



ISLAMIC FINANCE AND THE PRINCIPLES FOR RESPONSIBLE INVESTMENT

THOUGHT LEADERSHIP SERIES PART 2 - MARCH 2021

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DEFINED TERMS

AAOIFI - Accounting and Auditing Organization for Islamic Financial Institutions

CSR - Corporate Social Responsibility

ESG - Environmental, social and governance

ICD - Islamic Corporation for the Development of the Private Sector

IFFIm - International Finance Facility for Immunization

IsFI - Islamic financial institution

IsDB - Islamic Development Bank

ISRA - International Shari'ah Research Academy for Islamic Finance

MDGs - Millennium Development Goals

NGO - Non-Governmental Organisation

PRB - The UN Principles for Responsible Banking

PRI - Principles for Responsible Investment

PSI - Principles for Sustainable Insurance

SDGs - United Nations Sustainable Development Goals

SRI - Socially Responsible Investing

TCFD - Taskforce on Climate-Related Financial Disclosures

UKIFC - Islamic Finance Council (UK)

UN - United Nations

UNCTAD - United Nations Conference on Trade and Development

UNDP - United Nations Development Programme

UNEP FI - United Nations Environment Programme Finance Initiative

WCED - World Commission on Environment and Development



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FOREWORD

ESG investing and Islamic finance are complementary investment approaches, drawing on a number of mutual principles and product areas. Their modern forms emerged in the 1970's, though both have roots dating back much further. They share key tenets, such as embracing good stewardship particularly from a social perspective, but also toward the environment. ESG, or responsible investment, and Islamic finance offer products for both Muslim and non-Muslim investors alike and have overlaps in practices and policies.

When you look through the lens of the Sustainable Development Goals (SDGs) even more synergies emerge, as their achievement is in line with and critical to both investment approaches. At PRI, we believe global investors have a critical role to play in realising the SDGs. This, of course, includes our signatory base, which with a combined AUM of more than US \$100 trillion is in a unique position to help plug the US \$2-4 trillion a year funding gap currently required. However, achieving the SDGs will require action from investors around the world, and this includes the Islamic finance community.

Today there is significant urgency and opportunity in the SDG agenda, especially at a time as we seek to build back better from the global COVID-19 pandemic. Yet, despite this and the complementary nature of the approaches, we're yet to see significant traction for [ESG investing in Islamic finance](#). As we identified in our 2019 report on ESG Integration and Islamic Finance jointly with the CFA Institute, the key barrier we see is a lack of demand for ESG products in regions such as the Middle East as well as a lack of regulatory incentives, understanding and standardisation and higher time and cost to implement.

We therefore welcome this important report which aims to build on the nascent development of ESG investment and the SDGs amongst the Islamic finance community. The alignment of people, profit and planet and the drive to achieve a sustainable global financial system is a universal one; we invite asset owners, investment managers and service providers working in Islamic finance to join us at PRI to further this mission.



Fiona Reynolds
CEO, Principles for Responsible Investment (PRI)

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INTRODUCTION

This report forms part of a four part thought leadership series delivered by the Islamic Finance Council UK (UKIFC) in partnership with the International Shari'ah Research Academy for Islamic Finance (ISRA) and the Global Ethical Finance Initiative (GEFI). The series is intended to inspire Islamic financial institutions to embrace the UN Sustainable Development Goals (SDGs) and demonstrate to the world that consideration for people, planet and purpose can sit alongside profit and form the heart of the next generation of Islamic financial products. The UKIFC is committed to supporting the Islamic finance sector's engagement with the SDGs and has launched a Global Islamic Finance & UN SDGs Taskforce¹. The UKIFC has unique experience and skills to help organisations through capacity building, business case development, reporting and impact measurement (See Appendix 1).

The first report of the series, 'Islamic Finance and the SDGs: Framing the Opportunity', was published in May 2020², providing an introduction to the SDGs within the context of Islamic finance. Key conclusions included:

- There has been limited participation from the Islamic finance sector in leading UN initiatives (such as Principles for Responsible Investment (PRI), Principles for Responsible Banking (PRB) and Principles for Sustainable Insurance) that support financial institutions seeking to align with the SDGs.
- To achieve SDG targets, Islamic Development Bank Member Countries will need annual funding of between US\$700 billion and US\$1 trillion, which represents around 40% of the total global SDG financing gap.
- Commercial opportunities for the Islamic finance sector include tapping into emerging global liquidity pools seeking SDG-aligned products and increasing tactical alignment with development bank funders.
- Alignment with the SDGs supports the *tayyib* (wholesome) concept which contends that the focus of Islamic finance products and services should be on the evaluation of wider societal impact rather than an overly legalistic analysis of Shari'ah compliance.
- With assets expected to reach US \$3.8 trillion in 2022, through its adeptness at innovative financial structuring Islamic finance is particularly well placed to create innovative instruments that drive capital towards the SDGs.

This report uses the PRI to underpin an analysis of Islamic asset owners, investment managers and services providers engaged in responsible investing. A future paper will provide a similar analysis focused on Islamic banking using the PRB as the guiding framework for the research. The final report in the series will present views on the SDGs from leading global Shari'ah scholars.

KEY FINDINGS

This report provides a quantitative and qualitative analysis of responsible investing in the Islamic finance sector, assessing the level of engagement with PRI amongst financial institutions in Organisation of Islamic Cooperation (OIC) member states and then analysing the approaches and terminology used by 12 Islamic finance institutions signed up to the PRI. The headline findings from the report include:

Responsible Investment in OIC Member States

- Only 12 of the 57 OIC member states contained organisations which were PRI signatories.
- Of the 83 countries containing PRI signatory organisations 14.5% are OIC member states.
- Within the 12 OIC members states there are 37 signatory organisations, comprising investment managers (65%), service providers (24%) and asset owners (11%).
- Between 2008 and 2016 there were 9 PRI signatories based in OIC member states but since 2017 a further 28 new signatories have joined the PRI.
- Despite the OIC member states having a collective population of over 1.82 billion (24% of the total world population) only 1% of the 3,575 PRI worldwide signatories are based within them.

Analysis of Select PRI Signatories Involved in Islamic Finance

- For the purposes of this report 12 signatory organisations engaged in Islamic finance have been selected for analysis. These comprise 7 investment managers, 3 asset owners and 2 service providers.
- Of the 12 Islamic finance institutions selected for detailed analysis the total assets under management (AUM) for the 7 investment managers and 3 asset owners is around \$350 billion (the remaining two institutions are service providers and therefore not managing assets).
- 8 of the 12 organisations are based in OIC member states (Malaysia, Saudi Arabia and United Arab Emirates) with the remainder located in the UK and US.
- The website review of the 12 organisations identified three contrasting approaches to communicating PRI signatory status: using the PRI as a point of differentiation; using the PRI to demonstrate ESG integration; and making no obvious mention of PRI.
- In terms of their investment approach, 9 of the organisations specifically refer to ESG on their websites with only two making direct references to the SDGs.
- The majority of the organisations have relevant policies (i.e. Responsible Investment, Stewardship, Sustainability, Governance and Voting) in place and referenced on their websites.
- Detailed case studies were undertaken for four of the organisations: BIMB Investment Management Berhad, DDCAP Group, GIB UK and Sedco Capital.

RESEARCH APPROACH

For the purposes of this report the PRI has been used to identify and review a cohort of Islamic financial institutions deemed to be engaged in ESG and responsible investing, as the PRI is the leading global framework for responsible investment. As it is now 15 years since the PRI was launched, most asset managers and asset owners can be expected to be familiar with it.

Within the PRI website there is an option to download a full list of signatories³ in the form of an Excel table containing the following information: Account Name, Signatory Category, HQ Country and Signature Date. This list of 3,575 signatories (as at 28th January 2021) was analysed in detail to identify the 37 PRI signatories based in OIC member states. As well as geographical location the PRI data included information on the nature of the organisation and the year each organisation signed up to the PRI. Whilst it is acknowledged that Islamic financial institutions may engage in responsible investing without being a PRI signatory, the scope of this report is limited to PRI signatories only.

The primary purpose of this report is to increase awareness and inspire practical action amongst Islamic financial institutions (IsFIs) in relation to the SDGs. The target audience is asset managers and asset owners and the focus on PRI is intentionally being used as an indicator of engagement with international responsible investing trends. Along with IsFIs there are multiple conventional financial institutions involved in Islamic finance to varying degrees. Accordingly, this report focuses on both fully Shariah compliant fund managers and also select conventional fund managers with a well established Shariah offering. Whilst it is noted this is not comprehensive, this focused approach has as noted identified 12 relevant organisations with a recognised presence in Islamic finance which have been analysed in depth. This shortlist was further validated in consultation with external Islamic finance industry experts.

The analysis included an audit of the websites of each of the 12 organisations. The websites (including articles, reports and policies available on the sites) were reviewed in detail to gain an insight into how each organisation has approached questions of responsible investing, sustainability, ESG and the SDGs.

Thereafter, in-depth interviews were undertaken with senior representatives from 4 of the 12 organisations, providing detailed insights which form the basis of the case studies contained within.

OVERVIEW OF THE PRI

The PRI was launched in April 2006 following a development process that was led by the United Nations (UN) and involved the investment industry, intergovernmental organisations and representatives of civil society. The PRI is an independent organisation that is supported by, but not part of, the UN.

The PRI is the world's leading framework for responsible investment. It fosters understanding of the investment implications of environmental, social and governance (ESG) factors and encourages its signatories to incorporate these factors into their investment and ownership decisions. The PRI promotes the long-term interests of its signatories, the financial markets and the economies within which they operate, and, ultimately, the environment and society as a whole. In 2019 the PRI together with the CFA Institute published a report titled, *ESG Integration and Islamic Finance: Complementary Investment Approaches*. The report shows the alignment between the characteristics of Islamic finance and ESG investing and identifies challenges for ESG integration.

With a global signatory base (as at 28th January 2021) of over 3,500 asset owners, investment managers and services providers a majority of the world's professionally managed investments are represented in the PRI. It establishes six voluntary and aspirational investment Principles that offer a range of approaches for signatories to incorporate ESG issues into their investment practice. By committing to the PRI and embracing ESG, signatories are helping to develop a more sustainable global financial system.

