Using Islamic Finance Instruments for Infrastructure and Socially Responsible Investments

COMCEC
Financial Cooperation Working Group
9th Meeting

Ankara, Turkey
October 26, 2017

Muharrem Cevher
Financial Sector Specialist
The World Bank Global Islamic Finance Development Center
Istanbul, Turkey
mcevher@worldbank.org
Disclaimers


E-mail: feedback@worldbank.org

All rights reserved.

This work is a product of the staff of the International Bank for Reconstruction and Development/The World Bank. The findings, interpretations, and conclusions expressed in this work do not necessarily reflect the views of the Executive Directors of the World Bank or the governments they represent.

The World Bank does not guarantee the accuracy of the data included in this work. The boundaries, colors, denominations, and other information shown on any map in this work do not imply any judgment on the part of the World Bank concerning the legal status of any territory or the endorsement or acceptance of such boundaries.

Rights and Permissions

The material in this publication is copyrighted. Copying and/or transmitting portions or all of this work without permission may be a violation of applicable law. The International Bank for Reconstruction and Development / The World Bank encourages dissemination of its work and will normally grant permission to reproduce portions of the work promptly.

For permission to photocopy or reprint any part of this work, please contact the World Bank.
Islamic finance principles and the sustainable development goals…

**Islamic Finance Principles**

- Prohibition of Riba
- Prohibition of Speculation
- Prohibition of Financing Illicit Sectors
- Profit and loss sharing principle
- Asset backing principle

**Sustainable Development Goals**

1. No Poverty
2. Zero Hunger
3. Good Health and Well-Being
4. Quality Education
5. Decent Work and Economic Growth
6. Clean Water and Sanitation
7. Affordable and Clean Energy
8. Responsible Consumption and Production
9. Industry, Innovation and Infrastructure
10. Reduced Inequalities
11. Sustainable Cities and Communities
12. Peace, Justice and Strong Institutions
New growth opportunities for Islamic finance in 2010s…

- Infrastructure Projects
- Environment-friendly Projects
- Socially Responsible Investments
- Shariah-Compliant Risk Management
- Addressing Liquidity and Capitalization of IFIs
Why is Islamic Finance Suitable for Infrastructure Projects?

- Emphasis on tangibility
- Partnership- and equity-style financing
- Profit and loss sharing
- Socially responsible investments
Sukuk: A Viable Financing Alternative for Infrastructure Investment

- Asset – backed nature of Sukuk
- The link between infrastructure asset`s revenue and sukuk investor`s return
- Infrastructure financing is a leading reason for sukuk issuance
- Sukuk enables risk-sharing in high-risk infrastructure investments
- Sukuk offers flexible structures for different phases of infrastructure projects
- Sukuk might enhance Public-Private-Partnership structures
- A wider investor base for Sukuk
Recent Status of Infrastructure Sukuk Issuances

Infrastructure Sukuk as % of Total Sukuk Issuances (2009 -2011)

- Infrastructure Sukuk: $20.8 Billion; 13%

Infrastructure Sukuk as % of Total Sukuk Issuances (2012 – 3Q2015)

- Infrastructure Sukuk: $73.1 Billion; 17%

Total Sukuk Issuances: $160 Billion (2009 -2011)


Infrastructure Sukuk Issuances by Country (2012 – 3Q2015)

- Malaysia: 61%
- Saudi Arabia: 30%
- UAE: 7%
- Indonesia: 1%
- Pakistan: 1%
- Others: 0.2%

Source: MIFC
By 2030, US$ 54 – 70 trillion additional infrastructure capacity is needed.

Significantly higher contributions from both public and private sources are required to close the annual $1 trillion investment gap.

Fiscal pressures have reduced the contribution of traditional, public sources of investments, creating the need to explore private sources more vigorously.

Islamic financial institutions can contribute to both private and public sources of infrastructure investments.

Islamic finance for PPP is a niche segment of global PPP space.
The risk-sharing aspect of *Sukuk* gives them a clear advantage as a funding instrument for infrastructure.

