



How sukuk issuances are riding the wave of ESG

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At the heart of Islamic bonds or sukuk is the idea of responsible investing, little wonder, then, that it should be finding its place in the world of sustainable investment.



The demand for sukuk, commonly known as Islamic bonds, is expected to continue with its steady growth as more investors look for opportunities that are aligned with environmental, social and governance (ESG) investing and that also deliver stable income.

A sukuk is a shariah-compliant bond used in Islamic finance. Unlike conventional bonds, sukuk involves direct asset ownership and does not derive its income from interest payments or speculative activities.

GROWING DEMAND FOR SUKUK

Total sukuk issued in 2021 grew a strong 36.1% year-on-year to reach \$252.3 billion, with central banks, governments and multilateral institutions among the major issuers, according to Fitch Rating.

Malaysia, Indonesia, Turkey, Pakistan and members of the Gulf Cooperation Council are major sukuk issuers – global outstanding sukuk is estimated to be about \$711.3 billion as of end-2021 – with non-core market sovereigns such as the UK, Maldives and Nigeria also having entered the space.

“Much of this growth has been driven by robust issuance from sovereigns and supranationals as well as consistently growing demand for shariah-compliant securities by both institutional and retail investors alike,” said Hanifah Hashim, head of fixed income and sukuk (Malaysia), at Franklin Templeton to *AsianInvestor*.

She said one of the main reasons for the popularity and growth of sukuk has been its robust performance with consistently lower volatility, relative to conventional bonds.

She cited the sukuk market in Malaysia – a leading sukuk issuer responsible for almost half of the global market share of Malaysia Ringgit denominated sukuk - as a prime example of stability where many of the investors are long-term institutional investors with strong capital positions.

“They are also constrained by a limited opportunity set of shariah-compliant investment options that they can seek meaningful exposure to, based on their mandates,” she said, adding that these investors create stability for the Malaysian sukuk market even during periods of high market volatility.

Conventional bonds, on the other hand, are more susceptible to the short-term capital flows of international investors, who tend to shift in and out of asset classes in response to changes in the perceived risks in the market, she said.

Sukuk also has the advantage of access to liquidity in the Middle East and Southeast Asia as well as offering investors the exposure to the high-growth emerging markets in these regions. For asset owners and managers, sukuk is also a useful geographic or sector diversifier for their portfolios.

ESG VS. SHARIAH

“While the pairing of ESG and shariah in the equity space has received news headlines, it is worth noting that fixed income shariah investments are also showing signs of this trend. In recent years there has been an uptick in ESG-related sukuk issuances,” said Chow Kim Seng, senior fund manager at Eastspring Al-Wara’ Investments to *AsianInvestor*.

He said a new class of sustainable-sukuk issuances – or green sukuks - have gained traction in recent years. Unlike conventional Islamic bonds, the proceeds from green sukuks can only be used to finance investments in renewable energy and other environmental projects.

In terms of pricing performance, a recent report by Eastspring has found that the shariah ESG sub-index of the BPAM (Bond Pricing Agency Malaysia) ESG Index has outperformed its conventional ESG sub-index since 2018 when the index was created.

“This goes to show that it is possible to be rewarded for doing good and this transcends the equity space,” he said, adding that sukuk have seen strong demand from Muslim investors as well as investors in general.

GREEN SUKUK

According to Ernst & Young Consulting, Malaysia leads in sustainable and responsible investing (SRI) sukuk issuance among the Asean-6 countries, accounting for \$3.9 billion of issuance value or 56% of the total Asean SRI sukuk issuance, as of November 2021 on a compound annual growth rate of 278% between 2016 to 2020.

The world's first green SRI sukuk was issued by Malaysian company Tadau Energy in 2017 to finance the construction of solar photovoltaic power plants, opening the door for many other issuers to tap on green sukuk for project financing.

"Shariah principles stress the enhancement of societal and environmental welfare and justice, goals and ideas that are largely compatible with ESG and broader sustainability concepts," said Hashim.

She acknowledged that while there is still some way to go for sukuk to be widely accepted in the non-Islamic world, the trend toward sustainability complemented by strong governmental support would be the tailwind that could carry sukuk to the next level.

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