The six Principles are:

Principle 1:	<i>We will incorporate ESG issues into investment analysis and decision-making processes.</i>
Principle 2:	<i>We will be active owners and incorporate ESG issues into our ownership policies and practices.</i>
Principle 3:	<i>We will seek appropriate disclosure on ESG issues by the entities in which we invest.</i>
Principle 4:	<i>We will promote acceptance and implementation of the Principles within the investment industry.</i>
Principle 5:	<i>We will work together to enhance our effectiveness in implementing the Principles.</i>
Principle 6:	<i>We will each report on our activities and progress towards implementing the Principles.</i>

The PRI also promotes research, education and facilitates collaboration to help investors use responsible investment to enhance returns and better manage risks.

PRI AND THE SDGS

With sustainability and ethical values being at the core of their practices, according to CIBAFI⁴ "Islamic financial institutions represent one of the main channels for the attainment of the SDGs and the promotion of sustainability." The principles of Shariah aim to relieve hardship for human beings and achieve sustainable and inclusive development, addressing the same purposes as the SDGs in areas such as the elimination of poverty, economic growth, infrastructure development, education, social inclusion, the protection

of the natural world and sustainable consumption patterns. In the light of these synergies between Islamic finance and the SDGs this section will now look at the approach taken by the PRI to integrate the SDGs into its own Principles.

At the heart of the Principles is an aim to “help investors align their responsible investment practices with the broader sustainable objectives of society – as currently best defined by the SDGs.”⁵ PwC’s “The SDG Investment Case”⁶ Report sets out why the SDGs are relevant to investors, why there is an expectation that investors will contribute to their achievement and why investors should want to. The Report groups the SDGs’ relevance to responsible investors into five “overarching arguments”:

1. The SDGs are the globally agreed sustainability framework
2. Macro risks: the SDGs are an unavoidable consideration for ‘universal owners’
3. Macro opportunities: the SDGs will drive global economic growth
4. Micro risks: the SDGs as a risk framework
5. Micro opportunities: the SDGs as a capital allocation guide.

The PRI’s “Blueprint for Responsible Investment”⁷ highlights PRI’s commitment to driving sustainable development in line with the SDGs in order to create a more prosperous world for today and tomorrow.

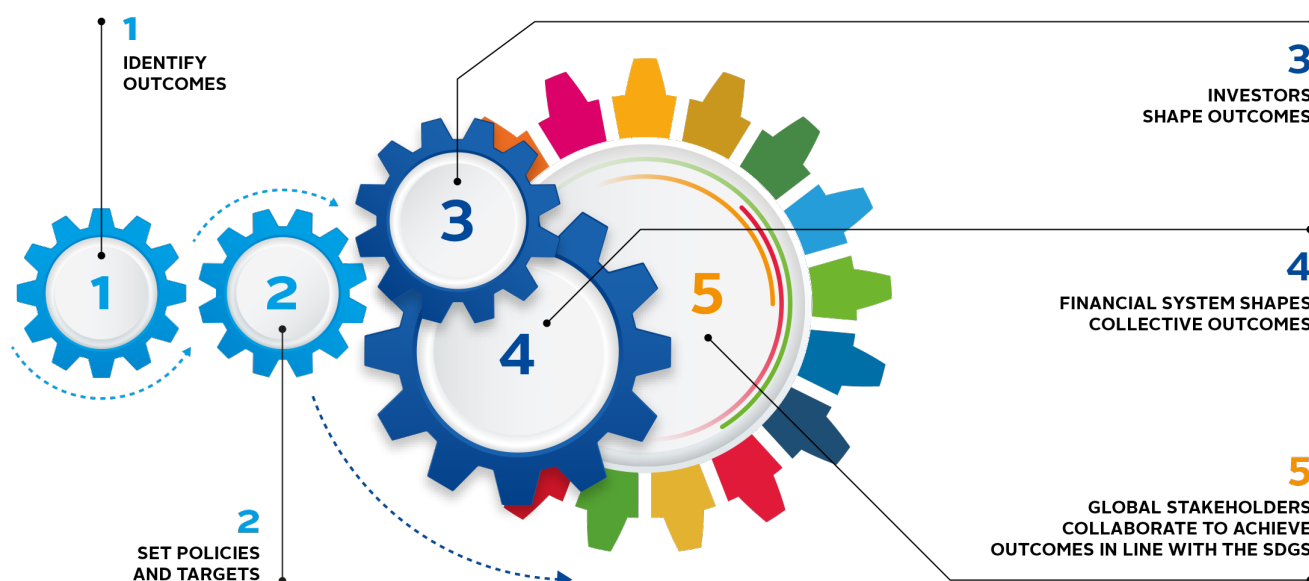
Adoption of the PRI will contribute to a more sustainable global financial system and ultimately create prosperous and inclusive societies for current and future generations. For PRI’s impact on investors to be meaningful, it needs to be reflected in the impact made through signatories on the real world. The Blueprint outlines the following actions required from signatories to deliver real-world impact aligned with the SDGs:

- Work with UN partners to deliver the SDGs, such as by leveraging UNEP FI’s Principles for Positive Impact Finance and the UN Global Compact’s Ten Principles;
- Set out steps and develop tools for investors to align their investment activities with the SDGs;
- Encourage investors to seek, through the full range of active ownership activities, corporate responsibility enhancements that advance the SDGs;
- Encourage capital towards projects with positive, real-world impact;
- Introduce the SDGs into the PRI Reporting Framework;
- Map PRI’s work against the SDGs, and report on each signatory’s contribution towards them; and
- Engage policy makers to encourage public policy that supports the SDGs.

In 2020 PRI launched a high-level framework for any investors looking to shape real-world outcomes in line with the SDGs. Following on from “The SDG Investment Case”, as mentioned above, this new “Investing with SDG Outcomes – A Five-Part Framework”⁸ report outlines a prospective framework for action. It is intended to be a useful reference

for all PRI signatories, while allowing sufficient scope for asset owners, investment managers and service providers to differ in the specific actions they undertake to shape outcomes in line with the SDGs.

The five-part framework is as follows:



1. IDENTIFY OUTCOMES

Investors must identify and understand the unintended outcomes of their investments and their own activities. This assessment involves identifying positive and negative real-world outcomes related to investees' operations, products and services. It can draw on activities such as mapping existing investments to the SDGs and determining the scale of investments in explicitly SDG aligned activities.

2. SET POLICIES AND TARGETS

Investors should set policies and targets to move from identifying and understanding unintended outcomes towards taking intentional steps to shape outcomes. As many outcomes are connected (e.g. climate change and water scarcity, food security and poverty) investors will have to look across all their investments and the SDGs holistically when assessing their most important outcomes.

3. INVESTORS SHAPE OUTCOMES

Investors should seek to shape outcomes in line with the policies and targets set in step 2 above, and report on progress against those objectives. The PRI outlines examples of how this takes place through investor actions including investment decisions, stewardship of investees and engagement with policy makers and key stakeholders – and how the results can be communicated through disclosure and reporting.

4. FINANCIAL SYSTEM SHAPES COLLECTIVE OUTCOMES

Shaping outcomes in line with the SDGs at the financial system level takes place both

through aggregating the actions of individual investors, and from investors acting collectively (including alongside other financial system participants such as credit rating agencies, index providers, proxy advisors, banks, insurers and multilateral financial institutions).

5. GLOBAL STAKEHOLDERS COLLABORATE TO ACHIEVE OUTCOMES IN LINE WITH THE SDGS

The finance sector, businesses, governments, academia, civil society, the media, individuals and their communities must act collectively to ultimately achieve the SDGs. Necessary elements include programmes to connect supply and demand of investments at scale and collaboration on tools to contextualise outcomes data against the global thresholds and timelines required to achieve the SDGs. Although more support for investors needs to be developed, there are already several relevant tools, metrics and data sets that can be useful for investors to take action across the framework. Given the urgency with which implementation of the SDGs must be achieved, investors must work with others to further develop the tools and incentives needed.

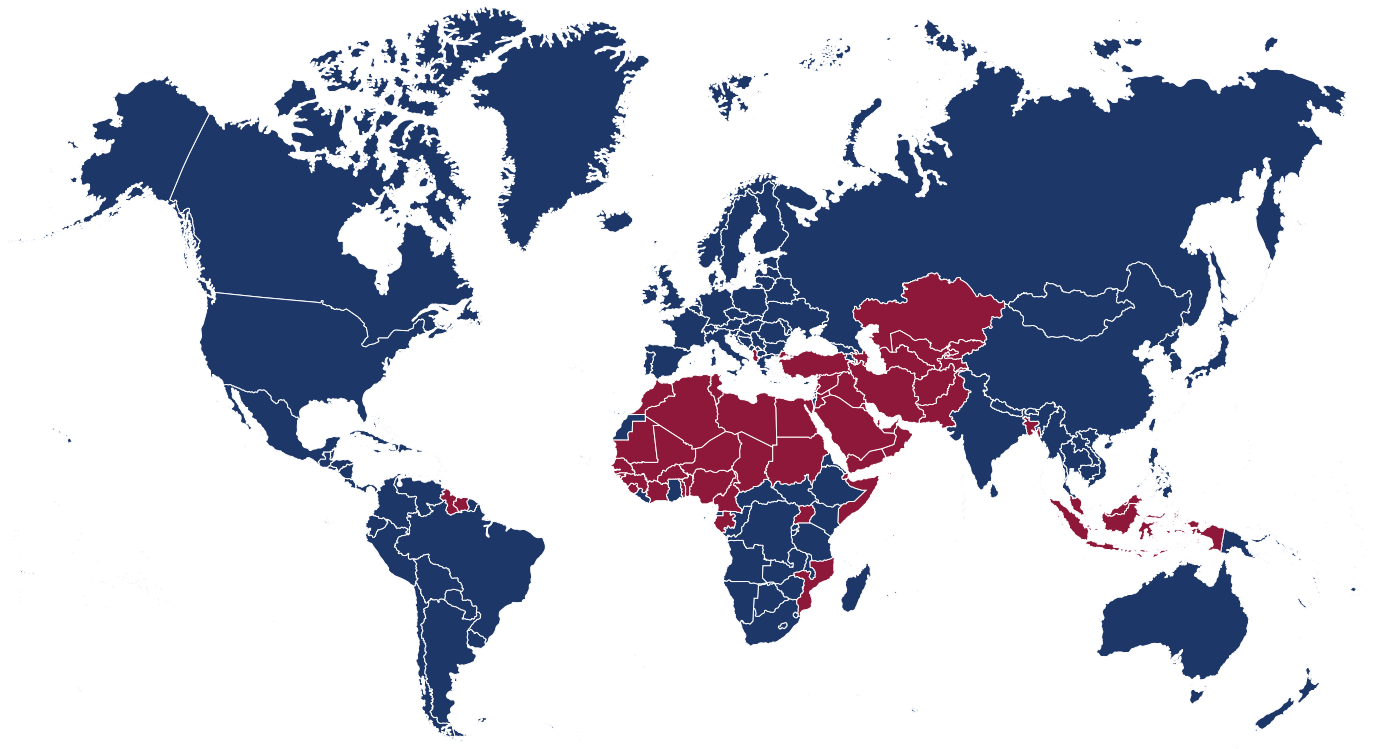
The PRI is now working to assist signatories seeking to shape outcomes in line with the SDGs, including supporting investors to focus on key issues that have systemic implications for market beta or the real economy, such as climate change and human rights. The PRI aims to do this for each part of the framework and across each of the investor actions.

