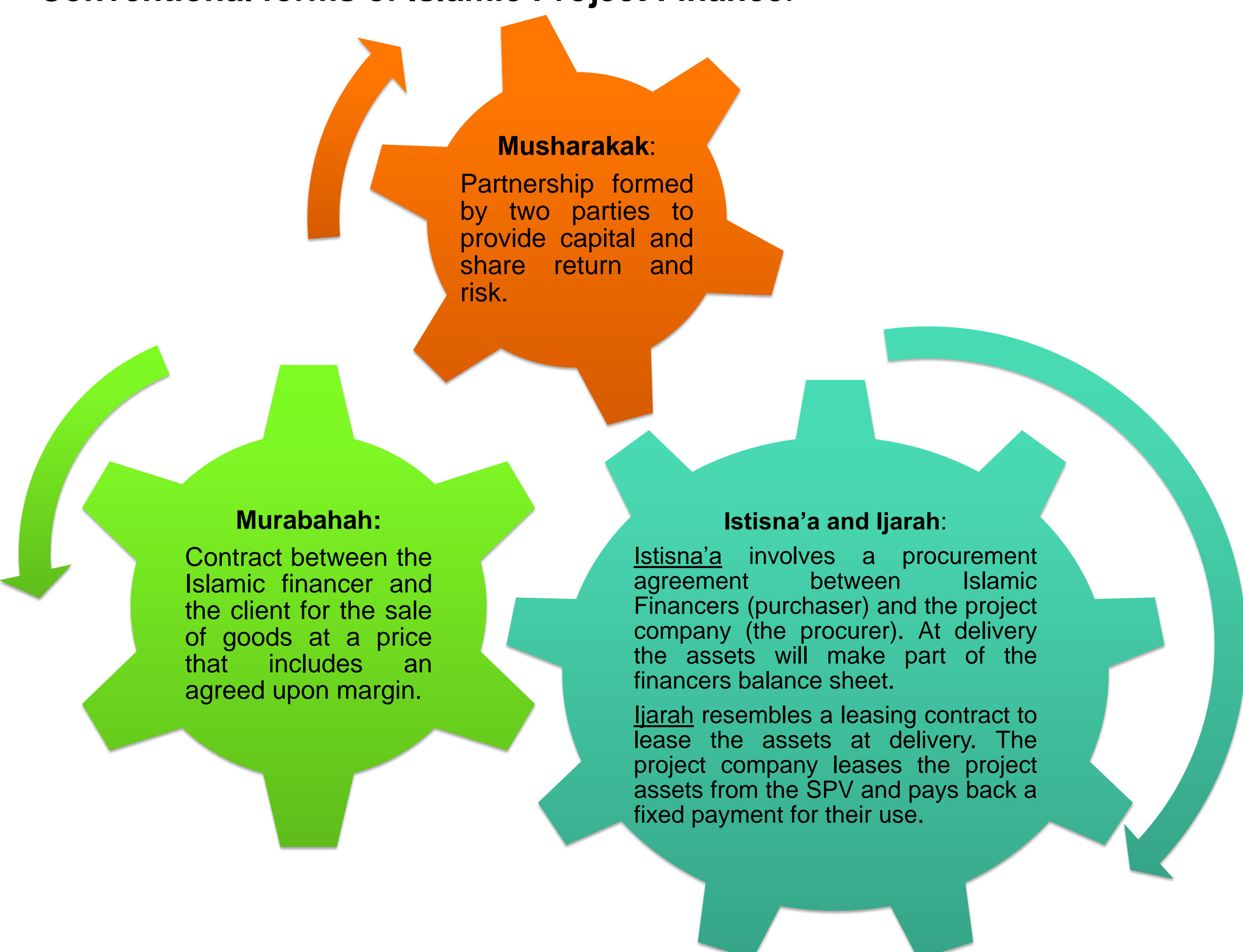
Under Islamic Finance some of the products identified as triggers in the last financial debacles would be void.

Some of the IF principles breached in the last crisis:

- The principle of Riba was violated by excessive lending and borrowing.
- The asset-backed financing principle would have eliminated a number of derivative transactions with speculative purposes only.
- Fair profit and risk-sharing principles were avoided with excessive management incentives and misalignment with investors' goals.

Sukuk: A Promising Tool for Sustainable Project Financing

Conventional forms of Islamic Project Finance:



The opportunity for Sukuk to bridge the current gap in project finance:

The recent **financial crisis** has brought more stringent capital conditions for conventional banks and has narrowed the amount of funds available for projects in the Middle East and Africa. In this context, **Sukuk** has a huge potential to attract private investors' funds, as it closely resembles traditional bonds.

A promising landscape:

- Increase in the number of Islamic banks (e.g., Alinma Bank in Saudi Arabia).
- Development of more creative Islamic Finance structures that can use projects' underlying assets.
- New capital regulations under Basel III will result in a higher supply of high-quality Assets and lowered yields for issuances. This scenario will represent a benefit for Sukuk.

Latest Sukuk issuances:

- The first Sukuk to be issued by a non-Muslim country was structured in **London** in June. The £200 million issue was oversubscribed, attracting orders for more than £2 billion. The deal was structured as *sukuk al-ijarah* and works as a leasing structure allowing rental income from three central UK government offices (IFLR, 2014).
- **Hong Kong** and **South Africa** followed the UK as the second and third non-muslim countries to issue Sukuk. The former raised \$1 billion and reached AAA rating, the latter saw \$500 million in sales. Both issues were oversubscribed (Financial Times, 2014).
- **Malaysia** and **Indonesia** are expected to raise up to US\$30 billion in Sukuk by the end of 2014. According to the media, Malaysia's PM has already announced an issue of at least US\$42 million by the end of the year, and in September Indonesia raised Sukuk worth US\$1.5 billion with a high demand.