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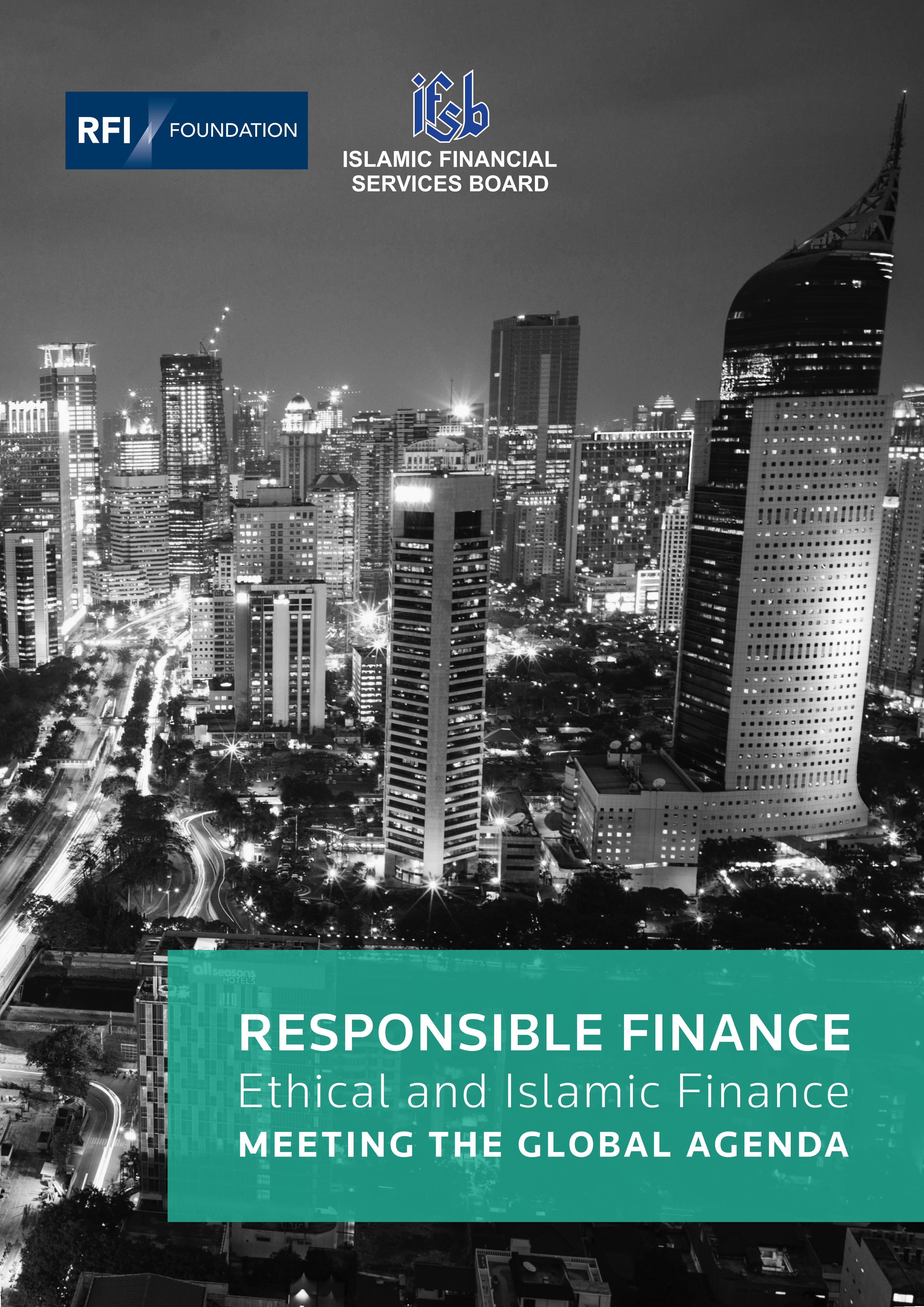

RESPONSIBLE FINANCE
Ethical and Islamic Finance
MEETING THE GLOBAL AGENDA

Responsible Finance - Ethical and Islamic Finance: Meeting the Global Agenda

Authors

Tan Sri Dr. Zeti Akhtar Aziz

Tan Sri Dr. Zeti served as Governor of Bank Negara Malaysia from May 2000 to April 2016. She had an important role in managing the resolution of the financial system during the Asian financial crisis in 1998 and the consequent strong recovery of the Malaysian economy. She was also instrumental in transforming Malaysia's financial system, including overseeing the enactment of twelve new pieces of legislation for the financial sector. During this period, the Malaysian financial system also underwent a period of progressive liberalisation.

In Asia, Dr. Zeti was active in strengthening cooperation and regional financial integration. In 2006, she chaired the regional task force that prepared the report for the future direction of central bank financial cooperation in East Asia. At the Bank for International Settlements (BIS), she was the chair of the BIS Central Bank Governance Group. She was a founding member of the BIS Asian Consultative Council, and was the first co-chair of the Financial Stability Board Regional Consultative Group for Asia.

Dr. Zeti also had an extensive role in the global development of Islamic finance, and was active in the global financial inclusion agenda. She has been an important voice for the emerging world on the many issues concerning the international financial system and on financial and economic management.

She is currently Co-chair, Board of Governors of Asia School of Business, established in collaboration with MIT Sloan. In May 2018, following the change in the government of Malaysia, Dr. Zeti was appointed as a member of the Eminent Council to advise the government on institutional and structural reforms. In July 2018, she was appointed group chairman of Perbadanan Nasional Berhad (PNB).

Dr. Zeti received her PhD in Economics from the University of Pennsylvania.

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Azleena Idris

Ms Azleena Idris is currently Director, Corporate Services Division, of Payments Network Malaysia, the country's main provider of payments infrastructure. She joined PayNet Malaysia on August 1, 2019, heading corporate planning, legal, governance and rules, as well as the corporate communications and marketing communications departments.

With over two decades of combined experience as a regulator and in the financial services sector, Ms Idris played an instrumental role in a number of national and international initiatives including the Financial Sector Masterplan 2001-2010, Islamic Financial Services Act 2013, International Islamic Liquidity Management Corporation and positioning Malaysia as an International Financial Centre (MIFC), as well as the founding of RHB Islamic Bank and merger and acquisition exercises involving the RHB Group.

Prior to PayNet, Ms Idris spent a brief stint as General Counsel at an Islamic bank during which the bank won a landmark Islamic finance case. Before that, she was with Bank Negara Malaysia with primary responsibilities in Islamic financial infrastructure development strategies for over a decade and RHB Capital for close to 10 years, where she held a senior legal position and was joint company secretary of Rashid Hussain Bhd., the ultimate listed parent company. She is also a short-term expert at both the International Monetary Fund and World Bank.

After training and qualifying as a lawyer in England, she obtained the Global Executive MBA jointly awarded by the London School of Economics and Political Science, New York University Stern School of Business, and HEC Paris. She is a Chartered Islamic Finance Professional as conferred by the Chartered Institute of Islamic Finance Professionals, where is she sits on the board and serves as a member of the Professional Education and Academic Committee and the International Chapter Committee.

Yousuf Sultan

Yousuf is an experienced Islamic FinTech strategist with a passion for spearheading Islamic Finance 3.0 . He has more than 10 years' experience in managing tech solutions and providing Shari'ah advisory. Blending academic training in Shari'ah and Islamic finance with hands-on experience in technology, he envisions a sustainable future for Islamic finance.