Following consultation with signatories on revising the PRI Reporting Framework, the PRI will also develop an initial set of outcomes questions in 2021, the pilot year of the Reporting Framework.

OVERVIEW OF ORGANISATION OF ISLAMIC COOPERATION (OIC) MEMBER STATE ENGAGEMENT

To investigate the level of engagement with the SDGs within Muslim countries, an analysis of PRI signatories based in OIC member states was undertaken. With 57 member states spread across four continents the OIC is the second largest inter-governmental organisation after the UN. It provides the collective voice of the Muslim world, endeavouring to safeguard and protect its interests in the spirit of promoting international peace and harmony among the peoples of the world⁹. As shown in Chart 1 below, OIC member states represent a significant proportion of the 'Global South' (i.e. regions outside Europe and North America, mostly (though not all) low-income and often politically or culturally marginalised).

Chart 1 – OIC Member States¹⁰



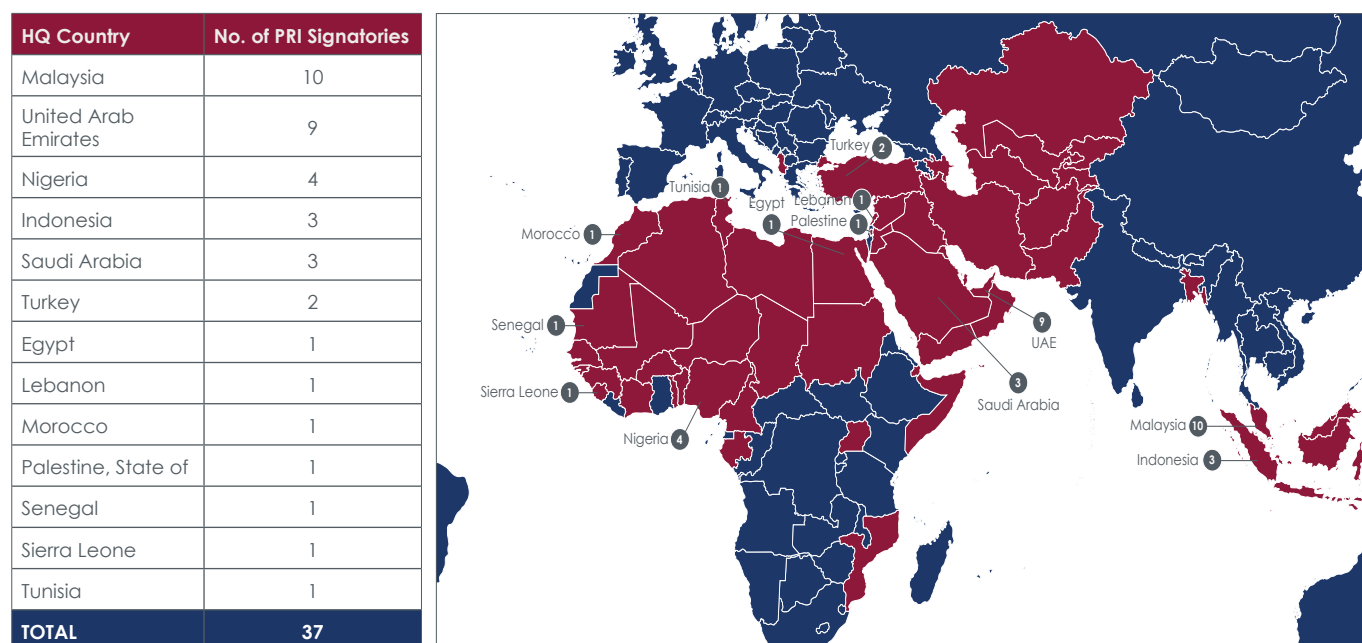
This analysis is focused on general participation in the PRI within Muslim jurisdictions and does not differentiate between conventional and Islamic financial institutions.

ANALYSIS OF OIC SIGNATORIES

PRI signatories are located across 83 countries of which 12 (14.5%) are OIC member states. In total there are 37 PRI signatory organisations spread across these 12 OIC countries, comprising over a fifth of the total 57 OIC states. The research also disclosed that 6 PRI signatories from OIC members states had been delisted during the period of the research (see Appendix 2). Reasons for delisting include: failure to meet the minimum requirements, failure to report and failure to pay the fees.

Figure 1 highlights the split of the 37 OIC signatories by country. This shows that 43% of signatories are in South East Asia (i.e. Malaysia and Indonesia), with 31% in the Middle East (United Arab Emirates, Saudi Arabia, Iran, Lebanon and Palestine), 20% in Africa (i.e. Nigeria, Egypt, Morocco, Senegal and Sierra Leone) and 6% in Europe (i.e. Turkey).

Figure 1 - Number of PRI Signatories in OIC Member States



Of these 37 PRI signatories, 65% are investment managers, 24% service providers and 11% asset owners.

Analysis of the PRI signatory list (as at 28th January 2021) indicates that in May 2008 Malaysian-based Corston-Smith Asset Management became the first organisation within an OIC member state to join the PRI. Over the eight-year period between 2008 and 2016 the OIC had a total of 9 PRI signatories, approximately a quarter of the current total. It is interesting to note that since 2017 there has been a notable acceleration with a further 28 organisations (76% of the current total) joining. At the time of writing ARM-Harith Infrastructure Investment Limited from Nigeria was the most recent signatory, having joined in December 2020.

The recent increase in OIC member state signatories to the PRI is likely to be linked to PRI's appointment of regional relationship managers. It may also be a corollary of the sharp rise in the application of ESG data to inform asset investment decisions which has more than tripled over eight years, to \$40.5 trillion in 2020¹¹. This has been driven by a combination of strong fund performance, customer demand and regulatory pressures. As global growth has stagnated in recent years the structural growth opportunities inherent in emerging markets has led to greater investor interest and this could be stimulating local activity.

Notwithstanding these recent developments since 2017 it is relevant to note that, despite the OIC having a collective population of over 1.82 billion and 24% of the total world population¹², barely 1% of the total 3,575 PRI signatories are based in OIC member states. This overall limited adoption needs to be further examined to identify the underlying factors. Whilst there could be multiple factors at play, such as those noted below, supporting evidence and data is required to understand better the issues and we recommend established research houses in the sector explore this further together with the PRI.

Possible factors:

- Lack of awareness of the PRI within OIC member states;
- Organisations having local/regional focus with limited participation in global financial systems;

- Limited development of domestic capital markets;
- Lack of government legislation, regulatory priority and associated incentives towards responsible investment;
- Role of adequate leadership in the sector; or
- Lack of innovation in IsFIs, etc.

Although initial uptake has been slow momentum has, as noted above, picked up since 2017. Nevertheless, the fact that after 15 years there has been such a low adoption by OIC member state organisations highlights the challenge in getting the SDGs, which emerged in 2015, on to the finance agenda in these countries.

ANALYSIS OF ISLAMIC FINANCE SIGNATORIES

General Overview

This section analyses PRI signatories that have a specific involvement in Islamic finance both in and outside the OIC region. Twelve qualifying organisations (see Table 1) were identified for detailed analysis. The initial desk-based research conducted in Q4 2020 involved a review of all of their websites (including articles, reports and policies) to identify how each organisation communicates its approach to responsible investing, sustainability, ESG and the SDGs. Thereafter in-depth interviews were completed with senior representatives from four of the organisations to develop detailed case studies.

The geographical location of the twelve organisations is as follows:

- 66% (8) are based in three OIC member states (namely, 5 in Malaysia, 2 in Saudi Arabia and 1 in United Arab Emirates)
- the remainder are located in the UK (3) and US (1).

The breakdown in terms of category of organisation is as follows:

- 58% (7) are investment managers
- 25% (3) are asset owners
- 17% (2) are service providers.

The total AUM, based on an aggregate of publicly available data in October 2020, for the 7 investment managers and 3 asset owners is around \$350 billion.

The first Islamic finance sector signatory was Hawkamah (a leading research body based in the UAE categorised by PRI as a 'Service Provider') which joined in 2009. Following Hawkamah there were no Islamic finance sector signatories until 2014 when Arabesque Asset Management and Sedco Capital signed. Since 2014 there were 2 new signatories in each year between 2016 and 2018 inclusive and with a further 3 in 2019. As an aside, it is interesting to note that the CIBAFI and the UKIFC, both similarly non-commercial institutions with research and advocacy mandates, were amongst the first stakeholder endorsers to the PRB and have been pathfinders in relation to the role Islamic finance can potentially play in the SDGs.

