Between 2006 and 2010, emerging markets contributed to approximately 60% of global GDP or $8 trillion, through aggressive market expansion and an annual growth rate of 15%.\(^1\) Whilst economies have slowed down over the last five years, the IMF still predicts emerging economies will surpass developed ones by more than 2% for 2014 and 2015.\(^2\)

The established contribution of financial services to GDP growth and development requires a banked population.\(^3\) More and more Africans, for example, are joining the banked albeit via unconventional methods.\(^4\) Globalisation has quickly nudged even those in rural areas to become technologically connected. The Guardian newspaper reported in June 2014 that Africa’s mobile phone users are expected to increase significantly in the next five years. With more than 635 million mobile subscriptions (Approximately 60% of the estimated African population) expected before the end of the year and a comparatively insignificant 20% of banked families in Africa, many of the newly banked have probably never seen a bank.

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2. International Monetary Fund, 2014
The World Bank estimates that 38% or 2 billion of the adult world population in 2014 did not have access to or did not use formal financial services. More concerning is the estimate that 73% of the poor are unbanked or financially excluded due to high banking costs, bureaucracy or accessibility. The link between income level and being financially excluded indicates that 20% of the wealthiest individuals in developing countries are more than twice as likely to have a bank account as compared to the poorest 20%. Financial inclusion through savings products and restricted withdrawal products have been shown to improve economic conditions of a society as they offer a multitude of benefits including financial discipline, economic empowerment, entrepreneurship, savings for education, property purchase and lower mortality rates due to affordability of better healthcare.5

Research6 over the last decade has shown that micro-credit increases the number of business start-ups and improves the profitability of existing ones, giving credence to the belief that financial inclusion can have significant positive effects for individuals and firms.

In the efforts to make Malaysia a high income developed nation by 2020, Bank Negara Malaysia drafted its Financial Sector Blueprint 2011-2020 and made the following recommendations, in order to achieve the high income country status:

i Encourage the establishment of family offices to better accommodate the demands of ultra-high net worth individuals and families, which will also contribute towards Malaysia’s aspirations to become a global centre for Islamic wealth management.

ii Promote Islamic fund and wealth management activities through the offering of innovative financial solutions to meet the more sophisticated investment demands of the increasingly affluent population, including households in Asia.

iii Enhance the development of important ancillary services that support the wealth management industry, such as legal services and real estate planning, in collaboration with relevant regulatory agencies and industry associations.7

6 Banerjee et al. (2010)
7 BNM’s Financial Sector Blueprint 2011-2020, page 68-69 under recommendations 2.1.8, items ii,iii, iv
By the beginning of 2015, Islamic finance assets globally are estimated at $2.1 trillion on the back of a Cumulative Average Growth Rate (CAGR) of 17.3% post financial crisis (between 2009 and 2014). The leading jurisdictions\(^8\): Malaysia, Saudi Arabia, UAE, Kuwait and Qatar, have contributed significantly to the global market with the Islamic banking market in Saudi Arabia growing at a CAGR of 23.1% compared to conventional banking that grew 10.7% for the same period.

\(^8\) Excluding Iran
Emerging Markets and Innovative Products

1 Innovative solutions

Emerging markets are unique on a country basis. These developing economies require that financial institutions design products that adapt to their individual needs. The unbanked population across Asia is estimated to be 73%, 10% more than the global median.9 The potential for banking and finance in Asia and emerging markets as a whole makes for a formidable platform, designing innovative Islamic finance solutions as Asia is home to more than 62% of the world’s Muslim population.10

Islamic finance and investment structures provide solutions to reach those requiring finance but have refrained due to the lack of options available to them. Structures like Forward sale financing (salam), Crop-farming through partnership (muzara’ah) and Agricultural financing (musaqat) provide immediate solutions to farmers across developing regions.

Each of these structures has the ability to be scaled down to provide micro-financing and micro-investment to low-income households. At the same time, these instruments can be scaled up for capital market issuance in the form of interbank notes, negotiable deposits and the darling of the Islamic finance industry: Sukuk. These investment certificates that comply with the tenets of the Islamic law inherently consist of ethical and socially responsible elements, maintaining the restrictions mentioned earlier in terms of share investment. This means that sukuk have been contributing to the SRI sector as they restrict investment or financing of what is considered socially harmful (casinos, indecent material, arms and ammunition, alcohol, etc.)

2 Sukuk

Defined as:

“Certificates of equal value representing undivided shares in the ownership of tangible assets, usufructs and services or (in the ownership of) the assets of particular projects or special investment activity”

and often referred to as an Islamic bond, sukuk have quickly become the preferred method of capital raising for Shariah-compliant funding requirements. Conventional firms as well, have been issuing sukuk (for example, Shell which issued the first corporate sukuk in 1990), making it a strong and successful capital-raising tool that has gained significant momentum over the last decade.

The sukuk market has become a formidable growth area within Islamic finance, recording USD116.23 billion in global issuance in 201412, 100 times more than in 2001 (USD1.17bn). With all the sukuk issuances in the pipeline and continuous demand for these products, global sukuk issuances are expected to surge within the next 5 years to become a major contributor to the sector overall.

