

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

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Abstract

Growing global interest in innovative financing tools that bridge the divide between traditional financing and responsible investing has, until relatively recently, remained largely distinct from market interest in the Islamic finance sector. Guided by socially motivated goals and investors and displaying a greater emphasis on societal impact than traditional finance, the responsible finance sector has grown in size and visibility within the conventional finance space. In line with this trend, the capital markets have seen a growth in the number of issuances of green, social and sustainability bonds. These capital markets instruments provide investors with an opportunity to pursue both societal and financial returns in their investment activity. They also provide issuers with additional liquidity and an opportunity to bolster their corporate social responsibility agenda.

The emphasis on financial and non-financial considerations in conventional responsible finance has led to suggestions that there are clear similarities between responsible finance and Islamic finance. It has not been until recently, however, that the *sukuk* market has sought to establish its place within the wider responsible finance market. This has led to debut issuances of green, social and sustainability *sukuk*.

With growing interest in responsible finance comes a need to consider the development of standards within the responsible finance bond and responsible finance *sukuk* market sectors. The objective of this article is, therefore, to consider relevant standards and parameters developed in the conventional and Islamic responsible finance industries, and to reflect upon any growing convergence between the standards applicable to, and practices within, these market sectors. In doing so, it will situate and discuss the development of responsible finance *sukuk* in the international capital markets and, using a case study as a guide, this article will analyse how concepts of responsibility

(*) The information in this article is correct as of July 2021. While there has been some discussion of this topic in Arabic sources, the sources referred to in this article are limited to those in English and reflect the increasingly international nature of the responsible finance *sukuk* market.

have been reflected in contemporary Islamic finance *sukuk* issuances and the measures that issuers have put in place to verify the responsible credentials of an issuance.

Keywords: Islamic finance; responsible finance; *sukuk*; bonds; green; social; sustainability.

1. Introduction

Sustainability and responsibility have become prominent themes in the contemporary finance industry. The rapid spread of Covid-19 infections in 2020 and 2021 further focused the attention of governments and other market participants on the relevance of raising capital with a targeted societal purpose⁽¹⁾. 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⁽²⁾, ‘responsible finance’ combines societal goals with value creation⁽³⁾. 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⁽⁴⁾.

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⁽⁵⁾ and intertwines principles derived from

(1) See a discussion of the relevance of social bonds in the context of Covid-19 in Edana Richardson and Aisling McMahon, ‘Are social bonds an option for Ireland’s coronavirus recovery?’ (RTE Brainstorm, 23 April 2020), online at: <https://www.rte.ie/brainstorm/2020/0423/1134274-ireland-social-bonds-finance-coronavirus/>, accessed 8 July 2021. In an Islamic finance context, the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI – a standard setting body in the Islamic finance industry) has called on the Islamic finance industry to play a part in the Covid-19 recovery effort and has noted the relevance of Islamic finance principles in overcoming the impact of the pandemic. Statement of Shaikh Ebrahim bin Khalifa Al Khalifa (Chairman of the AAOIFI Board of Trustees) at the AAOIFI Islamic Finance Virtual Forum on ‘Covid-19 Economic Implications, Islamic Finance and the Way Forward’ (May 2020).

(2) H. Kent Baker and John R. Nofsinger, *Socially Responsible Finance and Investing: Financial Institutions, Corporations, Investors, and Activists* (John Wiley & Sons, Inc., 2012) at 3.

(3) 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. Maria O’Brien Hylton, ‘Socially Responsible Investing: Doing Good Versus Doing Well in an Inefficient Market’ *The American University Law Review* 42 (1992) 1 at 6–10; J.M. Puauschunder, ‘On the emergence, current state, and future perspectives of Socially Responsible Investment (SRI)’, *Consilience* 16 (2016) 38 at 41.

(4) Baker and Nofsinger, *supra* (n 2) at 3.

(5) 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.

religious teaching with financial objectives⁽⁶⁾.

In the context of Islamic finance as it operates today, structural compliance with the Islamic legal prohibitions of *riba* (unjustified gain in a financial transaction, frequently translated today as interest), *gharar* (excessive risk), *maysir* (gambling) and *haram* (forbidden) activities demonstrates an Islamic finance product's *visible* adherence to rules of Islamic law⁽⁷⁾. Concurrently with these structural characteristics, the ethical framework that some argue is already embedded within Islamic finance⁽⁸⁾ is highlighted as creating a natural compatibility between Islamic finance and responsible finance⁽⁹⁾.

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⁽¹⁰⁾.

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 actively implement any ethical framework⁽¹¹⁾.

(6) See generally, Charles Tripp, *Islam and the Moral Economy*, (Cambridge University Press, 2010), Ibrahim Warde, *Islamic Finance in the Global Economy* (Edinburgh University Press, 2010), Muhammad Ayub, *Understanding Islamic Finance*, (John Wiley & Sons Ltd., 2007), Mahmoud El-Gamal, *Islamic Finance: Law, Economics and Practice* (Cambridge University Press, 2006).

(7) Frank Vogel and Samuel Hayes, *Islamic Law and Finance Religion, Risk, and Return* (Brill, 1998), Chapter 4.

(8) International Shari'ah Research Academy for Islamic Finance, Thomson Reuters and the Islamic Research and Training Institute, *Islamic Commercial Law Report 2018*, Akram Laldin, Mustafa Adil and Ahmed Iskanderani (eds.), (Islamic Research and Training Institute, 2018) at 7.

(9) See, for example, Gillian Rice, 'Islamic Ethics and the Implications for Business' (1999) 18 *Journal of Business Ethics* 345 at 346. Islamic Finance News, 'Islamic Green Financing: More Challenging than Expected', (2010) 10(43) *Newsletter*, 13 at 13. Umar F. Moghul and Samir H.J. Safar-Aly, 'Green Sukuk: The Introduction of Islam's Environmental Ethics to Contemporary Islamic Finance' (2014) 27 *The Georgetown International Environmental Law Review* 1 at 4. Jean-Yves Moissoner and Frederic Teulon, 'Is Morality-Based Islamic Economics an Answer to the Global Financial Crisis?' (2014) 27(1) *JKAU: Islamic Econ.*, 125 at 136. Nazrul Hazizi Noordin, Siti Nurah Haron, Aznan Hasan, and Rusni Hassan, 'Complying with the requirements for issuance of SRI sukuk: the case of Khazanah's Sukuk Ihsan', (2018) 9(3) *Journal of Islamic Accounting and Business Research* 415 at 416.

