

Islamic Business and Finance Series

ISLAMIC SUSTAINABLE FINANCE

POLICY, RISK AND REGULATION

Edited by

Mohd Ma'Sum Billah, Rusni Hassan,
Razali Haron and Nor Razinah Mohd Zain



Islamic Sustainable Finance

The central idea of sustainability in the modern world is intricate and ever-changing. Closely related to the realm of finance and socioeconomic discussion, the phrase “sustainable impact finance” has become increasingly popular among bankers, practitioners, financial analysts, investors and the relevant experts seeking an impactful connection between the best financing mechanisms or tools and sustainable development related investments or projects.

This book opens up the discussion by offering a Shari’ah-compliance perspective. It is a primer on how Islam addresses and offers solutions to the challenges facing us within the spirit of maqasid al-Shari’ah, among others, in tackling poverty, food supply, health and well-being, quality education, reducing inequalities, responsible consumption and production and climate action. It discusses the connection between Islamic sustainable finance and the Sustainable Development Goals (SDGs) and explains the strategic action-plan of Islamic banks towards achieving Islamic sustainable finance.

The book considers the relevant policies and regulations, evaluating the role of regulators, discussing jurisprudential solutions and focusing on the role of Islamic banking standards in relation to Islamic sustainable finance. Further, it explores the issue of risk mitigation and the effective role of Takaful. It presents a practical case study from the banking industry in Malaysia, which evaluates the carbon footprint of bank loans and climate change risk mitigation. Finally, it highlights sustainable finance innovations in an Islamic concept.

The book will appeal to advanced students, researchers and scholars of Islamic banking and finance, as well as those concerned with environmental social governance and Sustainable Development Goals research. Regulators, policy makers and Shari’ah-compliant practitioners will also find it to be a useful guide.

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This book is dedicated to the remembrance of my most beloved parents Allamah Mufti Nur Mohammad (r) and Ustazah Akhtarun Nisa' (r) who have nourished me with their love and wisdom. May Allah (swt) shower them with His Love and Mercy and grant them Jannat al-Ferdaus. I would also like to dedicate this book to my lovely wife Dr Khamsiah Nawawi (Head, OSHE-Hospital UKM) and our heart-touching kids Dr Ahmad Mu'izz Billah (Head of Surgical Department and Medical officer at the Mukah Hospital, a Government hospital under the Ministry of Health, Malaysia), Ahmad Mu'azz Billah (OP-Cadet-RMC, BSc Hons. Formerly affiliated with the JPM, Putrajaya and currently serves at Accenture, Malaysia), Ahmad Muniff Billah (OP-Cadet-RMC. Winner of Gold Medal Award 2023 in his outstanding innovative research project and currently pursuing with his BSc Honors in Aviation Management and Piloting, MSU) and Akhtarun Naba' Billah (Pursuing with her LLB Honors, IIUM and Winner of Dean's List), for their continuous supports and sacrifices.

May all be blessed with *Muwaddau Wa Rahmah, Qurratu A'yun* and *Mardhaati Allah* (swt) in the life and the next.

This book is also dedicated to the Ummah and the whole of humanity.

Mohd Ma'Sum Billah, PhD

A special dedication to my parents, my extended family, my teachers and Murabbi who inspired, guide and shape me to be the person I am today. A special thanks also to the Institute of Islamic Banking and Finance (IIUM) team members for their unwavering support in bringing the Institute to a higher level. May Allah provide us with the fortitude and dedication to contribute to the well-being of our institution and to the Ummah.

Rusni Hasan, PhD

Infinite gratitude to my loving parents, family and my teachers for their care and wisdom. May Allah (SWT) grant them the best reward. Also, for the endless support and trust entrusted in me by the Institute of Islamic Banking and Finance (IIUM) for their mission to be the Centre of Excellence.

Razali Haron, DBA

This book is dedicated to the loving memory of my parents, Sayiran Binti Hassan Raza and Haji Mohd. Zain Bin Haji Harun. My greatest gratitude goes to my husband, Mohd. Yusmadi Bin Mohd. Yunan for teaching me the value of being patience. Thank you also to all my respected teachers, especially Prof. Dr. Mohd Ma'Sum Billah and Prof. Dr. Engku Rabiah Adawiah Engku Ali. May Allah bless them always, Ameen.

Nor Razinah Mohd Zain, PhD

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Preface

The central idea of sustainability in the modern world is intricate and ever-changing. Closely related to the realm of finance and socioeconomic discussion, the phrase “sustainable impact finance” becomes popular with the increasing interests among bankers, practitioners, market players, financial analysts, investors and their relevant experts in finding the impactful connectivity between the best financing mechanisms or tools with sustainable development related investments or projects. In 2021, the World Bank follows the wise footsteps of the European Commission in connecting sustainable impact finance with investment decisions that prioritize three important components, which are environmental, social and governance, or ESG. While such priority is placed, the aim to have investments or businesses for sustainable economic activities may hopefully be achieved in the long run. On the flip side of the same coin, Shari’ah introduces to the world with a unique perspective on matters relating to sustainable development. Through tremendous growth of Islamic banking and finance globally, and with significant importance of Islamic social finance’s tools in the modern society, sustainable impact finance should also be viewed from Shari’ah-compliance nature which agreeably able to contribute more to the progress of ESG and ethical investments. By having such view, the sharing as provided in this book attempts to contribute Shari’ah-compliance perspective on sustainable impact finance which continues to progress across borders. This book titled *Islamic Sustainable Finance: Policy, Risk and Regulation* is organized into four crucial parts with 18 important chapters while having a specific introduction and index at the end.

