

I FOR IMPACT: BLENDING ISLAMIC FINANCE AND IMPACT INVESTING FOR THE GLOBAL GOALS



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IICPSD and IDB

I for Impact: Blending Islamic Finance and
Impact Investing for the Global Goals
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United Nations Development Programme

IICPSD AND IRTI



I FOR IMPACT:
Blending Islamic Finance and
Impact Investing for the Global Goals



**SUSTAINABLE
DEVELOPMENT GOALS**
17 GOALS TO TRANSFORM OUR WORLD



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ISLAMIC RESEARCH AND TRAINING INSTITUTE



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Establishment

The Islamic Research and Training Institute (IRTI) was established by the Board of Executive Directors (BED) of the Islamic Development Bank (IDB) in conformity with paragraph (a) of Resolution No. BG/14-99 of the Board of Governors adopted at its Third Annual Meeting held on 10th Rabi-ul-Thani, 1399H corresponding to 14 March 1979. The Institute became operational in 1403H, corresponding to 1983. The Statute of the IRTI was modified in accordance with the resolutions of the IDB BED No.247 held on 27/08/1428H.

Purpose

The Institute undertakes research to help economic, financial and banking activities in Muslim countries to conform to shariah, and to extend training facilities for personnel engaged in development activities in the Bank's member countries.

Functions

The functions of the Institute are to:

- A. Develop a dynamic and innovative Islamic Financial Services Industry (IFSI);
- B. Develop and coordinate basic and applied research for the application of shariah in economics, banking and finance;
- C. Conduct policy dialogue with member countries;
- D. Provide advisory services in Islamic economics, banking and finance;
- E. Disseminate IFSI-related knowledge through conferences, seminars, workshops, apprenticeships and policy and research papers;
- F. Provide learning and training opportunities for personnel engaged in socioeconomic development activities in member countries;
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- H. Collaborate to provide policy advice and advisory services on the development and stability of Islamic finance and on the role of Islamic institutions in economic development to member governments, the private sector and the NGO sector;
- I. Develop partnerships with research and academic institutions at the Organisation of Islamic Cooperation (OIC) and international levels.

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The President of the IDB is the President and the Legal Representative of the Institute. The Board of Executive Directors of the IDB acts as the supreme body of the Institute, and is responsible for determining its policy. The Institute's management is entrusted to a Director General selected by the IDB President in consultation with the Board of Executive Directors. The Institute has a Board of Trustees that functions as an advisory body to the Board of Executive Directors. The Institute consists of two departments and one centre:

Research and Development Services Department	Islamic Finance Capacity-Building Department	Islamic Financial Products Centre
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Advisory Services and Technical Assistance Division	Information and e-Programmes	



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Establishment

Istanbul International Center for Private Sector in Development (IICPSD), established in 2011 in partnership with the Government of Turkey, is one of six Global Policy Centres of the United Nations Development Programme (UNDP).

Purpose

IICPSD builds on Turkey's convening power and dynamic private sector as well as UNDP's global mandate to engage the private sector constructively in supporting global and local efforts to address development challenges. IICPSD supports the private sector and foundations to become transformative partners in development through research, advocacy for inclusive business, facilitation of public-private dialogue and brokering partnership. IICPSD leads the global work of UNDP on private sector and foundations and supports UNDP offices around the world.

Functions

IICPSD conducts demand-driven research on topics related to the private sector in development and collects case studies and data on best practices in relation to this. IICPSD uses these knowledge products to facilitate partnerships between public and private players to establish a space for all stakeholders to meet and create joint agendas. IICPSD also advocates for the private sector's role in development, through, for example, "inclusive business model" and "corporate social responsibility" practices. In addition, IICPSD provides training and technical assistance to assist potential stakeholders to develop their capacity.

The Center focuses on four thematic areas:

- › Inclusive Business
- › Private Sector Engagement in Skills Development
- › Impact Investing
- › Resilience and Crisis Response.

The Center hosts three global multi-stakeholder initiatives:

- › Business Call to Action
- › SDG Philanthropy Platform
- › Connecting Business Initiative
- › Global Islamic Finance and Impact Investing Platform.



FOREWORD

The world we live in today is full of challenges of poverty, social inequality and environmental adversities that cannot be taken lightly. In response, the United Nations 2030 Agenda for Sustainable Development envisages a revitalized and innovative global partnership for sustainable development to address such challenges.

In this context, the Islamic Development Bank Group (IDB Group) and UNDP have formed a partnership to establish the Global Islamic Finance and Impact Investing Platform (GIFIIP). The overall goal of the GIFIIP is to accelerate progress towards the Sustainable Development Goals (SDGs) by positioning Islamic finance and impact investing as a leading enabler (or enablers) of SDG implementation across the globe through engaging the private sector. It is important to note that the concept of impact investing is also in line with the objectives and strategy of the IDB's 10-year framework.

To facilitate the process of achieving this goal, this report aims to raise awareness of the compatibility between Islamic finance and impact investing. The report is therefore a major hallmark of solid collaboration between the two sectors. It also reviews recent developments and key factors for growth, pinpoints similarities between the two sectors and formulates policy recommendations for development actors to create the conditions for the two sectors to benefit from each other.

We do believe that Islamic finance is profoundly attuned to impact investing, since they are both based on rigorous ethical and social criteria with an emphasis on inclusiveness and a broader understanding of business–society relations. Such bridging could pave the way for an effective joint response, invoking both, to the mounting challenges related to development financing.

We sincerely hope that this report will bring benefits to those who are concerned with the developmental aspects of economics and finance. We also invite our readers to provide constructive remarks and feedback on the report.

Lastly, we wish to extend our appreciation to all team members from both IRTI and IICPSD for their tireless efforts and contributions. We remain deeply committed to furthering the achievement of the SDGs through various constructive means, and hope that this report may be of service to this end.

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LIST OF ACRONYMS

AAOIFI	Accounting and Auditing Organization for Islamic Financial Institutions
AUM	Assets Under Management
BoP	Base of the Pyramid
DFI	Development Finance Institution
ESG	Environmental, Social and Governance
GCC	Gulf Cooperation Council
GIFIIP	Global Islamic Finance and Impact Investing Platform
GIIN	Global Impact Investing Network
GIIRS	Global Impact Investing Rating Standards
HNWI	High-net-worth Individual
IDB	Islamic Development Bank
IFSB	Islamic Financial Services Board
IICPSD	Istanbul International Center for Private Sector Development
IRTI	Islamic Research and Training Institute
MENA	Middle East and North Africa
MFI	Microfinance Institution
MSMEs	Micro, Small and Medium-sized Enterprises
OIC	Organisation of Islamic Cooperation
SDG	Sustainable Development Goal
SIB	Social Impact Bond
SRI	Socially Responsible Investment
SMEs	Small and Medium-sized Enterprises
SWF	Sovereign Wealth Fund
UHNWI	Ultra-high-net-worth Individual
UNDP	United Nations Development Programme





EXECUTIVE SUMMARY

The scale and ambition of the 2030 Agenda for Sustainable Development, as embodied in the 17 SDGs, call for substantial financial and technical resources, estimated to be between US\$5 trillion and US\$7 trillion each year for the next 15 years.¹ These sums are far beyond the scope of individual governments and the multilateral funding agencies to supply. Private sector funding, capabilities and know-how need to be mobilized to sustain the new development agenda and the global partnership for sustainable development, to operationalize the policies and actions outlined in the Addis Ababa Action Agenda and end poverty within a generation.

Impact investment, defined as the deployment of funds with the aim to generate social and environmental impact as well as a financial return,² has established itself as an important source of funding the SDGs. Its global reach is growing rapidly. As much as three quarters of total impact investment assets is in developing countries and one fifth is allocated to microfinance, contributing to development efforts. Private debt and equity together account for 65 percent of impact investments, with bonds a prominent instrument. While institutional investors are currently constrained from large-scale participation in impact investing by their legal and fiduciary responsibilities, high-net-worth individuals (HNWIs) are key players. Impact investment funds and development finance institutions (DFIs) are also prominent as impact-driven organizations. Critical drivers of impact investing include the failure of governments to increase and deliver on their official development assistance (ODA) commitments and the emergence of the “value investor”.

The Islamic finance sector, meanwhile, has grown from a market of US\$200 billion in 2003 to an estimated US\$1.8 trillion in 2014,³ and is expected to reach US\$2.7 trillion in 2021.⁴ This represents a strong potential source of financing for the SDGs, fostering development and helping to end poverty. Although Organisation of Islamic Cooperation (OIC) member countries account for 22 percent of the world’s population, they house 40 percent of the world’s poor who live on US\$1.25 a day or less.⁵ Reaching more of those at “the base of the pyramid” (BoP) by deepening and widening the range of Islamic financing solutions available to the poor, especially microfinancing products, would be a major contribution to the 2030 Agenda. The resilience of Islamic finance to the 2008 global financial crisis has enhanced its prominence and the market for its products and services is growing. Its key pillars—being asset backed, ethical, participatory and subject to good governance—underline its suitability for deployment in pursuit of the 2030 Agenda and the elimination of poverty. Islamic financial assets are currently concentrated in the three markets of Malaysia, Saudi Arabia and Iran. The Islamic fund industry, dominated by Malaysia, Saudi Arabia and Luxembourg, is growing, but still of limited scale.⁶ Individuals (notably HNWIs), sovereign wealth funds (SWFs) and pension funds are among the key actual and potential investors. Among the DFIs, the Islamic Development Bank Group (IDB Group), fully compliant with Islamic financing principles, is preminent, having 57 member countries.

The principles of Islamic finance and impact investing, with their rigorous moral and social criteria, their emphasis on inclusiveness and broader understanding of business–society relations, complement each other. Both Islamic finance and impact investment occupy a value-based investment universe, associate themselves with a moral purpose, offer access to finance to those directly or indirectly kept out of the conventional financial investing arena and share a broader understanding of the relationship between business and society. These similarities

1 United Nations Conference on Trade and Development, *World Investment Report*. Geneva, 2014. Available from http://unctad.org/en/PublicationsLibrary/wir2014_en.pdf

2 See the website of the Global Impact Investing Network (GIIN) at <https://thegiin.org/impact-investing/>

3 International Monetary Fund, “Islamic Finance and the Role of the IMF”, 2017. Available from www.imf.org/external/themes/islamicfinance

4 Thomson Reuters and Dinar Standard, *State of the Global Islamic Economy Report 2015/16*. Available from www.dinarstandard.com/state-of-the-global-islamic-economy-report-2015/

5 Islamic Development Bank, *Annual Report 1435H (2014)*. Jeddah. Available from www.isdb.org/irj/go/km/docs/documents/IDBDevelopments/Internet/English/IDB/CM/Publications/Annual_Reports/40th/IDB_Annual_Report_1435H_English.pdf

6 “Thomson Reuters and ICD Launch The Islamic Finance Development Indicator”, 2 December 2015. Available from www.icd-ps.org/en/newsmedia/newsdetail/Thomson-Reuters-and-ICD-launch-the-Islamic-Finance-Development-Indicator-129



suggest that bridging the two sectors offers a promising avenue of response to the growing challenges related to development financing, through collaboration, cross-learning and reaching new markets. “Islamic finance impact investing” offers a potent new mechanism for fulfilling SDG poverty-reduction targets by harnessing private sector finance targeted, in particular, at micro, small and medium-sized enterprises (MSMEs), which are often excluded from conventional financing mechanisms.

Islamic finance has widened the market for impact investors. It provides impact investors with access to new sources of finance and new markets, increases the range of impact investing tools and has the potential to speed up and simplify access to finance for small companies using Islamic financial instruments. For Islamic financiers, partnering with the impact investing sector, especially in monitoring and evaluation methodologies, offers the potential for the expansion of scope and scale and for greater worldwide recognition. Through Islamic finance impact investing, the poorer segments of society in OIC member countries could gain greater access to finance and development opportunities and the toolbox of Islamic financing instruments could be greatly enlarged.

Among the principle aims of this report is the identification of ways to enlarge the area of overlap between Islamic finance and impact investing and to develop collaborative strategies between them. It makes a number of specific recommendations for this endeavour, based on research undertaken during its preparation.

An **enabling environment** to promote Islamic finance impact investing should be created as part of the larger dialogue on inclusive financial systems and responsible investing principles. Support should be offered to the creation and functioning of an **effective capital market system** for Islamic finance impact investing, including supporting existing and new intermediaries. Well-thought-out, comprehensive **regulatory, accountability, tax and legal frameworks** are needed and it is important to raise awareness of the **current and potential levels of convergence** of Islamic finance and impact investing. **Standards for impact measurement** and reporting should be established so that the sector’s metrics are aligned with the common practices of the global impact investing community. **Key stakeholders** from governments, the private sector and support organizations in both the Islamic and conventional impact investing realms should be brought together to discuss critical bottlenecks, learn from best practices, establish relationships and benefit from the cross-pollination of ideas and shared beliefs. A **centre of excellence** should be established to take the lead in positioning Islamic finance impact investing as part of the global dialogue on politically neutral, inclusive financial systems and to connect innovators and interested parties together to raise awareness and encourage cooperation.

To further these recommendations, UNDP and the IDB established the Global Islamic Finance and Impact Investing Platform (GIFIIP) in 2016 to position Islamic finance impact investing as one of the leading enablers of SDG implementation around the world, through private sector engagement. UNDP and the IDB aim to create a collaborative working space among stakeholders to address the above-mentioned challenges and nurture an Islamic finance impact investing business ecosystem.

The GIFIIP aims to:

- › develop a spectrum of shariah-compliant impact investing tools and instruments; and
- › improve the access of impact enterprises to Islamic funding.



IICPSD and the IDB have articulated a three-pillar strategy for the GIFIIP:

Conceptualization and Capacity-building: Maintain a network of Islamic finance impact investors to foster an Islamic finance and impact investing ecosystem. Knowledge products, tools and data will aim to equip its members with the necessary know-how to foster this new niche industry.

Advocacy and Inter-industry Collaboration: Engage in advocacy to raise awareness of the compatibility of Islamic finance and impact investing and their capacity to implement the SDGs, and build bridges between Islamic finance and impact investing. The GIFIIP will undertake targeted work in large-scale global Islamic finance and impact investing conferences and forums such as the World Bank Annual Conference on Islamic Banking and Finance, the World Islamic Economic Forum, etc.

Deal-sourcing and Matchmaking: Play a matchmaking role between investors and other players in the ecosystem, such as business incubators, development organizations and, most importantly, inclusive business ventures seeking capital. This will significantly reduce the time, effort and costs involved in due diligence procedure and help overcome information barriers for investors.

UNDP and the IDB are uniquely positioned to advance convergence between Islamic finance and impact investing because of their convening power, global reach, technical expertise and impartiality. The GIFIIP will seek to advance Islamic finance impact investing by establishing a GIFIIP Members Network composed of impact investors, Islamic financiers, fund managers and impact enterprises. The network will act as a key resource for disseminating and advocating Islamic finance impact investing, which has the potential to act as a powerful worldwide driver of development and poverty reduction.





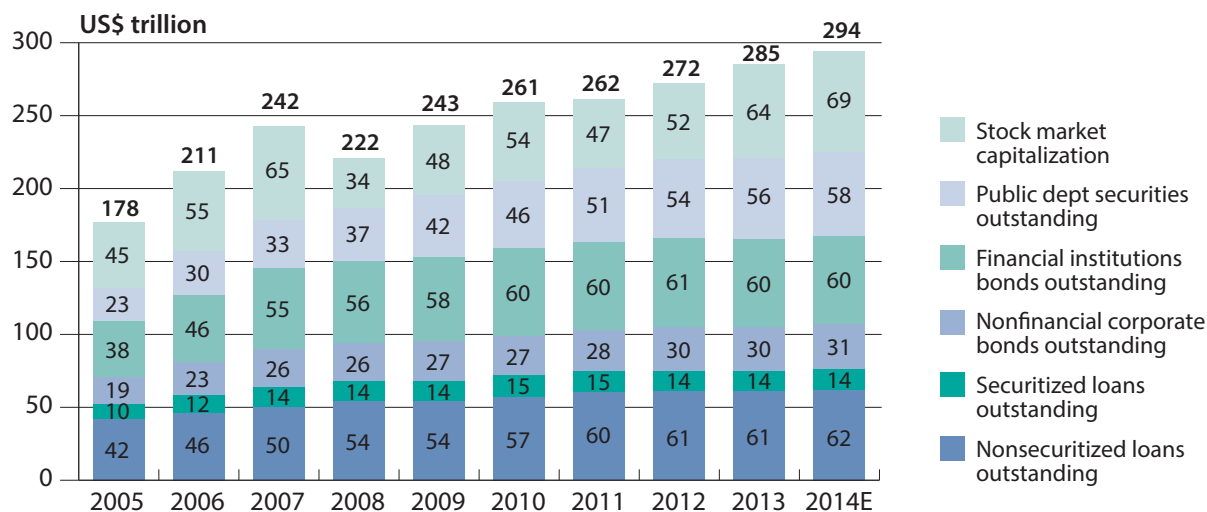
Introduction

The scale and ambition of the SDGs call for the deployment of unprecedented financial and technical resources, with a significant role for private sector, market-based funding solutions. Impact investing, a rapidly growing financial modality, has already been recognized as an important source of funding. Islamic financial services, also growing rapidly, draw on moral and social criteria, which, with their stress on inclusiveness and understanding of business–society relations, are congruent with those of impact investing and with the aims of the SDGs to “leave no one behind”. With this report, UNDP and the IDB aim to underline the convergences between these two sectors and foster synergies between them to advance Islamic-finance-based impact investing in OIC member countries.

World leaders have adopted the 2030 Agenda for Sustainable Development. The new Agenda defined global sustainable development priorities and aspirations for 2030 and sought to mobilize global efforts to fulfil 17 Sustainable Development Goals (SDGs) for people, planet, peace and prosperity.¹ Its success relies heavily on action and collaboration by all actors, particularly the private sector. The Addis Ababa Action Agenda (AAAA) of the Third International Conference on Financing for Development, which is an integral part of the roadmap for the next 15 years, called for a revitalized global partnership for sustainable development supported by concrete policies and actions to achieve the SDGs within a generation.²

The scale and ambition of the SDGs requires equally ambitious amounts of financial and technical resources, of between US\$5 trillion and US\$7 trillion annually.³ Official development assistance (ODA) amounted to US\$132 billion in 2015, the highest level ever. There are enough resources and capabilities to address the global development challenges. Global capital is massive, dwarfing the funds available to governments (Figure 1). Thus, increasing the responsiveness of private resources to positive human development outcomes could be a game-changer. For example, in 2014 the estimated value of the stock market was about US\$69 trillion.⁴ What is needed today is to deploy all available resources in the implementation of the SDGs, moving from the provision of billions of dollars in development assistance to trillions of dollars of development investments. This includes exploration of innovative sources of finance and leveraging private investments alongside ODA.

Figure 1: Stock of Global Financial Assets



Sources: Estimates from McKinsey Global Institute, Haver, Bank for International Settlements and Deutsche Bank.

Impact investment, an important source of funding for the SDGs, is defined as investments generating a measurable, positive social or environmental impact alongside a financial return on investment.⁵ As of 2016, the impact investing sector has developed into a potent source of development finance, with billions of dollars' worth of assets under management (AUM). Impact investing is widely recognized, including by the Group of Eight Industrialized Nations (G8), Organisation for Economic Co-operation and Development (OECD) and European Union (EU), and acknowledged in the AAAA as an effective means of development finance. Considering the size⁶ and the growth rates of the various forms of impact investment, the global impact investing market could reach US\$1 trillion of investments with the right policies.⁷



It is in this context that Islamic financial services, a market that has grown from US\$200 billion in 2003⁸ and is expected to reach US\$2.7 trillion in 2021,⁹ can provide a strong and non-traditional source of financing for the SDGs. With its global assets estimated to reach US\$3.2 trillion in 2020, Islamic finance has a footprint in Asia and the Middle East, is ripe for growth in South America and Europe and has future markets in North America, Central Asia and Australia. Given its emphasis on risk-sharing, its linkages to real economic activities, its partnership-based and equity-focused approach, widening geographic reach and the rapid expansion of its global assets in Muslim and non-Muslim countries, Islamic finance can be a potent (and is an as-yet-untapped) source of SDG finance. Its major principles—financial stability, financial inclusion and shared prosperity—can be instrumental in the successful implementation of SDGs such as those on ending poverty (SDG 1), achieving food security (SDG 2), ensuring healthy lives (SDG 3), achieving gender equality (SDG 5) and promoting a peaceful and inclusive society (SDG 16).¹⁰

The principles of Islamic finance and impact investing, with their rigorous moral and social criteria, their emphasis on inclusiveness and broad understanding of business–society relations, are compatible with each other. These similarities suggest that bridging the two sectors might create a promising avenue for effective response to the growing challenges related to development financing, through collaboration and cross-learning.

For the purpose of advancing the SDGs and stimulating dialogue about the compatibility of Islamic finance and impact investing, UNDP and the IDB have established the Global Islamic Finance and Impact Investing Platform (GIFIIP) as an example of successful cooperation and partnership. Through engaging the private sector, governments and key stakeholders operating in the Islamic finance and impact investing markets, this global Platform is expected to drive forward business solutions to sustainable development challenges in a fair, transparent, quantifiable and verifiable manner.

Furthermore, this report attempts to raise awareness of the compatibility of and complementarities between Islamic finance and impact investing and mobilize Islamic financiers and impact investors to cooperate towards achieving the SDGs. It reviews recent developments and key factors for growth, pinpoints similarities between the two sectors and makes policy recommendations for development actors to create the conditions for the two sectors to benefit from each other. The report is structured as follows:

- Chapters 1 and 2 provide the background to and outline the universe of impact investing;
- Chapters 3 and 4 provide the background to and outline the universe of Islamic finance;
- Chapters 5 and 6 identify and devise a strategy to enhance the areas of overlap between the two.





The world is on the brink of a revolution in how we solve society's toughest problems. The force driving this revolution is "impact investing", which harnesses entrepreneurship, innovation and capital to power social progress.¹¹

Chapter 1

On the Brink of a Revolution: The Emergence of the Impact Investing Sector

There is currently a renewed emphasis on the use of investment to generate positive and measurable social or environmental impacts as well as returns, and an acceptance that such outcomes should be an integral part of investment criteria. Impact investments, where positive impacts are sought alongside financial returns, can play an important role in providing funds and technical assistance to contribute to Agenda 2030 and the SDGs. UNDP, like other multilateral development-based organizations within and outside the United Nations family, is fully committed to seeking ways to deploy impact investing to foster development, as called for in the recommendations of the AAAA.