(10) Moghul and Safar-Aly, *supra* (n 9) at 26.

(11) Valentino Cattelan, 'Islamic Finance and Ethical Investments: Some Points of Reconsideration' in M Fahim Khan (ed), *Islamic Banking and Finance in the European Union* (Edward Elgar Publishing Limited, 2010) 76, 77; Haider Ala Hamoudi, 'The Muezzin's Call and the Dow Jones Bell: On the Necessity of Realism in the Study of Islamic Law' (2008) 56(2) *American Journal of Comparative Law* 423 at 460.

Mainstream Islamic finance transactions to date have, therefore, generally⁽¹²⁾ been ones in which the wider societal benefits arising from a transaction have been incidental to, rather than being considered equally important as, financial returns⁽¹³⁾.

This can be seen in the *sukuk* market, where the majority of issuances to date have structurally complied with rules of Islamic law⁽¹⁴⁾, but have been value-neutral with respect to their impact on society more generally⁽¹⁵⁾.

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⁽¹⁶⁾. In economic effect, *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 *sukuk* promoted as being ‘responsible’ remain only a tiny portion of the *sukuk* certificates issued to date⁽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

(12) 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 8)). 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) at 63.

(13) Richard de Belder, ‘The Form over Substance Debate in Islamic Finance – Is aligning Islamic Finance more proactively with the ethical finance space the way forward?’ (2017) SOAS Law of Islamic Finance Working Papers Series, online at: <https://www.soas.ac.uk/cimel/workingpapers/file119697.pdf>, accessed 8 July 2021.

(14) AAOIFI Governance Standard (GS) 12, ‘Sukuk Governance’, para. 8a.

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

(16) AAOIFI, Shari’a Standard No. (17), ‘Investment *Sukuk*’. AAOIFI defines a *sukuk* as ‘... certificates of equal value representing undivided shares in ownership of tangible assets, usufruct and services or (in the shares in ownership of tangible assets, usufruct and services or (in the ownership of) the assets of particular projects or special investment ownership of) the assets of particular projects or special investment activity, however, this is true after receipt of the value of the Sukuk, the activity, however, this is true after receipt of the value of the Sukuk, the closing of subscription and the employment of funds received for the closing of subscription and the employment of funds received for the purpose for which the Sukuk were issued. purpose for which the Sukuk were issued.’ AAOIFI, Shari’a Standard No. (17), para. 2.

(17) Idraki, *supra* (n 15) at 15.

sukuk issuances⁽¹⁸⁾ - initially in Malaysia, but more recently in other Muslim-majority countries, such as Indonesia and the United Arab Emirates. 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.

Growth in the global responsible finance sector more generally has been accompanied by 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⁽¹⁹⁾.

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 *sukuk* market, the development of responsible finance standards has more often been government-led. However, despite a growing number of responsible finance *sukuk* issuances coming to market, the evolution of responsible finance *sukuk* standards, and their application in practice, remains under-researched in an academic context.

With current growth in interest in responsible finance transactions, now is an opportune time to reflect upon the development of the responsible finance *sukuk* market. The objective of this article, therefore, is to consider the evolving standards and parameters of responsible finance *sukuk*.

To provide context and a point of comparison, this article will discuss the conventional responsible finance sector and its increased standardisation. It will also analyse the contemporary responsible finance *sukuk* market and the development of relevant standards. Using the issuance of responsible finance *sukuk* certificates by the Republic of Indonesia as a case study, this article will analyse how concepts of responsibility have been reflected in contemporary responsible finance *sukuk* issuances and the measures that issuers have put in place to verify the responsible credentials of an issuance. This article will conclude that common responsible finance *sukuk* standards may now be a

(18) In practice, there are no universally agreed definitions of 'green', 'social' or 'sustainability' and the scope of each concept will vary between individuals and market participants. In the context of this article, these concepts will be understood broadly - green financial instruments are those that target environmentally friendly objectives (such as a reduction in greenhouse gases), social financial instruments target social objectives (such as access to healthcare) and sustainability financial instruments target both green and social goals.

(19) 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 8 July 2021, noting that 'the EU should introduce an official EU Green Bond Standard'.

welcome development that could boost the growth and geographic reach of the responsible finance *sukuk* market.

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

Conventional responsible finance bonds are contractually similar to standard bonds. However, rather than directing the bond's issue proceeds towards the funding of value-neutral activities such as 'general corporate purposes', responsible finance bonds ring-fence and then direct these proceeds towards projects⁽²⁰⁾ meeting environmental and/or social criteria⁽²¹⁾.

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 market participants, wider stakeholders, as well as policy makers and regulators'⁽²²⁾ in the context of responsible finance⁽²³⁾. 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 green, social, sustainability-linked or social impact. 'Green bonds' are instruments whose issue proceeds will be used to finance or refinance environmentally-beneficial projects⁽²⁴⁾. 'Social bonds'

(20) The term 'project' is used here to cover enterprises, activities and projects that may be invested in.

(21) 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, quality 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.

(22) ICMA, *Sustainable Finance; High-level definitions* (May 2020) at 3, online at: <https://www.icmagroup.org/assets/documents/Regulatory/Green-Bonds/Sustainable-Finance-High-Level-Definitions-May-2020-110520v4.pdf>, accessed 8 July 2021.

(23) 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.

(24) The World Bank, *What Are Green Bonds?* online at: documents.worldbank.org/curated/en/400251468187810398/pdf/99662-REVISED-WB-Green-Bond-Box393208B-PUBLIC.pdf, accessed 8 July 2021.

earmark funding for projects that seek to address social issues or to achieve positive social outcomes⁽²⁵⁾. ‘Sustainability bonds’ fund projects having both green *and* social objectives⁽²⁶⁾. ‘Sustainability-linked bonds’ provide funding to help issuers to achieve future improvements in sustainability outcomes. Finally, social impact bonds (also known as ‘pay-for-success’ bonds⁽²⁷⁾) 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⁽²⁸⁾.