Table 1 - PRI Signatories Involved in Islamic Finance

	Signatory	Type: Islamic only or Islamic and Conventional	Category	HQ Countr	Selection Rationale	Approximate Total AUM in US\$
1	Alistithmar Capital	Islamic only	Investment Manager	Saudi Arabia	Provides customers with specially tailored Islamic Investment products	\$4 billion
2	Arabesque Asset Management	Islamic and Conventional	Investment Manager	UK	Offer preferences Shariah compliant preference filter using AAOIFI's Shariah Standard 21.	\$344 million
3	BIMB Investment Management Berhad	Islamic only	Investment Manager	Malaysia	Licensed Islamic fund management company registered with Securities Commission Malaysia.	\$304 million
4	DDCAP Group	Islamic only	Service Provider	UK	Provides responsible, sustainable intermediary services to the Islamic financial market.	N/A
5	Employees Provident Fund	Islamic and Conventional	Asset Owner	Malaysia	No specific Shariah investment strategies or asset allocations but own significant shariah-compliant assets.	\$228 billion
6	GIB UK Trading as GIB Asset Management (GIB AM)	Islamic and Conventional	Investment Manager	UK	Wholesale commercial bank and asset manager. fully owned by GIB BSC in Bahrain which has a robust Shariah governance mechanism to ensure that all the products and services are duly accredited and in line with Shariah principles.	\$11 billion
7	Hawkamah	Islamic and Conventional	Service Provider	United Arab Emirates	Developed services specifically tailored to the needs of the Islamic finance sector (including developing Shariah governance frameworks).	N/A
8	Khazanah Nasional Berhad	Islamic and Conventional	Asset Owner	Malaysia	No specific Shari'a investment strategies or asset allocations but own significant shariah-compliant assets.	\$18 billion
9	Principal Asset Management	Islamic and Conventional	Investment Manager	Malaysia	Principal Islamic, which offers Shariah-compliant investment solutions, manages RM26.68bn (30%) of Principal Asset Management's total AUM.	\$23 billion
10	Retirement Fund (Incorporated) (KWAP)	Islamic and Conventional	Asset Owner	Malaysia	No specific Shariah investment strategies or asset allocations but own significant shariah-compliant assets.	\$35 billion
11	SEDCO Capital	Islamic only	Investment Manager	Saudi Arabia	Seeks diverse Shariah-compliant investment opportunities in Saudi Arabia and around the world.	\$5 billion
12	The Wafra Group	Islamic and Conventional	Investment Manager	US	Offers Shariah-compliant strategies, including Murabaha and ijarah structures.	\$28 billion

WEBSITE REVIEW

Whilst the above organisations have signed up to the PRI, in order to understand the priority and importance of the responsible investing agenda within the organisation a high-level analysis of each of their websites was undertaken 1) to understand how the organisations are promoting their responsible investment beliefs and associated policies; and 2) to reflect on the taxonomy employed.

Website analysis was undertaken during Q4 2020 and the detailed results of this analysis are set out in Appendix 3.

The website review also identified contrasting approaches as to how each of the 12 organisations has communicated their status as a PRI signatory.

The following have used the PRI as a point of differentiation:

- BIMB Investment Management Berhad - “the only bank-backed Islamic Asset Manager in Malaysia and Southeast Asia to be a signatory of the responsible investment initiative”
- DDCAP Group - “the first and only intermediary in the Islamic financial services industry to become a signatory of the PRI”
- GIB AM - “one of the first regionally-owned asset managers to sign up to the PRI”
- Hawkamah – “the first-ever institution from the MENA region to sign up to the PRI”
- KWAP - “the first pension fund in Malaysia to become a signatory to PRI”
- SEDCO Capital – “the first Shariah compliant asset manager in the world, and the very first Saudi Arabian company, to become a signatory to the PRI.”

It is interesting to note that whilst all of the organisations reviewed are committed to responsible investment, few of them (at the time of research) make direct references to the SDGs on their websites.

ISLAMIC FINANCE PRI SIGNATORIES - CASE STUDIES

The analysis in Appendix 3 was based on information publicly available on the websites of the PRI signatories active in Islamic finance. To further broaden the picture, in-depth interviews were conducted with senior representatives of four of the organisations from the 12 identified. These four were selected because of their advanced approach to ESG integration and/or their specific engagement with the SDGs. The interviews provided deeper insights on their focus on sustainability, engagement with the PRI, approach to the SDGs and reflections on their sustainability journey. The interviews also explored how the PRI process has impacted their ability to transform culture, develop new products and services and improve financial returns at the same time as having a positive impact upon people and the planet.

Organisations selected:

1. BIMB Investment Management Berhad – focus on ESG integration.
2. DDCAP Group – engagement with SDGs.
3. GIB AM – engagement with SDGs.
4. Sedco Capital – focus on ESG integration.

PRI Engagement with Islamic Finance

The organisations were asked why, in their view so few, Islamic financial institutions have become PRI signatories. The general consensus was that the mass market, particularly in OIC member states, lacks awareness and understanding of sustainability and ESG. If local market demand is not driving responsible investment, and regulators are not focused on ESG disclosures, the onus is on Islamic finance institutions to take proactive steps to adopt and embrace responsible investment.

Although the PRI is widely recognised at the institutional investor level where it can add value for asset managers, within OIC member states it does not carry as much weight as it does in Europe or the wider Western world. As sustainability and ESG move up the finance agenda in OIC countries it is feasible that more Islamic financial institutions will become signatories. To achieve this, it was suggested that the PRI should increase its visibility and presence in OIC member states and consider how it could support Islamic financial institutions that lack the financial and/or human resources to sign up to and implement the Principles.

A further suggestion was for the PRI to provide a more suitable reporting framework for service providers, be they operating in Islamic or conventional finance.

The PRI initially focused on investors and asset managers. It has since been expanded to include service providers but is still geared towards asset owners/asset managers. This means that there is not always a clear way for service providers to participate.

Islamic Finance and SDG Reporting

There was collective agreement that there is insufficient guidance from Islamic finance industry bodies in relation to SDG engagement and reporting. With knowledge and awareness improving there is an appetite to have standardised measurable outcomes linked to the SDGs. However, with the comprehensive PRI reporting requirement and the myriad of ESG reporting standards, there are concerns around adding another reporting framework specific to Islamic finance.

It was mentioned that Islamic finance bodies have been discussing the SDGs, with those interviewed suggesting that greater focus could be placed on aligning Shariah and the SDGs within the context of Islamic finance. With signatory Islamic financial institutions already reporting to PRI, as well as other global conventional reporting frameworks that incorporate the SDGs, it was felt it would be more efficient for Islamic finance institutions to work together to develop a consistent approach to these existing frameworks rather than develop a new framework specifically for Islamic finance. The UKIFC Global Islamic Finance and UN SDGs Taskforce reporting and disclosure working group presents a non-competitive platform which could support signatories to come together to share learning and ideas in order to develop a tailored, collective approach for Islamic financial institutions in relation to PRI reporting as it is currently doing for PRB.

CASE STUDIES

The following summarises the response of each of the four interviewee organisations on the topics of sustainability, PRI engagement and their approach to the SDGs, as well as noting their own product offerings in these areas.

BIMB Investment Management Berhad (BIMB)	
Focus on Sustainability	
In 2015, BIMB began its journey towards sustainability, having recognised that sustainability is a rising global trend that greatly influences the financial and investment sectors. As an Islamic fund manager, BIMB observed that ESG factors were becoming mainstream and there was an opportunity to integrate ESG into its investment process and offer ESG products to Malaysians. At the same time, Bank Negara Malaysia and the Securities Commission Malaysia were beginning talks about sustainability and developing an ESG framework. To leverage first mover advantage a strategic partnership was formed with Arabesque Asset Management, a relatively new ESG quantitative specialist. This partnership enabled BIMB to introduce sustainability into a fundamental data-driven selection process. As it was recognised that ESG improves investment decisions the Arabesque 'S-Ray' was adopted, using over 50,000 data sources and applying 200+ ESG metrics to: • reduce human bias; • assess the sustainability performance of companies; • gain insights into the quality of management; and • make strategic decisions taken to secure long-term financial success. Based upon the success of its first Islamic ESG fund (2015) BIMB has since launched 3 additional ESG funds. Critical to the success of these funds was the initial support from regulators coupled with a strategy of initially targeting sophisticated investors. Generally, investors are only interested in financial returns and are not acquainted with ESG and sustainability as investment themes. In view of this BIMB took time to explain the investment rationale in traditional financial terms as well as explaining how non-financial information can help mitigate potential risks. The new investment process has helped the four funds to provide strong risk adjusted financial performance with the added bonus of being both Shariah compliant and sustainable.	
Engagement with PRI	
In Malaysia, the world's leading Islamic finance centre, BIMB has actively participated in national initiatives, working closely with regulators to develop the country's Sustainable and Responsible Investment agenda. With a focus on ESG integration and sustainable long term returns there was a natural alignment with the PRI and, in 2019, BIMB became the only bank-backed Islamic asset manager in Malaysia and Southeast Asia to join the PRI. Becoming a PRI signatory was a natural progression in BIMB's journey and, as well as positioning the organisation as a leader in the region, it was an important opportunity to work with PRI and other signatories from across the globe to learn, share and collaborate. The overall experience has been positive for BIMB as the organisation has developed its knowledge and expertise in sustainability and ESG and been able to leverage its PRI signatory status to positively engage with investors.	

Approach to the SDGs

BIMB's commitment to sustainability is inherited from its parent company BIMB Holdings Berhad (BHB) which views sustainability as:

"investing in the bright future of our organisation and ensuring that what we do makes a positive and lasting impact on our community, our economy and our country. Our purpose is to meet and support society's financial needs in a responsible and ethical manner, anchored on Islamic values. Through this purpose, we aim social and economic wellbeing towards inclusive growth that creates economic opportunities for all, support ongoing efforts to develop real economy, enhance the welfare of the community and contribute towards environmental conservation."