On the Brink of a Revolution: The Emergence of the Impact Investing Sector

Drivers of Impact Investing

The 2008 global financial crisis highlighted the interconnectedness and the fragility of the global financial system and called for rethinking the role of finance in society.¹² It set the scene for a transition from maximization of financial gains from investment towards optimization of non-financial risks and returns. A responsible and accountable flow of financial capital, as well as sustainable and long-term value creation as opposed to short-term profit maximization, became concerns in investment decisions.¹³

Responsible finance initiatives such as the United Nations Principles for Responsible Investing (UNPRI) and the United Nations Global Compact (UNGCC) encourage responsible deployment of capital to address social and environmental challenges. In 2011 the European Union, for instance, issued a regulation to create European Social Entrepreneurship Funds as a European Union-wide brand for funding social businesses. With this label, investors will be able to identify funds focusing on social businesses.¹⁴ Likewise, the Government of the United Kingdom has provided a 30 percent tax relief mechanism, the Social Investment Tax Relief (SITR), to support social enterprises.¹⁵

On the other hand, the philanthropic commitments of foundations and corporations are also vulnerable to financial crises and the 2008 crisis exposed the limits of traditional philanthropy. First, the conventional tools of philanthropy are not sufficient to cater to the social and environmental problems of today. Addressing problems such as unemployment, poverty and climate change requires trillions of dollars per year, and such amounts far exceed those available through ODA or grants. Second, traditional philanthropy is inhabited by numerous small non-profit enterprises, corporations and foundations dispersed across the marketplace, making it difficult for the sector to generate a long-term development impact. The one-way donor-recipient model of traditional philanthropy has even been accused of perpetuating social inequalities, treating people as the passive recipients of charity and creating market distortion, donor reliance and tokenism.¹⁶ Accordingly, philanthropy is seeking alternative market-borne solutions, such as venture philanthropy, to increase the effectiveness of programmes given ever-shrinking budgets.

Another key driver that increased the attractiveness of impact investments was the failure of governments to deliver on ODA commitments. Although ODA continues to play a pivotal role in supporting development, especially in least-developed countries and small island developing states, it is limited in terms of volume. ODA from OECD Development Assistance Committee (DAC) countries remained at 0.3 percent of their gross national income (GNI) in 2015.¹⁷ This limitation requires the leveraging and mobilization of additional sources of finance for sustainable development.¹⁸

The emergence of the “value investor” (i.e. investors who invest capital in line with their values) was another driver for growth in the impact investing market. This new generation of investors is highly enthusiastic about assets that create development results. Millennial investors (the 18–32-year-old age group), who comprise one quarter of this investor segment, are nearly twice as likely to invest in companies or funds that target specific social or environmental outcomes than in those that do not.¹⁹ Those in the new “high-net-worth individual” (HNWI) and “ultra-high-net-worth individual” (UHNWI) investor categories follow a similar trend when making investment decisions.²⁰ A United States Trust survey of 680 HNWI and UHNWI adults in 2014 revealed that half the participants and two thirds of the millennials saw their investment decisions as a way to express their social, political and environmental values. Almost three quarters of the millennials surveyed believed that it is possible to achieve market-rate returns when investing for social or environmental impact.²¹

The growth of impact investing has also benefited from recent intergovernmental initiatives. During the United Kingdom’s Presidency of the G8 in 2013, the G8 established a global taskforce that evolved into the Global Social Impact Investment Steering Group. This has helped to stimulate the development of an effective



impact investing market. Upon the request of the taskforce, the OECD produced a report, “Social Impact Investment: Building the Evidence Base”, to provide a framework for conceptualizing and assessing the impact investing market.²² UNDP, for its part, spearheaded a public–private dialogue to increase the volume and quality of impact investments in Africa.²³ The dialogue formed the basis for the 2015 Cape Town Declaration on Impact Investment in Africa. Through this Declaration, 150 stakeholders committed to supporting and operationalizing the “Impact Investment in Africa Action Plan” and the roadmap to be implemented for the advancement of impact investment.

All these developments at the national and regional levels injected new dynamism into market-based solutions at the global level. The outcome document of the United Nations Summit for the Adoption of the Post-2015 Development Agenda considered “private business activity, investment and innovation” as the linchpin for the successful implementation of Agenda 2030.²⁴ Impact investing was explicitly mentioned in Articles 37 and 42 of the AAAAA:

37. [...] We encourage impact investing, which combines a return on investment with non-financial impacts [...].

42. [...] We also encourage philanthropic donors to consider managing their endowments through impact investment, which considers both profit and non-financial impacts in its investment criteria.²⁵

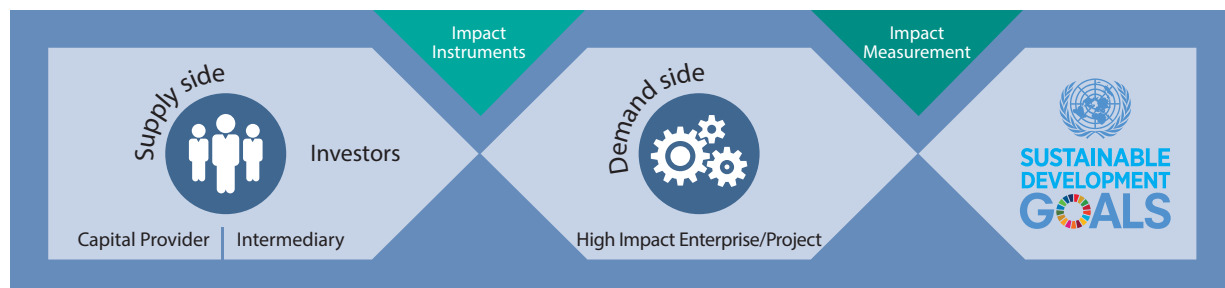
Thus, the impact investing industry is now globally recognized as an effective means of sustainable development finance.

Unfolding Impact Investing

The term “impact investing” acknowledges the private sector as a partner in sustainable development through profitable market-based development investments. Although the term was coined in 2007 to name investments that generate social or environmental impact alongside profit, the practice of “investing for impact” dates back more than two decades.²⁶ Impact investor surveys reveal that 13 percent of 158 impact investors made their first impact investment before 1995.²⁷

Impact investments are distinguished from conventional investments by their **deliberate intention to generate positive social or environmental impact at the outset**, by setting outcome objectives and measuring their achievement. Impact investors go beyond negative screening (i.e. excluding investments in certain companies based on moral or environmental criteria), and actively seek out investments for which there are measurable, positive social and financial returns. The value chain of impact investing is presented in Figure 2.

Figure 2: The Impact Investment Value Chain



Source: UNDP illustration based on Bridges Ventures and African Private Equity and Venture Capital Association (AVCA), 2014.



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Since the introduction of the term, the practice of impact investing has elicited various responses, ranging from enthusiasm to confusion resulting from ever-evolving definitions. The Global Impact Investing Network (GIIN)'s definition of impact investing is the most frequently cited and most widely accepted: "Impact investments are investments made into companies, organizations and funds with the intention to generate social and environmental impact alongside a financial return. Impact investments can be made in both emerging and developed markets, and target a range of returns from below market to market rate, depending upon the circumstances."²⁸

The **proactive** intention to generate social and/or environmental impact is an essential characteristic of impact investing. Investments that coincidentally or unintentionally provide positive social and/or environmental outcomes are not considered to be impact investing. Impact investments can be made across asset classes, including but not limited to cash equivalents, fixed income, venture capital and private equity. Investors expect to generate returns on capital and, at a minimum, a return of capital. Thus, the spectrum of financial-return expectations can range from below-market (sometimes called concessionary) to risk-adjusted market rates (Figure 3).

Figure 3: Impact Investing Return-rate Expectations Spectrum



Source: Etzel, 2015.

Impact investors provide capital to impact-driven organizations and might accept below-market rates for creating positive impact that addresses societal or environmental challenges. These market-based solutions could create impact mainly through providing socially or environmentally beneficial **products or services**, adapting **practices** to increase the participation of disadvantaged populations and operating at **places** to serve the underserved.²⁹ Table 1 provides examples of measurable social or environmental outcomes across key sectors where impact investors deploy finance.









Impact measurement constitutes the hallmark of impact investing as it quantifies the social and environmental benefits that investment generates. When the right method of measurement is employed, it: (i) creates value for all stakeholders in the impact investing ecosystem; (ii) mobilizes additional capital by showcasing aggregate impacts delivered by the investment; and (iii) increases transparency and creates accountability for delivering the social and environmental impact intended at the outset.³⁰

Impact measurement should be a deliberate and well-articulated process in the impact investment cycle, starting with the planning phase and moving through setting goals and establishing a framework with key performance indicators. For this purpose the G8 Social Impact Investment Taskforce has identified a seven-step guide for the impact measurement process (Table 2).

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Table 1: Measurable Social or Environmental Outcomes Across Key Sectors

				
SECTOR	AGRICULTURE	EDUCATION	ENERGY	ENVIRONMENT
DEFINITION	Supply of adequate and appropriate food sources for communities in a manner that is affordable, consistent and appropriate to meet basic human needs. This includes not only food and foodstuffs but sustainable practices that help to ensure land and crops will be able to support future generations.	Provision of affordable, consistent and quality education to all children in a manner appropriate for the local context.	Development and delivery of sustainable energy sources for people and businesses to meet the needs of the present population without compromising the ability of future generations to meet their energy needs. This is usually through renewable energy sources such as solar, geothermal, hydro and wind energy.	Sustainable management of nature and biodiversity. This includes improving environmental performances of enterprises for ensuring ecological sustainability.
EXAMPLES OF MEASURABLE SOCIAL OR ENVIRONMENTAL OUTCOMES	Increase in productivity or crop yield as a result of improved technology or training	Participation rates of girls in secondary education in sub-Saharan Africa	Number of individuals at “the base of the pyramid” (BoP) who gain access to electricity	Tons of CO ² equivalent offset as a result of organization’s product or service
				
SECTOR	FINANCIAL SERVICES	HEALTH	HOUSING	WATER
DEFINITION	Access to financial services that are appropriate for the income level and needs of the client in order to improve economic empowerment and encourage contribution to the formal financial sector through the use of retail or business products and services.	Provision of access to affordable and quality health care, medication and professional medical advice to the population, in an efficient and consistent manner, and according to need, appropriate for local conditions.	Provision of affordable, long-term housing of an appropriate quality and type to accommodate people. This is distinct from short-term shelter used in relief efforts. Housing is highly contextual, based on climate, geography and materials.	Provision of water and sanitation facilities of sufficient quantity and quality to meet minimum standards of living. This includes potable water for consumption and access to water for meeting basic needs.
EXAMPLES OF MEASURABLE SOCIAL OR ENVIRONMENTAL OUTCOMES	Number of micro-insurance products sold to HIV-positive people and people with AIDS	Readmission rate of diabetes patients using innovative products for monitoring health	Reduction in the rate of homelessness in major United States cities	Number of individuals at “the base of the pyramid” who gain access to clean water

Sources: World Economic Forum, 2013, adapted by Istanbul International Center for Private Sector in Development.



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Table 2: The Seven Guidelines of the Impact Measurement Working Group

	Guideline	Description
Plan	Set Goals	Articulate the desired impact of the investments Establish a clear investment thesis/theory of value creation (ToVC) to form the basis of strategic planning and ongoing decision-making and to serve as a reference point for investment performance
	Develop Framework and Select Metrics	Determine metrics to be used for assessing the performance of the investments Develop an effective impact measurement framework that integrates metrics and outlines how specific data are captured and used; use metrics that align with existing standards
Do	Collect and Store Data	Capture and store data in a timely and organized fashion Ensure that the information technology, tools, resources, human capital and methods used to obtain and track data from investees function properly
	Validate Data	Validate data to ensure sufficient quality Verify that impact data are complete and transparent by cross-checking calculations and assumptions against known data sources, where applicable
Assess	Analyse Data	Distil insights from the data collected Review and analyse data to understand how investments are progressing against impact goals
Review	Report Data	Share progress with key stakeholders Distribute impact data coherently, credibly and reliably to effectively inform decisions by all stakeholders
	Make Data-driven Investment Management Decisions	Identify and implement mechanisms to strengthen the rigour of investment process and outcomes Assess stakeholder feedback on reported data and address recommendations to make changes to the investment thesis or ToVC

Source: Social Impact Investment Taskforce, 2014c.



The industry uses various standards, metrics and monitoring tools and approaches that are critical to the measurement of impact. Examples include:

- › Reporting standards, such as the GRI standards³¹ (on sustainability reporting) of the Global Reporting Initiative, and the ESG standards³² (on environmental, social and corporate governance) and SRS standards³³ (on social impact reporting) of the International Finance Corporation (IFC);
- › Impact Reporting and Investment Standards (IRIS), a database of around 600 widely adopted impact reporting metrics, developed by GIIN;
- › The Global Impact Investing Rating Standards (GIIRS), a robust system of rating criteria to assess, benchmark and report data on private companies; modelled on the B Lab's B Impact Rating System and using the standardized metrics of IRIS, GIIRS provides comprehensive ratings of social and environmental performance;³⁴
- › Social return on investment (SROI), a method to assess the social impact of activities, enterprises or interventions and to impute dollar values to the created social changes;³⁵ the aim is to be able to compare the social returns of different investments.

Beyond 2015: An Historic Opportunity for the Private Sector in Development and for Impact Investment

Following the successful Millennium Development Goals (MDGs) experience, the Member States of the United Nations unanimously adopted the 2030 Agenda for Sustainable Development and its 17 SDGs. The SDGs seek “to end extreme poverty in all its forms and to have in place the building blocks of sustained prosperity for all.”³⁶ The SDGs promise to continue where the MDGs left off, but also to go beyond and “leave no one behind”, covering novel areas that are indispensable for addressing the root causes of poverty. Developed through a broad and participatory global consultation process, the SDGs provide a comprehensive and clear set of goals at the global level for the people, planet, prosperity, peace and partnership.




Impact investing emerges as an effective market-based mechanism to contribute to the financial and technical needs of the SDGs. Through impact investing, financiers drive forward innovative go-to-market opportunities to address sustainable development challenges in a transparent, quantifiable and verifiable manner in a variety of sectors, such as affordable housing, agriculture, BoP, community development, education, energy, energy efficiency, environment, environmental markets, financial services, green real estate, health, ICT, microfinance, small and medium-sized enterprise (SMEs), social enterprise, sustainable consumer products, transportation, waste management/recycling, water and sanitation.

Table 3 presents representative examples of impact investment potential in relation to each of the SDGs.







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Table 3: Impact Investment Cases for the Sustainable Development Goals

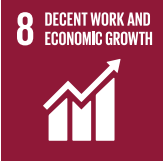

Sustainable Development Goal	Business Theme	Opportunities for Impact Investors
SDG 1  End poverty in all its forms everywhere	Access to financial services Access to land Availability of products and services for those on low incomes Disaster/emergency planning and response Earnings, wages and benefits Economic development in areas of high poverty Economic inclusion Electricity access Physical and economic displacement	In 2011 the United States Small Business Administration launched the Small Business Investment Company (SBIC) Program's Impact Investment Initiative. The initiative provided US\$1 billion over five years to support businesses operating in low-income communities within the country. See: http://icic.org/sbas-latest-approach-incentivizes-impact-investments-underserved-areas/
SDG 2  End hunger, achieve food security and improved nutrition and promote sustainable agriculture	Access to land Changing the productivity of organizations, sectors or the whole economy Food labelling Food safety Genetic diversity of farmed and domesticated animals Healthy and affordable food Indigenous rights Infrastructure investments Physical and economic displacement Sustainable sourcing	In 2010, FONDS de solidarité FTQ, the Government of Quebec and Desjardins Capital established the Investment Fund for Farmers (FIRA) to provide a US\$75 million private fund to support sustainable agriculture and encourage the next generation of farmers in Quebec. The loan programme provides patient capital of up to US\$500,000 in equity, up to US\$250,000 in subordinated debt or 15-year lease agreements on farmland. See: www.rbc.com/community-sustainability/_assets-custom/pdf/Financing-Social-Good.pdf
SDG 3  Ensure healthy lives and promote well-being for all at all ages	Access to medicines Air quality Disaster/emergency planning and response Healthy and affordable food Land remediation Occupational health and safety Responsible content dissemination Spills Waste Water quality	Leapfrog Investments invested in AllLife, a South African life insurance company that offers affordable life insurance to people living with HIV. AllLife clients show an approximately 15 percent improvement in their CD4 count (an immune system marker) within six months of being insured. Apart from having a remarkable social impact, Leapfrog runs a profitable business that has seen 50 percent growth since its establishment in 2004. See: www.leapfroginvest.com/portfolio_company/alllife/






Sustainable Development Goal	Business Theme	Opportunities for Impact Investors
SDG 4  Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all	Accessibility of buildings Education for sustainable development Employee training and education Media literacy	Nesta Impact Investments works to enhance the innovation capacity of the United Kingdom. Nesta has invested £500,000 into GetMyFirstJob, an online platform that helps young people find the right apprenticeship. Over 160,000 young people are registered on the web-based platform, which has managed 8,000 vacancies in 2014. See: www.nesta.org.uk/news/youth-unemployment-rises-nesta-invests-technology-help-more-young-people-find-apprenticeship
SDG 5  Achieve gender equality and empower all women and girls	Economic inclusion Equal remuneration for women and men Gender equality Infrastructure investments Non-discrimination Parental leave Women in leadership Workplace violence and harassment	SNS Impact Investing invests globally for social impact and market-rate financial returns, focusing on microfinance and agriculture. SNS Impact Investing's US\$ 3 million senior loans made in local currency helps Pro Mujer Bolivia (a microfinance institution (MFI) that provides credit services, education and health care to low-income women in Bolivia) to continue to expand its client base. See: https://thegiin.org/knowledge/profile/pro-mujer-bolivia
SDG 6  Ensure availability and sustainable management of water and sanitation for all	Land remediation Spills Sustainable water withdrawals Waste Water efficiency Water quality Water recycling and reuse Water-related ecosystems and biodiversity	WaterCredit is a programme to put microfinance tools to work in the water, sanitation and hygiene sector. WaterCredit provides the world's poor with small loans (around US\$178 each) for building household water connections and toilets. As of March 2016, WaterCredit has provided more than 3.6 million people in nine countries with access to safe water and sanitation; 99 percent of WaterCredit loans are repaid in full. See: http://water.org/solutions/watercredit/
SDG 7  Ensure access to affordable, reliable, sustainable and modern energy for all	Electricity access Electricity availability and reliability Energy efficiency Environmental investments Infrastructure investments Renewable energy	FMO, the Dutch development bank, invests EUR 21.4 million in Clean Energy (CE), a special-purpose vehicle created to fund the construction of Mongolia's first wind farm. The Salkhit Wind Farm will increase access to and the share of renewable energy in Mongolia. It will reduce CO2 emissions by 180 thousand tons and save 1.6 million tons of fresh water and 160 thousand tons of coal every year. See: https://thegiin.org/knowledge/profile/clean-energy



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Sustainable Development Goal	Business Theme	Opportunities for Impact Investors
<p>SDG 8</p>  <p>Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all</p>	<ul style="list-style-type: none"> Abolition of child labour Access to financial services Availability of a skilled workforce Changing the productivity of organizations, sectors or the whole economy Diversity and equal opportunity Earnings, wages and benefits Economic inclusion Economic performance Elimination of forced or compulsory labour Employee training and education Employment Energy efficiency Equal remuneration for women and men Freedom of association and collective bargaining Indirect impact on job creation Jobs supported in the supply chain Labour practices in the supply chain Labour/management relations Materials efficiency Non-discrimination Occupational health and safety Parental leave Resource efficiency of products and services Technological legacies Water efficiency 	<p>Bridge International Academies is a large-scale education innovation company serving the 700 million families who live on less than US\$2 per day. It was established using capital from various investors—Overseas Private Investment Corporation (OPIC), United Kingdom Department for International Development (DFID), LearnCapital, Rethink Education, Omidyar Network and CDC, the United Kingdom’s DFI. The first Bridge International Academy opened in Nairobi, Kenya, in 2009. Bridge International Academies aims to educate 10 million children in a number of countries by 2025. See: www.bridgeinternationalacademies.com/company/about/</p>
<p>SDG 9</p>  <p>Build resilient infrastructure, promote inclusive and sustainable industrialization and foster innovation</p>	<ul style="list-style-type: none"> Access to financial services Environmental investments Infrastructure investments Research and development 	<p>Investisseurs & Partenaires (I&P) is an impact investing group dedicated to supporting the development of responsible and profitable SMEs in Africa. Established in 2002, I&P has supported 50+ companies located in 15 countries and which operate in a variety of sectors. I&P also provides capital, technical and strategic support to the SMEs. Thus, I&P has contributed to the creation of more than 2,600 jobs, as well as to annual growth of 24 percent in the investee companies. See: https://vc4a.com/investisseurs-partenaires/</p>





Sustainable Development Goal	Business Theme	Opportunities for Impact Investors
SDG 10  Reduce inequality within and among countries	Access to financial services Accessibility of buildings Accessibility of events Accessibility of media content Economic development in areas of high poverty Equal remuneration for women and men Foreign direct investment Socially inclusive events Responsible finance	The Departments of Social Development and Health of the Western Cape Province of South Africa committed 25 million rand (US\$1.62 million) to fund three social impact bonds (SIBs) to support maternal health and early childhood development. The implementation of the SIBs was facilitated by the Bertha Centre for Social Innovation and Entrepreneurship at the University of Cape Town, and Social Finance UK. These SIBs will be the first impact bonds in Africa. See: www.brookings.edu/2016/04/06/south-africa-is-the-first-middle-income-country-to-fund-impact-bonds-for-early-childhood-development/
SDG 11  Make cities and human settlements inclusive, safe, resilient and sustainable	Access to affordable housing Access to public spaces Cultural diversity through media content Cultural heritage Disaster/emergency planning and response Infrastructure investments Noise Sustainable buildings Sustainable transportation	Acumen invested US\$1.2 million in Ansaar Management Company (AMC), a low-cost housing development and management company in Pakistan. AMC constructs commercial hubs, schools, recreational facilities and places of worship equipped with utilities such as electricity, water and sewerage systems. Established in 2009, AMC targets low-income populations, who earn 8,000 to 16,000 Pakistani rupees (US\$81 to US\$162) per month and are served inadequately by the public and private sectors. See: http://acumen.org/investment/ansaar-management-company/
SDG 12  Ensure sustainable consumption and production patterns	Air quality Energy efficiency Environmental investments Land remediation Materials efficiency/recycling Procurement practices Product and service information and labelling Resource efficiency of products and services Spills Sustainable sourcing Transport Waste Water efficiency Water quality	InvestEco Sustainable Food Fund invests in companies that operate in the food and agriculture sectors. The companies invested in are selected according to their strategic advantage in the market, such as their brand, distribution channels, supply chain, processing capabilities or patented technologies. The US\$11 million Fund invests in enterprises that supply locally produced or organic agricultural products and technologies that contribute to a more efficient and sustainable agricultural sector and that support agricultural waste management to develop products such as biofuels and biomaterials. See: www.investeco.com