Yousuf holds an MSc degree in Islamic finance from INCEIF, Malaysia. He earlier graduated in Shari'ah and Islamic jurisprudence. As a certified Shari'ah Advisor and Auditor (CSAA) from AAOIFI, he advises several institutions in Bangladesh, Malaysia, and Africa.

At Ethis, Yousuf brings his expertise in technology and leadership to bear in heading operations and Shari'ah. Ethis pioneered several Islamic crowdfunding platforms for investment and charity in Indonesia, Malaysia, Singapore and Dubai.

Yousuf loves reading, speaking at events, training and spending quality time with his kids, family and friends.

Executive Summary

The devastating impact of the Great Financial Crisis was intensified by the delinking between finance and the economy, and by international financial centres having become a leading source of national income and wealth in their own right. In short, there was too much finance. However, the reaction since to the unethical behaviour and excesses that caused the crisis, though understandable, may have swung too far in the other direction by relying too heavily on rules and regulations rather than addressing the underlying ethics.

Responsible finance, by providing models for different forms of finance that explicitly factor in ethics, provides an alternative response. This paper will highlight the specific characteristics and features that ethical finance and Islamic finance share and those that set them apart. In reviewing the similarities and assessing future connections, this report aims to provide a firm basis for cooperation between the two types of finance and contribute towards a greater understanding of the forms of finance that bring value to the economy, society and the environment and thereby support sustainable development in the global economy.

The conjoining factors linking ethical finance and Islamic finance are their emphasis on the sustainability of investments that support preservation of resources for future generations while allowing sustainable financial intermediation that supports economic growth and development. Islamic finance further discloses excessive leverage and emphasizes disclosure and transparency to strengthen the financier-client relationships. While ethical and Islamic finance both serve and add value to the economy, each could draw elements from the other. In ethical finance, the focus is on outcome and the impact on the economy, society and environment, with greater emphasis placed on the latter two.

Within Islamic finance, the starting point has been supported by a Shari'ah governance process that requires four main features for a transaction to be permissible: that it be backed by real economic activity or assets; it is ethical in the sense that it supports the principles of Shari'ah; it is participatory, with risks commensurate with returns; and it displays principles of good governance and clarity around the transacting parties' accountability.

Linking the similar principles of ethical and Islamic finance further, there are five principles representing key values of responsible finance that include:

- **Fairness** - Emphasis on fair treatment of all stakeholders
- **Transparency** - Clarity and disclosure of all relevant information in a manner that does not mislead or prevent stakeholders from making informed decisions
- **The greater good** - Beyond profitability; ensuring that finance is conducted in a manner consistent with the greater good of society
- **Treatment of impermissible activities** - 'Cleansing' of tainted income from impermissible activities is mandatory in both forms of finance
- **Social dimension** - Both forms of finance require social considerations in business dealings

Assessing these similar principles can help promote outcomes at the institutional level, and they can also contribute to financial stability. Violations of these key principles have been indicative of a breakdown of ethical values, a lack of accountability and weak governance structures, which are frequently key contributors to instability in the financial system.

The shared common goals in these forms of responsible finance can be viewed as having two sets of priorities. The first relates to the primary intent of attaining sustainability – in terms of its impact on the economy, society and environmental sustainability – while at the same time being financially profitable and thus sustainable. As the world undergoes a period of great uncertainty amidst digital disruption and profound climate change, there are potential areas that ethical finance and Islamic finance can collaborate in to foster better synergies that will in turn benefit the international financial system.

For the responsible finance industry itself there remain some significant challenges, including the need to develop commonly accepted standards. In addition, there is a need for a larger pipeline of bankable projects with robust project management throughout their life cycles to attract additional financing from the private sector. Finally, these projects need to have a developed governance process to facilitate coordination among the many stakeholders involved.

Islamic finance faces similar constraints. Although it already has a built-in centralized screening process it has a tendency to look to the Shari'ah compliance process rather than the impact of the financing activity. However, there have been discussions around value-adding and value-based financial activities, where their impact is considered after Shari'ah rulings have been complied with. The established ESG framework can be adopted to achieve the desired social and environmental sustainability outcomes by being incorporated into existing governance frameworks.

Collaboration between the responsible forms of finance will yield benefits from the knowledge and experience that has been gained in assessing the impact of such financing and investments on the economy, society and the environment. It must promote greater awareness of the potential role these respective responsible forms of finance have in delivering a form of finance that is well anchored to the economy and that brings value to society and environmental sustainability.

A framework of cooperation will be helpful in articulating the stated intent of both forms of responsible finance to achieve this greater awareness and enabling an assessment of the impact of the various aspects covered by each type of responsible finance. With financial reforms by the international community now largely in place, the imperative for future finance is not only to become stable and resilient but also to become a deep anchor to its bedrock – the real economy – and to generate a positive benefit for the wider society and to environmental sustainability.

Letter from the CEO

It gives me great pleasure to release this report: *Responsible Finance – Ethical and Islamic Finance: Meeting the Global Agenda*. The report offers a detailed perspective of the similarities and differences between different forms of responsible finance. It looks at both the failures that were exposed during the Great Financial Crisis and the subsequent response, and analyzes how responsible finance has contributed to addressing the crisis and what more is required.

Blake Goud

The RFI Foundation was founded in 2015 with the ambition to build on developments that were occurring separately in Islamic finance, responsible investment and ethical finance to promote convergence around the many shared values motivating action. RFI has adopted 'responsible finance & investment' as an umbrella term to describe all of these forms together, and this informs our mission of building awareness around the shared values and using research and engagement with industry stakeholders to drive convergence across responsible finance.

The world has agreed to achieve the Sustainable Development Goals by 2030, and it is critically important that a responsible financial system that incorporates both ethical and Islamic approaches plays a part in achieving sustainable economic, social and environmental outcomes for current and future generations.

The report concludes with important recommendations that the RFI Foundation and other industry stakeholders should adopt if they are to create a financial system that serves the real economy and humanity, rather than expecting the reverse.

We are thankful for the efforts of our three report authors, with special appreciation for Tan Sri Dr. Zeti Akhtar Aziz, Chairperson of the RFI Foundation Council of Advisors. Without her visionary leadership on the future of responsible finance, the RFI Foundation would have not had the success that we have enjoyed during the past four years. We thank her and her co-authors, Azleena Idris and Yousuf Sultan, for their efforts in bringing this report to completion.

Sincerely,

Blake Goud
CEO
Responsible Finance & Investment (RFI) Foundation
November 2019

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01 CHAPTER

Introduction

The unprecedented upheaval in the global financial system over the past decade has prompted a rethink around the prevailing forms of financial intermediation. Particular attention has been paid to the aspects of finance that relate to its resilience and sustainability. The main focus, however, has been on regulatory reform and the financial strength of banks and other financial institutions. While there has been significant progress achieved on these fronts, there have also been calls for attention to be paid to the potential consequences of the reforms on the functioning of the financial system and the implications for the overall economy. The concern is that the reforms may have swung the pendulum too far in the opposite direction.

While the regulatory regime is vital to ensuring the soundness and stability of the financial system, of equal importance are types of financial intermediation that support growth and development in the overall economy. The aim of this report is to increase awareness around the aspects of ethical and Islamic finance that benefit the economy, society and the environment. It will also examine how ethical considerations are integrated within these two types of financial intermediation and the aspects particular to them that provide them with an in-built financial stability, and how together these reinforce sustainability.