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 and most recently for sustainability-linked bonds.

As parameters of ‘greenness’ vary between individual issuers and investors, whether a project to be funded is and remains ‘green’ is ultimately 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 using its issue proceeds.

This information will allow investors to make an informed investment decision based on their individual notions of ‘green’. 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:⁽²⁹⁾ the Green Bond Principles (the ‘GBPs’) issued by the ICMA⁽³⁰⁾; and the Climate Bonds Standard issued by the Climate Bond Initiative (the ‘CBI’)⁽³¹⁾, a non-governmental organisation.

These guidelines are aligned, with the Climate Bonds Standard building on

(25) ICMA, Social Bond Principles (ICMA, 2021).

(26) 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 8 July 2021.

(27) 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.

(28) OECD, *Social Impact Bonds: State of Play & Lessons Learnt* (2016) at 3, online at: <https://www.oecd.org/cfe/leed/SIBs-State-Play-Lessons-Final.pdf>, accessed 8 July 2021.

(29) Eurosif *European SRI Study 2016* (2016) at 39, online at: <http://www.eurosif.org/wp-content/uploads/2016/11/SRI-study-2016-HR.pdf>, accessed 8 July 2021.

(30) ICMA, Green Bond Principles (ICMA, 2021).

(31) CBI, Climate Bonds Standard, Version 3.0 (CBI, 2019).

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, disclosure with respect to the projects that are eligible to be financed using bond issue proceeds, and reporting⁽³²⁾.

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⁽³³⁾.

Both the GBPs and the Climate Bonds Standard also encourage an issuer's green credentials to be independently verified⁽³⁴⁾. 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)⁽³⁵⁾, verification by a qualified party, certification by an external green assessment standard⁽³⁶⁾, or a third party rating⁽³⁷⁾.

From a political perspective, steps towards harmonisation of green bond standards have also been taken. In March 2018, the European Commission published an Action Plan on Financing Sustainable Growth (the 'Action Plan')⁽³⁸⁾. This Action Plan sets a strategy to 'further connect finance with

(32) ICMA, Green Bond Principles, *supra* note 30 at Section 1 – Use of Proceeds, CBI, *supra* note 31 at Part A, Section 4 – Reporting Prior to Issuance.

(33) The CBI's list of eligible projects is more prescriptive than the corresponding list in the ICMA's Green Bond Principles. For an example of bond issuances whose use of proceeds aligns with industry standards, see 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.

(34) External review to confirm alignment with the Green Bond Principles is recommended by the ICMA, ICMA, Green Bond Principles, *supra* note 30, 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.

(35) Tahir Ashraf, 'Bond, green bond: a licence to tackle climate change' (April 2016) *Journal of International Banking and Financial Law*, 228 at 229.

(36) For example, the Climate Bond Initiative Climate Bond Certified stamp of approval (which also requires the appointment of a third party approved verifier).

(37) See for example the Moody's Investor Service, 'Moody's assigns Green Bond Assessment (GBA) of GB1 to the €14 million green bonds issued by GEN-I Sonce d.o.o. on March 2, 2017' online at https://www.moody's.com/research/Moodys-assigns-Green-Bond-Assessment-GBA-of-GB1-to-the-PR_396944, accessed 8 July 2021.

(38) European Commission, *Action Plan: Financing Sustainable Growth* (8 March 2018), online at: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52018DC0097&from=EN>, accessed 8 July 2021.

sustainability⁽³⁹⁾, including through the creation of standards and labels for green finance products⁽⁴⁰⁾.

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⁽⁴¹⁾. This led to the development of a Regulation on the Establishment of a Framework to Facilitate Sustainable Investment (the ‘Taxonomy Regulation’)⁽⁴²⁾.

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⁽⁴³⁾. The operational parts of the Taxonomy Regulation entered into force on 12 July 2020 with a phased implementation from January 2022. This represents a move towards the adoption of more prescriptive and identified 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”⁽⁴⁴⁾.

In June 2019, an updated draft of the Technical Expert Group’s report on the European Union Green Bond Standard (EU-GBS) was published⁽⁴⁵⁾. This was

(39) European Commission, *Sustainable finance*, online at: https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance_en, accessed 8 July 2021.

(40) *ibid.*

(41) European Commission, *Technical Expert Group on Sustainable Finance (TEG)*, online at: https://ec.europa.eu/info/publications/sustainable-finance-technical-expert-group_en, accessed 8 July 2021.

(42) Regulation 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment and amending Regulation (EU) 2019/2088.

(43) *ibid.*, Article 1. See also, EU Technical Expert Group on Sustainable Finance, *Taxonomy: Final report of the Technical Expert Group on Sustainable Finance* (March 2020) online at: https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/200309-sustainable-finance-teg-final-report-taxonomy_en.pdf, accessed 8 July 2021.

(44) EU Technical Expert Group on Sustainable Finance, *Report on EU Green Bond Standard* (June 2019) at 9, online at: https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/190618-sustainable-finance-teg-report-green-bond-standard_en.pdf, accessed 8 July 2021.

(45) European Commission, *EU Green Bond Standard* (19 June 2019), online at: https://ec.europa.eu/info/publications/sustainable-finance-teg-green-bond-standard_en, accessed 8 July 2021.

followed recently by an EU Green Bond Standard ‘Usability Guide’ providing details on the practical application of the EU-GBS⁽⁴⁶⁾ and in July 2021, the European Commission published a legislative proposal on the EU-GBS. Though not yet reflected in legislation that is in force, the EU-GBS provides an indication of the framework within which issuers of green bonds may have to operate in order for bond issuances to be classified as ‘European Green Bonds’⁽⁴⁷⁾.

The EU-GBS build on, and are aligned to, market best practices, most notably the ICMA’s GBPs. Like the GBPs, 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 European Green Bonds to the Taxonomy Regulation. As such, each eligible project should meet the requirements of environmentally sustainable economic activities set out within the Taxonomy Regulation⁽⁴⁸⁾.

Proceeds from the issue of European 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 still complying with certain ‘minimum social safeguards’ and technical screening criteria⁽⁴⁹⁾.