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Sustainable Development Goal	Business Theme	Opportunities for Impact Investors
SDG 13  Take urgent action to combat climate change and its impacts	Energy efficiency Environmental investments GHG emissions Risks and opportunities due to climate change	Yes Bank, one of India's largest banks, issued its first green infrastructure bond in February 2015. US\$161 million worth of funds will be issued for 10 years. The bonds received a AA+ rating and attract high demand from investors. The issue proceeds will be used for funding renewable energy infrastructure projects, such as solar, wind, biomass and hydropower projects. See: www.nrdc.org/sites/default/files/india-financial-market-green-bonds-report.pdf
SDG 14  Conserve and sustainably use the oceans, seas and marine resources for sustainable development	Environmental investments Land remediation Marine biodiversity Ocean acidification Spills Sustainable sourcing Water discharge to oceans	The Cape Cod Fisheries Trust (CCFT) was established in 2005 to support Cape Cod fishers. CCFT buys quota in scallop and ground-fish fleets and leases it to fishers who do not have enough financial resources to be able to purchase quota on their own. The Trust is funded by a combination of grants, loans and programme-related investments (PRIs). To date, CCFT has raised around US\$3 million for quota purchases and now operates a revolving loan fund that helps fishers reinvest in extra quota purchases. See: www.ecologyaction.ca/socialfinance
SDG 15  Protect, restore and promote sustainable use of terrestrial ecosystems, sustainably manage forests, combat desertification, and halt and reverse land degradation, and halt biodiversity loss	Deforestation Environmental investments Forest degradation Genetic diversity of farmed and domesticated animals Land remediation Mountain ecosystems Natural habitat degradation Spills Sustainable sourcing Terrestrial and inland freshwater ecosystems	Planting Empowerment was established in 2006 to grow high-value tropical timber and support smallholder farmers in Panama. The company offers an alternative investment option for accredited individuals seeking an impact investment option in sustainable agroforestry. Planting Empowerment offers accredited individuals the opportunity to earn a 5 percent targeted return, reforest tropical trees in at-risk areas, reduce CO ² emissions, increase food security and provide employment. See: www.plantingempowerment.com



Sustainable Development Goal	Business Theme	Opportunities for Impact Investors
<p>SDG 16</p>  <p>Promote peaceful and inclusive societies for sustainable development, provide access to justice for all and build effective, accountable and inclusive institutions at all levels</p>	<ul style="list-style-type: none"> Abolition of child labour Anti-corruption Compliance with laws and regulations Effective, accountable and transparent governance Ethical and lawful behaviour Freedom of expression Grievance mechanisms Inclusive decision-making Non-discrimination Public access to information Protection of privacy Responsible content dissemination Security Workplace violence and harassment 	<p>Acumen invested US\$1.15 million in Cacao de Colombia, a Colombia-based producer and marketer of premium chocolate that sources its cocoa beans from local farmers in post-conflict areas at fair prices. Cacao de Colombia works to transform the Colombian cocoa value chain into a competitive one. The company connects local producers of quality cocoa beans to the international chocolate market by working closely with local growers and cooperatives. Over the next five years, Cacao de Colombia expects to support between 1,000 and 1,300 smallholder farmers by increasing their incomes by 56 percent to 82 percent. See: http://acumen.org/investment/cacao-de-colombia/</p>
<p>SDG 17</p>  <p>Strengthen the means of implementation and revitalize the global partnership for sustainable development</p>	<ul style="list-style-type: none"> Environmental investments Foreign direct investment 	<p>Axa's Impact Investment Initiative established a US\$208 million fund of funds—a portfolio of investment funds—to create large-scale positive social impact. The fund of funds expects a 4 percent to 8 percent rate of return. The majority of the funds will go into the microfinance sector, private equity funds and structured bond funds. Of these investments, 70 percent will be in the developing world. See: www.theguardian.com/sustainable-business/axa-fund-socially-responsible-investment</p>

Sources: *SDG Compass* (<http://sdgcompass.org>); case studies drawn from the websites of impact investors.

The 2030 Agenda for Sustainable Development has set clear, global priorities for people and the planet, and showed the pathway for creating a more peaceful, inclusive and sustainable world. However, realizing our pledge to achieve the SDGs within a generation requires effective deployment of all sources of development finance in support of this Agenda. Through innovative financing mechanisms such as impact investing, the private sector can help tackle poverty, hunger, unemployment and climate change while still making a profit. The more investors consider impact investing as a viable and appealing investment approach, the faster the impact investing sector will thrive and reach considerable scale.³⁷ Realizing the SDGs represents an historic opportunity to demonstrate the relevance and usefulness of private sector market-based solutions for development and to bring together a wider coalition of parties whose aims converge.





Chapter 2

The Universe of Impact Investing

This chapter delineates the size, instruments and sectoral spread of impact investors. Understanding the actors in the impact investing ecosystem will help development practitioners formulate appropriate strategies and tools to expand the scale and scope of impact investing. As the market expands, the efforts of enabling-environment actors to establish investment conditions that favour impact capital are bearing fruit. The chapter describes the main players on both the supply side (asset owners and managers) and the demand side (impact-driven ventures and buyers) of the market. The market is growing rapidly and over 70 percent of the investments are in developing countries. Forms of finance span the conventional horizon of investment vehicles, though they are concentrated in private debt and equity instruments. Asset owners are predominantly retail investors, especially individuals and family investors with high net worth. Fund managers account for over half of the financing. Institutional investors, foundations and banks remain small players, but interest from these sectors is growing.



The large and complex universe of impact investing houses a spectrum of investors and socially responsible businesses. The major components of the continuum represented by impact investors and impact businesses are outlined in Table 4. On one end of the spectrum are conventional, purely profit-maximizing businesses and investors and on the other are purely charitable and humanitarian-oriented organizations. Within this spectrum, impact investors can be located in one of two groups according to their priorities: finance-first investors (also known as commercial investors or thematic investors) and impact-first investors. Commercial investors aim to create measurable social and environmental impact with competitive financial return expectations. Impact-first investors prioritize social or environmental outcomes and could accept concessionary returns on investment.

Table 4: The Spectrum of Investment

	Financial-only Investment	Responsible Investment	Sustainable Investment	Impact Investing		Philanthropy
Investor Profile	Financial Investors: Pure Profit Seeking	Financial Investors: Socially Responsible	Financial Investors: Following ESG	Impact Investors: "Finance First"	Impact Investors: "Impact First"	Charitable Donors
Aim of Investment	Greatest return possible	Highest financial return with screens eliminating harmful practices	Profit oriented, with responsible and integrated business practices	High to moderate financial return, while creating high social impact	Low to very low financial return, while creating the highest impact possible	Humanitarian interests with no expectation of financial return
Investor Philosophy	Limited or no regard for environmental, social and governance practices	Mitigate risky environmental, social and governance practices in order to protect value	Adopt progressive environmental, social and governance (ESG) practices that may enhance value	Address societal challenges that generate competitive financial returns	Address societal challenges that generate below-market financial returns	Address societal challenge(s) that do not generate financial returns
Investor Example	Vanguard NYSE Indexed funds	Fidelity International	Trillium Asset Management	LeapFrog Investments	Triple Jump	Mercy Corps
Enterprise Profile	Conventional Business	Companies focused on corporate social responsibility (CSR)	Companies focused on shared value	Businesses seeking impact and profit-with-purpose businesses	Profit-with-purpose businesses and social enterprises	Conventional charities
Enterprise Philosophy	Profit maximizing	Profit maximizing while doing no harm	Profit maximizing while creating some positive impact	Creating positive social impact while also generating profit	Social mission embedded in business model	Serve humanitarian and environmental goals
Enterprise Example	Boeing Aircraft	Apple Computers	Body Shop	Patagonia Outdoor Outfitters	Grameen Bank	Red Cross/ Red Crescent

Source: Social Impact Investment Taskforce, 2014a.

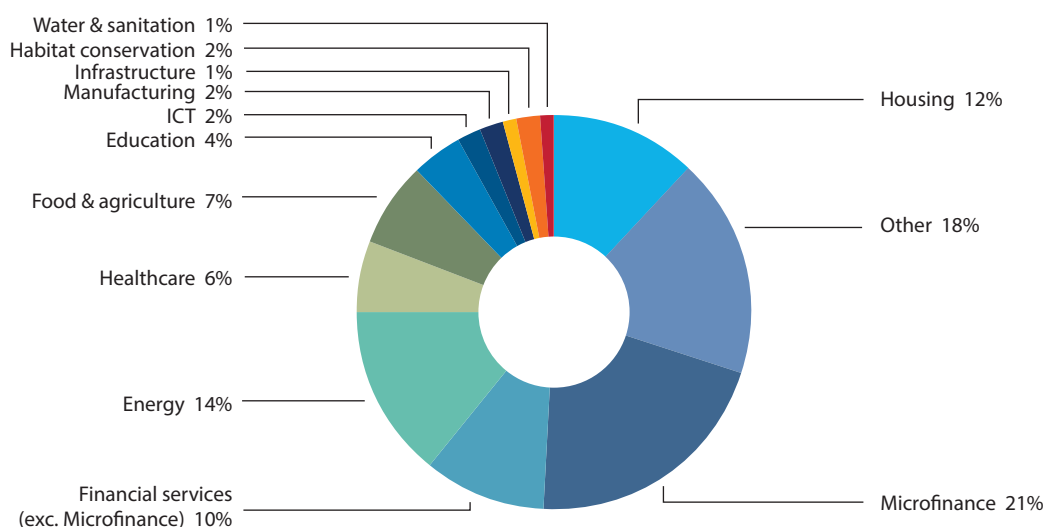


The Impact Investing Ecosystem

Impact investing is a subset of the responsible investment sector and differs from the rest by virtue of its clear focus on diligent impact measurement. It is hard to quantify the market size of the impact investing industry due to broad conceptualizations. In 2015 the 1,380 signatories to the six United Nations Principles for Responsible Investment (UNPRI) managed combined assets worth US\$59 trillion.³⁸ The annual impact investing survey of JPMorgan Chase and GIIN stated that 156 surveyed investors managed a total of US\$77.4 billion assets in impact investments in 2016.³⁹ Considering the size of the responsible investments and the growth potential of various forms of impact investments, the G8 Social Impact Investment Taskforce considers that the market could reach US\$1 trillion in total assets with the right policies.⁴⁰

According to the JPMorgan Chase and GIIN survey, 73 percent of the impact investments are in developing countries. Microfinance, a sector key for the SDGs, accounts for 21 percent of AUM; 14 percent is allocated to energy, 12 percent to housing and 10 percent to financial services excluding microfinance (Figure 4).

Figure 4: Impact Investments by Sector, 2015



Source: Mudaliar, Schiff and Bass, 2016.

The actors involved in the global impact investing ecosystem resemble conventional investors and participate in both investing arenas. The funds from conventional or impact sources flow to high-impact enterprises through impact investing instruments. Figure 5 presents a representative description of the impact investing ecosystem and examples of the major actors.⁴¹



Figure 5: The Impact Investing Ecosystem

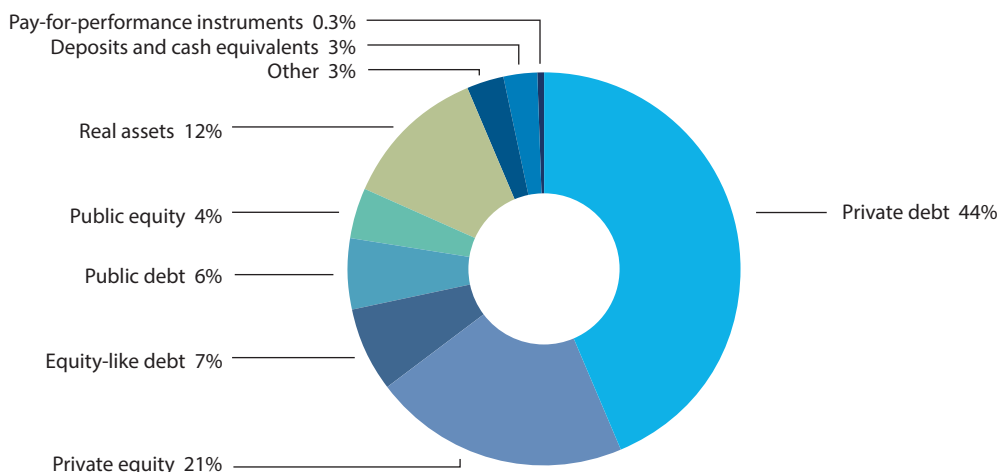


Source: UNDP illustration based on Social Impact Investment Taskforce, 2014b.

Forms of Finance

Forms of finance are the capital or funds available to impact-driven organizations. These encompass traditional financing tools such as money-market mechanisms, debt financing, guarantees and equity and quasi-equity instruments. Among the investors, the preferred forms of finance are private debt and private equity, which account for 44 percent and 21 percent of assets respectively (Figure 6).

Figure 6: Impact Investments by Instrument, 2015



Source: Mudaliar, Schiff and Bass, 2016.



Bonds: Among debt instruments, bonds are becoming increasingly popular in impact investing, providing investors with relatively risk-free, long-term annuities or investments. Bonds are central to diversifying an investment portfolio away from equities, short-term investments or higher risk investments. As impact funds continue to dominate the markets, fund managers are looking for more bond options that qualify as having “impact”, to balance portfolio composition and risk profiles.

“Green bonds”, or bonds backed by underlying assets in renewable energy or for brownfield projects, are proliferating. US\$41.8 billion worth of green bonds were issued in 2015.⁴² Increasingly, corporations and banks are issuing self-proclaimed “green” bonds, which are making a significant contribution to this rapidly growing market.⁴³

Social impact bonds (SIBs) are among the most recent types of impact investment. Currently accounting for only 1 percent of assets, they are promising investment tools. SIBs are multi-stakeholder partnerships in which governments work with the private sector and philanthropists to fund social programmes addressing pressing challenges. The government pays the investors on a “pay-for-success” basis (i.e. when the social programme achieves intended goals and targets). Social programmes funded through SIBs by and large focus on preventive interventions to alleviate poverty.⁴⁴ Currently, SIBs operate in the Australian, United Kingdom and United States markets.

Development impact bonds (DIBs) are results-based development financing instruments. They are modelled on SIBs but, unlike SIBs, involve donor agencies, either as the single funder or shared funders of outcomes together with government agencies.

Supply-side Actors

Asset Owners

Asset owners are the real persons or entities that own benefit from, or have use of, valuable income and impact-generating instruments. They provide the capital necessary for impact-driven organizations (i.e. impact enterprises). The impact investor survey respondent sample⁴⁵ shows that, in 2015, 58 percent of impact investment AUM came from fund managers, followed by development finance institutions (DFIs) and diversified financial institutions/banks.⁴⁶

The sample highlights that a variety of persons or entities can participate in impact investments, including retail investors, foundations, institutional investors, banks and diversified financial institutions, HNWIs and family offices, and sovereign wealth funds (SWFs).

Retail investors can also engage in impact investing through mechanisms such as crowdfunding, charity bonds, local cooperatives, social banks or impact investment funds. For example, the microfinance platform Kiva, which gives microfinance loans to individuals, has more than 1.2 million lenders worldwide. Oikocredit, a worldwide cooperative and social investor that invests in fair trade, microfinance and agriculture in more than 60 countries, has 52,000 investors from more than 20 countries.⁴⁷

Foundations are natural candidates for impact investing; however, they are relatively small players in impact investment in terms of AUM, representing only 4 percent of the

US\$77.4 billion of assets in impact investments in 2016. Although their impact investments are relatively small, foundations can support impact enterprises by supporting “capital-starved social businesses with strong growth prospects” but which have little prospect of producing market-rate returns in the near future.⁴⁸



Increasingly, foundations are deploying capital into social investment mechanisms such as mission-related investments (MRIs), programme-related investments (PRIs) and donor-advised funds (DAFs) to achieve their long term philanthropic goals:

- MRIs combine the core social and/or environmental mission of the foundation with a market-rate investment strategy, so that the foundation can guarantee long-term financial resources to sustain charitable investments. As MRIs are essentially pure financial investments, they aim to achieve market-rate returns with the endowment funds of foundations.⁴⁹
- PRIs provide capital, at a subsidized rate, usually for more innovative initiatives that are aligned with the mission of the foundation. PRIs are potentially financially self-sustainable.⁵⁰
- A DAF, on the other hand, is an investment or charitable giving vehicle that a donor can create by depositing either cash, securities or other financial instruments and then distributing the money to foundations over time.⁵¹ By investing in a DAF, the donor surrenders ownership of the financial instrument invested in the fund but retains control over how the account will be invested and how the money will be distributed to charities.

Institutional investors such as pension funds and insurance companies are relatively less active impact investors because of their legal duty to manage risks and fulfil their corporate liabilities towards their own investors. Fiduciary responsibility (societal duty to maximize people’s future pensions) emerges as a barrier for institutional investors to further engage in impact investments due to the perception that such investments cannot deliver appropriate risk-adjusted financial returns, unlike conventional investments.⁵²

Banks and diversified financial institutions also remain small players in terms of the frequency distributions of active impact investors. Only 6 percent of the investors involved in impact investing are banks and diversified financial institutions, and 9 percent of the total capital is invested by these institutions.⁵³ Nevertheless, there are promising examples from the sector, such as JPMorgan Chase, Morgan Stanley, BNP Paribas and Citigroup. BNP Paribas, a Paris-based bank, for example, is financing microfinance institutions (MFIs) and social businesses in Europe, Africa, South America and Asia. The bank currently invests €360 million in social businesses in France and neighbouring countries such as Belgium. In Asia, Africa and South America it engages in strategic partnerships with other institutions to create positive impact. The New York-based Citigroup is active in the agriculture sector, where it finances big corporate farmers employing local farmers.⁵⁴

High-net-worth individuals (HNWIs) and family offices are key players in the impact investment sector. With their ability to move funds quickly with relatively short due diligence processes—unlike institutional investors or foundations—these groups have the freedom to manage risk and returns in creative ways, by investing in new ideas and technology and in alternative assets that provide low correlations with traditional markets.⁵⁵

Sovereign wealth funds (SWFs) are pools of assets owned and managed directly or indirectly by governments to achieve national objectives.⁵⁶ As of 2013, only 2 percent of the US\$5 trillion worth of SWF assets had been invested in sustainable development projects. However, in the future, SWFs are expected to be one of the most important sources of long-term finance, along with pension funds and DFIs.⁵⁷



Asset Managers

Asset-managing real persons or entities connect impact investors to impact enterprises. They invest on behalf of the investors and help them access impact investment offerings. Fund managers are the dominant group in impact investment in terms of numbers as well as value of assets managed.

Impact investment funds have emerged as a critical tool for fund managers that enables them to assist asset owners to invest in impact enterprises in specific target sectors or places, or with specific return expectations

Table 5: Impact Investment Activities of the Major Development Finance Institutions

DFI	Investment Vehicles	Sector/Social Priorities
Asian Development Bank	Equity, loans	Education, environmental sustainability, healthcare services, infrastructure (roads, clean water, electricity)
CDC	Equity, loans	Communications, education, energy, health, infrastructure, job creation
European Investment Bank	Bonds, equity, guarantees, loans, microfinance	Environmental sustainability, job creation, infrastructure, SME development, sustainable energy
FMO, the Dutch Development Bank	Capital market transactions, loans, guarantees, mezzanine financing, private equity (fund of funds)	Energy, agribusiness, entrepreneurship, food and water
IDB	Loans (and loan syndications), partial credit guarantees, private equity funds, venture capital funds	Innovation and productivity, finance for micro, small and medium-sized enterprises (MSMEs), sustainable infrastructure (renewable energy, energy efficiency, green technology)
IFC	Equity finance (direct and fund of funds), loans, local currency and financing, risk management products, structured finance, syndicated loans, trade finance	Environmental and social sustainability, infrastructure (water, health, education, food supply chain), developing financial markets focusing on MSMEs and SMEs, assisting cross-border growth of firms in developing countries
KfW Development Bank	Loans, equity investments	Education, environmental and climate protection, financial sector development, health, water sector (water supply/ sanitation and waste management)
Norfund	Equity investments, loans	Agribusiness, greenfield projects, financial institutions, renewable energy, SMEs
Obviam	Private equity	SMEs in emerging and frontier markets
OPIC	Direct loans, guarantees, political risk insurance, senior debt into equity, debt and hybrid funds	Agriculture, clean and renewable energy, critical natural resources (agriculture, water, food security), education, financial services, health, housing for the poor

Source: Garmendia and Olzswewki, 2014.



and in specific institutional contexts.⁵⁸ The Mauritius-based LeapFrog Investments, for example, is among the world's largest impact investment funds, investing in financial services companies across Asia and Africa.⁵⁹ Mumbai-based Aavishkaar India Micro Venture Capital Fund, on the other hand, provides micro-equity funding to commercially viable grassroots impact enterprises to facilitate business linkages between rural entrepreneurs and urban markets.⁶⁰ With its US\$3 billion portfolio, ResponsAbility is another fund manager that supplies debt and equity financing to more than 500 firms in 90 countries to drive economic development.

Impact investment funds of funds (umbrella funds that fund impact investment funds) have also emerged in recent years in response to the demands of larger institutional investors, thanks to their relative size and opportunity for diversification. For example, in 2013 the European Investment Fund (EIF), launched the Social Impact Accelerator (SIA) as a fund of funds, which aims to mobilize an initial amount of €60 million of capital for investment in social impact funds.⁶¹

Development finance institutions (DFIs) are also among the leading impact investors. DFIs are involved in “additionality” (i.e. engagement in regions, sectors or segments that are challenging for the private sector due to high risk and a weak or missing institutional framework to enforce financing arrangements).⁶² DFIs engage in frontier, fragile and conflict markets through syndicated loans, asset management products such as equity and debt instruments, technical assistance and public–private cofinancing.⁶³ DFIs also develop impact funds to support private enterprise development.⁶⁴

Table 5 provides a snapshot of the overall investment activities of the major DFIs that formally use the term “impact investing”.

Crowdfunding platforms aggregate small amounts of capital from a large number of people and place it into a particular venture or idea that requires funding.⁶⁵ Crowdfunding can take the form of debt, equity, charitable contributions or performance-driven investing. Not all crowdfunding investments yield interest or provide a guaranteed rate of return over the money deployed.

Demand-side Actors

Impact-driven Organizations

Impact-driven organizations are individuals or corporate entities that need to create a return on investment in financial terms and have a positive measurable impact on the beneficiaries. Impact-driven organizations range from charities and non-profit organizations to social and solidarity enterprises, profit-with-purpose businesses and businesses seeking impact.