While ethical finance is becoming increasingly prominent in the developed world, Islamic finance, with which it has much in common, is less well known. Yet each type of finance has its origins in religion and as such aims to be of long-lasting benefit to the economy, society and the environment.

Ethical finance, which today includes business strategies such as socially responsible investing (SRI), originated in Christian movements to exclude financial activities that cause harm. A number of investment funds were established in the western world at the turn of the twentieth century that focused on ethical concerns. Although church groups were the original drivers of this approach to finance, institutional investors such as insurance companies, pension funds and asset management firms have since played a progressively larger part. SRI today is operating within an increasingly structured framework that gives emphasis to sustainable development, with specific attention given to environment, social and governance (ESG) factors. The movement continues to gain traction, even more so after the turmoil in financial and economic markets since the Great Financial Crisis erupted a decade ago.

So while ethical finance was founded on religious conviction, it now looks solely to the benefit it brings to the economy, society and the environment.

Islamic finance, in contrast, remains firmly wedded to religious principles. Its core underpinning is to achieve the objectives of Shari'ah (maqasid al-Shari'ah), which include the protection of religion, life, lineage, intellect and wealth, while upholding high ethical values and looking to a more equitable distribution of wealth. An explicit intent of Islamic finance is that financial transactions are accompanied by an underlying productive economic activity that will generate legitimate income and wealth. This is reinforced by basing such transactions on profit and risk sharing. Interest, or 'riba', is prohibited within this type of finance, so that suppliers of funds become investors rather than creditors.

Islamic finance conforms to these tenets through adherence to Shari'ah rules and principles. The underlying principle that requires financial transactions to be accompanied by an underlying productive economic activity establishes a close link between financial and productive economic flows. Also explicit in the Islamic finance business model is that financing or equity participation may only be extended to activities in real economic sectors that have economic value.

Financial oversight is conducted via a Shari'ah review process that ensures adherence to these principles. The arrangements around profit and risk sharing in an investment contract also require management of the risks involved. An essential component of the process is a high degree of transparency and disclosure, which ensures that both the rights and responsibilities of the parties involved in the contract are preserved. Governance arrangements are also an important consideration. These distinct features of Islamic finance represent the core principles in determining whether a particular transaction or institution falls within the parameters of Shari'ah.

This paper will highlight the specific characteristics and features that ethical finance and Islamic finance share and those that set them apart. The similarities and connections provide a firm basis for cooperation between the two types of finance. The paper will also identify specific features that are unique to one type and may not be incorporated or represented in the other. The study will thus identify the areas, strategies and approaches of each type of finance that could be incorporated by or otherwise beneficial to the other.

Thus by highlighting both the points in common of the two forms of finance and how each can learn from the other, this study may help ethical finance and Islamic finance to achieve their shared goals. It is hoped that this report can contribute towards a greater understanding of the forms of finance that bring value to the economy, to society and to the environment and thereby support sustainable development in the global economy.

The report is presented in five parts.

The first concerns finance and the economy. It looks at how ethical finance and Islamic finance contribute to and support the economy and its sustainability. It examines the role of each of these forms of finance in achieving positive outcomes for the economy.

The second part examines the role of finance in bringing value to society. It discusses the definition of social good and the forms of intermediation and investments that are designed to achieve it. Also highlighted are the areas of similarity between ethical and Islamic finance in achieving this objective. The second part then discusses the different strategies and screening processes aimed at addressing social issues such as income disparities, consumer protection, human rights and corruption. It also looks at the potential for ethical and Islamic finance to influence corporate behaviour so that they bring greater value to society.

Part three considers finance and environmental sustainability. Here we look at the role of alternative forms of finance in addressing critical environmental issues such as climate change, pollution, biodiversity, energy efficiency, and deforestation. It will discuss the principles and strategies adopted by ethical and Islamic finance to drive this agenda, and examine the role of financial regulatory authorities in reinforcing these efforts.

The fourth part of the study discusses the ethical aspects of the two forms of finance. It discusses what is meant by ethics and how ethical and moral principles have been incorporated into ethical and Islamic finance.

The fifth and final part looks at the effect of the two alternative forms of finance on financial stability. It discusses the inherent features of each type of finance that contribute to stability. It also highlights the role of regulators and standards-setting bodies in achieving this goal.

Finally, the report summarizes the common and different elements of ethical and Islamic finance that contribute to the economy, to society and to the environment. It will also summarize the unique features of ethical and Islamic finance that may offer solutions to other forms of finance. The report concludes by highlighting the potential areas for cooperation to achieve their shared common goals.

CHAPTER 02

Finance and Serving the Economy

A fundamental role of finance lies in its contribution to the economy. Indeed, finance was originally created to serve the real economy, to mobilize savings and allocate financial resources to productive investments, thereby driving economic growth. Finance is thus a means to an end. However, when finance becomes an end in itself there can be such an erosion of the links with the real economy that it becomes inherently unstable. It then becomes a destructive rather than constructive force. Finance therefore needs to remain anchored to the real economy.

The Great Financial Crisis of 2008 made it abundantly clear that the essential role of finance should be to drive sustainable growth and development. In the decade prior to the crisis, finance had gradually shifted from being a means to an end to becoming an end in itself. Finance had changed from serving as an enabler of growth to being an engine of growth. International financial centres became a leading source of national incomes and wealth. This was the beginning of the erosion of the linkage between finance and the real economy.

During this period, finance abandoned long-term value creation in favour of short-term returns. Activities generating trading fees became ever more lucrative, which in turn spurred innovations in the financial sector that removed it further still from its purpose of serving the economy. Prior to the ensuing financial turmoil, domestic credit provided by financial institutions soared to nearly three times the size of the affected economies. The volume of financial activity had far outstripped the volume of real economic activity.

Finance had thus decoupled from the real economy. There was too much finance. The consequent crisis demonstrated to what degree the costs to growth and stability had exceeded the benefits generated by these financial developments. Added to this, the financial disruption had an uneven impact on the societies affected as income disparities widened.

The disconnect between finance and real productive economic activity not only weakened the positive role of finance in economic growth and development but also increased its potential for financial instability. The economic function and role of financial intermediation had become less effective and had caused more harm than good to economic growth. Distortions also resulted from excessive risk-taking. The returns from such risk-taking generated large financial gains for some, but the losses were felt across the wider society. This caused a massive breakdown in trust between borrowers and creditors.

A major contributor to the crisis was a spate of financial innovation that had been allowed to flourish without adequate oversight. This in part reflected weak governance and low levels of disclosure and transparency in financial institutions. The prevailing incentive structure had encouraged excessive risk-taking, unbridled financial innovation and a focus on short-term gains. Neither were the financial innovations supported by the necessary governance arrangements and risk management systems they needed.

A general global consensus has since emerged on the need to return finance to its basic function, to provide financial services that add value to the real economy. This chapter examines the roles that ethical and Islamic finance can respectively play in adding value to the economy. We will discuss how the inherent features of these types of intermediation contribute to supporting the economy and highlight the progress that has so far been achieved. The chapter will compare similarities between ethical and Islamic finance while pointing to the features that remain unique to each. We will then consider the potential enhancements of these types of finance that could strengthen their roles in serving the economy.