Part I focuses on the overview of Islamic sustainable finance. Under this part, the chapters are divided into seven important chapters. Chapter 1 provides the discussion relating to Islamic sustainable finance paradigm. Chapter 2 discusses about Islamic sustainable finance and its connection towards Sustainable Development Goals (SDGs). Chapter 3 evaluates the essentiality of ESG in Islamic sustainable finance. Chapter 4 explains the strategic action-plan of Islamic banks towards achieving Islamic sustainable finance. Chapter 5 analyses the existence of SDGs and value-based intermediation (VBI) from the perspective of Islamic finance. Chapter 6 explores on how VBI facilitates Islamic sustainable finance. Meanwhile, Chapter 7 looks closely at the components of ESG, derivatives and Islamic financial sustainability.

Part II concerns with Islamic sustainable finance from the aspects of policies and regulations which stands out with three chapters. Chapter 8 evaluates the role of regulators in relation to Islamic sustainable finance. Chapter 9 discusses the jurisprudential solutions in relation to Islamic sustainable finance. Subsequently, Chapter 10 focuses on the role of Islamic banking standards in relation to Islamic sustainable finance.

Part III discusses about Islamic sustainable finance and risk mitigation. This part has two chapters. Chapter 11 presents the risk mitigation of sustainable finance and the effective role of Takaful. Chapter 12 evaluates carbon footprint of bank loans and climate change risk mitigation from the experience of banking industry in Malaysia.

Part IV highlights on Islamic sustainable finance and innovations. This part is divided into six chapters. Chapter 13 discusses about maqasid al-Shari'ah of zakat towards sustainable economy. Chapter 14 concerns how zakat management matters in relation to Islamic sustainable finance. Chapter 15 provides literature review on Islamic crowdfunding as a new innovation that can be used in Islamic sustainable finance. Chapter 16 highlights the feasibility of cash waqf from a regulatory analysis in enhancing climate change mitigation and adaptation in Malaysia. Chapter 17 highlights about sustainability in empowering mumpreneurs through Islamic social finance. Chapter 18 concerns with SRI sukuk which leads towards sustainable microfinance.

Leading to set the compass straight, it is crucial to have *Islamic Sustainable Impact Finance: Issues and Achievable Strategies Vol. 1* in the raising of literature relating to the discourse of sustainable impact finance. This is specially to capture the perspective of Shari'ah-compliance nature within the growing interests, appreciations and continuous innovations within the relevant socioeconomic and investment markets. *Islamic Sustainable Impact Finance* needs to be seriously considered, especially relating to ESG components, ethical investments and their decision-making process. This is significantly true in relation to the growth of Islamic banking and finance, Islamic social finance and the creation of innovations in financial services. Simultaneously, while meeting the sustainable development agendas as promoted by many governments, the players of Islamic banking and finance are triggered to find the most suitable practices or operations that meet the needs for sustainable socioeconomic development or business-oriented projects, which can be found here. At the same time, Shari'ah-compliance requirements as promoted by their regulations seriously needed to be fulfilled. On this nature, the principles of Shari'ah must be followed accordingly without any deviation. This brings us to the importance of having the discussion on *Islamic Sustainable Impact Finance* and its related issues while targeting towards analysing its achievable strategies. It is not only timely to have this research book but it is also important to discover about the Islamic sustainable finance and its relevant discussions. Nevertheless, as a product from limited human intellects, it is possible for this book to have any shortcomings. We really appreciate to all readers to notify us for any further improvement.

Introduction

The contemporary world is somehow confused with numerous uncertainties. We continue to be complicated by various demanding and urgent issues. One of the most important issues is how resources need to be utilized for it to be sustained, hence sustainable for the use of future generations. History repeatedly shows the inability to deal with sustainability in available resources. Humankind is faced with various problems including poverty, health, education, inequality and economic growth. The utilization of resources also needs to be balanced to avoid harming the people and planet. This means we need to preserve oceans and forests while utilizing the available resources and, at the same time, tackle climate change due to imbalance in economic and environmental activities.

Recognizing the importance of this agenda, the United Nations have adopted the 17 Sustainable Development Goals (SDGs) in 2015, also known as the Global Goals, as a universal call to action to end poverty, protect the planet and ensure that by 2030, all people enjoy peace and prosperity. The 17 SDGs are integrated. Action in one area will affect outcomes in others and that development must balance social, economic and environmental sustainability.

The core idea of sustainability is that current decisions should not impair the prospects for maintaining or improving future living standards, including the management of the economic systems. Creativity, innovation, know-how, technology and financial resources from all of society, therefore, are necessary to achieve the SDGs in every context.

Based on this problem, the question arises on “how” Islam deals with the problem of sustainability and “what” solutions are offered to address the problem. Islam stresses the importance of sustainability, as Islam requires its followers the observance of sustainable conduct in all facets of human endeavor. That includes *amanah* (responsibility that humans bear in observing Allah’s guidance), *khalifah* (humans are custodians of the earth), *adl and qist* (upholding of justice, protecting the rights of others and fulfilling one’s own obligations) and *mīzān* (the fine-tuning of the universal order by Allah, both in perfecting creation and in perfecting the self-sustaining cycles that preserve creation). Indeed, the Islamic scholarly proposition that best aligns with modern notions of sustainability is the *maqasid al-Shari’ah* proposition which was extensively developed by past Islamic scholars, including al-Ghazali, Ibn Taymiyyah, al-Shatibi and many others.

2 Introduction

It is thus timely to initiate exclusive research focusing on “what” and “how” Islam addresses and offers solutions to the challenges facing us within the spirit of *maqasid al-Shari'ah*, among others, in tackling poverty, food supply, good health and well-being, quality education, reducing inequalities, responsible consumption and production and climate action. Thus, the title *Islamic Sustainable Impact Finance: Issues and Achievable Strategies* is an effort to meet the expectations.

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