Social and solidarity enterprises cover enterprises whose primary objective is not the maximization of return, but pursuing economic and social aims and fostering solidarity, empowerment and local development. Cooperatives are a prominent example of social and solidarity enterprises.⁶⁶ **Profit-with-purpose businesses**, on the other hand, embed social mission into their core business model and governance structures.

Businesses seeking impact are businesses that maintain social outcomes as ancillary to their business models and governance structures.⁶⁷

A classification of impact-driven businesses according to their stage of maturity, using data from the 2016 impact investment survey of JPMorgan Chase and GIIN, reveals that most of the capital managed today goes to companies at the growth stage. Only 7 percent of the funds go to the seed/start-up phase and 12 percent goes to business ventures. This finding resonates well with how impact investors approach financial returns from investments. More than half the respondents surveyed in 2016 targeted “risk-adjusted, market rate



returns". Only 16 percent expected financial returns to be limited to preservation of the value of the initial investment with no gain or loss.⁶⁸

Impact-seeking Purchasers

Impact-seeking purchasers include individual and corporate actors such as socially minded individuals, governments, firms or foundations. These actors are purchasers of choice that deliberately choose to buy the goods and services developed by impact enterprises.

Enabling-environment Actors

This group is composed of real persons or entities that establish the favourable conditions to attract impact capital. It encompasses: professional networks such as the Aspen Network of Development Entrepreneurs (ANDE) or GIIN; rating and certification organizations such as GIIRS or B Lab; foundations such as Rockefeller Philanthropy Advisors and Skoll Foundation; actors that help develop the infrastructure of the sector, such as impact evaluation standards, information, legislation, advocacy and capacity-development, and consulting firms for business development and investment support; accelerators and incubators such as UNDP or Echoing Green; government-led programmes such as the Global Social Impact Investment Steering Group, the successor of the G8 Social Impact Investment Taskforce; research institutions such as the Morgan Stanley Institute for Sustainable Investing; and exchanges and platforms such as the Social Stock Exchange in the United Kingdom.

This chapter has surveyed the fast-evolving and increasingly sophisticated universe of impact investing, showing how the concept runs through and can be adapted by more traditional financing vehicles. With its dynamic actors, rich set of instruments and committed resources, the impact investing universe reveals itself as a firm enabler of the SDGs. Aligned with United Nations General Assembly decisions and its mandate, UNDP will support the enabling environment for impact investment and will mainstream impact investing across continents, sectors and industries. The next chapter turns to the principles—congruent with those of impact investing—that underlie Islamic financing.





Chapter 3

Towards More Ethical Financial Markets: The Essence of Islamic Finance

This chapter describes the ethical values and principles, based on the shariah framework, that underpin Islamic financing. Understanding these, and appreciating the variety and flexibility of Islamic financing forms, underlines their relevance to and congruence with development objectives, especially with respect to providing finance for the SME sector. Islamic financing activities share four main features: they are asset backed, ethical, participatory and subject to good governance. As such, they are well aligned with the tenets of the 2030 Agenda for Sustainable Development: inclusiveness, equitable and participatory growth, social and distributive justice, open and accountable institutions and sustainability. This chapter offers a brief introduction to the principles of Islamic finance and defines basic terms and concepts.



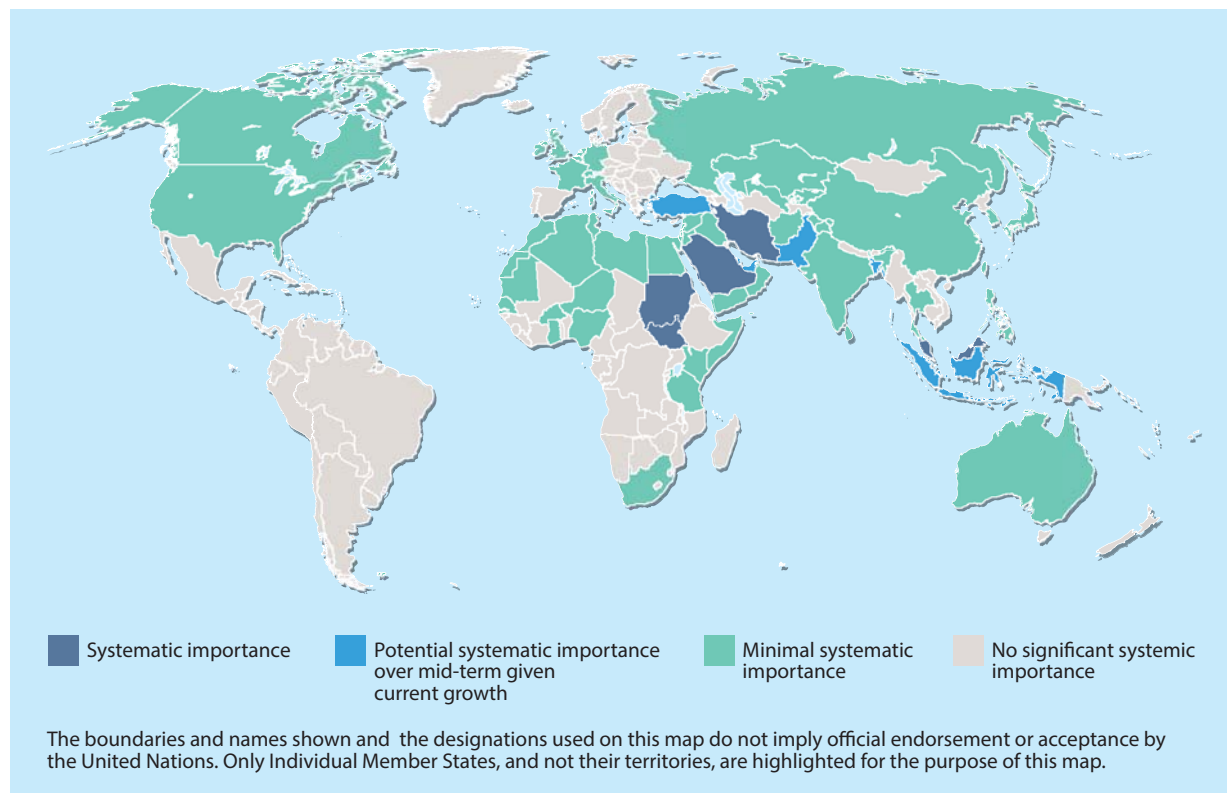
Towards More Ethical Financial Markets: The Essence of Islamic Finance

The Islamic financial system is based on moral principles and backed by the value-based legal framework of Islam (shariah) to guide the behaviour of the economic agent. Islamic finance balances rewards and risks and links finance with the real economy. As a system, it helps to stimulate economic activity and entrepreneurship while addressing poverty and inequality, ensures financial and social stability and promotes comprehensive human development and fairness. In addition, the Islamic finance industry has become more prominent because of its resilience to the 2008 global financial crisis and because of increased demand for Islamic financial products and services.⁶⁹

The market for Islamic financial services has grown from US\$200 billion in 2003⁷⁰ to an expected US\$2.7 trillion in 2021, making it one of the fastest growing segments of the global financial industry.⁷¹ Its global assets are expected to surpass US\$3 trillion by 2020. This fast growth stems from the demand from large and relatively unbanked Muslim populations who are ready to deposit money or invest in shariah-compliant banks and financial products.⁷² The Islamic finance industry is seen to have its roots in the introduction of Islamic banking in the mid-1970s,⁷³ since which time it has gone through “a four-stage evolution”.⁷⁴

The growth and resilience of the Islamic finance industry has been gaining attention in new geographical areas, especially in recent years. The industry is well established in Asia and the Middle East and has demonstrated growth potential in South America and Europe. North America, Central Asia and Australia also offer prospective markets for the Islamic financial services industry in the coming years (see map).

Map: The Global Kaleidoscope of Islamic Finance



Source: IFSB, 2015.







Main Features of Islamic Finance

The values and principles embraced by Islamic finance are universal in nature and their origins go back in time to even before the advent of Islam. These values are shared not only by all the Abrahamic faiths but also by other religions. Their adoption and implementation contribute towards the formation of a sustainable society based on honesty, equitable wealth distribution and social justice.

The sustainability and viability of Islamic finance relies on the implementation of some basic principles of shariah. Islamic transactions should strictly adhere to the permissible (*ḥalāl*) and abstain from the prohibited (*ḥarām*). The term *ḥalāl* encompasses everything that is good for the community and does not cause harm, whereas the term *ḥarām* encompasses everything that promotes or leads to harm and is not good for the community.

All permissible Islamic financial activities share four main features: they are asset backed, ethical, participatory and subject to good governance (Table 6).

Table 6: Main Features of Islamic Finance

 ASSET BACKED	 ETHICAL	 PARTICIPATORY	 GOOD GOVERNANCE
Transactions are supported by real assets and services	Avoidance of unethical and immoral activities (harmful commodities)	Transparency regarding risks and profit-sharing	Promotes greater transparency and disclosure
Contributes directly to the growth of real economy	Avoidance of interest-based transactions	Transactions based on different contractual relationships	Leads to accountability and responsibility
Promotes financial stability	Avoidance of gambling and excessive speculation	Promotes entrepreneurship	Promotes the well-being of society
Contributes to sustainable development	Promotes equity, justice and fairness	Equity-based and risk-sharing transactions	Avoidance of uncertainty and ambiguity

Asset backed: The Islamic financial system highlights the need for finance to be tightly integrated with real economic activities. In Islamic finance, transactions must be backed by real assets. Islamic investments aim to generate “profit” instead of “interest”. Money may be used to earn profit through three different kinds of activities: trading, leasing and profit-and loss-sharing. Those who engage in financial transactions need to produce and exchange goods and services, or provide services by way of the sale of goods, their usufruct⁷⁵ or their expertise, in order to generate profit.⁷⁶ As a result, Islamic finance establishes a strong link between financial transactions and productive flows. Islamic financial assets are expected to grow in tandem with the growth of economic activities that money is deployed in.⁷⁷ The asset-based nature of Islamic finance ensures that debt creation stems from productive activities and cannot grow beyond real assets.⁷⁸

Ethical: Islam is very much concerned with the impact of financial activity on society. Islamic investments should pass diligent screening processes where permissibility and compliance with social and ethical



Towards More Ethical Financial Markets: The Essence of Islamic Finance

responsibilities are verified in accordance with the basic principles of Islamic finance (see Box 1). Anything that contradicts these principles or anything which is potentially harmful to society needs to be avoided.

Participatory: The key principle for the development of any Islamic enterprise rests on the basis of profit-and-loss-sharing. Islam does not allow the charging of interest on loans, but is concerned with the successful outcome of a given concern or enterprise, whereas, in conventional finance, interest-bearing loans are common and the lender is not directly involved in the outcome of the enterprise (i.e. loans must be repaid irrespective of outcomes). The main proposition of Islamic finance is that the return to capital is determined after the investment period is concluded (ex post) and should be based on the return on the economic activity in which the capital was employed. In Islamic finance, financiers are not creditors in the conventional sense; they are investors. Sharing risks and rewards in order to be entitled to profit spurs entrepreneurship, economic development, fairness and social justice.⁷⁹

Good governance: The principles espoused by Islamic finance aim to contribute towards a sustainable society that is based on strong economic fundamentals and moral values. The ultimate objective of the Islamic financial system is to balance market incentives (shareholders' value maximization) with social objectives (fulfilling social responsibilities). This invokes the spirit of *takāful al-ijtimai* (mutual social responsibility), which includes all material and moral aspects of life that are implicit in the *maqāṣid al-sharī'ah* (the objectives of shariah).⁸⁰ Mutual social responsibility calls for caring for public as well as private interests and keeping others from evil and harm so that everyone realizes that they have mutual obligations.

In establishing the right balance in a given Muslim society, Islam prescribes that social gains have priority over private benefits. It takes an emphatic stance towards avoidance of harm, doing good to others and promotion and encouragement of social cooperation. This is a key economic policy imperative with critical consequences for the practice of any economic activity that is not considered as sustainable and hence may adversely affect the environment. Justice is upheld in the shariah by rejecting any forms of exploitation but at the same time enabling a conducive business environment that promotes basic needs fulfilment for the needy while simultaneously protecting social cohesion for all (*maṣlaḥah*).

Islamic finance seeks to create transparent and free markets, commercial fairness and ethical business as basic standards of economic activities. People are encouraged to compete in business, work hard for economic gain that should accrue to them and own private property. However, it is also widely recognized in Islam that the economic and psychological pressure of poverty may induce some individuals to seek unethical means of earning an income. Therefore, for those for whom there is no work and for those who cannot work, society must provide the minimum required for a dignified life: shelter, food, health care and education.

Finally, Islam advocates promoting social trust, cooperation and solidarity; seeks a balance between the rights of individuals, society and the state; and strongly prohibits encroachment on anyone's property rights. Islam upholds contractual obligations and the disclosure of information as a sacred duty. Therefore, it requires that contracts be clear on their subject matters, dates and price to eliminate any uncertainty or ambiguity.⁸¹

As briefly discussed in this chapter, the values and principles embedded in Islamic finance are consonant with the new development vision. Islamic finance embodies the main tenets of the 2030 Agenda for Sustainable Development: inclusiveness, equitable and participatory growth, social and distributive justice, open and accountable institutions and sustainability. Islamic investments count on private business activity, productivity, entrepreneurship and employment, all of which are needed to ensure the necessary financial and technical support to achieve the Agenda for Sustainable Development. This creates an opportunity to unleash the potential of Islamic finance in support of the Agenda.



Box 1: Shariah Principles



The following are the main shariah principles that govern Islamic finance:

Money alone has no inherent value: Islamic finance is very much concerned with the promotion of the production of useful goods and services and also with the exchange of these goods among members of society. In doing so, Islamic finance aims at promoting equity and discouraging debt. Money has no value on its own and cannot be a commodity with value to be bought or sold. Money is only permitted to be exchanged for the production of new goods/services, for the procurement of finished goods/services or for acquiring assets and services. Money is not permitted to be exchanged for its own sake without being backed up by an equivalent value of goods (through the flow of the production of goods and services, i.e. money is only a medium to command goods). One of the most important characteristics of Islamic finance is that it is an asset-backed type of financing, whereas the conventional financing system predominately deals in short-term debt-based financial instruments detached from the real flow of goods or assets in the physical economy. This is why money in Islam has no intrinsic utility as it is only to be used as a medium of exchange for the creation, sale or lease of *ḥalāl* goods and services that generate income and employment. Money increases or decreases in value only when joined with other resources for the purposes of productive activities. Money that is not backed by other assets, therefore, cannot increase in value over time; profits or losses cannot be had due to the time value of money.

Prohibition of usury/interest-based transactions (*ribā*): The word *ribā* in Arabic means “in excess of” or “a surplus” or “in addition to”, which in shariah implies a compensation without any due justification or reasonable consideration. In Islamic finance, any return on money deployed should be linked to profit from production. As shariah considers money to be a measuring tool for value and not an asset in itself, it requires that one should not receive income from the money invested (or anything that has the genus of money) alone. Thus, interest payments are prohibited, as they constitute *ribā*. The implication for Islamic financial institutions is that the trading and selling of debts, receivables (for anything other than their face value), conventional loan lending and types of credit are not permitted.

Prohibition of ambiguity in transactions (*gharar*): *Gharar* refers to elements in a contract that intend to deceive, cheat or cause uncertainty. In order to protect the rights of parties engaging in a contract, shariah forbids any sale transaction contract that contains elements that are uncertain and ambiguous and may ultimately lead to dispute between the contracting parties.

Prohibition of gambling and excessive speculation (*maysir*): Speculation refers to actions whereby an individual engages in excessive risk-taking and expects a windfall gain based on chance. This is similar to gambling, where no productive activity is involved and a person makes gains at the expense of others. There is merely a transfer of wealth from one party to another without any counterpart involved. This is considered to be immoral and does not benefit society.

Prohibition on dealing with harmful commodities (*ḥarām*): One of the aims of the shariah is to promote a society in which people are of sound mind, sound body and sound morals. Anything that



Towards More Ethical Financial Markets: The Essence of Islamic Finance



is potentially harmful to society is to be avoided. Examples are intoxicants, alcohol, pornography and weapons, among others.

Zakāt (2.5 percent mandatory welfare tax): Islamic finance considers the ownership of private property as constituting a sacred right to be protected and safeguarded at all times, provided the responsibility towards vulnerable and weak members of society is regularly upheld and the rightful dues accrued to the poor segment are adequately distributed. Islamic finance obligates the *zakāt*, a monetary contribution taken from the rich and given to the poor that encourages cooperation, fair dealings, transparency and spending on others.







Chapter 4

The Universe of Islamic Financial Markets

This chapter details the financial ecosystem within which Islamic finance aims to stimulate economic activity and entrepreneurship towards addressing poverty and inequality, to contribute to financial and social stability and to promote comprehensive human development and fairness, all of which are integral to the SDGs. It also surveys the horizon of Islamic finances in terms of instruments, actors and institutional regulation and support. It presents the various forms of Islamic contract—transactional and equity based, and fee or commission based. The still nascent but rapidly growing Islamic financial market is dominated by Islamic banking. Malaysia, Saudi Arabia and Iran predominate, but Islamic banking is spreading worldwide. Islamic bonds (ṣukūk) are the most common debt instrument, both domestic and international. Islamic funds are growing but they are concentrated among retail investors. As with impact investing, HNWI are key actors. The IDB Group is the preeminent Islamic DFI. The chapter ends by outlining challenges to the further development of Islamic financing.



The universe of Islamic investing is still nascent in many respects, but is becoming more mainstream, with many global banks developing subsidiaries or windows for Islamic financing. Islamic financing was previously restricted to retail banking services but it is now evolving into a financial industry with comprehensive services and products.

Islamic investments have to comply with the following general obligations:

- Only shariah-compliant investments are permitted.
- Industry and financial screening must be performed to ensure compliance with shariah.
- A shariah board or shariah advisor with at least one recognized shariah scholar should be appointed to monitor compliance.
- Regular shariah audits or reviews must be conducted either by the shariah board, the shariah advisor or an external specialized and recognized third party.
- In the event that non-shariah-compliant income is received by the investment, it must be purified by being donated to charitable institutions.
- In no event, not even in the case of failed trade and/or late payments, can interest be charged.

Key Structures for Financial Transactions: Islamic Contracts

All Islamic finance products are contract based. Contracts aim to reduce the risk of asymmetric information and moral hazard and guarantee that the terms and rights of the investor and the investee are protected in conformity with Islamic principles. Islamic contracts may be classified into three broad categories: transactional (debt-like), equity (profit-and-loss-sharing) and support contracts (Table 7).⁸²

Table 7: Types of Islamic Contract



TRANSACTIONAL CONTRACTS	EQUITY CONTRACTS	SUPPORT CONTRACTS
Murābahah (cost-plus sale)	Muḍārabah (trust-partnership)	Wakālah (agency)
Bay' bi al-thaman al-ājil/ bay' mu'ajjal (deferred-payment sale)	Mushārahah (joint venture)	Wadī'ah (custody)
Ijārah (leasing)	Muzāra'ah (output-sharing)	Kafālah (guarantee)
Istiṣnā' (manufacture sale)		

Source: Islamic Research and Training Institute, adapted by Istanbul International Center for Private Sector in Development.



Box 2: Islamic Contracts



Transactional Contracts

Transactional contracts are debt-like contracts. Such contracts are generally used for credit financing, renting assets and funding manufacturing projects.⁸³

Murābahah (cost-plus financing) is the most widely offered shariah-compliant contract, and is predominantly used in trade financing. It is an asset-based debt structure used to finance goods needed as working capital, structured as a cost-plus market sales contract. In *murābahah* contracts the financier buys the asset on behalf of the debtor and resells the product with an agreed mark-up to the debtor, which will be paid in instalments.⁸⁴ It is not a loan but a sale. The ownership of the assets will instantly be transferred to the buyer (debtor) the moment the transaction takes place. It is not permissible to stipulate that ownership of the item will not be transferred to the customer until the full payment of the selling price.⁸⁵

Bay' bi al-thaman al-ājil or bay' mu'ajjal (deferred-payment sale) is a sale contract in which the payment of the price of the commodity is deferred and payable at a certain time in the future. In this contract, the commodity to be sold is delivered immediately to the buyer. However, payment for the commodity is either deferred to a specific date or paid by instalments. The selling price includes the actual cost of the commodity plus an agreed profit margin, which increases depending on the length of the period over which the deferment is agreed.

Ijārah (rent/lease/hire) is a leasing contract used for machinery, equipment, buildings and other capital assets, with prespecified duration and related payments. The financier purchases the asset and leases it to the debtor for an agreed rental, which may be fixed in advance or subject to occasional review by a mutually acceptable third party.⁸⁶ Ownership of the asset remains with the financier until the obligations of the contract have been fulfilled. Lease payments are agreed in advance over a specified period of time.

Istiṣnā' (financing for commissioned or preordered production) is a contract "where an asset is transacted before it comes into existence. A purchaser orders a manufacturer to manufacture a specific asset according to the purchaser's specifications and deliver it at a pre-agreed delivery date for a pre-agreed price, which is payable either in lump sum or instalments at any time as agreed".⁸⁷ This process includes manufacturing, construction, assembling or packaging. Initially used to finance the sale of unripe agricultural products, it has been used for the advance funding of major industrial projects or large items of equipment or facilities such as manufacturing plants, power plants, airports, roads and extractive resource operations.⁸⁸ In *istiṣnā'*, the Islamic financier finds suitable manufacturers on behalf of the purchaser and a three-way contract is issued among the financier, purchaser and contractor. Upon completion, the manufacturer delivers the product to the financier, who then provides it to the purchaser, based on the fulfilment of the contractual terms.



Salam (forward financing) is a sales contract like *istiṣnā'*, whereby the price of the purchased goods/services is paid in advance at the time of contract and goods are delivered at a specified future date. Salam contracts are usually applied only to fungible assets.⁸⁹

Equity Contracts

Equity contracts are profit-and-loss-sharing financing mechanisms. As they include profit-and-loss-sharing, these contracts are also known as trustee project finance and joint venture project finance, respectively.⁹⁰ Risk-and-reward-sharing in equity contracts promotes greater social justice, making them the least controversial financing mechanisms among shariah scholars.