Value Proposition: To Serve the Economy

While the intent of ethical finance is more explicit than Islamic finance with respect to bringing value to society and the environment, this chapter examines the fundamental features of ethical finance that also contribute towards serving the economy.

Three such features can be identified. The first relates to ethical finance's focus on the longer term and its emphasis on the sustainability of investments. By avoiding a short-term view of the performance of companies, it protects the long-term interests of its beneficiaries, thus bringing value to the economy. Additionally, by adopting the ESG framework, in which the focus is on environmental, social and governance considerations, the safeguards are provided that support the longer-term orientation of the business and thus its sustainability. The ESG factors incorporated within ethical finance allow for better management of risk and return, and this too contributes to economic health.

The second feature of ethical finance is the avoidance of high-risk and speculative activities, which protects the economy from distortions and increases the potential for efficient allocation of resources. Also, by contributing to generation of growth that is not subject to high-risk activities, the medium term becomes much more sustainable.

Thirdly, under ethical finance companies are actively encouraged to improve the impact of their investments on society and the environment while generating income on those investments, thereby bringing benefit to the overall economy. Investment strategies are expected to maximise both financial returns and the social good, while at the same time looking to their sustainability and overall impact on the economy.

Ethical finance is also aimed at promoting social inclusion. By encouraging wider participation, this promotes more inclusive growth, which in turn supports a more balanced and stable growth trajectory. It also supports the development of social entrepreneurship, part of which involves working to raise awareness of the role of finance and the adverse consequences that can arise from investing with a short-term view and with profit as the over-riding objective. These inherent features of ethical finance when taken together avoid the build-up of systemic risks and are less prone to result in financial crises. The focus on sustainability is central to ethical finance's role in serving the economy.

The role of finance in adding value to the economy is more explicit in Islamic finance. The central tenet of Islamic finance is that financial transactions are supported by genuine economic activity. This reinforces the link between finance and the economy. It also aligns financial innovation with productive economic activity. In the Islamic finance business model, finance – whether in terms of financing or equity participation – can only be provided for real economic activities that generate economic value. As a consequence, the pace of growth of Islamic financial assets generally corresponds with growth in the underlying economy. Islamic finance also specifically advocates the creation of wealth through trade and commerce.

Islamic finance's encouragement of genuine business and trade activities that generate legitimate returns is reflected in the explicit requirement for materiality and validity in its transactions. Islamic finance also provides clarity regarding profit- and risk-sharing, thereby ensuring their mutuality. The entitlement to profit is contingent upon shared risk-taking, and by requiring risk to be shared, Islamic finance ensures that the appropriate due diligence on the viability of a business is undertaken. Islamic finance thus strengthens the incentives for participants to screen and monitor transactions for economic viability and to recognise the associated risks. It also encourages an appropriate governance process. For these reasons, Islamic finance can be considered a form of financial intermediation that adds value to the economy.

Islamic finance also contains elements that support sustainability, such as the requirement that financial and economic activities do not bring harm to future generations. It is further stated that speculative activities are prohibited, and any innovations must be screened against Shari'ah principles to ensure they bring value to society. Islamic finance also explicitly discourages excessive leverage, thus making it less prone to the disruption and instability that can result from an excess of debt. Finally, Islamic finance promotes inclusivity to reduce the prospect of any segment of society being financially excluded. Taken together, these elements contribute to economic advancement and sustainability.

Also, to facilitate the required due diligence, Islamic financial transactions must adhere to a high degree of transparency. This helps to preserve the rights and responsibilities of the parties involved in a contract. Disclosure on market conduct and customer relationship management also form a part of these core principles.

There also needs to be open disclosure on how investors' funds are being managed so as to provide assurance that the underlying business operations, risk profile and risk control mechanisms are in place. Disclosure of the true and fair value of financial operations in the financial statements is also provided to depositors to allow for an informed assessment of their performance. Additionally, an Islamic financial institution's Shari'ah board signs off on the governance process, adding an additional layer of assurance that is not found in conventional finance.

Strategies and Approaches

The broad strategies adopted by ethical and Islamic finance have been to develop financial products, funds, markets and institutions that adhere to their respective principles, practices and objectives.

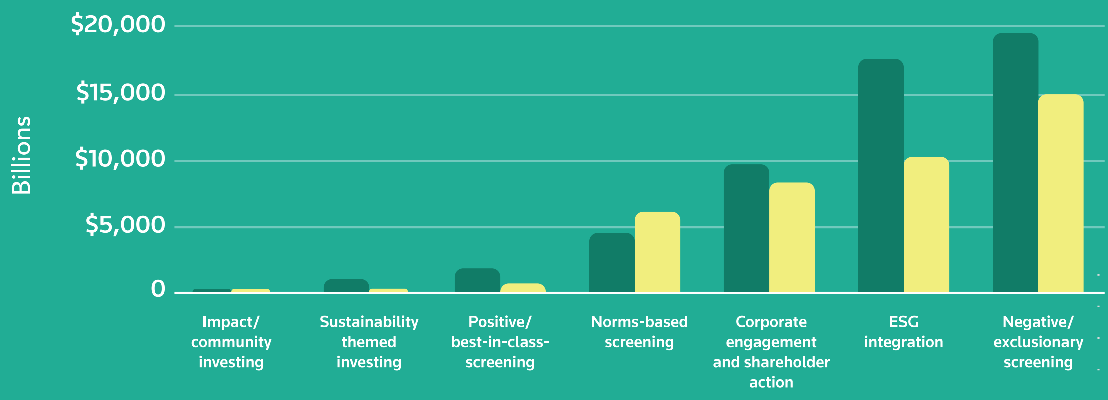
For ethical finance, a screening process against specific criteria, both positive and negative, is applied to identify activities that will be eligible for financing. These may be financed either by financial institutions or by funds raised through the capital markets. Funds extended by financial institutions are generally based not just on the financial viability of the project concerned but also on its adherence to the specified principles. Alternatively, investment activities can also draw on specific financial schemes or funds that have been established for purposes that meet the specified criteria.

Growth in sustainable investment is accelerating. According to the Global Sustainable Investment Review 2018, sustainable investing assets in the major markets of Europe, the U.S., Canada, Japan, and Australia and New Zealand rose 34% from 2016 to US$30.7 trillion. Between 2014 and 2016, by contrast, the figure had risen 25%, to US$ 22.9 trillion.[1]

Funds developed applying the United Nations Principles for Responsible Investment (PRI) have also expanded rapidly. These funds incorporate ESG considerations in their investment analysis, decision-making and ownership, in addition to their policies and practices. They therefore require disclosure on ESG issues to be provided by investees. The positive screening of these funds is based on ESG values, which take into account sustainability, the benefits they bring to society, and the adoption of good governance practices. The negative screening excludes companies whose activities damage societies and the environment and which do not promote workplace equality. As of 2018, the PRI initiative had garnered more than 2,000 signatories and US$ 82 trillion of assets under management, increasing from just US$ 4 trillion in 2006.[2] This represents a compound annual growth rate (CAGR) of 29%.