BHB's sustainability strategy draws guidance from the Bursa Malaysia Securities Berhad's Main Market Listing Requirements and Global Reporting Initiative Standards, SDGs and the Bank Negara Malaysia's Value Based Intermediation concept. Its efforts are detailed under the following five key pillars:

1. Responsible Finance
Provide financial solutions that effectively deliver economic and social benefits, while uplifting people and environment.
2. Inclusive Growth
Promote participations from all segments of society, especially the disadvantaged and underserved communities, in our financial activities and businesses.
3. Talent Management
Invest in our people to allow them to develop and become an important contributor to our business and society.
4. Ethical Practice and Reporting
Realise ethical values by being honest, trustworthy and transparent in all our decisions and actions.
5. Islamic Finance and Knowledge-Sharing
Propagate our wealth of experience and knowledge to create a learned society and advance the industry.

Product Innovations / Financial Instruments*

Global Equity Islamic ESG – BIMB-Arabesque I-Global Dividend Fund 1
Asia Pacific Equity Islamic ESG – BIMB-Arabesque Asia Pacific Shariah-ESG Equity Fund
Malaysia Equity Islamic ESG – BIMB-Arabesque Malaysia Shariah-ESG Equity Fund
Global Sukuk ESG – BIMB ESG Sukuk Fund

**This case study is prepared for information purposes only. It does not have regard to specific investment objectives, or the financial situation needs of any specific person who may receive it. Neither the information nor any opinions expressed constitute an offer, or an invitation to make an offer to buy or sell any securities or unit trust. The information contained herein has been obtained from sources believed in good faith to be reliable, however, no guarantee is given in its accuracy or completeness. All opinions in respect of the information provided herein constitute the Manager's judgments as of the date of the issuance of this report and are subject to change without notice.*

Investors are advised to read and understand the contents of the Fund's Prospectus, including its supplemental (if any) and the Fund's Product Highlight Sheet (PHS) prior to investing, which have been registered with the Securities Commission Malaysia (SC) who takes no responsibility for its contents. A copy of the Fund's Prospectus and PHS can be obtained from the Head Office of BIMB Investment Management Berhad or at www.bimbinvestment.com.my. The SC's approval or authorization, or the registration of the Fund's Prospectus should not be taken to indicate that the SC has recommended the Fund. There are fees and charges involved and investors are advised to compare and consider them before investing in the Fund. Investments in any of the Fund is exposed to risks, please refer to the Fund's Prospectus for detailed information. Investors are advised to consider the risks in the Fund and should make their own risk assessment and seek professional advice, where necessary, prior to investing. Investors should also note that the price of units and distribution payables, if any, may go down as well as up.

Focus on Sustainability

For DDCAP Group the focus on sustainability has been driven by the passion and vision of the Managing Director, Stella Cox CBE and is embodied in DDCAP's Sustainable and Responsible Actions (SRA) programme. The SRA Programme began with a traditional CSR programme consisting of individual initiatives that were proposed to, and accepted by, the board of directors. Following a series of successful projects, a broader sustainability approach was approved by the board with the following actions agreed:

- Appointment of an executive tasked with the initiative (Head of Corporate Responsibility);
- Establishment of a SRA Working Group; and
- Inclusion of a SRA Champion within DDCAP Group's Shariah Supervisory Board (SSB).

The SRA Working Group was originally tasked with continuing the work inspired by the PRI annual reporting process as well as increasing employee engagement with the SRA goals. Having a forum promoted discussion and this led to the development of further policies and procedures. It brought together separate workstreams that had been siloed within the organisation and once consolidated, a momentum built as common concerns were identified and new areas of growth emerged. As the work expanded, it was decided to separate the CSR and employee engagement matters into a CSR Working Group (reporting to the SRA Working Group) and allow the SRA Working Group to focus more on commercial and operational matters.

The screening modules embedded within ETHOS AFPTM allow strict parameters to be applied to the inventory offered to clients. The commodity screens embedded in ETHOS AFPTM originally reflected client demands to meet their corporate governance requirements (e.g. sanctions) and now additional screens have been added to allow clients to reflect their SRA considerations in the commodity they select.

Through the SRA programme, DDCAP Group has committed to developing a more sustainable, equitable and prosperous world and supports the view that those in business must adopt strategies to deliver not only financial results but also social and environmental outcomes.

DDCAP has found that from its discussions and publications on the development of its SRA Programme it has been able to strengthen relationships with existing clients and create new commercial partnerships in light of a common culture and commitment to sustainability and responsibility.

Engagement with PRI

In 2016 DDCAP Group became the first and, as yet, the only provider of asset facilitation services focused on Shariah compliant products to become a service provider signatory to the PRI. Recognising a need to become more sustainable, and have a greater focus on ESG, becoming a PRI signatory allowed DDCAP Group to:

- Align with a global framework, and get support from a similarly aligned global network;
- Dedicate resources to meet the qualifications and reporting standards; and
- Send a message out to other members of its industry.

Although the focus of PRI has traditionally been on investors and asset managers, in recent years it has been opened up to service providers. Despite a willingness to participate and engage where appropriate the historical asset owner / asset manager focus has meant that, as a service provider, it has been challenging at times for DDCAP Group to fully optimise the benefits of PRI. For example the transparency report for service providers has a number of questions that are not applicable and other resources are focused more on non-service provider signatories.

DDCAP Group has discussed with the PRI that there is an opportunity for PRI to tailor further the reporting framework for service providers and has supported recent efforts by the PRI to review the process. DDCAP Group also is in discussions with the PRI with regard to increasing its outreach, particularly with smaller organisations, within the Islamic finance sector in South East Asia and MENA.

DDCAP Group strives to focus its business concerns within Principle 3 and prioritises the targets and objectives set out in Principles 1, 5 and 6 as they fit within DDCAP Group's industry position as an intermediary. Furthermore DDCAP Group seeks to engage with clients and the Islamic finance industry in the spirit of Principle 4.

Approach to the SDGs

DDCAP Group strongly identifies with the targets and objectives set for SDG 4 (Quality Education), SDG 5 (Gender Equality), SDG 9 (Industry, Innovation and Infrastructure) and SDG 17 (Partnerships for the Goals to strengthen the means of implementation and revitalize the global partnership for sustainable development) and is working with various international initiatives to achieve them.

These particular SDGs were shortlisted due to their alignment with the activities DDCAP Group was already supporting as part of its CSR programme (i.e. internships, gender projects, sponsoring initiatives that promote ethical behaviour etc) and where it was therefore felt the most impact could be made.

Additionally, as sustainability and responsibility considerations now support DDCAP Group's identification and selection of inventory SDG 12 (Sustainable Production and Consumption) is now relevant.

Going forward DDCAP Group will be looking at sustainability metrics internally with an eye to external reporting in the near future. DDCAP Group has worked with an external consultant on SRA matters for several years and this individual has been appointed to consider: baselines, relevant metrics / standards and to identify areas for improved growth. A plan will then be developed to implement the recommendations and develop an on-going reporting process.

Product Innovations / Financial Instruments

ETHOS Asset Facilitation Platform™ (ETHOS AFPTM) – this is a DDCAP Group's bespoke, real-time trade and post trade services platform which provides continuous coverage and enables clients worldwide to purchase from a diverse responsible asset inventory via a secure, web-based portal.

GIB Asset Management (GIB AM)



Focus on Sustainability

The pressing need to finance sustainable development is undisputed. GIB AM believes that good stewardship means safeguarding the needs of future generations, and that capital must be mobilised in support of a more sustainable world and global economy. To do this GIB is building an asset management business that provides solutions for clients' long-term investment objectives whilst always seeking to build a sustainable future.

GIB AM's focus on sustainability started in 2018 following the appointment of Katherine Garrett-Cox as Managing Director and Chief Executive Officer. Given the commonalities between Islamic finance and sustainability, Katherine was keen to ensure an integrated approach between the two that would allow GIB AM's clients to have a greater positive impact.

As GIB AM serves clients predominantly in the Middle East and GCC regions, where sustainability as a concept is typically not as well developed, the approach has been driven internally from the top. A critical success factor in embedding sustainability into GIB AM's culture has been putting colleagues at the heart of the transition and ensuring that the organisation holds itself to the same ESG standards as investee companies.

Specific initiatives include:

- Increasing awareness to change the perception of investing within the ME / GCC region.
- Demonstrating that there does not need to be a sacrifice on returns by incorporating sustainability-related risk and opportunities.
- Developing more sustainability-focused products and services.
- Delivering internal training and awareness programmes on ESG throughout the organisation.
- Encouraging colleagues to participate in sustainability-related projects.
- Developing thought-leadership on sustainability-related issues.

Engagement with PRI

GIB AM was one of the first regionally owned asset managers to sign up to the PRI in 2018. Becoming a PRI signatory was an opportunity for GIB AM to work with others to drive a more responsible approach and raise global awareness of the importance of sustainable investing. Whilst through its proprietary approach to sustainability (as outlined in the Approach to Sustainability and the SDGs section) GIB AM had already implemented many aspects of the principles, the PRI framework provides a consistent framework to drive improvements as well as to embrace new ideas and collaborations.

In the first year, there were a few hurdles for GIB AM to overcome in the PRI process because, while the firm was committed to achieving the highest possible standards, unfamiliarity with the reporting framework made compiling responses challenging. Furthermore, GIB AM believes that sustainability is a key part of everyone's job, rather than just the responsibility of a standalone sustainability team, so completing the PRI reporting required strong collaboration across the organisation.

Whilst the on-going annual reporting requirement is not onerous, GIB AM is committed to improving year on year and therefore uses the PRI framework to help guide its development efforts.

Approach to the SDGs

As a globally recognised framework, the UN's SDGs were adopted to enable GIB AM to:

- Map out the criteria that matter most to the organisation;
- Represent what GIB AM stands for; and
- Develop investment products that deliver profit with purpose.

GIB AM's overarching investment philosophy and investment pillars are aligned with certain of the SDGs. Furthermore, its ESG-Plus strategy is fully customisable, and hence investment strategies can be tailored for clients depending on their own sustainability goals. Central to this is the need to talk in the language of investment, so that investors buy into the underlying themes and products.

