



BACKGROUND NOTE

Green Islamic Bonds

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Green Sukuk Standards

Similar to green bonds, proceeds of green sukuk can be used to fund environment-friendly projects, but unlike green bond, green sukuk is a Shariah-compliant financial instrument. Green sukuk has two labels: “Islamic” and “Green”.

The “Islamic” label means that sukuk, an interest-free bond that generates returns to investors, is based on Sharia (Islamic law) principles. Instead of interest, investors receive an agreed share of the profits generated by the pool of underlying assets, which are partially owned by investors (World Bank 2020).

The “Green” label means that sukuk is compliant with green bond standards (also called principles and framework). Proceeds of green bonds are used to finance climate change mitigation, climate change adaptation, and environmental projects. Issued green sukuk were labelled green following the International Capital Market Association’s (ICMA) Green Bond Principles (GBP) (World Bank 2020). In addition to the International Capital Market Association’s GBP, several green sukuk are labelled following ASEAN Capital Market Forum’s ASEAN Green Bonds Standards. Green sukuk issued in Malaysia and Indonesia follow not only international green bond standards, GBP and ASEAN Green Bonds Standards, but also their own national, i.e., Malaysia’s Sustainable and Responsible Investment (SRI) Sukuk Framework and Indonesia’s Green Bond and Green Sukuk Framework.

Green Sukuk Issuance

As the first green Islamic bond, green sukuk was issued over 3 years ago in June 2017. Since then, the annual issuance of green sukuk increased five times and reached \$4 billion in 2019 (Figure 1). The annual green sukuk issuance was only 2.4% of all sukuk and 1.7% of green bonds globally in 2019. As of September 2020, \$10 billion value of green sukuk has been issued by 11 entities from four countries, namely Indonesia, Saudi Arabia, the United Arab

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Emirates, and Malaysia (in descending order); and from one multilateral development bank (Figure 2). Green sukuk is issued by top four sukuk-issuing countries. More than half of sukuk (65%) (Figure 2) and more than half of green sukuk (64%) are issued in the Asia and Pacific region (Indonesia and Malaysia) (Figure 3). Indonesia is the largest issuer of green sukuk (54%). The large amount of green sukuk (\$5.5 billion) is because of the issuance by the Government of Indonesia. Although Malaysia is the smallest issuer of green sukuk (\$1 billion), it has the largest number of private issuers, which are supported by green bond grant and tax incentives.