Muḍārabah (partnership between capital owner and entrepreneur) involves a combination of entrepreneurship and capital. In *muḍārabah* the financier provides financing for a specific venture indicated by the entrepreneur. The financier, called *rabb al-māl*, is the owner of the capital and the entrepreneur, called *muḍārib*, is responsible for the running of the business. The *muḍārib* provides all necessary expertise, professional, managerial and technical, for launching and operating the business venture. Profit is shared according to a ratio that has been agreed previously.⁹¹

Mushārah (partnership among all parties contributing capital to a venture).⁹² The partners agree to combine their financial resources to create a business venture. Parties share the profits according to a predetermined ratio. In the event of a loss, it would typically be shared depending on the capital contribution of each partner. Another form of *mushārah* that has been developed by contemporary jurists is diminishing *mushārah*. The practice of this contract in Islamic banking typically involves a financier and client who participate in either the joint ownership of property or equipment or a joint commercial enterprise. The share of the financier is further divided into a number of units and subsequently the client will purchase the units one by one until all the units are purchased, so that the client ends up as the sole owner of the asset.⁹³

Muzāra'ah (partnership in agriculture between capital/landowner and labour/entrepreneur) is a partnership between a landowner and a farmer for the purpose of growing crops. In *muzāra'ah* agreements, the gross revenue is distributed instead of the net profit. By the time the contract ends, the land is due back to its owner. The core features of *muzāra'ah* are: (i) distribution of gross profit between the landowner and the farmer, and (ii) the return of the fixed asset (land) to the landowner as it is.⁹⁴

Support Contracts

Islamic finance also provides several fee- or commission-based services such as *wakālah* and *wadī'ah* and *kafālah*.

Wakālah is an agency or a delegated authority whereby a *muwakkil* (principal) appoints a *wakil* (agent) to carry out a specific job on behalf of the *muwakkil*. In *wakālah* agreements the *muwakkil* and the *wakil* agree to share in the profit and risk of investment. The principal and the agent agree at the start the level of profit the agent expects to make. By the time of maturity, the agent pays the principal actual



return on investment (the matured amount) to the client if it is equal to or less than the anticipated amount. If the matured amount is greater than the anticipated level of return on investment, the extra profit is retained by the agent.⁹⁵

Wadi'ah means safekeeping. In *wadi'ah* the saver gives the property to a depository who becomes the trustee and guarantor of the saver's funds. The trustee guarantees repayment of the whole amount deposited when demanded by the saver. The saver is not entitled to any profit but the depository can provide financial returns as a mean of appreciation.⁹⁶

Kafalah is a contract whereby a person guarantees to take responsibility for a liability or duty of another person. The term *kafalah* in Islamic jurisprudence has a specific meaning—literally, responsibility or suretyship—and technically means the conjoining of the guarantor's liability to that of the guarantee, so that the responsibility of the original bearer is established as a joint liability. In other words, it is used widely in supporting and complementing commercial contracts, when one party does not have full confidence in dealing with another.⁹⁷

Islamic Finance Industry

Size of the Islamic Financial Market

Globally, Islamic finance had total assets of US\$1.84 trillion in 2014, up 9.4 percent from US\$1.66 trillion in 2013. Islamic banking accounts for 79 percent of the market by value, while *shukūk* comprises approximately 16 percent, shariah-compliant investment funds 4 percent and *takaful* 1 percent (Figure 7). The global assets of Islamic finance are expected to increase by 80 percent over the next five years, and reach US\$3.24 trillion by 2020.⁹⁸

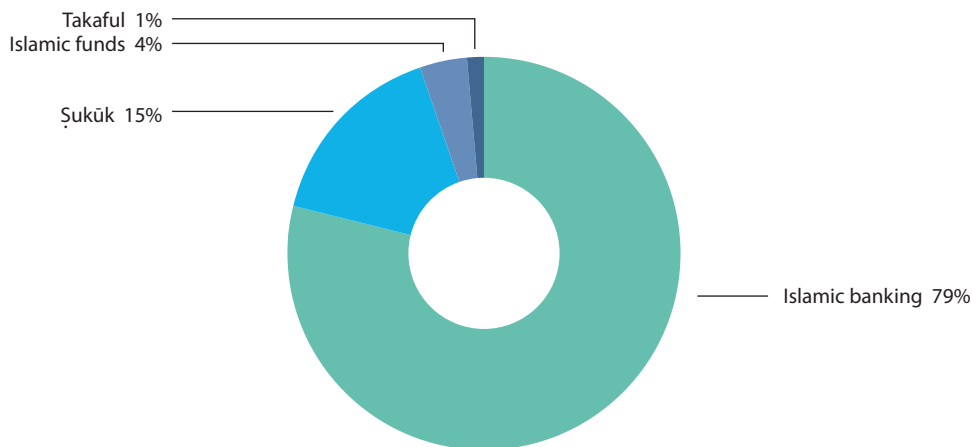
In 2014, Malaysia and Saudi Arabia accounted for 23 percent of the world's Islamic finance assets, followed by Iran (19 percent).⁹⁹ These three countries together own 65 percent of the global Islamic financial assets. Ranking seventh in total Islamic financial assets, Bahrain had the highest Islamic finance penetration as a share of gross domestic product (GDP) (217 percent), followed by Malaysia (127 percent) and Iran (85 percent). Global Islamic finance penetration is just 2 percent of GDP.

Islamic Banking

Generally, an Islamic banking system promotes an equity-based system. As such, the system was initially characterized by the principle of two-tier *muḍārabah*, that is, on the liabilities side of the balance sheet, the depositor would be the financier and the bank the entrepreneur, and on the assets side, the bank would be the financier and the person seeking funding the entrepreneur.¹⁰⁰ Nonetheless, as it has undergone the above-mentioned four-stage evolution, the operationalization of Islamic banks which dominates the Islamic finance industry has essentially moved from two-tier *muḍārabah* to two-tier *murābaḥah*, whereby the bulk of the assets and liabilities sides of Islamic banks are predominantly made up of *murābaḥah* (cost-based) modes of finance.¹⁰¹ Figure 8 depicts the composition of assets of Islamic banks as of 2015.

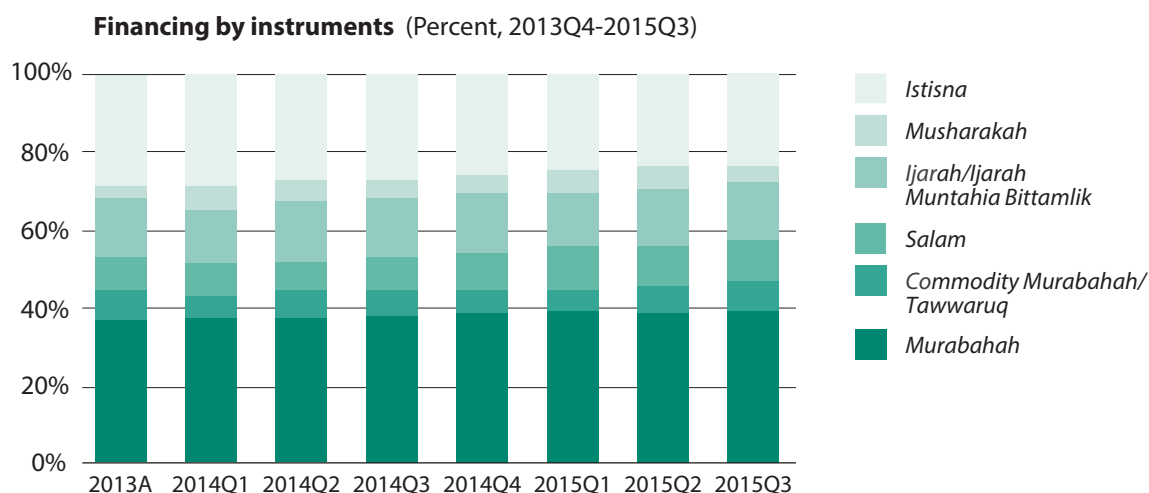


Figure 7: Sectoral Composition of the Global Islamic Financial Services Industry 2014



Source: IFSB, 2015.

Figure 8: Assets of Islamic Banks



Source: International Monetary Fund, 2017a.

Islamic banking is the most developed sector of the industry. Estimates of the asset size and growth rate vary significantly; however, results from various reports show that assets in fully fledged Islamic banks, subsidiaries and windows amounted to approximately US\$1.5 trillion at the end of the first half of 2015.¹⁰² The assets of Islamic finance have experienced double-digit growth compared with conventional banking.¹⁰³ This sustained growth is seen as a sign of the resilience of the industry. The assets of Islamic banks and banking windows are expected to grow by an average of 11–12 percent a year until 2020, remaining at about 80 percent of total global Islamic finance assets.

In recent years, Islamic banking has spread to Africa, Europe, South America and North America. As of 2015, Islamic banking services were launched in Suriname, a first for Islamic finance in the South America and the Caribbean region. In Europe, KT Bank (a subsidiary of Kuveyt Turk, in turn, the Turkish subsidiary of Kuwait Finance House) was established in Germany in July 2015 as a fully fledged Islamic bank with €45 million (US\$49.6 million) of capital. This is the first Islamic bank in the Eurozone and offers products to both retail



and corporate customers.¹⁰⁴ Islamic finance in the sub-Saharan Africa region has also been making inroads in recent years, with Islamic banking now being offered in many countries, including Kenya, Niger, Nigeria, Senegal and South Africa, among others.

Despite the wide reach of Islamic banking, industry assets remain highly concentrated in a small number of countries. Approximately 93 percent of international Islamic banking assets are based in nine core markets, while the Qatar, Indonesia, Saudi Arabia, Malaysia, United Arab Emirates and Turkey (QISMUT) share stands at 80 percent.¹⁰⁵

Şukūk

A *şakk* is a certificate of ownership applied to an underlying asset. The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) defines *şukūk* (the plural of *şakk*) 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”.¹⁰⁶

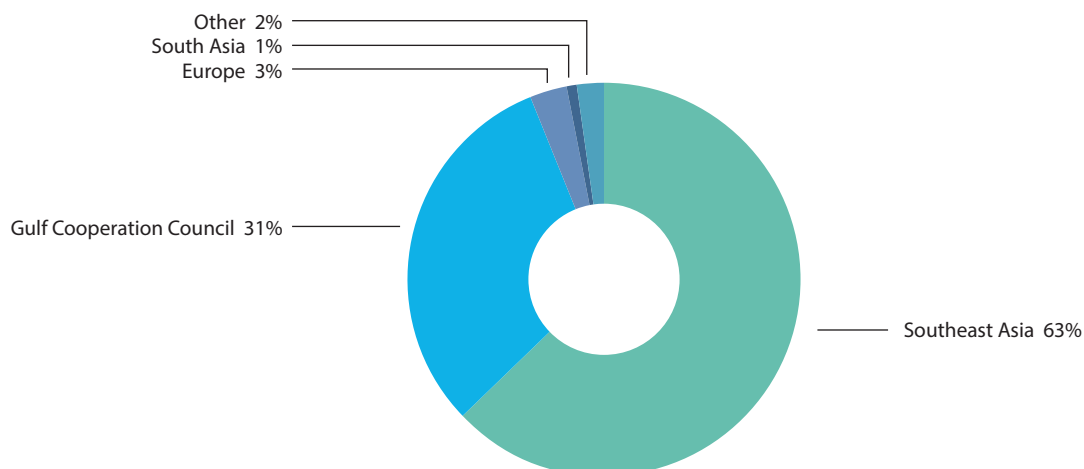
Şukūk commonly refer to the Islamic equivalent of bonds that comply with Islamic commercial jurisprudence and its investment principles. Unlike conventional bonds, *şukūk* grant the investor a share of an asset, along with the corresponding cash flows and risk.¹⁰⁷ In *şukūk*, the issuer sells the certificate of ownership to a buyer. The buyer rents it back from the issuer based on a predetermined rental fee. The issuer also makes a contractual obligation to buy back the bond, the contractual instrument, at a future date at par value.

On the debt side, bonds (*şukūk*) can be issued without collateral by governments (sovereign or municipal), DFIs or corporates. While the value of *şukūk* may depend on the issuing organization and other factors, its underlying structure can vary (*murābaḥah*, *ijārah*, *wakālah* or others). Bonds can also be asset backed and, in most cases, payments are tied to the cash flows associated with an underlying performing asset.

As of 2014, total global *şukūk* outstanding stood at US\$295 billion.¹⁰⁸

Of the *şukūk* bonds issued in 2014, 76 percent came from local markets, led by Malaysia, Saudi Arabia, Bahrain, Brunei and the United Arab Emirates. In regional terms, South-East Asia led the way, accounting for 64 percent of total global *şukūk* (Figure 9).

Figure 9: Total Global Şukūk Outstanding by Region, 2014

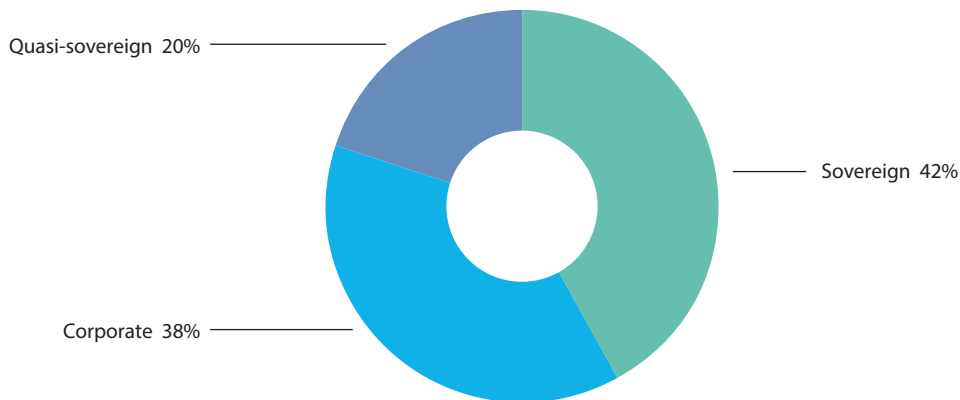


Source: Hasan, Mohamed and Eid, 2015.



Issuance of international *ṣukūk* (issued in hard currencies) is gaining more global momentum, but issuers still find that local currency *ṣukūk* are less expensive to hedge and are cheaper and faster to issue. In comparison with conventional financing, a lack of institutional investor appetite still limits the development of the market for Islamic bonds. While about 70 percent of conventionally issued bonds are held by institutional investors, the figure is only about 20 percent for Islamic bonds, about 80 percent of which are held by retail investors.¹⁰⁹ Figure 10 presents the share of global *ṣukūk* issued by the three main types of issuer in 2015.

Figure 10: Total Global *ṣukūk* Outstanding by Issuer Type, 2014

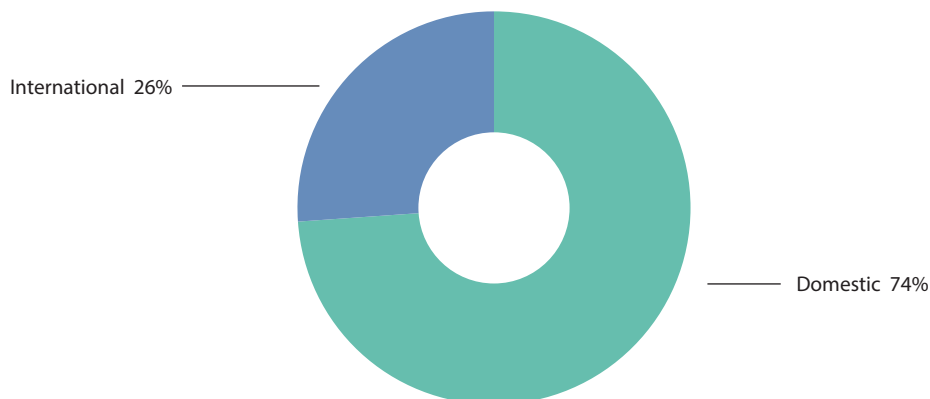


Source: Hasan, Mohamed and Eid, 2015.

Of the total global *ṣukūk* outstanding at the end of 2015, 67 percent were issued by Malaysia. Other issuers in order of their share in the global *ṣukūk* market were the United Arab Emirates (8.1 percent), Saudi Arabia (7.8 percent), Indonesia (3.7 percent), Qatar (3.0 percent), Bahrain (2.76 percent) and Sudan (2.1 percent).¹¹⁰

The relative shares of the total global *ṣukūk* market issued by domestic and international entities is presented in Figure 11. As of December 2015, the domestic *ṣukūk* market is dominated by sovereign issuers whereas the international *ṣukūk* market is almost equally divided between quasi-sovereign and corporate *ṣukūk* issuers.

Figure 11: Total Global *ṣukūk* Outstanding by Market, 2014

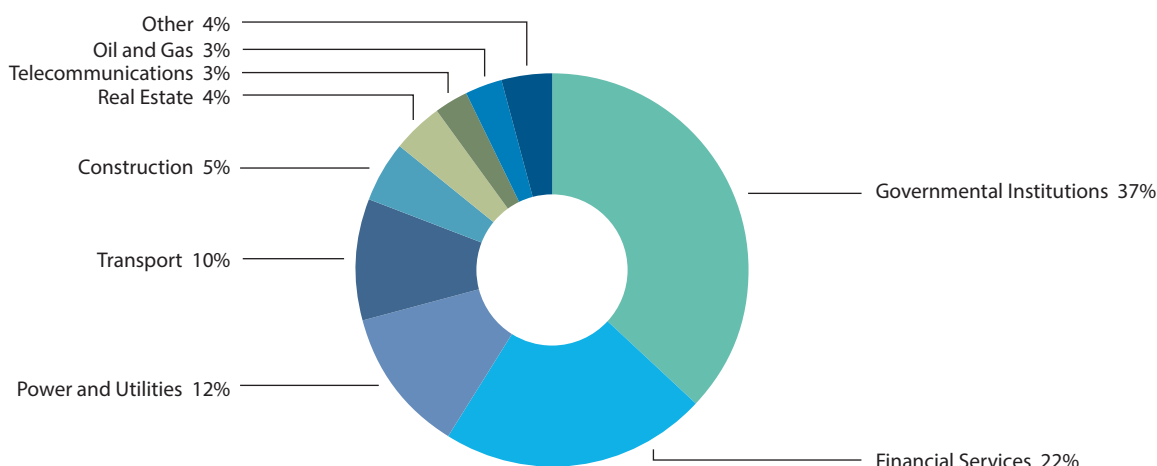


Source: Hasan, Mohamed and Eid, 2015.



More than one third of the *ṣukūk* outstanding (37 percent) is owed by the government sector. Financial services are the major sector issuing corporate *ṣukūk*, with 22 percent of the total outstanding (Figure 12).

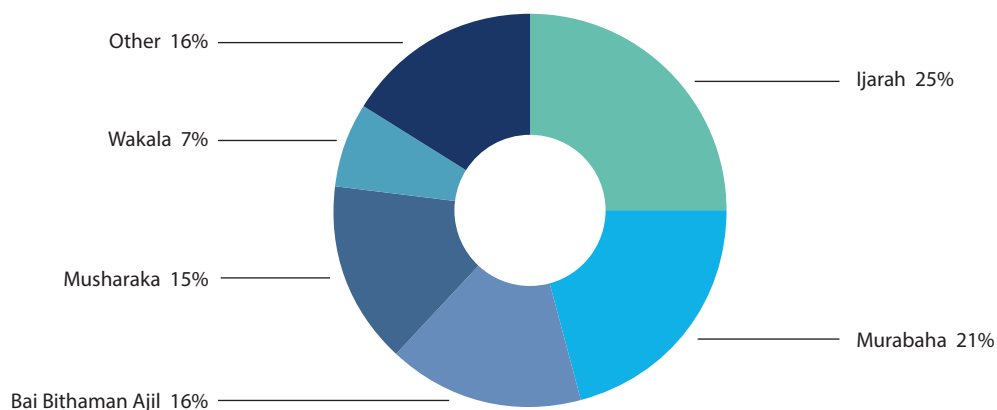
Figure 12: Total Global *ṣukūk* Outstanding by Sector, 2014



Source: Hasan, Mohamed and Eid, 2015.

Ṣukūk rely on a variety of underlying assets from which revenue streams derive. Ownership in a *ṣukūk* can be through partial ownership in a debt (*murābaḥah*), asset (*ijārah*), project (*istiṣnā'*), business (*mushārakah*) or investment (multiple structures) (Figure 13).

Figure 13: Total Global *ṣukūk* Outstanding by Structure, 2014

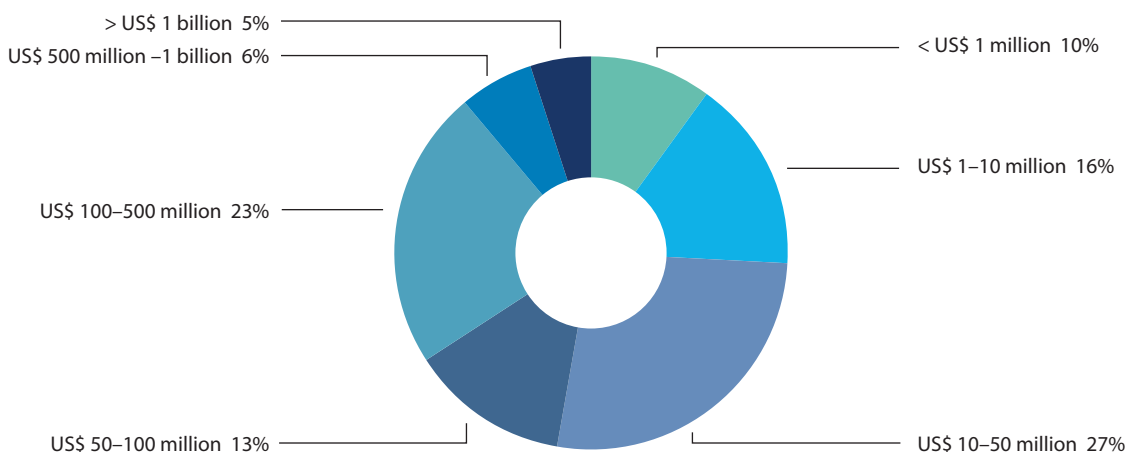


Source: Hasan, Mohamed and Eid, 2015.



For countries that follow the AAOIFI standards, trading *murābahah ṣukūk* is prohibited, but in Malaysia it is permissible to exchange *murābahah* papers, *ijārah* and *ṣukūk al wakālah*, where the investor assigns an agent (*wakil*) to manage investments on behalf of the investor for a particular duration. These forms are the favourite choice of *ṣukūk* in the Gulf Cooperation Council (GCC) and Middle East and North Africa (MENA) regions, given their attractiveness and tradability.

Figure 14: Total Global ṣukūk Outstanding by Value, 2014



Source: Hasan, Mohamed and Eid, 2015.

Ṣukūk has become an increasingly important source of funding for a few countries. The *ṣukūk* to GDP ratio has been on the rise for developed *ṣukūk* markets, led by Malaysia (51 percent) and followed by Bahrain (11 percent), the United Arab Emirates (7 percent), Saudi Arabia (6 percent) and Qatar (6 percent).