The Technical Expert Group also recommended that issuers of European 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’,⁽⁵⁰⁾ that the use of proceeds and impact

(46) EU Technical Expert Group on Sustainable Finance, *Usability Guide TEG Proposal for an EU Green Bond Standard* (March 2020), online at: https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/200309-sustainable-finance-teg-green-bond-standard-usability-guide_en.pdf, accessed 8 July 2021. European Commission Proposal for a Regulation of the European Parliament and of the Council on European Green Bonds 2021/0191 (COD) (the ‘European Green Bond Regulation’).

(47) EU Technical Expert Group on Sustainable Finance, Report on EU Green Bond Standard, *supra* (n 44) at 9.

(48) EU Technical Expert Group on Sustainable Finance, *Usability Guide - EU Green Bond Standard* (March 2020), online at: https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/200309-sustainable-finance-teg-green-bond-standard-usability-guide_en.pdf, accessed 8 July 2021. European Green Bond Regulation, Art 6.

(49) EU Technical Expert Group on Sustainable Finance, Taxonomy, *supra* (n 43) at 43.

(50) EU Technical Expert Group on Sustainable Finance, Report on EU Green Bond Standard, *supra* (n 44) at 32.

of a green bond issuance be reported, and that an issuance's alignment with the EU-GBS be verified by an accredited external verifier⁽⁵¹⁾. The European Commission has proposed that issuers of European Green Bonds complete a European Green Bond Factsheet pre-issuance, which will set out the issuer's environmental strategy, the proposed selection process for eligible projects and the intended qualifying green projects⁽⁵²⁾.

Complementing the GBPs, therefore, the EU-GBS will 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, sustainability or sustainability-linked 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 (the 'SBPs')⁽⁵³⁾.

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 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 and empowerment⁽⁵⁴⁾. The SBPs also outline suggestions as to target populations who can benefit from the relevant social projects⁽⁵⁵⁾. Like the GBPs, the SBPs recommend external review to verify the social objectives of a social bond issuance⁽⁵⁶⁾.

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').

These voluntary guidelines provide that a bond can be classified as a

(51) *ibid.*

(52) European Green Bond Regulation, Art 8.

(53) ICMA, Social Bond Principles (ICMA, 2021).

(54) *ibid.* at section 1 – Use of Proceeds.

(55) *ibid.* at section 1 – Use of Proceeds.

(56) *ibid.*, External Review.

sustainability bond if it complies with the core components of both the GBPs and the SBPs⁽⁵⁷⁾. The guidelines do not themselves set out specific structural recommendations for sustainability bonds, but rather direct market participants to the GBPs and the SBPs⁽⁵⁸⁾.

In June 2020, the ICMA published its Sustainability-Linked Bond Principles for issuances of sustainability-linked bonds⁽⁵⁹⁾. These Sustainability-Linked Bond Principles (together with the GBPs, the SBOs and the sustainability Bond Guidelines, the CMA Responsible Finance Bond Principles) focus on five core components: selecting key performance indicators to determine whether an issuer has met relevant sustainability targets; calibrating sustainability performance targets; bond characteristics; reporting; and verification⁽⁶⁰⁾. Given the forward-looking nature of the sustainability outcomes of sustainability-linked bonds, the Sustainability-Linked Bond Principles focus on how to measure attainment of sustainability objectives and targets, rather than on the specific categorisation of projects to be funded.

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, the relevance of independent verification of a project's social credentials and the nature of post-issuance disclosure 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 Standard and the EU-GBS are also voluntary, in order to be certified as a green bond under the Climate Bonds Standard or to be classified as a 'European Green Bond' under the EU-GBS (once in force), 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.

(57) ICMA, Sustainability Bond Guidelines (ICMA, 2021), Sustainability Bond Definition.

(58) *ibid.*

(59) ICMA, Sustainability-Linked Bond Principles (ICMA, 2021).

(60) *ibid.* at 2.

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. It also reduces the scope for an issuance's green or social claims to be misrepresented or exaggerated.

3. Responsible Finance *Sukuk* – Types and Standardisation

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 certificate holders 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 certificate holders 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 (or an amount equivalent to those proceeds) to fund green and/or social 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 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’⁽⁶¹⁾. This promotion of socially responsible finance and investment has become a key aspect of Malaysia’s capital markets regulatory infrastructure⁽⁶²⁾. 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⁽⁶³⁾. In the 2014 revised edition of the SC’s *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*’⁽⁶⁴⁾.

The *Guidelines on Sukuk* have since been superseded by the *Guidelines on Unlisted Capital Market Products under the Lodge and Launch Framework*⁽⁶⁵⁾ and the *Guidelines on Issuance of Corporate Bonds and Sukuk to Retail Investors*⁽⁶⁶⁾, each of which has a separate chapter dedicated to responsible finance *sukuk* (these chapters are together referred to as 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

(61) SC, *Resolutions of the Shariah Advisory Council of the Securities Commission of Malaysia* (31 December 2019) at 124, online at: <https://www.sc.com.my/api/documentms/download.ashx?id=5f0c31dc-daa9-43c1-80ac-e7ecf70c8e44>, accessed 8 July 2021.

(62) This goal was initially set out in SC, *Capital Market Masterplan 2* (Securities Commission Malaysia, 2011) at 3.1.4.

(63) 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 ‘[a]ll 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.’

(64) SC, *Guidelines on Sukuk*, Revised 28 August 2014, Part D (now superseded).

(65) SC, *Guidelines on Unlisted Capital Market Products under the Lodge and Launch Framework*, SC-GL/4-2015 (R8-2021), first issued 9 March 2015, revised 26 April 2021 (‘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.

(66) SC Retail Guidelines.

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⁽⁶⁷⁾. 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⁽⁶⁸⁾. When the SC's SRI *Sukuk* Standards were initially published, the list of eligible projects that could be funded was specific and finite⁽⁶⁹⁾.

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⁽⁷⁰⁾. 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, and projects that combine green and social projects⁽⁷¹⁾. It is the issuer's responsibility to establish internal processes to evaluate and select eligible projects based on these criteria⁽⁷²⁾.

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 Bonds Standard individually.

Recent amendments to the SC's SRI *Sukuk* Standards have also brought the disclosure requirements imposed on issuers into line with those set out in the ICMA Responsible Finance Bond Principles. Like these principles, 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

(67) SC LOLA Guidelines, para. 7.02 and SC Retail Guidelines, para. 20.02.