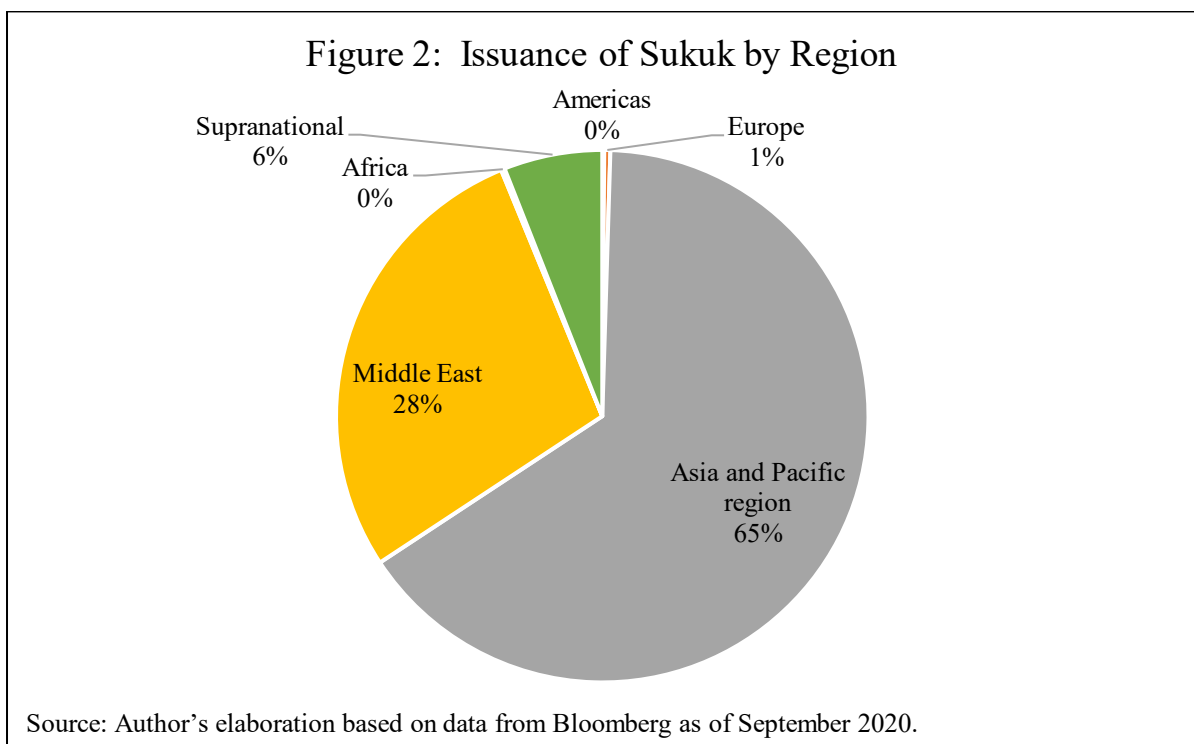
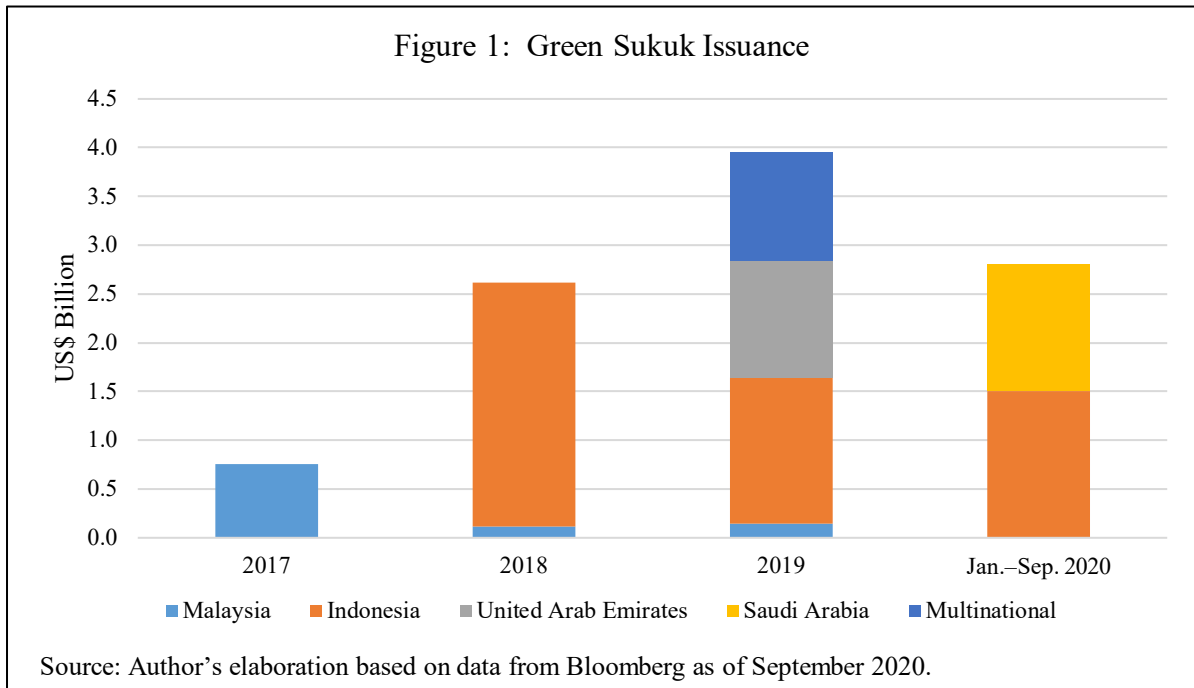
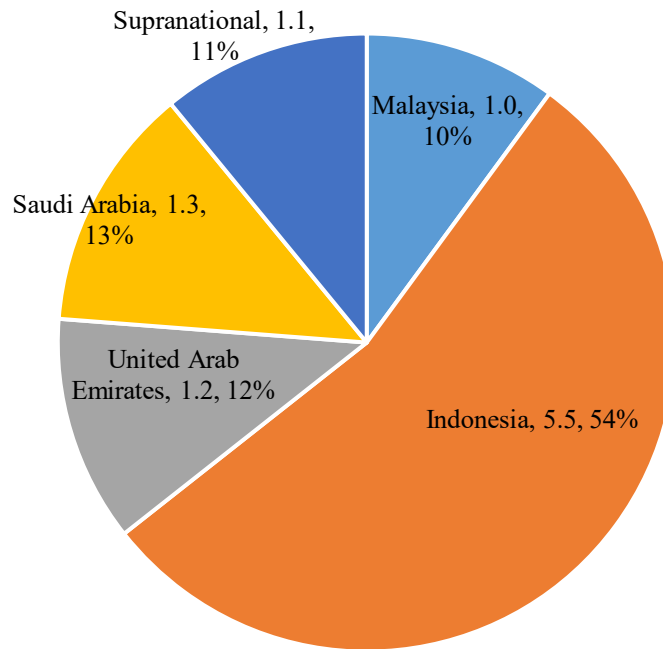


Figure 3: Green Sukuk Issuance by Country (US\$ billion)



Source: Author's elaboration based on data from Bloomberg as of September 2020.