Recently, two African countries, Senegal and Côte d’Ivoire, issued their first sovereign *ṣukūk*. There has been a strong growth momentum in the international sovereign *ṣukūk* market, with US\$3 billion coming from additional countries between June 2014 and July 2015. In June 2014, the United Kingdom became the first western country to issue a sovereign *ṣukūk*. Hong Kong, South Africa and Luxembourg followed suit (Table 8), and all the issues were greatly oversubscribed.¹¹¹

Table 8: Sovereign ṣukūk Issuance between June 2014 and July 2015

Sovereign Issuer	Issue Date	Amount (US\$ million)	Tenure (years)	Currency of Issue	Structure	Rating by S&P
United Kingdom	June 2014	339.5	5.00	GBP	Ijarah	AAA
Hong Kong	Sep 2014	1 000.0	5.00	USD	Ijarah	AA+
South Africa	Sep 2014	500.0	5.75	USD	Ijarah	BBB-
Luxembourg	Oct 2014	220.0	5.00	EUR	Ijarah	AAA
Hong Kong	May 2015	1 000.0	5.00	USD	Wakālah	AA+

Source: International Islamic Financial Market ṣukūk database.



Green and socially responsible *ṣukūk* were born as a new category of investment with the issue of socially responsible investment (SRI) *ṣukūk* by the World Bank-linked International Finance Facility for Immunization (IFFIm) and Khazanah Nasional Berhad in the form of *iḥsān ṣukūk* in June 2015.

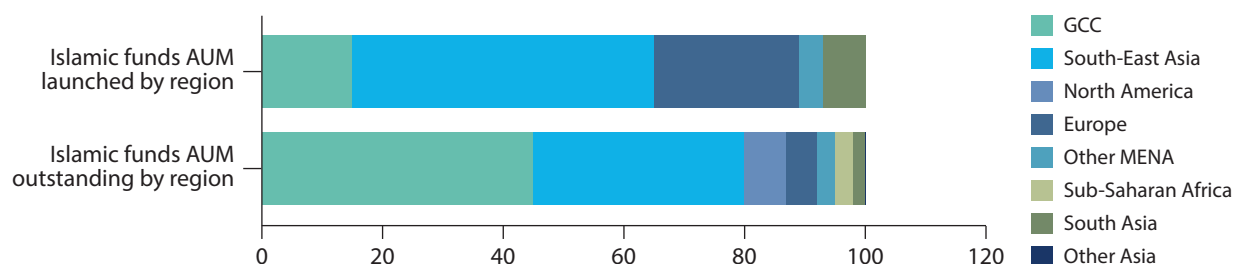
Islamic Funds

AAOIFI defines investment funds as “investment vehicles, which are financially independent of the institutions that establish them. Funds take the form of equal participating shares/units, which represent the shareholders’/unitholders’ share of the assets and entitlement to profits or losses. The funds are managed on the basis of either *muḍārabah* or agency contract.”

Islamic funds are similar to conventional funds, but differ because of their conformity with shariah principles.¹¹² Shariah-compliant funds first appeared in the 1960s in South-East Asia.¹¹³ Their creation was driven mainly by individuals who were attracted by the idea of faith-based investments.¹¹⁴ There are many types of Islamic funds, such as Islamic index funds, shariah private equity funds, shariah-compliant hedge funds, Islamic equity funds, shariah-compliant exchange-traded funds (ETFs), Islamic real estate investment trusts (REITs), *murābahah* funds, Islamic commodity funds and *ijara* funds.¹¹⁵

Malaysia,¹¹⁶ Saudi Arabia and Luxembourg are the clear leaders among countries in the number and size of their Islamic funds launched in 2014. South-East Asia and the GCC accounted for 80 percent of Islamic funds AUM outstanding in 2014 (Figure 15).

Figure 15: Islamic Funds Launched and Outstanding by Region, 2014

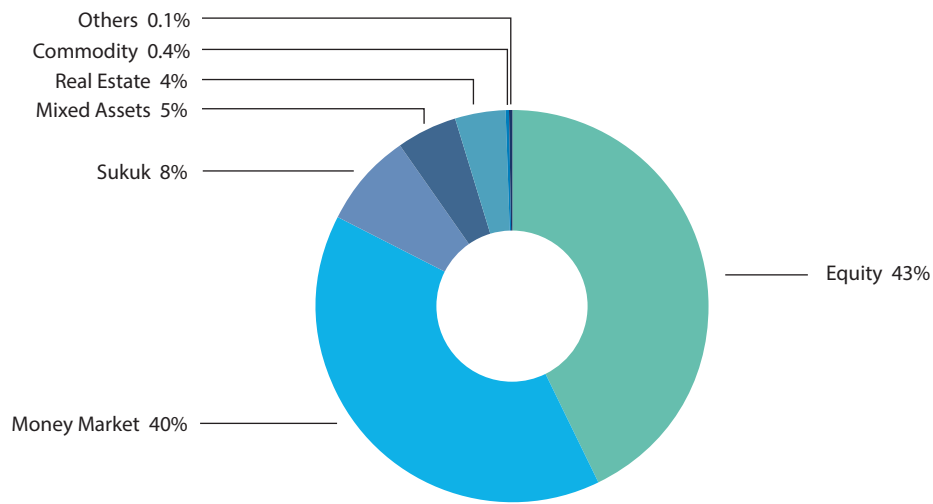


Source: Hasan, Mohamed and Eid, 2015.

In seven of the top 10 Islamic fund countries (Indonesia, Iran, Kuwait, Pakistan, South Africa, the United Kingdom and the United States), the AUM outstanding as a percentage of GDP was below 1 percent in 2014. Islamic funding constitutes 5 percent of the GDP of Malaysia and 3 percent of the GDP of Saudi Arabia and Luxembourg.¹¹⁷

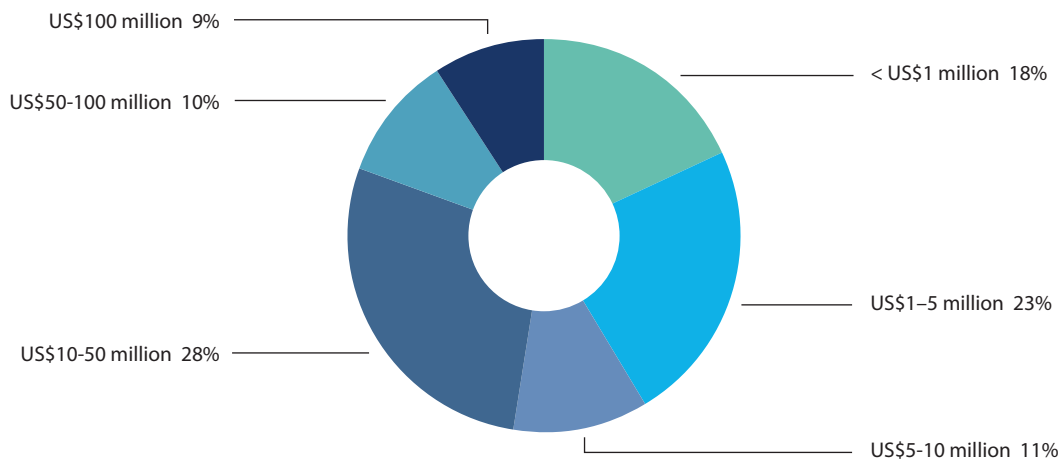


Figure 16: Islamic Funds Assets Under Management Outstanding by Type, 2014



Source: Hasan, Mohamed and Eid, 2015.

Figure 17: Global Islamic Funds by Size, 2014



Source: Hasan, Mohamed and Eid, 2015.

In the context of this report, there are a few shariah-compliant fund offerings worth noting in particular, since they are friendly to impact investing or they invest in assets in impact-friendly sectors, for example:

- Sedco: A UNPRI signatory (www.unpri.org/directory) that launched its first shariah+ ESG mutual fund. Based in Saudi Arabia.
- Azzad: Not necessarily impact investing, but an award-winning leader in the field of impact investing, and impact friendly. Based in the United States.
- Arabesque: A UNPRI signatory. Recently published a report on quantification of impact investing principals with University of Oxford. New Zealand registered.



Takaful (Islamic cooperative insurance)

The concept of *takaful* implies compensation and responsibilities for sharing among the community. The AAOIFI definition of *takaful* is “a system through which the participants donate part or all of their contributions, which are used to pay claims for damages suffered by some of the participants”. In general, *takaful* contracts are short-term contracts. The contributions made by the participants are pooled into the general *takaful* fund, which is then invested by the *takaful* operator, and the profits generated are paid back to the fund. *Takaful* is designed to safeguard individuals and corporations from any material loss or damage resulting from a catastrophe or disaster that affects the participants’ assets or properties.¹¹⁸




Globally, there are 308 *takaful* operators, whose assets reached US\$33 billion by the end of 2014. Of these assets, 86 percent are concentrated in three countries—Saudi Arabia, Malaysia and Iran. Among these, Saudi Arabia holds the most *takaful* assets (US\$12.3 billion managed by 40 fully fledged *takaful* operators).

Key players in the *takaful* industry are: Etiqa Takaful Bhd; The Company for Cooperative Insurance; Syarikat Takaful Malaysia Bhd; The Mediterranean and Gulf Cooperative Insurance and Reinsurance Co.; Islamic Arab Insurance Company (Salama); Takaful Ikhlas Sendirian Berhad; and BUPA Arabia for Cooperative Insurance.

Key Investors in Islamic Finance

A 2009 report by Ernst and Young identified seven significant investor segments in the Islamic finance industry, grouped into three broad subgroups (Table 9).

Table 9: Key Investor Profiles in Islamic Finance

		
INDIVIDUALS	QUASI- INSTITUTIONAL	INSTITUTIONAL
Mass Affluent	<i>Awqāf</i> and Endowments	<i>Takaful</i>
High-Net-Worth Individuals		Sovereign Wealth Funds
Ultra-High-Net-Worth Individuals		Pension Funds

Source: Ernst and Young, 2009.

Mass affluent individuals are individuals with liquid wealth of US\$50,000–US\$500,000 and who have a high propensity to invest in shariah-compliant products. This group tends to focus on simple, short-tenure investments and providers of safe products, such as annuity- and insurance-linked products that require small monthly contributions. **HNWIs** are defined as people with financial assets of at least US\$1 million; **UHNWIs** are people with financial assets of more than US\$30 million. In general, these latter two groups prefer shariah-compliant products, but they seek safe assets and capital preservation.

The quasi-institutional subgroup includes *awqāf* and *endowments*, which are growing segments that require capital preservation and fund management. Shariah compliance is a necessity for *awqāf* and is an important feature for the majority of endowment funds. As it seeks long-term capital growth, the *awqāf* segment



focuses on long-term assets. These investors purchase real estate as part of their operations as they hold large amounts of land used for religious and philanthropic activities. For awqāf and endowments, real estate is the dominant asset class, with a small allocation to equities.

Institutional investors include *takaful*, which constitutes a large institutional segment with liquid assets requiring shariah compliance. However, a lack of depth in Islamic investments, particularly in the fixed-income asset class, forces many operators to reinsure large portions of their risk. Due to the long-term nature of their obligations, this segment is drawn to opportunities for capital appreciation. In general, takaful operators favour liquid investments in fixed-income asset classes and listed/tradable products that can be easily exited.

Sovereign wealth funds (SWFs) constitute a large investor group that uses only sophisticated and proven fund managers. Most SWFs do not have a strictly Islamic mandate but do adopt ethical investment strategies, and conventional financial institutions are not excluded from their investment strategies.

SWFs invest through well-established and reputable international brands, with whom they establish long-term relationships. In general, this group likes sophisticated, structured product offerings and exposure to international markets, as well as products that can compete in terms of price, returns, scale and service quality with best-of-breed conventional offerings.

Pension funds require long-term asset managers. They are large institutional investors that do not have a high propensity to consume Islamic products; however, this does not prevent their involvement in Islamic investments. As awareness of shariah compliance grows, these funds will be increasingly pressured into allocating more capital to Islamic offerings. Pension funds prefer international investments in listed instruments, conducted through international portfolio managers with a focus on mature markets. On the other hand, they invest in local conventional and Islamic banks for cash deposits. In general, this group is likely to be involved in alternatives to the cash/money market, which provide attractive returns with low risk and allow for short tenures. Islamic mutual funds, which can deliver stable returns through exposure to international equities in mature markets, are also attractive to this group.

Development Finance Institutions

DFIs typically aid developmental goals in the frontier, fragile and conflict markets through their products such as syndicated loans, equity and debt instruments, and technical assistance and public-private cofinancing.¹¹⁹ The IDB Group is the leading multilateral DFI in the realm of Islamic finance. It supports the economic development and social progress of its member countries and Muslim communities. It engages in a wide spectrum of activities and financial services in accordance with the principles of shariah, including direct equity investment in Islamic financial institutions, and insurance and reinsurance coverage for investment and export credit.

International organizations have been paying increasing attention to Islamic finance. The United Nations World Humanitarian Summit, held in Istanbul in May 2016, for example, publicly called for a greater role for Islamic finance to reach humanitarian goals.¹²⁰ International DFIs, including the World Bank, IFC and Asian Development Bank (ADB), are becoming increasingly involved in Islamic finance. The World Bank Group has established the Global Islamic Finance Development Center in Istanbul, which acts as a knowledge hub, provides technical advisory and assistance services to World Bank client countries and conducts research.



Box 3: The Islamic Development Bank Group



The IDB Group is a South-to-South multilateral DFI.¹²¹ Headquartered in Jeddah, Saudi Arabia, its purpose is to foster the economic development and social progress of its 57 member countries and Muslim communities in accordance with the principles of shariah. The prerequisites for membership are that a country should: (i) be a member of the OIC; (ii) pay its quota subscription to the capital of the Bank; and (iii) be willing to accept the terms and conditions that were and will be decided upon by the IDB Board of Governors.¹²²

The IDB Group comprises five entities: (i) Islamic Development Bank (IDB); (ii) Islamic Research and Training Institute (IRTI); (iii) Islamic Corporation for the Insurance of Investment and Export Credit (ICIEC); (iv) Islamic Corporation for the Development of the Private Sector (ICD); and (v) International Islamic Trade Finance Corporation (ITFC).

IDB Group activities include project financing in the public and private sectors, development assistance for poverty alleviation, technical assistance for capacity-building, economic and trade cooperation among member countries, trade and SME financing, resource mobilization, direct equity investment in Islamic financial institutions, insurance and reinsurance coverage for investment and export credit, research and training programmes in Islamic economics and banking, *awqāf* in investment and financing, special assistance and scholarships for member countries and Muslim communities in non-member countries, emergency relief, and advisory services for public and private entities in member countries.

Enabling-environment Actors

Regulatory and Standard-setting Institutions

Regulation has played a key role in the evolution of the most successful Islamic markets. Countries such as Malaysia and Bahrain, where proactive regulators seek to create a regulatory framework that encompasses Islamic financing in addition to conventional banking, have experienced accelerated growth and a larger market share. Banking and finance are complicated and therefore highly regulated industries and, in this regard, the needs of the Islamic financing industry do not differ from conventional financial services.

Shariah-compliant investments are all certified by experts, generally through a panel or board made up of respected shariah scholars, called **shariah supervisory boards (SSBs)**. AAOIFI defines a shariah supervisory board as “an independent body of specialized jurists in *fiqh al-mu’āmalāt* (Islamic commercial jurisprudence)”. These scholars regulate through issuing *fatwas* (religious rulings) on financial transactions. Their main responsibility is to provide direction, guidance and supervision related to the activities of the Islamic financial institution. The purpose is to ensure that Islamic financial institutions comply with shariah rules and principles.¹²³ The SSB ensures full compliance of the investments and transactions with Islamic principles, both on an individual level and through regular audits.¹²⁴



Table 10: Regulatory and Standard-setting Institutions in Islamic Finance

Institution	Description
AAOIFI	The Accounting and Audit Organization for Islamic Financial Institutions, a non-profit organization founded in 1991 and headquartered in Bahrain, prepares accounting, auditing, governance, ethics and shariah standards and guidelines on Islamic finance, which are followed by the leading Islamic financial institutions across the world, such as central banks and regulatory authorities, financial institutions, accounting and auditing firms and legal firms. It also runs professional qualification programmes such as the Certified Islamic Professional Accountant (CIPA) and Certified Shari'a Adviser and Auditor (CSAA). ¹²⁵
CIBAFI	The General Council of Islamic Banks and Financial Institutions, established in 2001 and headquartered in Bahrain, represents the Islamic financial services industry globally, defends and promotes its role, and consolidates cooperation among its approximately 120 members within 30 jurisdictions and with other institutions with similar interests and objectives. ¹²⁶
IFSB	The Islamic Financial Services Board, established in 2003 in Malaysia, develops globally accepted standards, mechanisms and guiding principles for the Islamic finance industry in line with shariah to enhance the stability and transparency of Islamic financial services. The Board also conducts research, coordinates industry-related initiatives and organizes events and awareness programmes for the industry stakeholders. ¹²⁷
IICRA	The International Islamic Centre for Reconciliation and Arbitration, an independent non-profit organization, organizes and supervises reconciliation and arbitration services for financial institutions that apply the provisions of shariah principles in resolving disputes between themselves, with their customers and/or with any third party, through reconciliation or arbitration. ¹²⁸
IIFM	The International Islamic Financial Market, founded in 2002, is a standard-setting body of the Islamic financial services industry. It focuses on standardization of Islamic financial contracts and product templates for the capital and money markets, corporate finance and trade finance. ¹²⁹
IIRA	The International Islamic Rating Agency, established in 2005, makes independent rating assessments of Islamic capital markets and the banking sector globally. It facilitates financial market development by defining relative investment or credit risk and providing an assessment of the risk profile of Islamic financial institutions and instruments. ¹³⁰
IILMC	The International Islamic Liquidity Management Corporation, founded in 2010 in Malaysia, creates and issues short-term shariah-compliant financial instruments to facilitate effective cross-border Islamic liquidity management. Its members are composed of central banks, monetary authorities, financial regulatory authorities, government ministries or regulatory agencies in finance or trade and commerce, and other multilateral organisations. ¹³¹
LMC	The Liquidity Management Centre, established in 2002 and regulated by the Central Bank of Bahrain, assists Islamic financial institutions to manage any liquidity mismatches through short- and medium-term liquid investments structured in accordance with shariah principles. It provides innovative, adaptable and tradable Islamic shariah-compliant financial instruments. ¹³²



Challenges Facing the Islamic Finance Industry

The Islamic financial industry has made remarkable progress since the establishment of the first Islamic bank in Dubai in 1975. While Islamic finance has great opportunities for growth and development, the sector faces challenges that limit its potential contribution. In the current Islamic financial system, for example, the use of equity and profit-and-loss-sharing modalities in transactions have been relatively less frequent compared with debt-creating sales-based modalities, due to a lack of trust among the participants in Islamic finance. This owes much to the fact that the current Islamic financial system lacks “institutions that may help minimize the risks associated with anonymity, moral hazard, principal/agent conflict of interest, and late settlement of financial obligations”.¹³³ In addition, many countries do not have the legal, regulatory or supervisory infrastructure necessary for facilitating the implementation of Islamic banking and financial contracts (commercial, banking, property and company laws, etc.).¹³⁴ Therefore, it is imperative to strengthen respective national infrastructures in order for the Islamic finance sector to thrive.

Although the enabling-environment actors such as AAOIFI and IFSB have created principles and detailed technical standards, there is still room to improve their implementation by national authorities, who are often more focused on global conventional banking standards.¹³⁵ Fragmentation of national regulations and variations in how shariah principles are interpreted and implemented within and among jurisdictions across borders creates additional challenges for Islamic investors. Some products may be accepted in some jurisdictions but not in others.¹³⁶ Thus, it is crucial to harmonize and standardize national Islamic financial jurisdictions, strengthen the international enabling-environment facilitators, and ensure the compliance of the Islamic financial industry with international market standards and principles.¹³⁷

Another challenge is that the current legal system in some countries does not recognize Islamic finance operations. To strengthen a conducive legal system and infrastructure and to support the growing development of Islamic finance, Bank Negara Malaysia established the Law Harmonisation Committee in 2010.¹³⁸

In addition, research shows that Islamic financial institutions have low levels of innovation capacity, particularly due to the fact that Islamic finance is a relatively novel segment.¹³⁹ The scarcity of shariah scholars with financial sector expertise is another challenge that impedes the further growth of the industry.¹⁴⁰ In a recent survey, 82 percent of the surveyed countries reported a shortage of professionals with the right competencies and skills in areas such as shariah and *takāful*. Another 60 percent of Islamic finance professionals require further training and skills development.¹⁴¹ Using relevant mechanisms for promoting innovation and technology, especially in the developing world, might help these countries to integrate innovation and develop technological solutions for the growth of the sector.

The participation of the larger Muslim population as actors in Islamic finance markets is an essential element of the growth of the Islamic financial industry, as well as sustainable development and just social progress. Even though community support and involvement constitutes the main tenet of Islamic finance, the sector’s contribution to SMEs and social investments is minimal, and the tools and instruments mentioned in this section operate on a larger scale.¹⁴² A more just Islamic financial system should facilitate “social inclusiveness”—the participation of the lower income and wealth segments in financial transactions—by making its services accessible to them.¹⁴³

Finally, perceptions about Islamic finance matter as they can play a role in determining the level of acceptance of Islamic finance penetration in certain jurisdictions. Many still view Islamic finance as an industry designed by Muslims and offered solely to Muslims.¹⁴⁴ Although this appears to be partially the case, the spirit of Islamic finance is in fact more comprehensive and inclusive. For example, interest (*ribā*) prohibition is shared with both Judaism and Christianity. It is also interesting to note that charging interest is prohibited in Buddhism, Hinduism and many other faiths and philosophies.



Box 4: Islamic Finance and the Sustainable Development Goals



Innovative Islamic financial instruments such as *ṣukūk* can be used to mobilize resources to finance infrastructure development projects such as water and sanitation projects (SDG 6) or sustainable transportation systems (SDG 11). *Ṣukūk* can also be used in promoting investments in climate change solutions (SDG 13) or funding health programmes in developing countries (SDG 3). *Istiṣnā'* contracts can be used to finance sustainable and affordable energy facilities (SDG 7) or build resilient infrastructure (SDG 9).¹⁴⁵ Salam contracts can be used to support sustainable agriculture (SDG 2). *Mushārahah* and *muḍārabah* can be used to support financial inclusion of the poor through innovative business models (SDG 12), which could be instrumental in ending poverty (SDG 1), reducing inequalities (SDG 10), empowering women (SDG 5) and promoting peaceful and inclusive societies (SDG 16). Islamic funds can invest in shariah-compliant businesses across a broad set of sectors, such as renewable energy (SDG 7), sustainable fisheries (SDG 14), forestry (SDG 15), agriculture (SDG 12), health (SDG 3) and education (SDG 4). *Takāful* can increase the resilience of individuals and businesses to catastrophes or disasters (SDG 11). With its principles of risk-sharing, Islamic finance is well suited to the financing of SMEs and start-ups, thereby contributing to more inclusive growth (SDG 8).¹⁴⁶

This chapter has shown that the full potential of Islamic finance products in financing the SDGs has not yet been unleashed. Islamic financial institutions need to collaborate with other major or emerging financial institutions in order to benefit from their experience. The globalization of the sector and the increasing interest from additional countries, as well as from conventional and unconventional financial investors, might spur the broadening of this cooperation. Knowledge sharing and collaborating with newly growing communities of SRI and impact investing might enhance the contribution of Islamic financial institutions to human and business development.