(68) SC LOLA Guidelines, *supra* (n 65), para. 7.04(c) and SC Retail Guidelines, *supra* (n 63) at para. 20.04(c).

(69) 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...'

(70) SC LOLA Guidelines, *supra* (n 65) para. 7.08 and SC Retail Guidelines, *supra* (n 63) at para. 20.08.

(71) SC Retail Guidelines, *supra* (n 64) at para 20.08.

(72) SC LOLA Guidelines, *supra* (n 65) para. 7.12 and SC Retail Guidelines, *supra* (n 63) at para. 20.12.

of proceeds, and reporting⁽⁷³⁾.

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⁽⁷⁴⁾.

The SC's SRI *Sukuk* Standards, therefore, 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, therefore, sought to facilitate the development of specifically designated ASEAN green, social or sustainability bonds and *sukuk*⁽⁷⁵⁾. The first such standards were the ASEAN Green Bond Standards⁽⁷⁶⁾.

These standards are based on the GBPs and seek to 'enhance transparency, consistency and uniformity of ASEAN Green Bonds'⁽⁷⁷⁾. The ASEAN Green Bond Standards were updated and republished in 2018, together with the ASEAN Social Bond Standards⁽⁷⁸⁾ (which are based on the SBPs) and the ASEAN Sustainability Bond Standards (which are based on the Sustainability Bond Guidelines) (the three standards together are referred to in this article as the 'ASEAN Responsible Finance Bond Standards')⁽⁷⁹⁾.

(73) SC LOLA Guidelines, *supra* (n 65) para. 7.09 et seq and SC Retail Guidelines, *supra* (n 63) at para. 20.09 et seq.

(74) SC LOLA Guidelines, *supra* (n 65) para. 7.14 and SC Retail Guidelines, *supra* (n 63) at para. 20.14.

(75) 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 8 July 2021. 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.

(76) ASEAN Capital Markets Forum, ASEAN Green Bond Standards (ACMF 2017, updated 2018) at 2, online at: <https://www.theacmf.org/images/downloads/pdf/AGBS2018.pdf>, accessed 8 July 2021. In 2017, the State Bank of Pakistan also published its Green Banking Guidelines (Issued vide IH&SMEFD Circular Number 08, dated 9 October, 2017) however, these focus more on how a financial institution can work towards making its own business green, rather than on standards to be followed by bond or *sukuk* issuers.

(77) ASEAN Green Bond Standards (2018), *supra* (n 76) at para. 2.0.

(78) ASEAN Capital Markets Forum, ASEAN Social Bond Standards (ACMF, 2018), online at: <https://www.theacmf.org/images/downloads/pdf/ASBS2018.pdf>, accessed 8 July 2021.

(79) ASEAN Capital Markets Forum, ASEAN Sustainability Bond Standards (ACMF, 2018), online at: <https://www.theacmf.org/images/downloads/pdf/ASUS2018.pdf>, accessed 8 July 2021.

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⁽⁸⁰⁾, how the proceeds from the issue of responsible finance bonds or *sukuk* are to be managed⁽⁸¹⁾ and the level of disclosure expected of issuers before and following an issue of green bonds or *sukuk*⁽⁸²⁾. The ASEAN Responsible Finance Bond Standards also recommend external verification⁽⁸³⁾.

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⁽⁸⁴⁾.

However, the ASEAN Responsible Finance Bond Standards also specifically confirm that certain categories of projects are *ineligible* for funding⁽⁸⁵⁾. These projects cover fossil fuel power generation projects⁽⁸⁶⁾ and projects involving activities that ‘pose a negative social impact related to alcohol, gambling, tobacco and weaponry’⁽⁸⁷⁾.

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⁽⁸⁸⁾. The standards also require that external reviewers ‘have the relevant expertise and experience in the area which they are reviewing’ and that such credentials are

(80) ASEAN Green Bond Standards (2018), *supra* (n 77) at para. 4.2. ASEAN Social Bond Standards (2018), *supra* (n 78) at para. 4.2.

(81) ASEAN Green Bond Standards (2018), *supra* (n 77) at para. 4.3. ASEAN Social Bond Standards (2018), *supra* (n 78) at para. 4.3.

(82) ASEAN Green Bond Standards (2018), *supra* (n 77) at para. 4.4. ASEAN Social Bond Standards (2018), *supra* (n 78) at para. 4.4.

(83) ASEAN Green Bond Standards (2018), *supra* (n 77) at para. 5.0. ASEAN Social Bond Standards (2018), *supra* (n 78) at para. 5.0.

(84) ASEAN Green Bond Standards (2018), *supra* (n 77) at para. 4.1.5. ASEAN Social Bond Standards (2018), *supra* (n 78) at para. 4.1.5.

(85) ASEAN Green Bond Standards (2018), *supra* (n 77) at para. 4.1.6. ASEAN Social Bond Standards (2018), *supra* (n 78) at para. 4.1.6.

(86) *ibid.*

(87) ASEAN Green Bond Standards (2018), *supra* (n 77) at para. 4.1.7. ASEAN Social Bond Standards (2018), *supra* (n 79) at para. 4.1.7.

(88) 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 76) at paras. 3.1 and 3.2. ASEAN Social Bond Standards (2018), *supra* (n 78) at paras. 3.1 and 3.2.

made publicly available⁽⁸⁹⁾.

Finally, continuous publicly available access to information on the use of proceeds, the process for project evaluation and selection, and management of proceeds, as well as periodic reporting to investors on a more frequent basis than that advocated by the ICMA Responsible Finance Bond Principles is encouraged under the ASEAN Responsible Finance Bond Standards⁽⁹⁰⁾.

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⁽⁹¹⁾.

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 standardisation and harmonisation is now based on transparency, disclosure 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 and discussed below).

(89) ASEAN Green Bond Standards (2018), *supra* (n 77) at para. 5.0. ASEAN Social Bond Standards (2018), *supra* (n 79) at para. 5.0.

(90) ASEAN Green Bond Standards (2018), *supra* (n 77) at para. 4.4. ASEAN Social Bond Standards (2018), *supra* (n 78) at para. 4.4.