*Sukuk* spreads the risk more broadly as all investors share the same manner.

*Sukuk* is used more flexibly over time as payments are tied to underlying returns rather than to fixed schedules.

*Sukuk* resembles Public-Private Partnership (PPP) financing whereby investors finance the assets, own them—leading to true securitization—and then transfer them back to the government at maturity.

Socially responsible investing (SRI) is any investment strategy which seeks to consider both financial return and social good. In the USA, estimated total volume of assets held by explicitly SRI investors now exceeds US$3 trillion, having increased by more than 30 percent just since 2005.

Commonalities

- Share an ethical investment philosophy
- Pay attention to social return as well as economic return
- Focus on real economies activities to improve living conditions and well-being
- Consider the same set of businesses such as tobacco, alcohol, gambling, pornography non-permissible
- Focus on protection of natural and environmental resources
- Create more profound effect on organizational culture and behavior and mankind as whole

Broader Understanding of The Relationship Between Business and Society

Ultimate Benefit of Society

Sukuk as an instrument to facilitate Socially Responsible Investments

Sukuk is well-suited to serve as a means of raising funds for socially responsible investments.

Sukuk provides investors with a high degree of certainty that their money will be used for a specific purpose.

The structuring of Sukuk is a rigorous process overseen by several stakeholders that ensures that Sukuk does not finance any activity considered harmful to the society (a kind of built-in SRI due diligence process).

Many more SRI investment products exist on the equity side of the capital markets than on the fixed income side. Sukuk addresses lack of supply of fixed-income products for SRI.

Once conventional SRI investors realize the potential of SRI Sukuk as a new fixed income alternative for their portfolios, the number issues of this type should increase dramatically and investor base for sukuk broadens as well.
SRI Sukuk: The Case of Vaccine Sukuk

- International Finance Facility for Immunization (IFFIm), a multilateral development institution, has expanded the boundaries of Islamic finance for a **socially responsible purpose** with its debut sukuk transaction in 2014.

- In its attempt to issue SRI sukuk, the IFFIm was motivated to raise funds to be utilized for **vaccinations**. For this transaction, a **mubaraha** structure was preferred due to the ease of implementation.

- The offering received a **high demand** in the market. As a result, the IFFIm increased the deal size to $500 million from original $300 million. Also, the pricing was sealed at the tight end of price guidance implying a **lower cost** compared to its vaccine bond issuance took place in 2013.

- Following the successful sukuk debut, the IFFIm tapped the market for another $200 million SRI sukuk issuance in less than a year.

- These issuances gave the Islamic investors an opportunity to invest in a **high-quality socially responsible investment**.

- With vaccine sukuk issuances, the IFFIm **expanded its investor base** to the Islamic investors.

- Vaccine sukuk promises **portfolio diversification** opportunity with attractive risk-adjusted returns and socially responsible goals.
**SRI Sukuk: The Case of Vaccine Sukuk**

<table>
<thead>
<tr>
<th>Term Sheet: Details of Both IFFIm’s Sukuk Issuances are Listed Below</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Date</strong></td>
</tr>
<tr>
<td><strong>Issuer</strong></td>
</tr>
<tr>
<td><strong>Obligor</strong></td>
</tr>
<tr>
<td><strong>Obligor Rating</strong></td>
</tr>
<tr>
<td><strong>Issue Size</strong></td>
</tr>
<tr>
<td><strong>Profit Rate</strong></td>
</tr>
<tr>
<td><strong>Type</strong></td>
</tr>
<tr>
<td><strong>Maturity</strong></td>
</tr>
<tr>
<td><strong>Sukuk Structure</strong></td>
</tr>
<tr>
<td><strong>Format</strong></td>
</tr>
<tr>
<td><strong>Governing Law</strong></td>
</tr>
<tr>
<td><strong>Global Coordinator</strong></td>
</tr>
<tr>
<td><strong>Joint Lead Managers</strong></td>
</tr>
<tr>
<td><strong>Co-Lead Managers</strong></td>
</tr>
</tbody>
</table>

THANK YOU...