[1] 2018 and 2016 Global Sustainable Investment Review
[2] https://www.unpri.org/pri/pri-blog/fiona-reynolds-quarterly-update-reporting-consultation-takes-centre-stage

Figure 1: Growth of sustainable and responsible investment (SRI) strategies 2016-2018



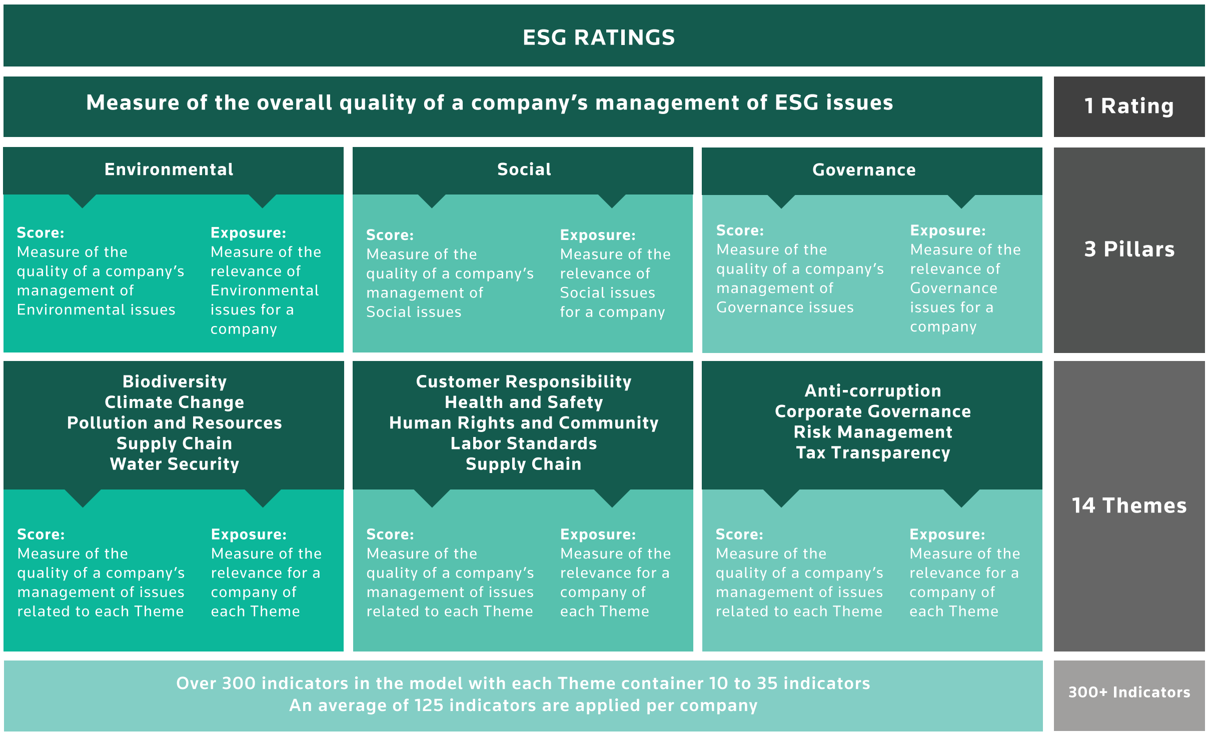
	Impact/ community investing	Sustainability themed investing	Positive/ best-in-class-screening	Norms-based screening	Corporate engagement and shareholder action	ESG integration	Negative/ exclusionary screening
2018	$444.26	$1,017.66	$1,841.87	$4,679.44	$9,834.59	$17,543.81	$19,770.96
2016	$248.47	$276.16	$818.01	$6,195.40	$8,385.17	$10,353.20	$15,063.57
Growth 2016-18	79%	269%	125%	-24%	17%	69%	31%
CAGR	33.7%	92.0%	50.1%	-13.1%	8.3%	30.2%	14.6%

Source: 2018 Global Sustainable Investment Review

The development of capital market indices and the issuance of bonds for investment activities that adopt ESG considerations are further evidence of the mounting significance of this form of finance. The Dow Jones Sustainability Indices (DJSI) are based on analysis of corporate, economic, environmental and social performance while taking into consideration issues around corporate governance, risk management, branding, climate change mitigation, supply chain standards, and labour practices. Companies that do not operate in a sustainable and ethical manner are excluded. The indices are based on general as well as industry-specific sustainability criteria across 61 sectors.

The UK's FTSE4Good Index series also include companies that meet ESG criteria. The indices also apply a negative screening process to organisations listed on the FTSE All-Share Index. Industries that may cause harm such as the tobacco, nuclear power and weapons industries are excluded. Companies where coal mining is a big part of their business are also excluded.

Figure 2: FTSE4Good Selection Criteria



Source: FTSE Russell

The screening process has also been extended so that now every single stock can be vetted, rather than via an industry elimination process. Screening can even be customized further to include the financing aspect of listed companies to determine whether their leverage is under control and they are backed by genuine assets and/or economic activity.

Then there is the Change the World list drawn up by Fortune magazine, which ranks companies that have employed creative business tools to address societal problems, reduce damage to the environment, strengthen communities, or serve the underserved as a function of their business model.[3] As an example, the company that topped Fortune's list in 2019 was mobile-chip designer Qualcomm, which aims to introduce inexpensive, low-power chips for smart devices and sensors, which could have a profound impact on the planet. By using these chips, cities will potentially be able to monitor air and water quality in real time, farmers can avoid over-watering or over-fertilising crops, and self-driving cars can communicate with each other to avoid traffic jams and reduce emissions.

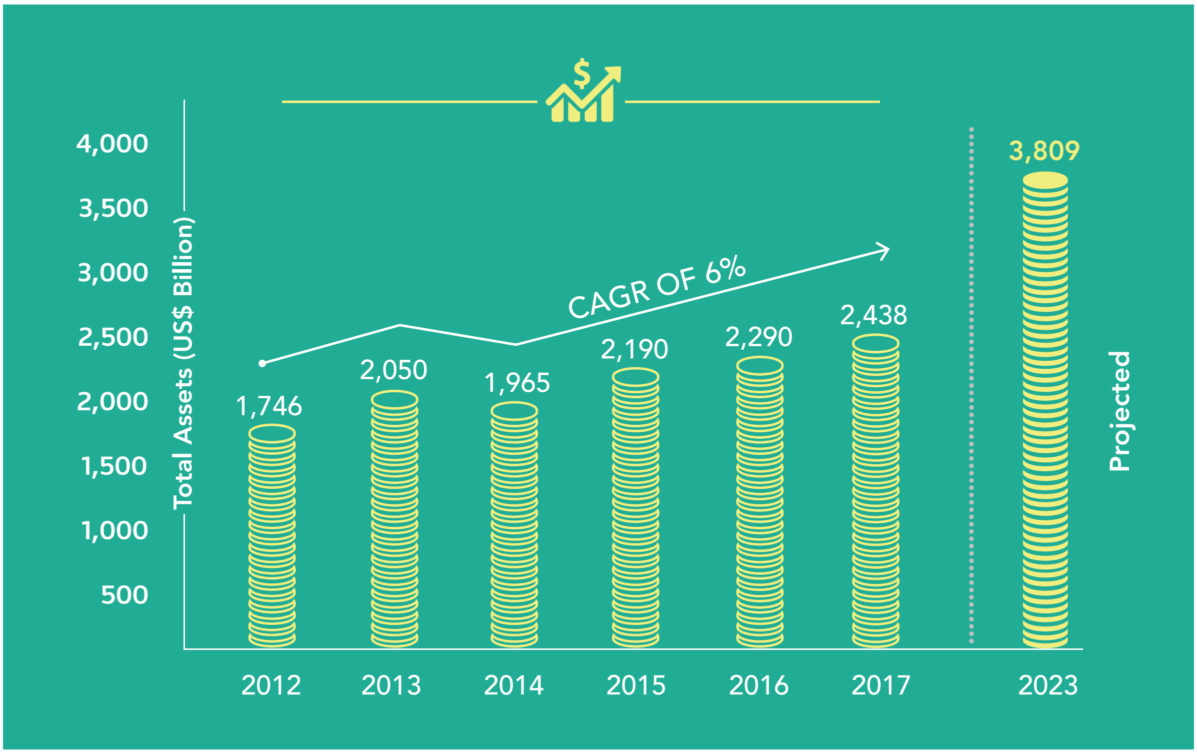
Finally, specialised institutions have also emerged to provide financing according to the principles of ethical finance. These include green banks, ethical banks and social banks. ESG principles are also being adopted by pension funds and other specialised banking institutions. In 2009, the Global Alliance for Banking on Values