Green Sukuk Policy Support

Both Malaysia and Indonesia introduced national green sukuk standards: Sustainable and Responsible Investment (SRI) Sukuk Framework (Malaysia) and Green Bond and Green Sukuk Framework (Indonesia). Issuers of green sukuk that are compliant with Malaysia's SRI Sukuk Framework receive tax incentives and a subsidy (Table 1). Issuers of green bonds compliant that are with the Malaysia's SRI Sukuk Framework also receive a subsidy of 90% of the cost of external reviewer (maximum \$77,000) (Azhgaliyeva et al. 2020). Although Malaysia is the smallest green sukuk issuer, it has the largest number of green sukuk issuers. After the implementation of green sukuk supporting policies, seven entities issued green sukuk in Malaysia—five of them are first-time sukuk issuers with no previous experience in sukuk issuance.

Table 1: Green Sukuk National Policies in Indonesia and Malaysia

| Country | Policy Title | Policy Implementation Date | Policy Description |
|----------------|---|-----------------------------------|--|
| Indonesia | Green Bond and Green Sukuk Framework | 2017 | Eligible projects are renewable energy, energy efficiency, resilience to climate change or disaster risk reduction, sustainable transport, waste to energy and waste management, sustainable management of natural resources, green tourism, green buildings, and sustainable agriculture. Excluded projects are new fossil fuel-based electric power generation capacity, large-scale hydro plants, and nuclear and nuclear-related assets. |
| Indonesia | Sovereign Green Sukuk | March 2018 | From March 2018 to October 2020, Perusahaan Penerbit SBSN Indonesia III has issued \$5.5 billion (half of global green sukuk) of sovereign green sukuk. |
| Malaysia | Sustainable and Responsible Investment Sukuk Framework | August 2014 | Eligible projects are natural resources, renewable energy and energy efficiency, and community and economic development. |
| | Green Sustainable and Responsible Investment Sukuk Grant Scheme | July 2017 | Cost of external reviewer for issuing green bonds compliant with the SRI Sukuk Framework can be subsidized at 90% of the costs of independent review, but up to RM300,000. |
| Malaysia | Income tax exemption | January 2018 | Income tax exemptions for recipients of the Green SRI Sukuk Grant Scheme. |
| Malaysia | Tax deduction | 2017 | Tax deductions on the issuance costs of SRI sukuk. |

Source: Azhgaliyeva, Kapoor and Liu (2020).

Demand for Green Sukuk

Demand for green sukuk is represented mainly by investment advisors, banks, insurance companies, and sovereign wealth funds (in descending order) from 13 countries (Figure 4). Interestingly, country investors in green sukuk are nearly all top country investors in sukuk, which means that countries with high demand for sukuk represent a demand for green sukuk. Also, most investors in green sukuk are the top investors in sukuk. Thus, green sukuk attracts investors in sukuk with environmental objectives.

Most issuers of green sukuk rely on international demand, except for issuers from Malaysia. Unlike issuers from other countries, issuers from Malaysia denominate green sukuk in domestic currency (Figure 5). United States dollar-denominated issuances make up 80% of green sukuk issuances, followed by euro-denominated (11%) and ringgit-denominated (10%) issuances. Green sukuk that are denominated in United States dollars and euro attracted international investors, while Malaysian ringgit-denominated green sukuk in Malaysia attracted local investors only.