Chapter 5

Current Areas of Overlap Between Islamic Finance and Impact Investing

Islamic finance is already developing as a practice building on longstanding experience, interacting with various forms of investment and various sectors. Its future evolution as a development mechanism will depend on creating a more robust legal and institutional infrastructure and reaching down towards those at the bottom of wealth and income distribution. SMEs, a key constituent of the development landscape in the developing world, stand to gain from the further development of Islamic financing and impact investment products. This represents a significant potential source of development funding for sectors that have not yet accessed the necessary financial instruments. Both the impact investing and the Islamic finance sectors can derive added value from closer collaboration, including expanded markets, enhanced impact and greater access to finance opportunities for the small-scale private sector. There is scope to greatly expand the range of financial offerings by borrowing from and adapting each other's financing mechanisms.



Current Areas of Overlap Between Islamic Finance and Impact Investing

Similarities Between Islamic Finance and Impact Investing

The principles of Islamic finance and impact investing, with their rigorous moral and social criteria and emphasis on business–society relations, are compatible with one another. The two industries resemble each other in a number of ways.

First, both Islamic financing and impact investing dwell in a **value-based investment universe**. In any type of values-based investing, the core concepts around which investments are made are represented in a shared set of values that are present in both the investment philosophy and the companies/entities into which funds are deployed. This core set of values overrides other criteria and becomes a defining parameter of investment.

Second, in both **investment structures, investors associate themselves with a moral purpose**: “doing good and avoiding harm to others” is the main underlying ethical principle of Islamic finance, which requires negative screening. Impact investing carries this beyond responsible investment and embeds positive screening. The AAOIFI Governance Standard for Islamic Financial Institutions on Corporate Social Responsibility Conduct and Disclosure for Islamic Financial Institutions, for example, sets as a baseline “provisions for proactively establishing, monitoring and acting on realizable and profitable investment quotas/targets, based on the extent to which the investments directly or indirectly contribute to social, development and environmental causes”.¹⁴⁷

Third, an important area of overlap is that both sectors have provided **access to finance** for the pockets of the world’s population that are directly or indirectly kept out of the formal financial sectors. This extends to both conventional and Islamic financing. This approach can be applied to a variety of subsectors, including MFIs, SME banking, marginalized populations, religious groups and BoP, to name a few.

Fourth, Islamic finance shares one common behavioural concern with impact investing, which is to “promote the wellbeing of all humankind”.¹⁴⁸ Although both sectors accept that investors should earn acceptable returns within a market system, financial returns constitute only one dimension of investment. Besides that, Islamic finance also encourages investors **to create positive non-financial value alongside financial returns** to support a socially concerned, environmentally friendly system.¹⁴⁹

Finally, both Islamic finance and impact investing share a **broader understanding of the relationship between business and society**, which is centred on advancing human well-being, as described above. The quest for creating positive societal value for all humankind removes the incompatibility between investors’ interest and the social interest, thereby creating a “social contract”¹⁵⁰ between the investor and society.¹⁵¹

These similarities suggest that blending aspects of the two sectors might represent an opportunity for collaboration, cross-learning and improved development outcomes for both.

Value Added for Impact Investors

Expanding new sources of finance: With Islamic finance having an estimated US\$2 trillion market and projected growth of 17 percent per annum,¹⁵² the participation of Islamic financiers in impact investing may provide new sources of finance for impact investments.

Developing new markets: The annual JPMorgan Chase and GIIN impact investing survey in 2015 suggested that impact investment practices are proliferating globally. However, the regional breakdown reveals that the MENA region was almost absent from the report. Bridging Islamic finance and impact investing may leverage representation and investor interest through development of new, innovative Islamic finance instruments (Islamic crowdfunding, SRI *ṣukūk*) for impact enterprises and impact funds in the MENA region.



Enlarging the impact investing tools: Engaging Islamic finance in impact investing requires searching for tools and instruments to converge these two industries without compromising shariah compliance. This will drive development of new investment tools and products for impact investors to engage in Muslim-majority markets.

Asset-backed nature of Islamic finance: By using models such as partnerships or joint ventures, agency hiring and social cooperation, Islamic finance helps small business companies access finance faster than they could have through a conventional bank loan. In recognition of this, the G20 proposed systematically integrating the features of asset-based financing practices into global finance.¹⁵³

Value Added for Islamic Financiers

Transformation from compliance to impact:¹⁵⁴ Impact investing may help Islamic finance to expand its scale as a relevant and non-traditional finance structure. Employing the principles of impact investing offers Islamic financiers a clear and benchmarkable methodology for assessing the social and environmental impact of financial activity. This might cause a paradigm shift for Islamic finance towards a proactive emphasis on creating trackable positive impact instead of “do no harm”.

Expanding the reach of Islamic finance: ImpactBase (“the global online directory of impact investment vehicles”, www.impactbase.org) has more than 3200 subscribers and lists around 425 funds and products. Bridging Islamic finance and impact investing would further expand the market for Islamic finance by providing access towards a broader set of institutional investors beyond OIC member countries.¹⁵⁵

Global recognition: Impact investment has emerged as a promising tool for financing the 2030 Agenda for Sustainable Development. Linking Islamic finance and impact investing will position Islamic finance among the major global development-financing instruments and expand the reach of Islamic finance to non-Muslim countries.

Expanding the scope of innovative Islamic finance instruments towards the needy: Shariah-compliant financial instruments today generally serve the wealthier segments of the Muslim community. Bridging Islamic finance with impact investing will pave the way towards putting more effort into developing innovative products that benefit the less well off. The ethical principles of Islamic finance, such as social justice, economic empowerment and equitable distribution of wealth, will be promoted as a result.

Value Proposition for Member Countries of the Organisation of Islamic Cooperation

Although OIC member countries account for 22 percent of the world’s population, they house 40 percent of the world’s poor who live on US\$1.25 a day or less, and their total GDP accounts for 7.0 percent of world GDP. The total GDP of the less-developed member countries (LDMCs) is only 4.5 percent of the total GDP of the IDB member countries, but the population of LDMCs accounts for 25 percent of the total population of IDB member countries. Nineteen of the 50 IDB member countries are in the low-income country group.¹⁵⁶

While public investment is vital for development, a dynamic private sector can significantly contribute to development of an economy. Promoting entrepreneurship and supporting innovative business model development are key drivers of economic growth and development, especially in developing and emerging countries. Limited or no access to finance is one bottleneck within the business chain, which hinders the poor from borrowing and saving money, establishing and expanding businesses and dealing with uncertainties. Religious norms should be counted as an influential decision factor in access to finance interventions in Muslim countries. Approximately one third of SMEs in the MENA region are excluded from the formal banking sector because they seek shariah-compliant products that are not readily available in the market.¹⁵⁷



Islamic Finance and Impact Investing Instruments

Although impact investing is a relatively novel concept in Muslim-majority countries, there are already a number of tools and products compatible with the spirit of impact investment in use around the globe (Table 11). This section provides a bird’s-eye view of these tools and products.

Table 11: Islamic Finance Modes and Instruments for Impact Investment

Impact Investment Fund Type	Instrument	Impact Enterprises	Sample Results/ Beneficiaries
Crowdfunding	Per crowd type: Donation: <i>hibah, qarḍ ḥasan, murābaḥah</i> ; Reward: sale; Microfinance: <i>murābaḥah, ijārah</i> ; Equity: <i>mushārahah</i> ; Diminishing: <i>mushārahah</i> ¹⁵⁸	Crowdfunding platforms	Microenterprises
Green Investments	Green <i>ṣukūk</i>	Renewable energy enterprises	Reduction in carbon emissions
Microfinance	Transactional and equity contracts supported with Islamic social finance instruments	MFIs	Financial inclusion
Insurance coverage for the poor	<i>Takāful/micro-takāful</i>	Microinsurance	Risk mitigation
Social investments	SRI <i>ṣukūk</i>	Government programmes; Inclusive business; Social businesses	Improved access to health, education, etc.
SME finance	See Table 12 for various modes	SMEs	Livelihood improvement
Value chain	Transactional and equity contracts	Cooperatives; Inclusive businesses	Employment

Crowdfunding

Crowdfunded investing has been defined as securing funding for a specific project or a business venture by raising money from a dispersed group of people with shared interests—“the crowd”.¹⁵⁹ In 2014 global crowdfunding expanded by 167 percent to raise US\$16.2 billion, up from US\$6.1 billion in 2013. In 2015, the industry is expected to double once again to raise US\$34.4 billion.¹⁶⁰

There are four categories of crowdfunding platforms: equity-based (shareholder contract), lending-based (credit contract), donation-based (donor contract) and reward-based crowdfunding (purchase contract). Equity-based and lending-based crowdfunding embrace financial return expectations, while donation-based



and reward-based crowdfunding are effective tools for campaigns that appeal to funders' values.¹⁶¹ With a strong community-based approach, crowdfunding is compliant with the *maqāṣid al-sharī'ah*, and can be an alternative source of development investment that might combine business and human development.

Crowdfunding has shown an upward trend in Muslim-majority financial markets in recent years. Employing the principles of impact investing to measure the social and environmental impacts of their initiatives, these programmes might set more concrete goals, thereby communicating more effectively with prospective donors, investors and other external stakeholders.

Green Investments

Green investments deploy money to enterprises or projects that are committed to environmentally conscious business practices such as reducing energy consumption or using green technologies in production. US\$41.8 billion worth of green bonds were issued globally in 2015.¹⁶²

The key financial instrument by which Islamic finance facilitates green investment is green *ṣukūk*. The Climate Bonds Initiative defines green *ṣukūk* as “Shari’ah compliant investments in renewable energy and other environmental assets”.¹⁶³ Projects funded by green *ṣukūk* include clean energy, mass transit, water conservation, forestry and low-carbon technologies.¹⁶⁴ Green *ṣukūk* can be used for the same purposes as a green bond.

Green *ṣukūk* are gaining traction as issuers seek to find low-cost sources of Islamic financing to fund infrastructure projects. Malaysia is a leader in providing funding to environmentally friendly projects through *ṣukūk*. The Malaysia International Islamic Financial Centre Community reports that “over the past four years, Islamic financing has grown to account for over 40 percent of all funds granted under the Green Technology Financing Scheme, facilitated by Malaysian Green Technology Corporation.” The scheme commenced with a budget of MYR1.5 billion (US\$0.45 billion) soft loan to companies and users of green technology.¹⁶⁵

In August 2014, the Securities Commission of Malaysia published guidelines for the issuance of sustainable and responsible investment *ṣukūk*. Furthermore, within the GCC, the Dubai Supreme Council of Energy has announced a partnership with the World Bank to develop a green investment strategy, which will potentially incorporate *ṣukūk*.¹⁶⁶ Another example, Morocco’s Ouarzazate 1 (the world’s largest concentrating solar plant, currently under construction) is being financed by green bonds along with other development bank sources.

Microfinance

Microfinance has emerged as a growing means to provide a range of financial services such as credit, savings and insurance to low-income enterprises and households.¹⁶⁷ Islamic microfinance has the potential to call on Islamic social principles to provide financial access to the poor living in Muslim-majority countries who do not use formal financial services because of their religious beliefs. IRTI identifies three kinds of Islamic MFIs:

- Islamic MFIs that use for-profit contracts but seek modest returns on investment to ensure sustainability of operations;
- Not-for-profit Islamic organizations and member-based cooperatives that are also based on for-profit contracts;
- Not-for-profit Islamic organizations and member-based cooperatives that are based on not-for-profit contracts such as *qard*, *kafālah*, *ḥawālah*, etc.¹⁶⁸

A United Kingdom-based research company forecast the global Islamic microfinance market to grow at 19.7



Current Areas of Overlap Between Islamic Finance and Impact Investing

percent per year over the period 2013–2018.¹⁶⁹ Islamic microfinance had an estimated 1.28 million clients in 19 countries in 2013, about four fifths of whom resided in Bangladesh, Indonesia and Sudan.¹⁷⁰ More than one third (36 percent) of Islamic banks surveyed in 2013 reported offering microfinance facilities. Even so, this customer base represents less than 1 percent of microfinance clients worldwide.¹⁷¹

As global Islamic MFIs constitute only a small percentage of the total microfinance industry, information on their performance is limited. The Islamic microfinance sector has so far rested on a narrow base of financial support. The base can be broadened by shifting the focus from donor-dependent organizations to tap the Islamic capital markets. Microfinance and other smaller financial institutions could also raise funds through *ṣukūk*.¹⁷²

Socially Responsible Investment

SRI can be described as an investment strategy that seeks to consider financial returns along with social goods that can be summarized under the heading of environmental benefits, social justice and corporate governance. A key instrument by which Islamic finance facilitates SRI is SRI *ṣukūk*.

Malaysia takes the lead in providing SRI *ṣukūk*. In 2014, the Securities Commission of Malaysia launched the Sustainable and Responsible Investment (SRI) *ṣukūk* Framework “to facilitate the financing of sustainable and responsible investment initiatives”.¹⁷³ In 2015, Khazanah Nasional Berhad, the strategic investment fund of the Government of Malaysia, offered RM100 million worth of SRI *ṣukūk*, labelled as Malaysia’s first SRI *ṣukūk*.¹⁷⁴

Value Chain and Small and Medium-sized Enterprise Finance

The G20 Inclusive Business Framework cited access to finance throughout the value chain and financial incentives as important means of increasing access to markets by the poor.¹⁷⁵ Impact investing emerges as a potent source of development finance by creating, managing and scaling up inclusive businesses.¹⁷⁶

SME finance—the funding of small and medium-sized enterprises—accounts for most of the formal jobs in emerging and frontier markets.¹⁷⁷ Approximately 35 percent of SMEs in the MENA region are excluded from the formal banking sector due to the lack of shariah-compliant products in the market. Islamic finance can play a significant role in closing the financing gap for SMEs through asset-based financing options.

Bahrain-based Bank Al Baraka (BAB), for example, offers diminishing *mushārahah* products for SMEs in a range of industries, including trade, retail, grocery, bakeries, auto garages and metalwork. The Pakistan branch of Wasil Foundation, on the other hand, offers *salam*-based products that allow advance-purchase agreements, predominantly in agriculture, to help smallholder farmers benefit from government-set crop prices.¹⁷⁸

Table 12 lists some proposed Islamic finance products for SMEs.¹⁷⁹

Takāful and *Micro-takāful*

Microinsurance is a mechanism to protect low-income people against risk, such as accident, illness and natural disaster, in exchange for insurance premium payments tailored to their needs, income and level of risk.

Takāful and *micro-takāful* are two forms of insurance and microinsurance in Muslim countries that are devised to ease vulnerability and alleviate the negative effects of natural or human-made disasters on the poor. *Takāful* policyholders agree to guarantee each other by making contributions to a mutual fund, or pool, which creates the *takāful* fund.¹⁸⁰ *Micro-takāful* products are primarily designed as “small size”, regular *takāful* products that are subject to the same considerations concerning profitability, sustainability and legal format as other *takāful* products.



Table 12: Islamic Finance Modes and Instruments for the Needs of Small and Medium-sized Enterprises

Product	Modes
Working capital financing	<i>Murābahah, salam, istiṣnā'</i>
SME trade finance: <ul style="list-style-type: none"> › Letter of credit › Export credit financing › Bank guarantee › Bills of exchange purchased › Trust receipts 	<i>Murābahah, salam, istiṣnā'</i> Other modes, such as <i>kafālah, wakālah, ḥawālah</i> may be used
<ul style="list-style-type: none"> › Asset acquisition and business expansion: SME auto (transport sector buses, coaches or trolleys or oil tankers, fleet car finance) › Plant factory financing › Equipment financing (photocopier, X-ray, digital lab) 	<i>Ijarah, diminishing mushārakah</i>
<ul style="list-style-type: none"> › Development of rural area infrastructure as required by local government. This may include schools, hospitals, roads, power houses targeting rural areas › Housing sector development and construction of houses, go-downs and commercial buildings 	<i>Istiṣnā', diminishing mushārakah</i>
<ul style="list-style-type: none"> › Financing productive activities, particularly agriculture, agro-based industries › Financing for a stable commodities market 	<i>Salam</i>

The IFSB and International Association of Insurance Supervisors (IAIS) published a joint paper on the regulation and supervision of micro-*takāful* that underlines the need to clearly define the roles and responsibilities of the stakeholders in establishing a cooperation mechanism and defining specific areas for micro-*takāful* regulation, such as corporate governance of operators, consumer protection, solvency requirements, underwriting practices and funds management.¹⁸¹

Micro-*takāful* products are not yet widely used by the Islamic financial institutions. There are few micro-*takāful* institutions in operation to provide insurance coverage to the poor and underserved populations in line with Islamic law. Proliferation of micro-*takāful* institutions operating on the ground can provide a safety net for these groups to sustain their standard of living, especially in times of crisis.¹⁸²

This chapter has identified some of the potential areas in which Islamic financing can supplement, build on and converge with impact investing principles and practices, especially when addressing the financing needs of SMEs in Muslim-majority countries and providing microfinancing products to the poor. The next chapter considers the joint efforts of UNDP and the IDB to build on the potential synergies between Islamic financing and impact investing.





Chapter 6

Global Islamic Finance and Impact Investing Platform: Blending Islamic Finance and Impact Investing for the SDGs

*The GIFIP, led by IRTI (of the IDB) and IICPSD (of UNDP), is an example of a partnership designed to foster linkages between Islamic finance and impact investment. This platform builds on innovation, entrepreneurship and multi-stakeholder collaborations to maximize the scale and effectiveness of development investments. The GIFIP serves as a **knowledge hub** for promoting peer-learning and experience-sharing, a **forum** for policy dialogue and advocacy and a **marketplace** for deal-sourcing and matchmaking. Connecting Islamic financiers with impact investors and impact enterprises, the platform drives innovative business solutions to help address sustainable development challenges in a fair, transparent, quantifiable and verifiable manner.*



Strategies to Grow the Area of Overlap

The financial needs of the SDGs—and the potential and promise of Islamic finance and impact investing—encouraged the IDB and UNDP to strategize and act on the convergence of Islamic finance and impact investing. The ethical and social orientation of Islamic finance resonates well with the concept of impact investing. Providing policy frameworks to grow the current areas of overlap and strengthen the enabling environment can support SDG financing through funding green and inclusive businesses, social enterprises and value chains, as well as MSMEs, towards enhancing poverty alleviation and sustainable human development.

The impact investing industry, although growing and expanding fast, needs support for its mainstreaming. Developed markets and countries, such as members of the G8 and some members of the OECD, have explored the impact investing concept and embraced it as a policy. However, in many developing countries, and especially among IDB member countries, impact investing needs support. What is more, Islamic finance impact investing, at the intersection of two sectors, requires foundational work.

Islamic finance assets are concentrated in the Islamic banking industry in a limited group of countries. However, the asset-based nature of the Islamic banking industry and the rapid growth of Islamic financial services are promising for the proliferation of innovations. In our digitized, global world, the new way of living and acting is amplified by the values of “millennials” who are insisting upon responsible business practices. Building on the strong foundation of Islamic social finance principles, institutions and instruments such as *zakāh*, *awqāf* and *qard ḥasan*, and taking account of the Islamic microfinance and SME finance experience, new forms of socially responsible, Islamic finance instruments and approaches, such as Islamic crowdsourcing and green and socially responsible *ṣukūk*, are emerging. In this context, Islamic impact investing is establishing itself at the intersection of impact investing and Islamic finance.

Despite the microfoundational alignments, there is limited interaction between these two highly relevant sectors, as shown by the very small number of GIIN members with shariah-compliant offerings. To catalyse and stimulate activities at the intersection of impact investing and Islamic finance, an ecosystem approach is required, in order to develop the capacities and capabilities of key stakeholders in the ecosystem simultaneously.

The AAAA states that a global framework for financing the 2030 Agenda necessitates solutions such as “strengthening public policies, regulatory frameworks and finance at all levels, unlocking the transformative potential of people and the private sector, and incentivizing changes in financing as well as consumption and production patterns to support sustainable development.”¹⁸³ In the light of the AAAA recommendations and the research underpinning this report, UNDP and the IDB came together to catalyse the convergence by influencing the ecosystem and reaching out to the stakeholders at all levels.

On the Islamic finance side, the IDB has strong links with the Islamic finance network and can provide technical guidance for convergence. On the development and impact side, UNDP has convening power, field presence and solid knowledge of local context. The IDB–UNDP partnership is well positioned to foster an Islamic finance impact investing ecosystem. The partners’ ability to identify, develop, manage and verify a pipeline of bankable projects would provide a key asset for deal-sourcing and growth. In this context, key interventions to establish the ecosystem fall mainly into four categories: creating and maintaining an enabling environment, advocating for the concept, convening stakeholders and establishing a centre of excellence to sustain these functions.



The first step is creating an enabling environment to promote Islamic finance impact investing as part of the larger dialogue on inclusive financial systems and responsible investing principles. An efficient and effective capital markets system with distribution channels to reach various types of institutional investors on the supply side could support scaling up the area of overlap. Supporting the creation and functioning of an effective capital market system for Islamic finance impact investing includes supporting existing and new intermediaries. Furthermore, such a market should be able to integrate measurable social and environmental impacts for the capital the investors contribute, with financial rigour. Creation of such a marketplace with appropriate institutions would also encourage impact enterprises on the demand side to adopt clear models for creating non-financial impact, provide a solid framework for measuring and reporting performance and help them develop the leadership and management capabilities they need to achieve their missions.¹⁸⁴

Well-thought-out, systemic and comprehensive regulatory, accountability, tax and legal frameworks are necessary to facilitate growth in Islamic finance impact investing. Governments could set such environments within their mandate, or could collaborate with other stakeholders to create intra- or interregional regulatory standards. Such frameworks would not only place Islamic finance impact investing within the larger dialogue of impact investment but would also attract institutional investors.

Passporting or disseminating through cooperation could help to address some of the issues of scale in Islamic investing. This strategy creates a commonly agreed framework for policy and regulation among members that makes doing business within the community consistent by adopting the same rules across the member countries. In this way, smaller fund managers or institutional investors can operate within a larger base of countries and investments as if it were one, thereby simplifying and opening up the market to more investors and to investments external to the local market.