Global challenges like climate change and equitable social development lend themselves to principles that are inherent in Shariah-compliant products. ‘Social Sukuk’ or ‘Green Sukuk’ are some of the most recent instruments in the socially responsible Shariah-compliant investment sector.

An example is the $500 million ‘Vaccine Sukuk’ issued in 2014 to fund disease prevention and eradication. The International Finance Facility for Immunisation Company (IFFIm) issued its inaugural sukuk in late 2014, raising half a billion dollars for an immunisation programme for children, focused on the world’s poorest countries. The IFFIm partnered with Gavi, the Vaccine Alliance, with the objective of protection against preventing disease for millions of young children in countries like Yemen, Mali and Afghanistan.13

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11 AAOIFI Shariah Standard No 17
12 Zawya
Khazanah Nasional Bhd, a Malaysian sovereign wealth fund, has also stepped into the foray of niche sukuk SRIis, offering RM100 million (USD25 million) as part of the Ihsan Sukuk Berhad’s RM1 billion sukuk programme (USD250 million) for responsible investment within the recently issued Sustainable, Responsible and Investment Sukuk framework by the Securities Commission Malaysia. The issuance can be classified as impact investing as it focuses on funding schools under the Yayasan AMIR Trust School programme, with the objective of improving the accessibility and quality of education through a public-private partnership with the Malaysian Ministry of Education. Beyond the uniqueness of the issuance, it will also allow sukuk-holders to convert their investment into a donation at any point of the tenure.

The ‘Green Sukuk’ initiative has also been gaining momentum as a part of the recent SRI sukuk structures. ‘Green Sukuk’ intend to encourage the issuance of investment certificates focused on renewable energy through the funding of projects including:

- Solar & wind parks
- Biogas plants
- Renewable transmission and infrastructure
- Electric vehicles and infrastructure, light rail.14

The growth of sukuk as an asset class has surpassed other forms of investment with a cumulative average (CAGR) of 16% pa between 2010 and 2015. This trend is expected to continue to a forecasted value of sukuk outstanding to be around $640 billion by 2020.15

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### Domiciles with Debut Sukuk Issuances (2013 - 2014)

<table>
<thead>
<tr>
<th>Issuer</th>
<th>Structure</th>
<th>Domicile</th>
<th>Currency</th>
<th>Issue Date</th>
<th>Issue Size (in millions)</th>
<th>Tenor</th>
<th>Issuance Type</th>
</tr>
</thead>
<tbody>
<tr>
<td>01 Golden Assets International Finance</td>
<td>Murabahah</td>
<td>Mauritius</td>
<td>MYR</td>
<td>1 Aug 13</td>
<td>153.89</td>
<td>5</td>
<td>Corporate</td>
</tr>
<tr>
<td>02 Salam III Limited</td>
<td>Wakalah</td>
<td>Luxembourg</td>
<td>USD</td>
<td>1 Oct 13</td>
<td>20</td>
<td>5</td>
<td>Corporate</td>
</tr>
<tr>
<td>03 Osun Sukuk Company Plc</td>
<td>Ijarah</td>
<td>Nigeria</td>
<td>NGN</td>
<td>1 Oct 13</td>
<td>70.82</td>
<td>7</td>
<td>Sovereign</td>
</tr>
<tr>
<td>04 South Africa</td>
<td>Ijarah</td>
<td>South Africa</td>
<td>USD</td>
<td>17 Sep 14</td>
<td>500</td>
<td>5.75</td>
<td>Sovereign</td>
</tr>
<tr>
<td>05 Oman</td>
<td>Ijarah</td>
<td>Oman</td>
<td>USD</td>
<td>22 Oct 14</td>
<td>519.62</td>
<td>5</td>
<td>Sovereign</td>
</tr>
<tr>
<td>06 Hong Kong</td>
<td>Ijarah</td>
<td>Hong Kong</td>
<td>USD</td>
<td>11 Sep 14</td>
<td>1,000</td>
<td>5</td>
<td>Sovereign</td>
</tr>
</tbody>
</table>

Source: ISRA, Zawya and Bloomberg KFHR

New sukuk issuances in 2013 were generally for medium term maturity and used a variety of structures as the foundation. Specific emerging markets have quickly recognised the benefit of sukuk issuance. By 2014, South Africa, Japan and the UK were all making inroads in their first sukuk issuances, spurring a move towards sukuk issuance globally.

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15 KFHR Research
Due to significant infrastructure requirements across the developing regions, emerging markets have and are expected to continue issuing more sukuk that ultimately improve standards of living on the back of wealth generation. As Malaysia enters its final segment of its Economic Transformation Programme (ETP), the 2020 goals that it has set are expected to be achieved with the majority of the spending towards socio-economic development.

Malaysia’s established regulation and adoption of international best practices including Basel and the IFSB\(^{16}\) standards and its strong arbitration and financial mediation have attracted foreign corporates in raising capital using the Malaysian sukuk platform.

