

# Helping Malaysia develop the green sukuk market

## OVERVIEW

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



Photo credit: Thinkstock

## Background

Developing countries have limited access to capital to invest in key sustainable infrastructure, often resorting to local bank loans with unsuitable terms. Capital markets offer a cheaper source of longer-term finance. Green bonds have been identified as a new source of climate finance for cities, municipalities and low carbon infrastructure projects across many sectors and an opportunity for the private sector to address global development priorities.

The World Bank, which launched the first labeled green bond in 2008 and has since then issued over \$10 billion equivalent, is a key promoter of green bonds as an important means to address climate change.

A sukuk is an interest-free bond that generates returns to investors without infringing the principles of 'Shari'ah' (Islamic law). There are commonalities

between sukuk and green bonds that can easily be channeled 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 complements the green bond structure as it provides investors with a high degree of certainty that the funds raised are only used for the designated purpose.
- 2) The values of both are deeply rooted upon 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 and land, and the ecosystems that depend on them are intrinsic to Shari'ah principles.

Despite the huge potential, the green sukuk market had not taken off mainly due to lack of knowledge at the issuer and investor levels about the process

and benefits of such issuances; perceptions about complexity and pricing; lack of a framework, lack of consensus among government agencies on policy coordination, lack of bankable green projects, etc.

Malaysia is the world's biggest Shari'ah-compliant debt market, accounting for \$34.7 billion (46.4%) of the \$74.8 billion issued globally in 2016. In 2014 Malaysia introduced the Socially Responsible Sukuk (SRI) Guidelines to establish itself as a center for sustainable finance.

## Financing Objectives

The Financing objective is to help the Malaysian government develop innovative financial instruments to address its infrastructure and green financing needs, including its target of generating 7,200 megawatt (MW) of renewable energy by 2020, of which 2,080 MW will be contributed by solar energy.

## Financial Solution

In January 2017, the World Bank joined a Technical Working Group with the Central Bank and Securities Commission of Malaysia to explore options to encourage investments in green or sustainable projects through the development of green Islamic finance markets. The Malaysia Green Finance Project facilitated the development of the green sukuk market in Malaysia which led to the launch of the first green sukuk in the world.

## World Bank's Role

The World Bank, identified the opportunity to leverage Malaysia's role in Islamic finance to combine the sukuk and the green bond and meet Malaysia's need for financing green initiatives. The Technical Working Group promoted the concept of the green sukuk and shared international experience of green bond issuance with various stakeholders in the green economy, including Ministry of Energy, Green Technology and Water (KeTTHA), Green Tech Malaysia Sdn Bhd, Ministry of Finance, financial institutions and potential issuers.

Specifically, the World Bank:

- 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 a nationally adopted green bond framework;
- Provided guidance on how the government can kick-start the local market by facilitating and reducing costs to issuers through incentives;
- Provided guidance on eligible green projects and helped identify potential issuers for demonstration issuances;
- Advised on the role of independent third party reviews; convened international certifiers; and facilitated the role of local institutions to conduct such assurance tasks at low cost;
- Helped the first issuers navigate government policies and international best practices.

## Outcome

On July 27<sup>th</sup>, 2017 Tadau Energy Sdn Bhd, issued the first green sukuk in the world, raising MYR250 million (\$59 million) to finance a 50MW solar photovoltaic power plant in Sabah, Malaysia. The sukuk was issued under Malaysia's SRI sukuk framework, endorsed by the Shari'ah Advisory Council, and received the highest rating by the Center for International Climate and Environmental Research Oslo (CICERO).

A key demonstration of the success of this project was that another issuer—Quantum Solar—followed quickly with a larger (MYR1 billion) issuance. A number of others are in the pipeline, such as PNB Merdeka Ventures (MYR 2 billion for a green building) and Sinar Kamiri (MYR 245 million for another solar project).

The World Bank team, comprising the World Bank Treasury, Malaysia Knowledge and Research Hub and Finance & Markets Global Practice Group, continues to work with issuers to further deepen the green sukuk market. The model is now being replicated in other countries that requested technical support encouraged by the success of the Malaysian project.