The second step is advocating for Islamic finance impact investing to be included in the larger dialogue for Islamic finance, impact investing and creating financially inclusive environments. Raising awareness in the international development, Islamic finance and impact investment communities about the current level of convergence of Islamic and impact investing is important in promoting a collaborative dialogue for the SDGs. This includes further engagement with their platforms to promote similarities and overlap. The Islamic finance tools and products outlined in the previous chapter are compatible with the spirit of impact investing, as evidenced by their intention to generate positive social or environmental impact at the outset, as well as a financial return. Incorporating a standard for impact measurement and reporting may help attract more capital to these tools and initiatives, as they help quantify the social and environmental outcomes of a particular investment. Therefore, it is imperative for the shariah-compliant impact investors and impact enterprises to develop “a common language and data infrastructure”¹⁸⁵ for impact measurement in line with the common practices of the global impact investing community.

Third, convening key and innovative actors from government, the private sector and support organizations in both the Islamic and conventional impact investing realms could help them to discuss critical bottlenecks, learn from best practices, establish relationships and benefit from cross-pollination of ideas and shared beliefs.

Finally, establishing a centre of excellence to foster Islamic finance impact investing is part of the global dialogue on politically neutral, inclusive financial systems. The centre of excellence will support the conceptualization of Islamic finance impact investing through:

- › developing, adapting and codifying standards, metrics and monitoring tools for Islamic finance impact investing;



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- › promoting areas of overlap between Islamic finance and impact investing through research and publication of good practices and case studies;
- › facilitating knowledge transfer among the actors in Islamic finance and impact investing to encourage the areas of overlap through training and workshops.

The IDB and UNDP are uniquely positioned to advance the area of convergence between Islamic finance and impact investing because of their convening power, global reach, technical expertise and impartiality. Together, they established the GIFIIP in 2016 to position Islamic finance impact investing as one of the leading enablers of SDG implementation around the world through private sector engagement. By bringing together different actors in Islamic finance impact investing, the IDB and UNDP aim to create a collaborative working space among stakeholders and nurture an Islamic finance impact investing business ecosystem.

The Global Islamic Finance and Impact Investing Platform

The GIFIIP, led by the IRTI and IICPSD, engages the private sector, governments and key stakeholders operating in the Islamic finance and impact investing markets to promote market-based solutions to sustainable development challenges, by creating a collaborative working space among these actors.

Vision

Its vision is to position Islamic finance and impact investing as a leading enabler of global SDG implementation through private sector engagement.

Mission

The Platform will strategize and nurture an Islamic finance and impact investing business ecosystem through:

- › developing a spectrum of shariah-compliant impact investing tools and instruments;
- › improving the access of impact enterprises to Islamic funding.

Strategy

IICPSD and the IDB have defined a three-pillar strategy to advance the GIFIIP:

Conceptualization and capacity-building: Maintain a network of Islamic finance impact investors to foster an Islamic finance and impact investing ecosystem. Knowledge products, tools and data will aim to equip its members from the impact investment industry and the Islamic finance industry with the necessary know-how for the establishment and growth of this new niche industry.

Advocacy and inter-industry collaboration: Engage in advocacy to raise awareness on the compatibility of Islamic finance and impact investing and their capacity to implement the SDGs, and build bridges between Islamic finance and impact investing. The Platform will accomplish this by targeted advocacy work in large-scale global Islamic finance and impact investing conferences and forums, such as the World Bank Annual Conference on Islamic Banking and Finance, the World Islamic Economic Forum, etc.

Deal-sourcing and matchmaking: Play a matchmaking role between investors and other players in the ecosystem, such as business incubators, development organizations and, most importantly, inclusive business ventures seeking capital. Such functions significantly reduce the time, effort and costs involved in due diligence and help overcome information barriers to investors. The Platform will also convene and increase finance opportunities among relevant industries.



Anticipated Outcomes

The following outcomes are anticipated from the GIFIIP:

- › Developed principles, policies, tools and practices to foster a stable and inclusive Islamic finance and impact investing climate;
- › Increased knowledge-sharing awareness of good practices and efficient organizational structures;
- › Enhanced access to capital for impact enterprises that have avoided conventional finance for religious reasons;
- › Improved access to sustainable livelihood opportunities through an innovative and competitive market-based approach;
- › The addressing of information and funding gaps between investors and impact enterprises.

Governance and Operational Structure

The GIFIIP is established as a joint programme between the IDB and UNDP, operated by a Secretariat operationally managed by IICPSD.

The GIFIIP's governance and programme implementation structure is planned to be comprised of the following bodies and formations:

The **Executive Committee** will act as the primary governing body providing strategic oversight for the Platform and its Secretariat. The Executive Committee will be composed of lead representatives from the IDB and UNDP, as well as the Platform's funding partners.

The **Advisory Board** will be the main consultative body of the GIFIIP. Advisory Board members will provide advisory inputs to and assist in joint activities with the Secretariat.

The **Secretariat** will be responsible for the management and coordination of the Platform's day-to-day activities, including the establishment and enlargement of the Platform network. The Secretariat is subject to the direction and guidance of the Executive Committee.

Businesses that commit to engaging in Islamic finance impact investing in line with a mutually agreed work plan will be invited to join the **GIFIIP Members Network**. This will act in an advisory capacity to the Executive Committee and will elect a representative to join the Executive Committee on a yearly basis. The GIFIIP Members Network will be composed of impact investors, Islamic financiers, fund managers and impact enterprises.



ENDNOTES

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- ² United Nations, 2015a.
- ³ United Nations Conference on Trade and Development, 2014.
- ⁴ Ro, 2015.
- ⁵ Global Impact Investing Network, n.d.
- ⁶ United Nations Principles for Responsible Investment, 2017.
- ⁷ JPMorgan Chase, The Rockefeller Foundation, and Global Impact Investing Network, 2010.
- ⁸ International Monetary Fund, 2017b.
- ⁹ Thomson Reuters and Dinar Standard, 2015.
- ¹⁰ Islamic Development Bank, 2015.
- ¹¹ Social Impact Investment Taskforce, 2014b.
- ¹² Shiller, 2012.
- ¹³ Addis, Macleod, and Raine, 2013.
- ¹⁴ European Commission, 2011.
- ¹⁵ Government of the United Kingdom, 2015.
- ¹⁶ United Nations Development Programme, 2015.
- ¹⁷ Organisation for Economic Co-operation and Development, 2017.
- ¹⁸ United Nations, 2015b.
- ¹⁹ Morgan Stanley, 2015.
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- ²¹ United States Trust, Bank of America Private Wealth Management, 2017.
- ²² Wilson, 2015.
- ²³ United Nations Development Programme, 2015.
- ²⁴ United Nations, 2015b.
- ²⁵ United Nations, 2015a.
- ²⁶ Svedova, Cuyegkeng, and Tansey, 2014.
- ²⁷ Mudaliar, Schiff, and Bass, 2016.
- ²⁸ Svedova, Cuyegkeng, and Tansey, 2014.
- ²⁹ Bridges Ventures, The Parthenon Group, and Global Impact Investing Network, 2010.
- ³⁰ Social Impact Investment Taskforce, 2014c.
- ³¹ See resources at <https://www.globalreporting.org/standards>.
- ³² See resources at http://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/sustainability-at-ifc/policies-standards/performance-standards.
- ³³ Social Reporting Standards, 2014.
- ³⁴ Rangan, Appleby, and Moon, 2012.
- ³⁵ Reeder and Colantonio, 2013.
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- ³⁹ Mudaliar, Schiff, and Bass, 2016.
- ⁴⁰ JPMorgan Chase & Co., The Rockefeller Foundation and Global Impact Investing Network, Inc, 2010.
- ⁴¹ For a brief overview of the evolution of the impact investing space and the prominent players globally, see ET Jackson and Associates, "Accelerating Impact: Achievements, Challenges and What's Next in Building the Impact Investing Industry" (New York: Rockefeller Foundation, 2012).



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- ⁴² Kidney, 2016.
- ⁴³ Bloomberg New Energy Finance, 2014.
- ⁴⁴ For more information, see <https://www.rockefellerfoundation.org/our-work/initiatives/social-impact-bonds/>.
- ⁴⁵ Mudaliar, Schiff, and Bass, 2016.
- ⁴⁶ An HNWI is usually considered a “qualified” investor when he or she has at least US\$1 million in liquid assets.
- ⁴⁷ Vaccaro, 2014.
- ⁴⁸ Etzel, 2015.
- ⁴⁹ Lilly Family School of Philanthropy, 2013.
- ⁵⁰ Grant, 2012.
- ⁵¹ Holland, 2014.
- ⁵² World Economic Forum, 2013.
- ⁵³ Mudaliar, Schiff, and Bass, 2016.
- ⁵⁴ Sottas, 2014.
- ⁵⁵ Eurosif, 2012.
- ⁵⁶ Blundell-Wignall, Hu, and Yermo, 2008.
- ⁵⁷ United Nations, 2013.
- ⁵⁸ World Economic Forum, 2013.
- ⁵⁹ LeapFrog Investments. See <http://www.leapfroginvest.com/>.
- ⁶⁰ Aavishkaar. See <http://www.aavishkaar.in>.
- ⁶¹ European Investment Fund, 2013.
- ⁶² Buiters and Fries, 2012.
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- ⁶⁴ Ngoasong, Paton, and Korda, 2015.
- ⁶⁵ Barnett, 2012.
- ⁶⁶ International Labour Organization, 2010.
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- ⁶⁸ Mudaliar, Schiff, and Bass, 2016.
- ⁶⁹ Hasan and Dridi, 2010.
- ⁷⁰ International Monetary Fund, 2017b.
- ⁷¹ Thomson Reuters and Dinar Standard, 2015.
- ⁷² Prasad, 2015.
- ⁷³ Izhar and Rehman, 2015.
- ⁷⁴ Composed of four distinct phases: the early years (1975–1991); the era of globalization (1991–2001); post-11 September, 2001; and after the 2008 global financial crisis.
- ⁷⁵ A legal right accorded to a person or party that confers the temporary right to use and derive income or benefit from someone else’s property. See Investopedia. 2003. “Usufruct.” <http://www.investopedia.com/terms/u/usufruct.asp>.
- ⁷⁶ Ayub, 2007.
- ⁷⁷ Islamic Financial Services Board, Islamic Development Bank, and Islamic Research and Training Institute, 2010.
- ⁷⁸ Ayub, 2007.
- ⁷⁹ Iqbal and Mirakhor, 2013.
- ⁸⁰ Ibid.
- ⁸¹ Islamic Research and Training Institute, 2015a.
- ⁸² Ibid.



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- ⁸³ Hussain, Shahmoradi, and Turk, 2015.
- ⁸⁴ “*Murābaha* Definition”. Lexicon.Ft.Com. <http://lexicon.ft.com/Term?term=murabaha>.
- ⁸⁵ Accounting and Auditing Organization for Islamic Financial Institutions, Shariah Standard No. (8) on *murābahah* 5/4 page 213 states: “It is not permissible to stipulate that the ownership of the item will not be transferred to the customer until the full payment of the selling price. However, it is permissible to postpone the registration of the asset in the customer’s name as a guarantee of the full payment of the selling price. The Institution may receive authority from the customer to sell the asset in case the customer delays payment of the selling price, in which case the Institution should issue a counter-deed to the customer to establish the latter’s right to ownership. If the Institution sells the asset as a result of the customer’s failure to make a payment of the selling price on its due date, it must confine itself to recovering the amount due to it and must return the balance to the customer.”
- ⁸⁶ Norton, 2008.
- ⁸⁷ Islamic Development Bank, 2016.
- ⁸⁸ Norton, 2008.
- ⁸⁹ Islamic Research and Training Institute, 2013.
- ⁹⁰ Obaidullah, 2005.
- ⁹¹ Accounting and Auditing Organization for Islamic Financial Institutions, Shariah Standard No. (13) on *muḍārabah* 4/4 page 371 states: “A *muḍārabah* contract is one of the trust-based contracts. Therefore, the *muḍārib* is investing *muḍārabah* capital on a trust basis in which case the *muḍārib* is not liable for losses except in case of breach of the requirements of trust, such as misconduct in respect to the *muḍārabah* fund, negligence and breach of the terms of *muḍārabah* contract. In committing these, the *muḍārib* becomes liable for the amount of the *muḍārabah* capital.”
- ⁹² Obaidullah, 2005.
- ⁹³ Accounting and Auditing Organization for Islamic Financial Institutions, Shariah Standard No. (12) on diminishing *mushārakah* 5/4 p. 347. 3/1/5/4
- ⁹⁴ Kahf, 2017.
- ⁹⁵ Norton, 2008.
- ⁹⁶ Kettell, 2011.
- ⁹⁷ Hussien, 2013.
- ⁹⁸ Islamic Financial Services Board, 2016.
- ⁹⁹ Thomson Reuters and Dinar Standard, 2015.
- ¹⁰⁰ Izhar and Rehman, 2015.
- ¹⁰¹ Iqbal and Mirakhor, 2013.
- ¹⁰² Islamic Financial Services Board, 2016.
- ¹⁰³ Within the Islamic Finance Development Indicator Report (IFDIR) universe of 108 countries.
- ¹⁰⁴ Islamic Financial Services Board, 2016.
- ¹⁰⁵ EY, 2016.
- ¹⁰⁶ Accounting and Auditing Organization for Islamic Financial Institutions. Definition in paragraph 2 of page 307 of *Shari’a Standards for Financial Institutions*, 2008.
- ¹⁰⁷ Islamic Development Bank, 2010.
- ¹⁰⁸ Thomson Reuters and Dinar Standard, 2015.
- ¹⁰⁹ Islamic Development Bank Group, Islamic Research and Training Institute, and Islamic Financial Services Board, 2014.
- ¹¹⁰ International Islamic Financial Market, 2016.
- ¹¹¹ The Economist, 2014.
- ¹¹² Association of the Luxembourg Fund Industry, 2012.
- ¹¹³ Gillet and Salaber-Ayton, 2017.
- ¹¹⁴ PriceWaterhouseCoopers, 2009.
- ¹¹⁵ Association of the Luxembourg Fund Industry, 2012.
- ¹¹⁶ Hasan, Mohamed, and Eid, 2015.



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- ¹¹⁷ Ibid.
- ¹¹⁸ Onagun, 2011.
- ¹¹⁹ Global Impact Investing Network and Open Capital Advisors, 2015.
- ¹²⁰ See <https://www.islamicfinancenews.com/islamic-microfinance-between-charity-and-commercialization-a-market-outlook.html>.
- ¹²¹ Islamic Development Bank, 2013.
- ¹²² Islamic Development Bank, 2017.
- ¹²³ Kasim, Nu NuHtay, and Salman, 2013.
- ¹²⁴ PriceWaterhouseCoopers, 2009.
- ¹²⁵ AAOIFI, 2015.
- ¹²⁶ General Council of Islamic Banks and Financial Institutions, 2017.
- ¹²⁷ Islamic Financial Services Board, 2017.
- ¹²⁸ International Islamic Centre for Reconciliation and Arbitration, 2017.
- ¹²⁹ International Islamic Financial Market, 2017.
- ¹³⁰ Islamic International Rating Agency, 2017.
- ¹³¹ International Islamic Liquidity Management Corporation, n.d.
- ¹³² Liquidity Management Centre, 2017.
- ¹³³ Chapra, 2007.
- ¹³⁴ Islamic Development Bank Group, Islamic Research and Training Institute, and Islamic Financial Services Board, 2007.
- ¹³⁵ Kammer and others, 2015.
- ¹³⁶ Finance Accreditation Agency, 2017.
- ¹³⁷ Islamic Development Bank Group, Islamic Research and Training Institute and Islamic Financial Services Board, 2007.
- ¹³⁸ Malaysia International Islamic Financial Centre, 2015.
- ¹³⁹ Al-Salem, 2009.
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- ¹⁴² Witooyo, 2016.
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- ¹⁴⁴ Izhar and Rehman, 2015.
- ¹⁴⁵ Islamic Development Bank, 2015.
- ¹⁴⁶ Kammer and others, 2015.
- ¹⁴⁷ Accounting and Auditing Organization for Islamic Financial Institutions, 2017.
- ¹⁴⁸ Chapra, 2000.
- ¹⁴⁹ Asutay, 2014.
- ¹⁵⁰ Hayat, 2012.
- ¹⁵¹ Asutay, 2014.
- ¹⁵² Islamic Development Bank, 2015.
- ¹⁵³ G20 Development Working Group, 2015.
- ¹⁵⁴ Rehman, 2015.
- ¹⁵⁵ Ibid.
- ¹⁵⁶ Islamic Development Bank, 2014.
- ¹⁵⁷ Alam, 2015.
- ¹⁵⁸ Asutay, 2014.
- ¹⁵⁹ Kumpf, 2014.



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- ¹⁶² Climate Bonds Initiative, 2017.
- ¹⁶³ Ibid.
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- ¹⁶⁸ Islamic Research and Training Institute, 2015a.
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- ¹⁷¹ Islamic Development Bank Group, Islamic Research and Training Institute, and Islamic Financial Services Board, 2014.
- ¹⁷² Ibid.
- ¹⁷³ Securities Commission Malaysia, 2014.
- ¹⁷⁴ Khazanah Nasional Berhad, 2015.
- ¹⁷⁵ G20 Development Working Group, 2015.
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- ¹⁷⁷ Makhoul, 2017.
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- ¹⁷⁹ Said, Ahmad, and Javaid, n.d.
- ¹⁸⁰ Institute of Islamic Banking and Insurance, 2017.
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GLOSSARY

	Transliterated as	English Meaning
عَالِمٌ (عُلَمَاءُ)	'alim ('ulamā')	scholar(s)
أَوْقَافٌ	awqāf	
بَيْعُ الْمُرَابَحَةِ	bay' al-murābahah	mark-up sale
بَيْعٌ (بَيْعٌ)	bay' (buyū')	sale(s)
بَيْعُ السَّلْمِ	bay' al-salam	sale in which payment is made in advance by the buyer and the delivery of goods is deferred by the seller
بَيْعٌ مُؤَجَّلٌ	bay' mu'ajjal	credit sale or sale at deferred payment
دِينَارٌ	dīnār	Dinar (currency)
فَتْوَى (فَتَاوَى)	fatwa (fatāwá)	religious verdict(s) made by a <i>faqih</i> competent <i>shari'a</i> scholar
فِقْهُ	fiqh	Islamic jurisprudence
فِقْهُ الْمُعَامَلَاتِ	fiqh al-mu'āmalāt	jurisprudence of transactions
غَرَرٌ	gharar	excessive risk and uncertainty, ambiguity
غَرَرٌ فَاحِشٌ	gharar fāhish	excessive risk
حَلَالٌ	ḥalāl	permissible, lawful, allowed
حَرَامٌ	ḥarām	not permissible, unlawful, not allowed
حَوَالَةٌ	ḥawālah	bill of exchange, promissory note, cheque, draft
هِبَةٌ (هِبَاتٌ)	hibah (hibat)	donation(s), gift(s)
إِحْسَانٌ	iḥsān	benevolence, compassion, kindness
إِجَارَةٌ	ijārah	leasing, rent
إِسْلَامٌ	islām	submission, peace
إِسْتِصْنَاعٌ	istiṣnā'	manufacturing contract whereby a manufacturer agrees to produce (build) and deliver a well-described good (or premise) at a given price on a given date in the future
كَفَالَةٌ	kafālah	guarantee
خَيْرٌ	khayr	good, beneficial
مَالٌ (أَمْوَالٌ)	māl (amwāl)	capital, money, property, wealth
مَنْفَعَةٌ (مَنْفَعَاتٌ)	manfa'ah (manāfi')	benefit(s), utility/utilities, usufruct(s)



	Transliterated as	English Meaning
مَقْصِد (مَقَاصِدُ الشَّرِيعَةِ)	<i>maqṣad (maqāṣid al-Sharī'ah)</i>	objectives of Islamic Law
مَصْلَحَة (مَصَالِح) مُرْسَلَة	<i>maṣlahah (maṣāliḥ) mursalah</i>	general benefits, public interest(s)
مَيْسِر	<i>maysir</i>	gambling
مُضَارَبَة	<i>muḍārabah</i>	partnership whereby one party, the capital owner, provides capital to an entrepreneur to undertake a business activity; profits are shared between them as agreed but any financial loss is borne only by the capital owner as one's loss is one's unrewarded efforts put into the business activity
مُرَابَحَة	<i>murābahah</i>	mark-up sale, sale at a margin
مُشَارَكَة	<i>mushārahah</i>	partnership whereby all the partners contribute capital for a business venture; they share profits on a pre-agreed ratio while losses are shared according to each partner's capital contribution
مُشَارَكَة مُتَنَاقِضَة	<i>mushārahah mutanāqishah</i>	diminishing partnership
مُشْتَرِك	<i>mushtarik</i>	participant
مُزَارَعَة	<i>muzāra'ah</i>	sharecropping contract whereby one party agrees to provide land, seeds and equipment and the other agrees to do the work needed in return for a part of the produce of the land
قَرْض (قُرُوض)	<i>qarḍ (qurūḍ)</i>	loan(s)
قَرْض حَسَن	<i>qarḍ ḥasan</i>	interest-free loan
قُرْآن	<i>Qur'ān</i>	the sacred book of Islam
قُرُوض	<i>qurūḍ</i>	loans
رَبُّ الْمَال (أَرْبَابُ الْمَال)	<i>rabb al-māl arbāb al-māl</i>	capital owner(s)
رِبَا	<i>ribā</i>	usury, interest
صَدَقَة (صَدَقَات)	<i>ṣadaqāt</i>	charity/charities
صَكّ (صُكُوك)	<i>ṣakk (ṣukūk)</i>	asset-based or asset-backed financial certificate(s)
سَلَف	<i>salaf</i>	loan; another word for <i>salam</i>
سَلَم	<i>salam</i>	forward sale where the price of a specific good is paid in advance for its delivery at a specified time in the future



	Transliterated as	English Meaning
شَرَاكَة	<i>sharākah</i>	partnership
شَرِيْعَة	<i>Sharī'ah</i>	Islamic law
صُكُوك	<i>ṣukūk</i>	equity-based certificates of investment
تَعَاوُن	<i>ta'āwun</i>	cooperation
تَأْمِيْن	<i>ta'mīn</i>	insurance
تَكَافُل	<i>takāful</i>	solidarity, mutual support
تَكَافُل تَعَاوُنِي	<i>takāful ta'awuni</i>	cooperative risk-sharing and mutual insurance
وَدِيْعَة (وَدَائِع)	<i>wadī'ah (wadā'i')</i>	deposit(s)
وَكَالَة (وَكَالَات)	<i>wakālah (wakālat)</i>	agency is a contract whereby one party appoints another party to perform a certain task on its behalf, usually for payment of a fee or a commission
وَكِيْل (وَكَلَاء)	<i>wakil (wukalā')</i>	representative(s), agent(s)
وَقْف (أَوْقَاف)	<i>waqf (awqāf)</i>	endowment(s), foundation(s), trust(s)
زَكَاة	<i>zakāh, zakāt</i>	obligatory contribution or poor due, payable by all Muslims who have wealth above <i>nisab</i> (threshold or exemption limit)



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