To support measurement, GIB AM does not feel it is enough to rely solely on third party provider scores. A robust ESG investment strategy requires a thorough understanding of the data, the underlying securities and what constitutes good ESG credentials. GIB AM has therefore developed a proprietary approach where third party data is deconstructed and recreated utilising the firm's own ESG scoring model, which draws on leading research, analysis and benchmarking against global targets and standards.

Product Innovations / Financial Instruments

Equity

GIB Equity Index Strategies

GIB Global ESG-Plus Equity Strategy

Credit

GIB Fixed Income Index Strategies

GIB Emerging Markets Credit Strategy

Focus on Sustainability

Sedco Capital has always been committed to deliver strong results for investors. With responsible investment emerging as a global trend Sedco Capital recognised the overlap between its default Shariah compliance approach (that focuses on positive impact and contributions to society) and ESG (that factors in risk).

Due to this overlap between Shariah-compliant and responsible investment, Sedco Capital conducted in depth analysis of approaches to responsible investment before concluding that ESG assessment added value in its investment process. This move was investment driven as sustainability was not, at the time, a core focus for Sedco Capital. Over time, Sedco Capital has expanded its responsible investment approach and today every investment strategy and product follow responsible investment approaches encompassing negative screening, ESG integration, active ownership, sustainability-themed and impact strategies.

The Prudent Ethical Investment (PEI) model was developed to become Sedco Capital's proprietary responsible investment approach that integrates traditional responsible investment and Shariah compliant investing. This approach recognises the following:

- Commonalities – exclusion of sectors such as arms, tobacco, alcohol, gambling and adult entertainment.
- Traditional responsible investment – analysis of ESG factors (positive screening).
- Shariah compliant investing – balance sheet screens and conventional financial sector exclusions.
- The Shariah investment universe was more resilient and less volatile during the Global Financial Crisis and subsequent years including the volatile market environment caused by the global pandemic this year.
- PEI avoids high financial risks and thus aims to enhance long-term risk-adjusted return.
- The Global Financial Crisis has clearly shown the downside of excessive leverage and financial risk. Through the entire business cycle, the avoidance of excessive financial risk leverage should deliver better risk-adjusted returns.
- PEI is an investment style, which through its prudence element biases portfolios to better quality, thus avoiding high and undue risks.
- PEI demands the understanding of the underlying risks, structure and cash flows.

The PEI approach has yielded better expected returns than each standalone strategy and has produced distinct return/risk characteristics.

Engagement with PRI

In 2014, Sedco Capital became the first Shariah compliant asset manager in the world, and the very first Saudi Arabian company to become a signatory to the PRI. The motivation behind signing up to the PRI was to show that it was possible to be both a responsible investor and Shariah compliant. As the traditional responsible investment universe is much larger than the Shariah compliant universe it was also an opportunity to demonstrate that Islamic finance criteria can be beneficial for traditional responsible investors.

Sedco Capital did have a concern whether it could become a responsible investor with a constrained investable universe. However, this was handled by Sedco Capital positioning ESG as an enhancement of the traditional due diligence approach with the addition of qualitative factors.

PEI is a systematic process driven approach that can deliver distinct return/risk characteristics relative to conventional strategies. Shariah-compliant balance sheet screens tend to provide a prudence element and bias portfolios towards quality characteristics. Positive ESG screening can potentially improve risk-adjusted returns as well. Exclusionary screening of “sin” sectors, the use of balance sheet ratios and the integration of ESG signals into factors model are techniques behind the improvement in performance.

The PRI has provided useful resources which has enabled Sedco Capital to enhance its investment approach.

Approach to the SDGs

For Sedco Capital, Islamic finance and responsible investing are both ethical in nature. Both principles align in their aim to improve the living conditions and well-being of society, to establish social equality and to prevent injustice in trade relations, which can be linked to the SDGs.

While Sedco Capital has not actively linked its initiatives to the SDGs and, to mitigate against the risk of greenwashing, does not discuss the SDGs in any detail publicly until they are actively working on specific initiatives that prove their tangible commitment to the Global Goals agenda, there have been investment initiatives with impact focus. Sedco Capital run thematic sustainability approaches such as the SC Global Sustainable Equities Fund, which invests in Energy Efficiency, Alternative Energy, Water technologies, Sustainable Food, Agriculture & Forestry, and Waste/Resource Recovery.

SC Built-to-Suit Real Estate Fund has built social infrastructure by constructing a school in Jeddah, Saudi Arabia, that follows the highest energy efficiency standards. Sedco Capital expect energy efficiency aspects will continue to grow in importance in this market benefitting from energy saving by using LED lights, solar energy for water, local materials for the construction process to cut down transportation distances and grey water recycling.

Signing up to the UN Global Compact is part of their overall plans and the SDGs are something that Sedco Capital will be looking at in future.

In relation to climate-related SDGs Sedco Capital is preparing a roadmap describing its position on climate change. This will outline the steps it will take to integrate carbon requirements into its investment process and provide an opportunity to align with SDG 13 (Climate action). This approach aims to:

- Identify investment opportunities
- Improve results for investors
- Mitigate against climate change
- Enhance Sedco Capital's credibility.

Product Innovations / Financial Instruments

Saudi/MENA Real Estate

SEDCO Capital Real Estate Income Fund I ("SCREIF I")
SEDCO Capital Real Estate Income Fund II ("SCREIF II")

International Real Estate

MENA Liquid Strategies – Public Funds
SEDCO Capital Flexi Saudi Equities Fund

International Equities

Private Equities
Direct/Co-Investments
Income Generating Private Investments (IGPI)

REIT

Sedco Capital REIT Fund

REFLECTIONS ON THE SUSTAINABILITY JOURNEY

The final interview questions enabled signatories to reflect on their PRI and wider sustainability journeys so that they could share their experiences with others who are considering following a similar path. This section will now present the key points raised in relation to stakeholder engagement and advice for other Islamic financial institutions. For ease of reading the key points have been summarised under topic headings.

Stakeholder Engagement

Each of the PRI signatories interviewed were asked how their Shariah scholars, employees and clients responded to their commitment to responsible investment.

- Shariah Scholars

The results of the interviews indicated that Shariah scholars do not, typically, engage in setting responsible investment guidelines and policies. Instead, the role of the Scholar remains focused on delivering a 'legalistic' approach to ensure that the form of transactions is Shariah compliant. They generally appear to be supportive, given the additional benefits of overlaying Shariah compliance with ESG factors. In jurisdictions such as Malaysia, where regulators and their Shariah Advisory Council are driving the responsible investment agenda, in-house Scholars tend to be more engaged. To raise awareness and gain further buy-in and support some Islamic finance institutions have involved their Scholars in training sessions and workshops on the integration of Shariah and responsible investment and this has been very positively received.

- Employees

Some of the PRI signatories have fully embraced their transition to being seen as a responsible investor and have transformed their internal culture. To gain buy-in and support, company-wide strategies have been developed and delivered to build capacity, gain support and inspire action. Where this has happened employees now understand and value ESG integration and the focus on sustainability. With strong engagement across all levels of an organisation, it has been suggested that employees have been empowered to participate in and lead on sustainability-related initiatives.

- Clients

For many clients ESG is a new concept that they can often see as a threat to their objective of maximising financial return. All of the PRI signatories in our group have worked with clients to explain the ESG process and how it delivers the following benefits:

- Strong long term financial returns in line with or above market.
- Strengthens investment risk management due to strong correlation between ESG performance and company/stock returns.
- Protects reputation as less likely to invest in a company involved in a scandal.
- Proven resilience of portfolio in difficult market conditions.
- Supports companies that make a positive impact on society and the environment.

The consensus is that clients are overwhelmingly positive when they understand and invest in ESG based investments.

Advice for Other IFI's

The interviewees offered the following advice to Islamic finance institutions not currently engaged in responsible investing:

- A higher purpose underpins Islamic finance and in pursuit of a just system Islamic financial institutions should be leading in this space.
- There must be a real willingness to engage in this area because it takes time and resources, but the rewards come in the form of investor returns and the non-tangible benefits relating to sustainability.
- Many Islamic financial institutions do not understand the alignment of ESG with Islamic finance so they should undertake their own research to understand that they are complementary concepts and are able to achieve more when they are integrated.
- ESG is now mainstream and if Islamic fund managers want to reach a wider investor base, they need to develop an ESG investment process to build on and complement their Shariah process.
- Islamic financial institutions should build capabilities. Compared to 5 years ago, there are now more knowledge resources to access whether that be from peers, regulators, global initiatives, etc.
- Reach out to the global finance community as there are resources that share a common purpose and organisations which are ready to provide support.
- Embracing ESG presents an opportunity to develop unique products to differentiate an Islamic financial institution from its competitors.

CONCLUSION

This report has used the PRI global framework to analyse current levels of engagement amongst Islamic financial institutions in relation to responsible investing and the SDGs.

Whilst a small number of organisations are making significant progress the report has highlighted the pressing need to raise awareness, in OIC member states and beyond, of responsible investing and the 'triple bottom line' benefits to be achieved by integrating Shariah compliance with ESG strategies.

Despite the natural synergy between Islamic finance and the SDGs, less than half of the PRI signatory Islamic financial institutions reviewed for this report mention the SDGs in detail on their websites and associated documents. The interviews indicated that although some are very much aware of the SDGs, their preference, partly to avoid the risk of greenwashing, is to hold back from going public until they have something of substance to say. With OIC countries amongst those in greatest need of SDG investment more work must be done to raise awareness and inspire practical action when it comes to Islamic financial institutions and the SDGs. The UKIFC's Global Islamic Finance and SDGs Taskforce has a dedicated working group on awareness and education which offers a potential solution to address this knowledge gap. Furthering products such as green sukuk can demonstrate practical commercial solutions and are instrumental in raising awareness.

The analysis of the 12 PRI signatories has highlighted that even amongst those Islamic financial institutions engaged in responsible investing there is a lack of consistency when it comes to taxonomy and general approach to measurement and reporting. There is an opportunity for PRI signatories to work in collaboration to develop a clear and consistent approach in these areas that can help position Shariah-compliant ESG engagement as a beacon of responsible investment.