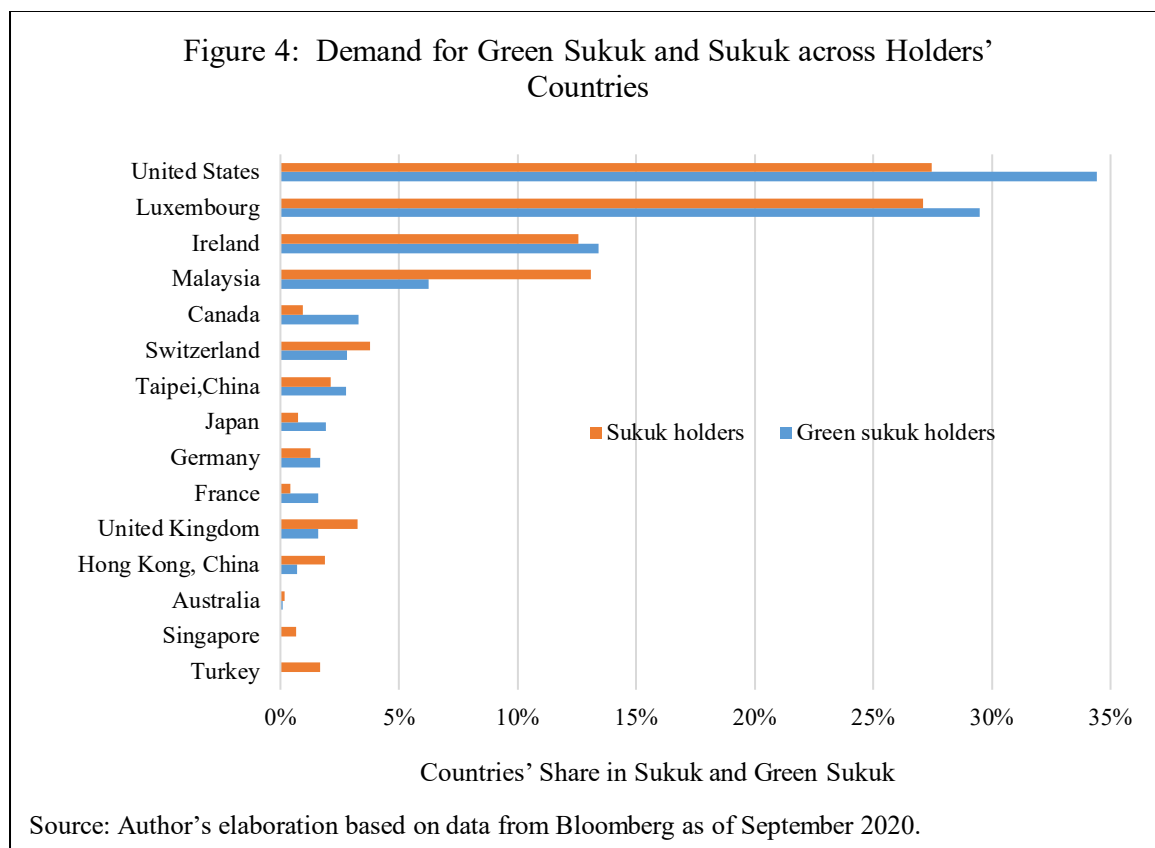
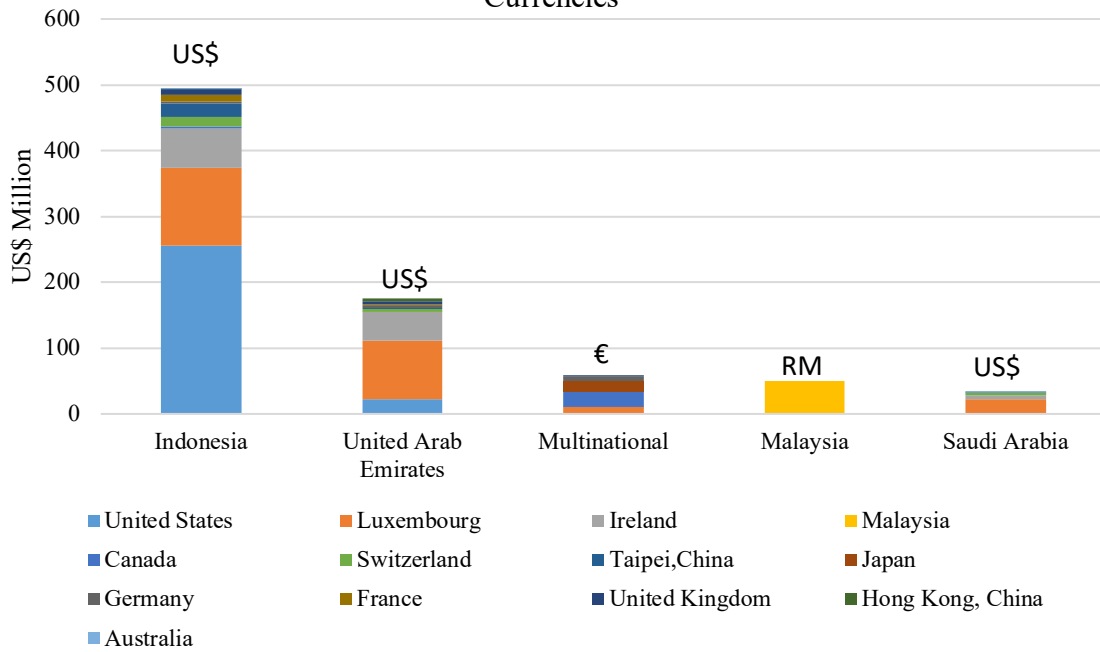


Figure 5: Demand for Green Sukuk across Issuing Countries and Currencies



Source: Author's elaboration based on data from Bloomberg as of September 2020.

References

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