\(^{16}\) Islamic Financial Services Board based in Kuala Lumpur, Malaysia
A CLEAR LEADER IN GLOBAL SUKUK ISSUANCE
SUUK ISSUANCE BY DOMICILE

MALAYSIA remains a key marketplace for global sukuk issuance in 1H2015 with

49.9% of total new issuances of USD39.70 billion of the year 1H2015

Malaysia, Indonesia and UAE leading issuances for this quarter

Source: ISRA and Zawya

Source: Zawya
GLOBAL SUKUK OUTSTANDING
BY COUNTRY in 1H2015

MALAYSIA holds
54.9%
of global sukuk market share
as of 1H2015

Source: ISRA and Zawya

Malaysia has led the sukuk issuance and outstanding sukuk tables by a significant margin over the years and by the first half of 2015, Malaysia holds 50% of the global sukuk outstanding market share, bearing testimony to the confidence of the local and international marketplace with respect to the Malaysian capital market environment.
The Securities Commission of Malaysia, in 2014, has revised the Guidelines on sukuk to incorporate new requirements on the issuance of Sustainable and Responsible Investment (SRI) sukuk.

SRI sukuk issuance proceeds will be utilised for the purpose of funding eligible SRI projects that aim to:

a. preserve and protect the environment and natural resources;
b. conserve the use of energy;
c. promote the use of renewable energy;
d. reduce greenhouse gas emissions; or

e. improve the quality of life for the society.

Only a project or physical assets/activities relating to an existing project in any of the following sectors is deemed to be an Eligible SRI project:

(a) **Natural resources**
   
   projects relating to:
   
   i. sustainable land use;
   ii. sustainable forestry and agriculture;
   iii. biodiversity conservation;
   iv. remediation and redevelopment of polluted or contaminated sites;
   v. water infrastructure, treatment and recycling; or
   vi. sustainable waste management projects,

(b) **Renewable energy and energy efficiency**
   
   projects relating to:
   
   i. new or existing renewable energy (solar, wind, hydro, biomass, geothermal and tidal);
   ii. efficient power generation and transmission systems;
   iii. energy efficiency which results in the reduction of greenhouse gas emissions or energy consumption per unit output,

(c) **Community and economic development**
   
   projects relating to:
   
   i. public hospital/medical services;
   ii. public educational services;
   iii. community services;
   iv. urban revitalization;
   v. sustainable building projects; or
   vi. affordable housing; or

(d) **Waqf properties/assets**
   
   any projects that undertake the development of waqf properties/assets.

**Disclosure requirements**

An issuer is obliged to disclose via prospectus or other disclosure documents:

(a) details of the Eligible SRI project and, to the extent possible, impact objectives from the Eligible SRI project; and

(b) a statement that the issuer has complied with the relevant environmental, social and governance standards or recognised best practices relating to the Eligible SRI project.

**Appointment of an independent expert**

If the SRI sukuk is issued or offered to sophisticated investors, the issuer has the option whether or not to appoint an independent expert to undertake an assessment of the Eligible SRI project. However, if the SRI sukuk is issued or offered to retail investors, it is a requirement under the guidelines for the issuer to appoint an independent expert to undertake an assessment of the Eligible SRI project.

**Reporting to investors**

The issuer or the obligor (if the issuer is an SPV) must provide annual reporting, via newsletters, website updates, annual report or any other communication channels, to investors on the following:

(a) The original amount earmarked for the Eligible SRI project;

(b) The amount utilised for the Eligible SRI project;

(c) The unutilised amount and where such unutilised amount is placed or invested pending utilisation; and

(d) Where feasible and to the extent possible, the impact objectives from the Eligible SRI project.
Waqf (Endowments)

Another structure contributing to the SRI objectives of community development and empowerment is the waqf (endowment) system that has prominence in the history of the Turkish region. This method has been used to expedite poverty alleviation because of the flexibility it allows in the distribution of the waqf’s potential benefits to the poor.16

The accumulated funds for the establishment of a waqf project could be realised through a number of instruments, for example:

1. Cash and E-Waqf Fund,
2. Per-square Feet Value Certificate, and
3. Sukuk issuance.

These instruments provide an opportunity for the philanthropic investors to dedicate their wealth to perpetual returns that continually benefit the communities the endowment has been designed to serve whilst in accordance with investor preference, for example:

1. The cash and e-waqf fund is considered the simplest for public participation as they have the option to donate relatively small amounts of money via cash or electronic transfer (through an e-waqf facility).
2. The waqf share model is another option that results in a public waqf after waqf shares are purchased in particular projects that contribute to social welfare. These are practiced in Malaysia, Indonesia, Sudan and Kuwait.
3. The corporate cash-waqf model is a company trust model that also creates a public waqf, also practiced in Malaysia, Pakistan and South Africa.
4. The waqf mutual fund model is a combined waqf investment trust structure the practice of which has been lauded in Indonesia.
5. The Wakalah (agency) with waqf fund model is a public waqf used primarily as Islamic insurance funds that benefit only those that contribute to it. This has been practiced for over a decade in Takaful (Islamic Insurance) companies in Pakistan, South Africa and Malaysia.

16 Rahman, 2013