[3] http://fortune.com/change-the-world/2019/

was founded as a worldwide network of banking leaders committed to advancing positive change in the industry.[4] Its goal is to change the banking system so that it is more transparent and supports economic, social and environmental sustainability.

Islamic finance is another fast-growing area of finance, with assets held by the industry totalling US$ 2.4 trillion in 2017.[5] There are Islamic financial products and services in 50 Muslim and non-Muslim jurisdictions around the world,[6] with participation by corporations and financial institutions from non-Muslim jurisdictions growing particularly strongly. This participation has primarily taken the form of raising funds from Islamic capital markets or investing in Shari'ah-compliant financial instruments.

Figure 3: Global Islamic Finance Asset Growth

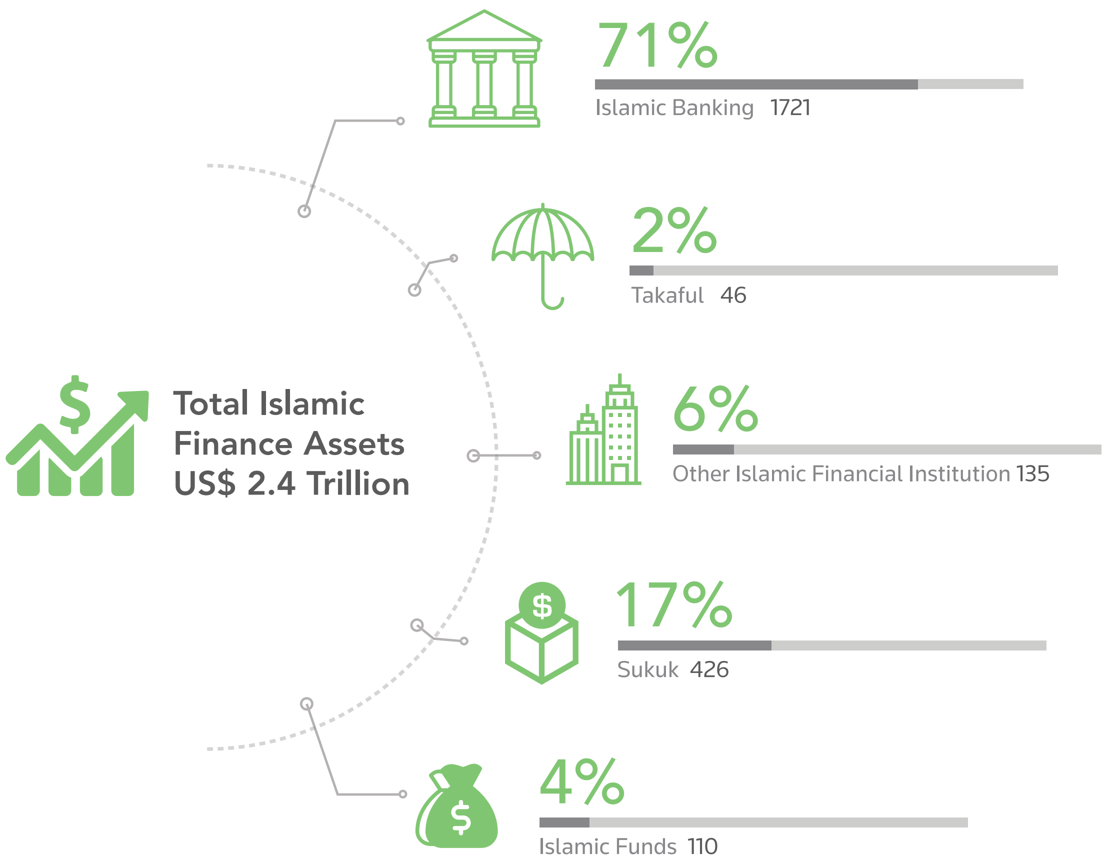


Source: 2018 Islamic Finance Development Report (Thomson Reuters)

[4] http://www.gabv.org/the-community/members/banks
[5] Islamic Financial Development Report 2018, Thomson Reuters and ICD (IFDR 2018)
[6] Global Report on Islamic Finance 2016, "Islamic Finance: A Catalyst for Shared Prosperity?", The World Bank and Islamic Development Bank Group

Islamic finance has evolved dramatically since the early 1970s, when its main activity was to meet the retail banking requirements of the Muslim community. The transformation has been particularly rapid since the turn of the millennium, and Islamic Finance now also comprises commercial banking; Islamic insurance, or takaful; Islamic bonds, or sukuk; and Islamic asset management.