There is scope to conduct further research on Islamic financial institutions involved in responsible investing but not currently signed up to the PRI. Given the overwhelmingly positive feedback from the interviews it would be interesting to understand the reasons why more Islamic financial institutions have not signed up to the PRI. A further additional area for future research would be to identify and analyse conventional PRI signatories and non-PRI signatories offering Shariah-compliant investment products. Once identified this would allow the compilation of a full list of Shariah-compliant funds, enabling performance to be benchmarked against conventional equivalents.

The report has highlighted an opportunity for the PRI to enhance its activities by means of greater engagement with the Islamic finance investment community. This might be through working groups, targeted awareness and outreach activities in OIC member states to encourage participation.

While certain Islamic finance organisations (such as the subjects of the four case studies above) have shown notable leadership in relation to the PRI and the SDGs, it is clear that at present the overall level of engagement both within Islamic finance institutions generally and the OIC region as a whole, remains low. Given the potential mutual benefits to both the Islamic financial institutions themselves and the responsible investment industry as a whole of substantially increasing this engagement it should be treated as a priority including, as noted above, by the PRI. It is hoped this report can contribute both to understanding the challenges involved and to exploring meaningful ways forward.

SPONSORS



gatehousebank

Financial Group Limited. In 2019 Gatehouse Bank a committed to strategically aligning with the SDGs by becoming a founding signatory of the UN Principles for Responsible Banking. Gatehouse Bank is authorised by the Prudential Regulation Authority (PRA) and regulated by the Prudential Regulation Authority and the Financial Conduct Authority (FCA).

Gatehouse Bank is an award winning Shariah-compliant bank offering savings products and finance for UK commercial and residential real estate, in addition to sourcing and advising on UK real estate investments with a focus on the build to rent sector. We offer a genuine alternative to conventional banks, with products that are transparent, fair and socially responsible.

Founded in 2007, the bank is based in London and Milton Keynes and is a subsidiary of Gatehouse

NORTON ROSE FULBRIGHT

Norton Rose Fulbright's global Islamic finance lawyers have long-standing experience in delivering pioneering legal advice on Islamic finance transactions for Islamic financial institutions, conventional banks

and corporates. With more than 30 years of experience in Islamic finance law, our lawyers have a wealth of knowledge across a range of Shariah-compliant structures, including market-leading experience in Sukuk transactions, Murabaha, Istisna'a, Ijara and Musharakah financings and Takaful deals. The members of our Islamic finance group also bring with them industry expertise and are members of our banking and structured finance, international securities, aviation, shipping, projects, acquisition finance and collective investments practice areas.

As well as having significant transactional experience, our lawyers regularly advise clients on Shariah governance matters including the establishment of Shariah supervisory boards. Based in the world's economic hubs and key Islamic finance centres across Europe, the United States, Canada, Latin America, Asia, Australia, Africa and the Middle East, our lawyers provide legal advice to governments worldwide on legislation concerning Islamic finance products.



Headquartered in central London, with representative offices in the Dubai International Financial Centre and Kuala Lumpur and a presence in Saudi Arabia, DDCAP Group TM (DDCAP) is a leading market intermediary and financial technology and systems solutions provider to the Islamic financial services industry.

Founded in 1998, DDCAP was the first market intermediary established specifically to support the growth and development of the Islamic finance industry. Over the past 20 years DDCAP has become a leading provider of responsible asset facilitation services to institutional clients from both Islamic and conventional markets, across a diverse range of Sharia'a compliant products and instruments in both the primary and secondary markets. In tandem with its adherence to Sharia'a stipulation, DDCAP aspires to connect to the global Islamic financial market responsibly and has developed systems technology to deliver against that aspiration. DDCAP's multi award winning Asset Facilitation Technology Platform, ETHOS AFP™, is a bespoke real-time trading platform with 24hour coverage, enabling clients worldwide to purchase commodities and other physical assets via a secure, web-based portal. ETHOS AFP™ encompasses Sharia'a and business focused operational requirements across treasury, capital markets, asset management, client consumer banking portfolios and takaful. ETHOS AFP™ infrastructure also supports DDCAP's stated intention to incorporate Sustainable and Responsible Investment (SRI) and financing principles within its business services and practices, including its supply of commodity and other physical assets.

DDCAP recognises that organisations and firms across our industry are working to translate their own vision into responsible, sustainable policies and procedures that produce positive social and environmental outcomes as well as delivering financial results. In addition to evolving our own services and technologies to meet the growing demand from global issuers and investors seeking to integrate SRI principles within their core financing, investment and allocation strategies, we are actively engaging with other stakeholders to encourage global initiatives, standards and best practice. DDCAP has been a member of the RFI Foundation, an industry body established to expand responsible finance by incorporating the positive screening strengths of the SRI industry with the governance and regulatory advances of Islamic finance, since 2015. In 2016, DDCAP became one of the first Islamic financial sector signatories to the UN supported Principles for Responsible Investment (PRI) and in April 2020, DDCAP Limited became a Stakeholder Endorser to the UNEP FI Principles for Responsible Banking, making it the first Islamic finance market intermediary to obtain this status. Last year DDCAP was also honoured to be asked to join The Global Islamic Finance & UN SDGs Task Force established by UKIFC.

APPENDIX 1

The UKIFC and the SDGs

The UKIFC is a specialist not-for-profit advisory and development body focused on promoting and enhancing the global Islamic and ethical finance industry.

Having identified a number of synergies the UKIFC has been at the forefront of positioning Islamic finance within the broader ethical finance umbrella. By following Shari'ah principles we believe that Islamic finance is intrinsically interwoven with ethical finance values and strategies. Over the last 10 years we have pioneered a number of internationally acclaimed and award-winning initiatives that have critically reviewed the ethical credentials of Islamic finance to help the sector better understand how it integrates into the wider ethical finance movement.

The emergence of the SDGs has posed a challenge to the financial services sector. Financing the SDGs is a complex task as it requires an unprecedented coordination between public sector organisations and private institutions. It requires reform to global financial regulation and meaningful commitment from financial institutions. With a step-change required in private investment financial institutions have been trying to understand and define their role in delivering the SDGs whilst making a commercial return.

Although momentum has built and progress is now being made in the conventional finance sector, despite what would appear to be a natural alignment in many areas with the Maqasid al Shariah, a lack of knowledge and understanding has held back widespread adoption of the SDGs by IsFIs.

With assets currently at US \$2.5 trillion and expected to reach US \$3.8 trillion in 2022, Islamic finance through its adeptness at innovative financial structuring, is well placed to create instruments that drive capital towards the SDGs.

At the UKIFC, we decided to take proactive steps to assist the global Islamic finance sector to better understand and engage with the SDGs. By joining the dots between Islamic finance institutions, business opportunities and the SDGs we are committed to support and encourage the sector to use the SDG framework to drive positive growth.

In 2019 the UKIFC became the first advisory body dedicated to Islamic finance to endorse the United Nations Environment Programme Finance Initiative's (UNEP FI) PRB. Also in 2020, we launched a Global Islamic Finance and UN SDGs Taskforce with the support of the UK Government. A new group of leading Islamic finance figures has been brought together by the UKIFC to draw up measures to encourage greater adoption of the SDGs. The Taskforce will have 24 months to come up with proposals on how to increase awareness and drive practical action within the sector.

As we enter the decade of delivery of the SDGs, this thought leadership series, delivered in partnership with ISRA, is intended to inspire IsFIs to embrace the SDGs and showcase to the world that consideration for people, planet and purpose sits at the heart of Islamic finance. ISRA equally shares a commitment to the SDGs and is particularly well placed to encourage Shari'ah scholars to engage with the SDGs.

Through partnering with the Global Ethical Finance Initiative (GEFI) and UNDP and building internal capacity, the UKIFC have developed unique insights and skill sets coupling strong in-depth knowledge of mainstream sustainability, responsible and ethical finance together with Islamic finance. We can assist our clients and stakeholders in successfully

responding to the challenges raised by the SDGs:

1. What it is? Enhance understanding through training, capacity building and thought leadership
2. Why do SDGs matter to my business? Developing the business case
3. How do we do this? Advising on mapping business processes, impact measurement and reporting.

We hope that you find this report useful and we welcome interest from individuals and organisations willing to amplify our message and/or participate in future collaborations.

APPENDIX 2

Organisations removed from the PRI Signatory List

Account Name	Signatory Category	HQ Country	Signature Date
Ithmar Capital	Asset Owner	Morocco	14/11/2016
SDS Int'l Group (Sustainable Development Strategy International Group)	Service Provider	Iran	27/06/2019
Corfina Capital	Investment Manager	Indonesia	14/01/2015
PT. ASABRI (PERSERO)	Asset Owner	Indonesia	17/07/2017
Nabla Global	Investment Manager	Malaysia	24/10/2019
GE3S	Service Provider	United Arab Emirates	29/10/2019

Website review

Promoting PRI

Signing the PRI allows organisations to publicly demonstrate their commitment to responsible investment and share their desire to build a more sustainable financial system. The website review (undertaken during Q4 2020) identified contrasting approaches in relation to how each of the 12 organisations identified communicates their status as a PRI signatory.

The following organisations have used the PRI as a point of differentiation:

- BIMB Investment Management Berhad - “the only bank-backed Islamic Asset Manager in Malaysia and Southeast Asia to be a signatory of the responsible investment initiative”
- DDCAP Group - “the first and only intermediary in the Islamic financial services industry to become a signatory of the PRI”
- GIB AM - “one of the first regionally-owned asset managers to sign up to the PRI”
- Hawkamah – “the first-ever institution from the MENA region to sign up to the PRI”
- KWAP - “the first pension fund in Malaysia to become a signatory to PRI”
- SEDCO Capital – “the first Shariah compliant asset manager in the world, and the very first Saudi Arabian company, to become a signatory to the PRI.”

Employees Provident Fund issued a press release highlighting that by signing the PRI it is “hoping to meaningfully incorporate ESG factors into our investment due diligence and decision-making process, given its potential to enhance return while reinforcing our existing risk management framework.”

Arabesque Asset Management, Alistithmar Capital, Khazanah Nasional Berhad and The Wafra Group mention that they are PRI signatories, highlighting how this informs their approaches to ESG integration and reporting. Principal Asset Management is the only organisation with no obvious references to PRI on their website or associated documents.