(91) SC LOLA Guidelines, *supra* (n 65), Chapter 8 and SC Retail Guidelines, *supra* (n 63), Chapter 21.

4. Case Study – Indonesian Green *Sukuk*

Since 2017, Malaysian issuers have dominated the responsible finance *sukuk* market⁽⁹²⁾. However, gradually issuers from other jurisdictions have begun to issue responsible finance *sukuk*, with issuers from Indonesia, the United Arab Emirates⁽⁹³⁾, Saudi Arabia⁽⁹⁴⁾ and Turkey recently accessing this market.

Reflecting this geographic spreading of responsible finance *sukuk* issuances, in March 2018, February 2019, June 2020 and most recently in June 2021, the Republic of Indonesia (the ‘Republic’) became the first sovereign to issue internationally offered responsible finance *sukuk* certificates⁽⁹⁵⁾. These certificates, the USD1,250,000,000 green *sukuk* due 2023 (the ‘2018 Indonesian Green *Sukuk*’), the USD750,000,000 green *sukuk* due 2024 (the ‘2019 Indonesian Green *Sukuk*’), the USD750,000,000 green *sukuk* due 2025 (the ‘2020 Indonesian Green *Sukuk*’ and the USD750,000,000 green *sukuk* due 2051 (the ‘2021 Indonesian Green *Sukuk*’) and, together with the 2018 Indonesian Green *Sukuk*, the 2019 Indonesian Green *Sukuk* and the 2020 Indonesian Green *Sukuk*, the ‘Indonesian Green *Sukuk*’) were aligned with domestic, regional and international best practice standards. These issuances reflect 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’)⁽⁹⁶⁾ under a USD25,000,000,000 trust certificate programme (the ‘Indonesian *Sukuk* Programme’)⁽⁹⁷⁾. The *sukuk* certificates in each series of Indonesian Green *Sukuk* were issued for a period of between five and thirty years and were listed

(92) 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.

(93) 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.

(94) 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.

(95) It also issued domestic retail green *Sukuk* in February 2019 and November 2020, which will not be discussed in this article.

(96) The issuer was established under Government Regulation No. 57 of 2011 on the Establishment of *Perusahaan Penerbit Surat Berharga Syariah Negara Indonesia III* in conjunction with the Government Regulation No. 56 of 2008 on *Perusahaan Penerbit Surat Berharga Syariah Negara* as amended by Government Regulation No. 73 of 2012 on the amendment of Government Regulation No. 56 of 2008 on *Perusahaan Penerbit Surat Berharga Syariah Negara*.

(97) Authorised by Law No. 19 of 2008 on Sovereign Sukuk (*Surat Berharga Syariah Negara*). The *sukuk* certificates, purchase undertaking, transfer undertaking, declaration of trust and agency agreement are governed by English law. The purchase agreement, procurement agreement, servicing agency agreement and Wakala Agreement are governed by Indonesian law.

on Nasdaq Dubai and the Singapore stock exchange⁽⁹⁸⁾.

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⁽⁹⁹⁾. The *wakalah* structure was used for all four series of Indonesian Green *Sukuk*⁽¹⁰⁰⁾. Pursuant to this structure, on the issue date of the Indonesian Green *Sukuk*, PPSI-III issued *sukuk* certificates to certificate holders.

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*')⁽¹⁰¹⁾. 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*')⁽¹⁰²⁾.

(98) 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'), Part B, Item 1. 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'), Part B, Item 1. Pricing Supplement dated 16 June 2020 for the issue by Perusahaan Penerbit SBSN Indonesia III of USD750,000,000 2.3% due 2025 under the USD25,000,000,000 Trust Certificate Issuance Program (the '2020 Indonesian Green *Sukuk* Pricing Supplement'), Part B, Item 1. Pricing Supplement dated 2 June 2021 for the issue by Perusahaan Penerbit SBSN Indonesia III of USD750,000,000 3.55% Trust Certificates due 2051 under the USD25,000,000,000 Trust Certificate Issuance Program (the '2021 Indonesian Green *Sukuk* Pricing Supplement'), Part B, Item 1.

(99) Offering Memorandum dated 23 January 2018, Indonesian *Sukuk* Programme, Appendix, *The Green Bond and Green Sukuk Framework* at 2 – *Structure Diagram and Cash Flows*, Offering Memorandum dated 31 January 2019, Indonesian *Sukuk* Programme, Appendix, *The Green Bond and Green Sukuk Framework* at 2 – *Structure Diagram and Cash Flows*, and Offering Memorandum dated 16 June 2020, Indonesian *Sukuk* Programme, Appendix, *The Green Bond and Green Sukuk Framework* at 2 – *Structure Diagram and Cash Flows*, and Offering Memorandum dated 2 June 2021, Indonesian *Sukuk* Programme Appendix, *The Green Bond and Green Sukuk Framework* at 2-*Structure Diagram and Cash Flows*, the four Offering Memoranda together, the 'Offering Memorandum, Indonesian *Sukuk* Programme'. These structures were permissible pursuant to Law No. 19 of 2008 on Sovereign *Sukuk* (*Surat Berharga Syariah Negara*) Article 3.

(100) Pricing Supplement, Indonesian Green *Sukuk* at Part A Item 18.

(101) By way of examples, in the 2020 Indonesian Green *Sukuk*, the total *Ijarah Assets* that were invested in were valued on the date of issuance of the Indonesian Green *Sukuk* at Indonesian Rupiah (IDR) 5,508,069,013,620 (converted at the average IDR/USD exchange rate for June 2020, as set out on page v of the Offering Memorandum, Indonesian *Sukuk* Programme, this represented a value equivalent to USD387,128,831 or 51% of the proceeds from the issue of the 2020 Indonesian Green *Sukuk*). See more generally, AAOIFI, Shari'a Standard No. (17), '*Investment Sukuk*', para. 5/1/2.

(102) By way of example, in the 2020 Indonesian Green *Sukuk*, the total *Project Assets* that were invested in were valued on the date of issuance of the Indonesian Green *Sukuk* at IDR 5,292,054,844,200 (converted at the average IDR/USD exchange rate for June 2020, as set out on page v of the Offering Memorandum, Indonesian *Sukuk* Programme, this represented a value equivalent to USD 371,946,503 or 49% of the proceeds from the issue of the 2020 Indonesian Green *Sukuk*).