Figure 4: Global Islamic Finance Assets Distribution 2017

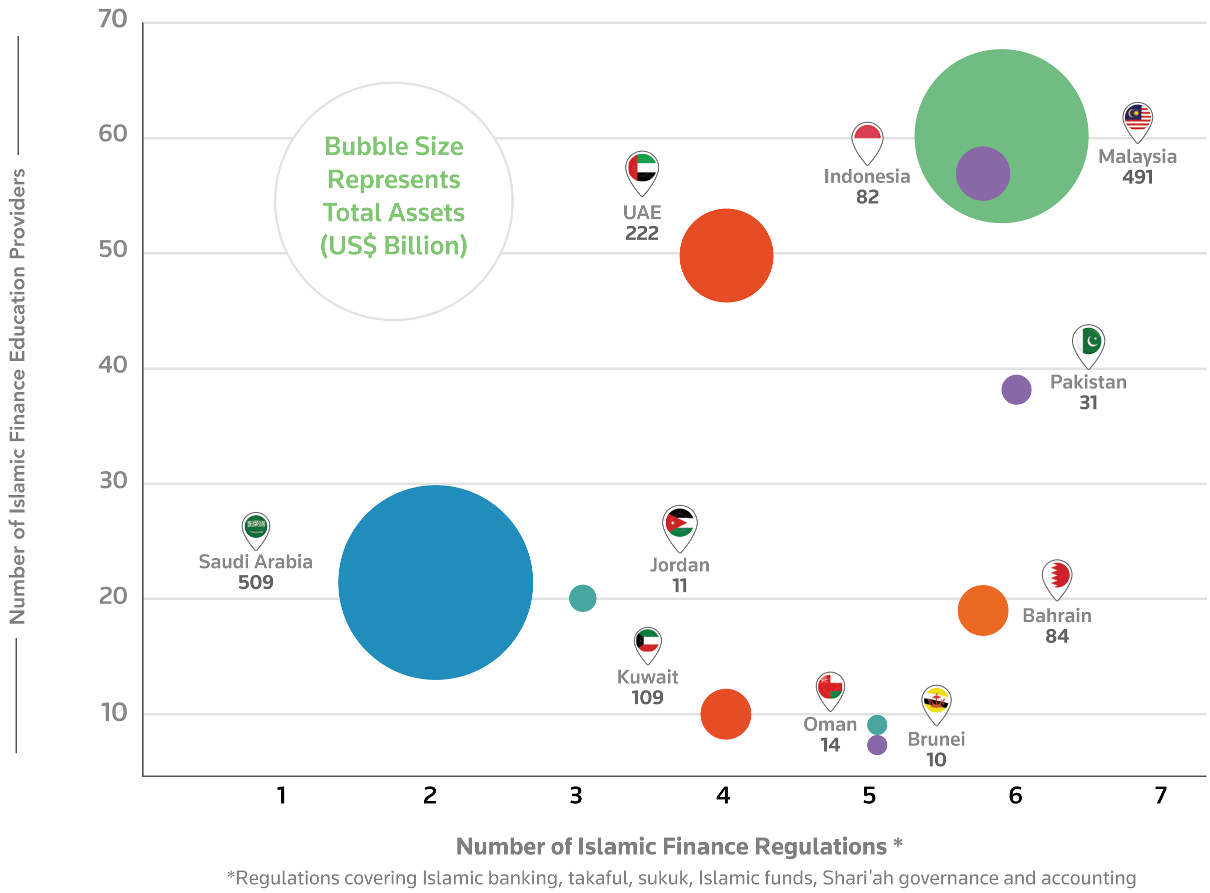


Source: 2018 Islamic Finance Development Report (Thomson Reuters)

The extensive diversification of products and participants in Islamic finance has gained added momentum in the present decade, supported by growing liberalisation, market maturity, and knowledge and awareness of the industry.

The Islamic banking sector has mushroomed from US$ 660 billion in assets as of 2007 to US$ 1.57 trillion by the second quarter of 2018. [7] The fastest growth, however, has been in the sukuk market, with total sukuk outstanding growing from US$ 6 billion in 2004 to US$ 24 billion in 2007 and US$ 530.4 billion in 2018.[8] Meanwhile, takaful premium contributions have grown from US$ 3.4 billion in 2007 to US$ 27.7 billion in 2018.[9] The Islamic funds management industry reached US$ 61.5 billion in 2018, from US$ 47 billion in 2008.[10]

Figure 5: Top Islamic Market Ecosystem 2017



Source: 2018 Islamic Finance Development Report (Thomson Reuters)

[7] Islamic Financial Services Industry Stability Report, 2019, Islamic Financial Services Board
[8] ibid
[9] ibid
[10] ibid

A number of indices have also been developed on stock markets around the world to facilitate investment in Shari'ah-compliant equities. These indices apply a negative screening process to rule out companies that do not comply with minimum Shari'ah standards, whether in their primary business or capital structure. Examples include the Dow Jones Islamic Market Index and S&P Global BMI Shari'ah Index in the U.S., and the FTSE Global Equity Shari'ah Index and FTSE All World Shari'ah Index in the UK.

One increasingly widely used area of Islamic finance is financing for large projects, especially infrastructure financing, which by contributing to a country's growth and development aid economic sustainability. When such financing is raised through issuance of sukuk, typically an Ijarah structure is used where a special purpose vehicle (SPV) is established to hold an underlying asset. The issuer would sell the underlying asset to the SPV to raise the funds needed to fund the large project and then leases back from the

Figure 6: Emerging interest in Islamic Finance in Developed Economics

UK

- Top Western centre for Islamic finance
- 5 fully licensed Shari'ah-compliant banks
- Islamic bank assets of $4.7 billion as of 2018
- 72 sukuk listed, raising $53 billion as of 2018

Hong Kong

- Amended laws in 2017 to stimulate sukuk issuance
- Issued 3 sovereign sukuk in 2014, 2015 and 2017
- Hang Seng Islamic China Fund was launched 2007

Singapore

- Amended laws to encourage Islamic banking in 2006
- Introduced tax neutrality in 2005
- Launched FTSE SG Shari'ah Index in 2018

Source: Global trends in Islamic finance and the UK market 2019

SPV by paying rental. These funds are raised from investors. The rental is then paid to sukuk investors which effectively represents the coupon payments. At the end of the rental period, the SPV self-liquidates after the underlying asset is bought back by the issuer from the SPV. This process enables investors to realise their gains from the investment. [11]

Similarities between Alternative Forms of Finance

The important role that finance can play in serving the economy is evident in both ethical and Islamic finance.

In ethical finance, it is achieved through an emphasis on sustainability. A focus on the long-term orientation of investments and adoption of ESG considerations bring value to society and environmental sustainability. Sound governance and risk management help avoid the high-risk and speculative activities that increase systemic risks and potentially damage the economy. An emphasis on social inclusion and social entrepreneurship also leads to balanced growth in the economy.

Although ethical finance isn't directly linked to the economy, it does contain the key elements required to support economic sustainability. More explicit in ethical finance is its impact on the value it brings to society and the environment. It has well-developed frameworks for its principles which have been drawn up by different international organisations. There is no peak body that regulates and determines the application of these principles by financial institutions and companies, however. Rather their adoption is subject to and overseen by regulatory bodies within their home jurisdictions. Still, the absence of a globally recognised body for the specific oversight of ethical finance has not hindered its advancement. On the contrary, its growth and stability have been a result of its inherent principles and values. Its growth has been particularly evident since the 2008 financial crisis, along with greater calls for finance to return to its basic function of serving the economy.

With Islamic finance, the linkage to the economy is explicit. A central tenet of Islamic finance is that financial transactions are supported by genuine economic activity. It also aligns financial innovation with productive economic activity, thereby reinforcing the link between finance and value creation. The emphasis on risk-sharing in Islamic finance strengthens the incentives to adequately manage risk and provide a governance process that ensures economic viability. The duty of Islamic finance is also to preserve for future generations. This ensures there is a focus on the long-term orientation of financing and investment activities. Grounded in such principles, Islamic finance generates a model for sustainable financial intermediation that supports economic growth and development, discourages excessive leverage, emphasizes disclosure and transparency, and strengthens the financier-client relationships.

[11] Details of financing of such infrastructure projects and the funding of smaller projects in Islamic finance are discussed in "Thoughts from Islamic Capital Markets for Sustainable Development in Asia and the Pacific" by Obiyathulla Ismath Bacha, United Nations Escap Discussion Paper, March 2016

There are therefore significant similarities in the roles of the two forms of finance in serving the economy. The requirement for Islamic financial transactions to be supported by underlying economic activity is ensured by the Shari'ah governance process and reinforced by the appropriate regulatory regime. However, while this ensures Islamic finance's sustainability and contributes to its resilience, its ultimate impact on the economy is less clear. Thus the next stage in the development of Islamic finance will be to create a framework that allows for a measured assessment of its impact on the economy, the community and the environment.

It has been thus proposed that Islamic finance should be both value-based and value-adding:[12] value-adding in that it facilitates and supports economic activity, and value-based in that it benefits society. Such an approach would also help develop the relationships that build trust in finance, which in turn would help it to become more firmly anchored to the economy.