Approach to ESG

The PRI defines responsible investment as “a strategy and practice to incorporate environmental, social and governance (ESG) factors in investment decisions and active ownership”¹³ and as signatories it is unsurprising that the majority of the organisations analysed make specific references to ESG on their websites.

BIMB Investment Management Berhad provides considerable detail on how it defines and integrates ESG into its investment process. While Alistithmar Capital, Employees Provident Fund, DDCAP Group, Khazanah Nasional Berhad, KWAP, SEDCO Capital, GIB AM and The Wafra Group do not provide specific definitions of ESG they each, to a greater or lesser extent, mention or provide details as to how they have embedded ESG analysis into their decision-making processes.

Arabesque Asset Management can be differentiated from others in our sample in that it has access to a proprietary research framework, the Arabesque S-Ray®, that provides

increased transparency into a company's long- and short-term risks and opportunities by analysing its 'corporate DNA' through a range of sustainability lenses. The framework employs big data and natural language processing techniques to convert qualitative information (e.g. news, company reports, NGO studies) into numerical outputs. This assessment of sustainability performance produces sector specific ESG scores that identify companies that are better positioned to financially outperform over the long term compared to their sector peers. Arabesque Asset Management uses the S-Ray® ESG Score in the investment process to remove companies ranking at the bottom of their sector and include companies that exhibit a positive ESG score momentum, based on the premise that ESG improvements might not always be reflected in their share price and may add alpha¹⁴.

Hawkamah, a corporate governance institute, launched the first ever MENA wide ESG Index in cooperation with Standard & Poor's and with the support of the International Finance Corporation. The ESG Index, which covers Saudi Arabia, the United Arab Emirates, Kuwait, Qatar, Bahrain, Oman, Jordan, Egypt, Lebanon, Morocco and Tunisia, provides qualitative information to investors looking to analyse companies' sustainability performance. This incentivises listed companies to pursue sustainable business practices through improved environmental and socially responsible operations, as well as enhanced corporate governance systems¹⁵.

Again Principal Asset Management does not appear to make any specific references to ESG on its website.

Approach to Sustainability and the SDGs

Whilst all of the organisations reviewed in this section are, by virtue of their PRI signatory status, committed to responsible investment few of them make direct references to the SDGs on their websites. This perhaps illustrates the lack of progress PRI has had in delivering the actions set out in the "Blueprint for Responsible Investment" report outlined above.

Two examples where the SDGs most prominently feature are noted below.

Example 1: GIB AM

GIB AM's "Sustainability Report 2019"¹⁶ makes it clear that sustainability is 'part of GIB AM's DNA'. It sits at the heart of the organisation informing strategy, investments and operations. With a belief that "responsible investment is critical to achieving sustainable development", GIB AM's overarching investment philosophy is stated to be aligned with the SDGs. The investment pillars (see Figure 2) are based on some of the SDGs and are used to structure and drive investment analysis, assess the impact of investments and to organise engagement activities.

FIGURE 2 – GIB AM's Investment Pillars



Example 2: DDCAP Group

DDCAP Group recognises that there are many facets to sustainable and responsible finance and, as part of its approach to sustainability, encourages and supports initiatives that promote best practice in the financial and professional services industry as a whole. As part of its Sustainable & Responsible Actions (SRA) DDCAP Group outlines how, through its business activity and services, corporate infrastructure and policies and social responsibility programme, it is proactively working to support the achievement of targets and objectives set for SDG 4 (Quality Education), SDG 5 (Gender Equality), SDG 9 (Industry, Innovation and Infrastructure) and SDG 17 (Partnerships for the Goals).

It is further noted that Hawkamah Institute was a founding member of the Dubai International Financial Centre “Dubai Sustainable Finance Working Group” that is aligned with the UAE Sustainable Development Goals 2030 and Dubai's Strategic Plan 2021.

Whilst the other organisations studied do not overtly highlight the SDGs, with the exception of Principal Asset Management, the remainder refer to sustainability more broadly on their websites. Examples include:

- Alistithmar Capital – “The Responsible Investment Position Statement sets out the overall philosophy that guides our sustainability efforts and describes our responsible and ethical investing program - the strategies, procedures and lines of accountability towards our sustainability goals”
- Arabesque Asset Management - “We aspire to be a catalyst for change in finance by integrating sustainability into our investment products, and empowering people through transparency. For us, a sustainable company is one that positions itself for long-term success— addressing short term risks and long-term opportunities while accounting for all stakeholders' interests.”
- BIMB Investment Management Berhad – “Sustainability is a rising trend in the world that greatly influenced the financial and investment sector to appreciate the areas for positive growth of a company in the long run.”
- Employees Provident Fund - “Sustainability in investment is defined as the ability to continue doing business in a responsible manner, taking into account the impact on environment and social context while ensuring long term performance and existence”
- Khazanah Nasional Berhad – “We are committed to achieve our mandate to grow Malaysia's long-term wealth, through an inclusive and sustainable approach.”
- KWAP – “Sustainability has been recognized as a critical element in KWAP's operating culture and will be embedded in all its functions moving forward. Sustainability can be defined as working and living in an ideal ecosystem - a community that consumes resources at a rate equal to those that they utilize so that consumption and replacement are a zero-sum game.”
- Sedco Capital – “...intends for its investments to contribute to sustainable development - meeting the needs of the present without compromising the ability of future generations to meet their own needs.”

Wafra states it is committed to “sustainability by integrating environmental and social risk management and enabling strong governance within its investment process.” It adopts a three pronged approach to sustainability and investing:

1. Endeavor to be good stewards of capital and act in the best interest of fund clients and separately managed account investors (collectively, "clients"), by adhering to a high standard of ethics, honesty and transparency
2. Commit to integrating ESG factors in its investment decision making process.
3. Invest in long-standing, prudent partnerships and encourage long-term value creation best practices.

Policy Approach

As part of the website review specific policies relating to responsible investment were identified and analysed. Whilst it is recognised that some organisations may have policies in place but have chosen not to make them available on their website, it was still considered to be a useful exercise to see the levels of transparency amongst the cohort.

Employees Provident Fund, Khazanah Nasional Berhad and KWAP are all signatories to the Malaysian Code for Institutional Investors, which promotes the active integration of ESG considerations into investment analysis and decision-making. Additionally Khazanah Nasional Berhad provides its Investment Policy Statement, Responsible Investment Policy and Voting Policy on its website with KWAP also making its Corporate Governance Principles and Voting Guidelines and Corporate Level ESG Guidelines available online.

Other organisations with relevant policies on their website include: Alistithmar Capital (Responsible Investment Position Statement), GIB AM (Responsible Investment Policy and Stewardship Policy) and The Wafra Group (Sustainable Investment Policy). BIMB Investment Management Berhad has a Corporate Integrity Pledge but this is focused on regulatory compliance rather than investment.

Hawkamah has a Code of Ethics and in 2008, as part of its regional work to advance corporate governance, set up a Task Force on Corporate Governance of Islamic banks and financial institutions with the aim of identifying corporate governance challenges, priorities for standardisation and proposing concrete recommendations for implementation. A "Policy Brief on Corporate Governance for Islamic Banks and Financial Institutions in the Middle East and North Africa Region"¹⁷ was formally launched in June 2011.

DDCAP Group has its SRA commitment, as mentioned above.

Arabesque Asset Management, Principal Asset Management and Sedco Capital have no relevant policies available publicly on their websites.

ENDNOTES

* Copy and paste hyperlinks into your web browser

- 1 <https://www.ukifc.com/sdg/>
- 2 <https://www.ukifc.com/wp-content/uploads/2020/05/ISLAMIC-FINANCE-AND-THE-SDGS-%E2%80%93-THOUGHT-PAPER-1-13052020.pdf>
- 3 <https://www.unpri.org/signatories/signatory-resources/signatory-directory>
- 4 <https://cibafi.org/Files/L1/Content/CI1392-CIBAFI%20BRIEFING%2011.pdf>
- 5 <https://www.unpri.org/sustainability-issues/sustainable-development-goals>
- 6 <https://www.unpri.org/download?ac=5909>
- 7 <https://blueprint.unpri.org/>
- 8 <https://www.unpri.org/download?ac=10795>
- 9 <https://www.oic-oci.org/>
- 10 <https://www.mapsofworld.com/answers/world/what-is-the-organization-of-the-islamic-cooperation/#>
- 11 <https://www.pionline.com/esg/global-esg-data-driven-assets-hit-405-trillion#>
- 12 <https://www.worlddata.info/alliances/oic-organization-of-islamic-cooperation.php>
- 13 <https://www.unpri.org/pri/an-introduction-to-responsible-investment/what-is-responsible-investment>
- 14 <https://www.arabesque.com/2020/02/04/why-esg/>
- 15 <https://www.hawkamah.org/advisory/esg>
- 16 https://gibam.com/assets/Sustainabilityreport_Final.pdf
- 17 <https://www.hawkamah.org/uploads/Islamic-Finance-English.pdf>



The UKIFC is a specialist advisory and development body focused on promoting and enhancing the global Islamic and ethical finance industry. Established as a not-for-profit in 2005 the practitioner-led UKIFC has been at the forefront of identifying synergies and co-ordinating activities between Islamic and conventional ethical finance. In so doing the UKIFC has pioneered a number of internationally acclaimed and award winning initiatives that have moved the debate in Islamic finance to consider the broader ethical finance thematic. With a unique insight into both the Islamic and ethical finance markets the UKIFC is regularly approached by stakeholders, in both mainstream ethical finance and Islamic finance, for advice and support. Its capabilities include:

- UN SDGs – stakeholder endorser of the UN Principles for Responsible Banking and expertise in advising, capacity building and monitoring tools for all financial institutions (specialist tool kit for Islamic financial institutions)
- Advising on integrating Islamic with broader ethical finance strategies for product design to widen product appeal
- Advising conventional ethical finance bodies on adding an Islamic finance dimension to tap into new markets
- Planning, organising and supporting Islamic, ethical and interfaith finance events/conferences for publicity, product launches, educational and awareness purposes

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