PPSI-III declared a trust in favour of certificate holders 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⁽¹⁰³⁾.

As a result, PPSI-III will hold the Indonesian *Sukuk* Assets on trust for certificate holders in proportion to their holding of Indonesian Green *Sukuk*⁽¹⁰⁴⁾. 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⁽¹⁰⁵⁾.

The rent payable periodically from the lease of the *Ijarah* Assets will be an amount equal to the pre-agreed periodic distributions payable to certificate holders during the tenor of the Indonesian Green *Sukuk*⁽¹⁰⁶⁾. 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⁽¹⁰⁷⁾.

The Indonesian Green *Sukuk* were the first three series of *sukuk* issued under Indonesia's Green Bond and Green *Sukuk* Framework⁽¹⁰⁸⁾. This framework was established to align with both the domestic *Regulation on the Issuance and the Terms of Green Bond*⁽¹⁰⁹⁾ published by the Republic's Financial Services Authority, and the ICMA's GBPs⁽¹¹⁰⁾.

The Republic's Green Bond and Green *Sukuk* Framework is, therefore, built around the same four core components of use of proceeds, project evaluation and selection, management of proceeds, and reporting found in the GBPs⁽¹¹¹⁾. 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

(103) Offering Memorandum, Indonesian *Sukuk* Programme at Condition 4.1 – *Summary of the Trust*.

(104) *ibid.*

(105) *ibid.* at 63 – *Summary of the Principal Transaction Documents – Lease Agreement*.

(106) *ibid.*

(107) *ibid.* at 65 – *Summary of the Principal Transaction Documents – Wakala Agreement*.

(108) *ibid.*, Appendix A-1 (The Green Bond and Green *Sukuk* Framework).

(109) 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*.

(110) Offering Memorandum, Indonesian *Sukuk* Programme, Appendix A-1 (The Green Bond and Green *Sukuk* Framework) at II.

(111) Republic's Green Bond and Green *Sukuk* Framework (2018), paras II(1)-(4).

Principles⁽¹¹²⁾, the Republic will finance or re-finance expenditure relating directly to eligible projects⁽¹¹³⁾.

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⁽¹¹⁴⁾. The project must then fall within at least one of a number of specified sectors⁽¹¹⁵⁾. These eligible sectors include renewable energy, energy efficiency, sustainable transport, green tourism, green buildings and sustainable agriculture⁽¹¹⁶⁾. 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⁽¹¹⁷⁾.

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⁽¹¹⁸⁾.

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⁽¹¹⁹⁾. 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⁽¹²⁰⁾.

Pursuant to a unilateral purchase undertaking entered into by the Republic, at maturity or upon early redemption⁽¹²¹⁾ of the Indonesian Green *Sukuk*, the

(112) *ibid.*, para II(1).

(113) 2018 Pricing Supplement, Use of Proceeds. 2019 Pricing Supplement, Use of Proceeds. 2020 Pricing Supplement, Use of Proceeds. 2021 Pricing Supplement, Use of Proceeds.

(114) Offering Memorandum, Indonesian *Sukuk* Programme, Appendix, *The Green Bond and Green Sukuk Framework*, s II(2).

(115) *ibid.*, Appendix, *The Green Bond and Green Sukuk Framework*, s II(1).

(116) *ibid.*

(117) *ibid.* at II(1).

(118) *ibid.* at II(3).

(119) *ibid.* at II(4).

(120) *ibid.* at III.

(121) 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*.

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⁽¹²²⁾.

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⁽¹²³⁾.

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-party opinion) on the Republic's Green Bond and Green *Sukuk* Framework underpinning the Indonesian Green *Sukuk*⁽¹²⁴⁾. This independent verification is in line with international best practice in responsible finance bond and *sukuk* issuances.

Although the offering memorandum for the Indonesian *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-party 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⁽¹²⁵⁾. 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⁽¹²⁶⁾ reflecting 'projects and solutions that represent steps towards the long-term vision, but are not quite there yet'⁽¹²⁷⁾. As part of its second-party opinion, CICERO noted that the Republic's Green Bond and Green *Sukuk* Framework 'provides a sound

(122) Offering Memorandum, Indonesian *Sukuk* Programme at Condition 9 – *Capital Distributions of the Trust*.

(123) *ibid.*

(124) CICERO, "Second Opinion" on The Republic of Indonesia's Green Bond and Green *Sukuk* Framework' (3 January 2018).

(125) 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 Green Bond and Green *Sukuk* Framework against this as the Framework also contemplates the issuance of conventional green bonds.

(126) "Second Opinion" on The Republic of Indonesia's Green Bond and Green *Sukuk* Framework' (3 January 2018) at 2.

(127) *ibid.* at 5.

framework for climate-friendly investments⁽¹²⁸⁾, CICERO did, however, also highlighted the possibility that some eligible projects may include an element of deforestation⁽¹²⁹⁾. The Republic noted that there would be no deforestation in the context of sustainable agriculture⁽¹³⁰⁾. 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⁽¹³¹⁾.

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’⁽¹³²⁾, the Republic published its first annual ‘Green Sukuk Issuance Allocation and Impact Report’ (the ‘2019 Impact Report’). This was followed in March 2020 by the ‘Green Sukuk Allocation and Impact Report’ (the ‘2020 Impact Report’) and in May 2021 by the ‘Green Sukuk Allocation and Impact Report’ (‘2021 Impact Report’).

The 2019 Impact Report covered the allocation of proceeds from the 2018 Indonesian Green *Sukuk* and confirmed 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 transport sector, the waste to energy and waste management sector, the renewable energy sector and the energy efficiency sector⁽¹³³⁾. The remaining issue proceeds were used to finance new

(128) *ibid.* at 12.

(129) *ibid.* at 16 and 17.

(130) *ibid.* at 17.

(131) 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*, 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*, Offering Memorandum dated 16 June 2020, 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/b173hzfxhv8p0f/indonesias-green-sukuk-needs-a-harder-look, accessed 8 July 2021.

(132) Ministry of Finance, Republic of Indonesia, ‘Green Sukuk Issuance Allocation and Impact Report’ (February 2019) at 4, online at: <https://www.sdgphilanthropy.org/system/files/2019-02/Green%20Suku%20Issuance%20-%20Allocation%20and%20Impact%20Report%20.pdf>, accessed 8 July 2021.

(133) *ibid.* at 11.

projects in sectors covering sustainable transport, renewable energy, energy efficiency and resilience to climate change for highly vulnerable sectors and disaster risk reduction⁽¹³⁴⁾.

In assessing the impact of this allocation of the 2018 Indonesian Green *Sukuk* issue proceeds, the 2019 Impact Report noted 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⁽¹³⁵⁾, including in furtherance of the United Nations’ Sustainable Development Goals⁽¹³⁶⁾.

The 2020 Impact Report confirmed the allocations of the 2018 Indonesian Green *Sukuk* remained unchanged in 2020. It also confirmed that of the 2019 Indonesian Green *Sukuk* issue proceeds, 89 per cent of the proceeds were invested in projects addressing climate change mitigation, while the remaining 11 per cent were invested in climate change adaptation projects. These included projects related to the development of new, renewable energy and energy conservation infrastructure, and projects targeting resilience to climate change for highly vulnerable areas⁽¹³⁷⁾.

The 2021 Impact Report provided details on the use of proceeds from the 2020 Indonesian Green *Sukuk*. This confirmed that 49 per cent of the 2020 Indonesian Green *Sukuk* issue proceeds had been invested in financing new eligible projects, while 51 per cent was used to refinance projects originally funded using the issue proceeds from the 2018 Indonesian Green *Sukuk*. The majority of the funding (83 per cent) was directed towards projects focusing on climate change resilience for highly vulnerable areas and disaster risk reduction, with the remaining funding going towards sustainable transport projects and projects in the waste and waste to energy management sectors⁽¹³⁸⁾.

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, the allocation of the 2019 Indonesian Green *Sukuk*

(134) *ibid.* at 12.

(135) *ibid.* at 13

(136) *ibid.*

(137) Ministry of Finance, Republic of Indonesia, ‘Green Sukuk Allocation and Impact Report’ (March 2020) at 4, online at: <https://www.djppr.kemenkeu.go.id/page/loadViewer?idViewer=9468&action=download>, accessed 8 July 2021.

(138) Ministry of Finance, Republic of Indonesia, ‘Green Sukuk Allocation and Impact Report’ (May 2021) at 7, online at: <https://www.djppr.kemenkeu.go.id/page/loadViewer?idViewer=10577&action=download>, accessed 8 July 2021.

issue proceeds and the 2020 Indonesian Green *Sukuk* issue proceeds and, in each case, on the amounts of those issue proceeds allocated to eligible green projects⁽¹³⁹⁾.

Each issuance of Indonesian Green *Sukuk* was oversubscribed⁽¹⁴⁰⁾, with (by way of example) the 2018 Indonesian Green *Sukuk* attracting investors from across the Islamic, Asian, European, American and domestic Indonesian markets⁽¹⁴¹⁾.

The Indonesian Green *Sukuk* issuances highlight an appetite amongst investors for responsible finance *sukuk* instruments and the potential for these instruments to be used as a mechanism for raising capital to address societal issues. These instruments may now also stand as a precedent for future international issuances in the market. Though designed using classical Islamic contracts and structured to be compliant with principles of Islamic law⁽¹⁴²⁾, 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

(139) 2019 Impact Report at 36-40. 2020 Impact Report at 20-23. 2021 Impact Report at 40-44.

(140) Christophe Bahuet, 'Indonesia's green sukuk', United Nations Development Programme (8 October 2018) online at: <https://www.undp.org/blogs/indonesias-green-sukuk>, accessed 8 July 2021; Yosi Winosa, 'Indonesia issues \$2.5 bln global sukuk including \$750 mln green tranche', Salaam Gateway (19 June 2020), online at: <https://www.salaamgateway.com/story/indonesia-issues-25-bln-global-sukuk-including-750-mln-in-a-green-tranche>, accessed 8 July 2021.

(141) Ministry of Finance, Republic of Indonesia, *Indonesia's Green Bond & Green Sukuk Initiative* (Ministry of Finance, Republic of Indonesia, 2018) at 28.

(142) 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.*

bond issuances⁽¹⁴³⁾.

Unlike Malaysia, therefore, the Republic has not enacted binding legislative provisions dealing specifically with the form and structure of responsible finance *sukuk*. Instead, it established a framework to underpin its issuance of responsible finance instruments based on market best practice standards. This, it is submitted, is a positive step and is likely to be replicated as issuances of responsible finance *sukuk* targeted at international investors extend beyond Muslim-majority countries. 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 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.

5. 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.

As has been discussed in this article, increasingly, 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.

(143) See, for example, Ireland's sovereign green bond framework: National Treasury Management Agency, *Irish Sovereign Green Bond Framework*, (2018) online at: <https://www.ntma.ie/uploads/general/Irish-Sovereign-Green-Bond-Framework.pdf>, accessed 8 July 2021.

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 standards setting body (such as the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) or the Islamic Financial Services Board (IFSB), each of which issues *shari'ah* and governance standards for the Islamic finance industry)⁽¹⁴⁴⁾.

Indeed, AAOIFI has already encouraged Islamic financial institutions to pursue investments that contribute directly or indirectly to ‘social, development and environmental causes’⁽¹⁴⁵⁾. The establishment of common standards by an organisation such as AAOIFI or the IFSB 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

(144) Reflecting the cross-jurisdictional standard setting nature of AAOIFI, the organisation has recently noted the importance of developing a governance standard for mainstream *sukuk* noting that ‘[t]he observable shortcomings and lapses in the industry approaches to and methods in Sukuk made it imperative for AAOIFI to develop a Sukuk governance standard and harmonize global governance practices in this respect.’ AAOIFI Governance Standard (GS) 12, ‘Sukuk Governance’, Appendix C, para. BC3. It is argued in this article that a similar argument justifies the development of responsible finance *sukuk* industry standards.

(145) AAOIFI, Governance Standard No. 7, ‘Corporate Social Responsibility Conduct and Disclosure for Islamic Financial Institutions in Accounting, Auditing and Governance Standards’, (AAOIFI 2015), para. 5/3/3.

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.

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