Conclusion

The crucial role of finance in contributing to the economy is evident in both ethical finance and Islamic finance. By taking on this catalytic role, both types of finance help support economic growth and development. When the link between finance and the economy is weakened, finance deviates from being an enabler of economic growth to growing only itself. The shift from pursuit of long-term value creation to chasing short-term returns resulted in finance becoming inherently unstable and destabilising.

The focus on finance therefore needs to be on ultimate outcomes. While ethical and Islamic finance both serve and add value to the economy, each could draw elements from the other. Islamic finance has standardised principles that are explicit in terms of the requirement to link with and support the economy. In ethical finance, on the other hand, the focus is on outcome and the impact on the economy, society and environment, although with greater emphasis placed on the latter two.

Both ethical and Islamic finance will need to develop means by which to measure the impact they are having on the economy. This would encourage finance to add value to the economy, and in so doing, would drive economic development in a sustainable and responsible manner.

[12] Zeti Aziz: "Building Financial Systems for Sustainable Development", Global Ethical Finance Forum; Edinburgh, Scotland September 2015

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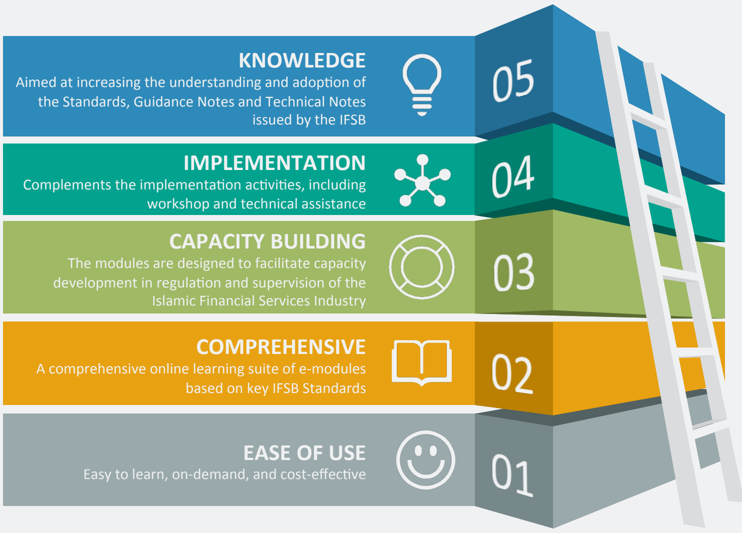


Core Principles

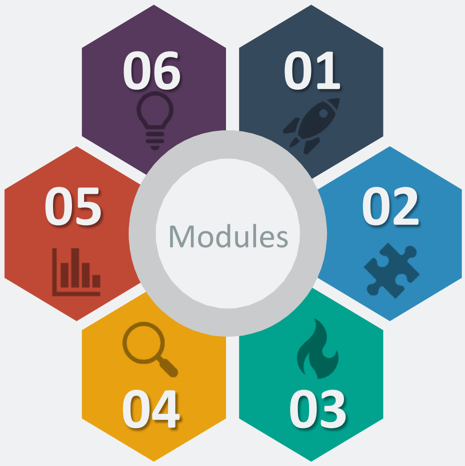
- IFSB-17: Core Principles for Islamic Finance Regulation (Banking Segment)

Supervisory Review Process

- IFSB-16: Revised Key Elements In The Supervisory Review Process

Conduct of Business

- IFSB-9: Conduct of Business for IIFS



Capital Adequacy

- IFSB-15: Revised Capital Adequacy

Risk Management

- IFSB-1: Guiding Principles of Risk Management
- IFSB-14: Risk Management for Takāful Undertakings

Governance

- IFSB-10: Sharī`ah Governance Systems
- IFSB-6: Governance for Islamic Collective Investment Scheme
- IFSB-8: Governance for Takāful Undertakings

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03 CHAPTER

Finance and Bringing Value to Society

In tandem with the efforts to strengthen financial stability, finance is also being re-examined in terms of the positive impact of bringing value to society. In the re-building of the global financial architecture, consideration has been given to securing the economic prospects of all segments of society. This is considered pivotal to a sustainable future.

With considerable benefit of hindsight, it has been established that finance, if not anchored to creating sustainable values that include bringing meaningful value to society, may undermine the ultimate goal of a greater shared prosperity. Therein lies the need for finance to advance the goals of a progressive society and thus of sustainable development. However, the social aspects of such financial goals are less clearly defined than environmental and economic factors.

Serving society beyond the predominant objective of enhancing shareholder value through short-term returns has become a narrative in all forms of ethical finance. A business is deemed socially sustainable if it supports all stakeholders, be it employees, customers, shareholders, investors, or the community the business operates in. This involves fair and equitable treatment of all stakeholders, including employees, and giving back to the community. It is also about running the business in a safe and sound environment. It is an approach that puts people before profit. Putting growth in line with job creation, supporting the community and overall economic development is therefore put at the forefront of any resource and funding mobilisation decisions.

This chapter examines different articulations of bringing value to society within ethical finance and Islamic finance. It first looks at the concept of social good and the various ways in which it can be implemented. It then takes a closer look at the strategies employed and how social issues are being addressed to deliver long-term, sustainable value. The chapter will conclude with a summary of the key features of ethical and Islamic finance that advance this agenda, highlighting both similarities and differences, and of the effects that such considerations have on corporate behaviour.

Defining 'Social Good'

The term 'social good' can be approached from at least two angles: 'providing social good' or 'doing social good'. While the former results from the provision of goods or services aimed at benefitting a large number of people to the greatest possible extent, the latter defines behaviour aimed at achieving a set of socially desirable outcomes. [1]

Both types of social good are present in ethical finance, and when widely practised they translate into long-term institutional sustainability and stability. The previous two decades have seen an increase in 'doing well' (financially and economically) while at the same time 'doing good' (socially and environmentally). There is now greater stewardship by corporate citizens in addressing the wider problems of society such as reducing carbon footprint, strengthening communities through economic empowerment and inclusion, and improving lives by bringing basic amenities to the underprivileged, all while pursuing economic goals.

Some banks and insurers have begun to incorporate sustainability considerations including societal concerns in their lending and investment decision-making processes. This has been pursued via the adoption of international frameworks such as the United Nations Global Compact and the United Nations Environment Programme – Finance Initiative (UNEP FI) Principles for Positive Impact Finance, which aim to support the UN's Sustainable Development Goals (SDGs). UNEP FI was founded with a mission to promote sustainable finance through collaborations between UNEP and global financial institutions.[2] It today has more than 280 financial institutions comprising banks, insurers and investors who have committed to "changing finance and financing change". UNEP FI places a strong emphasis on policy, facilitating dialogues between finance practitioners, supervisors, regulators and policy-makers and, at the international level, promoting the integration of environmental and social considerations into all aspects of members' operations. It takes into particular account the impact of climate change not only on the economy but on communities. In April 2018, UNEP FI took an important step forward in this regard in response to the Financial Stability Board's Task Force recommendations on Climate-Related Financial Disclosures (TCFD).[3]

These positive elements in finance are becoming increasingly powerful market forces, driving the kinds of productive activities that are much needed for long-term growth. A further requirement that has been introduced in several jurisdictions is that finance needs to be simple and easy to understand and transparent, so as to reduce the prospect of complex, opaque financial engineering that may bring harm to communities. This would also allow the necessary risk assessments to be made by consumers and businesses.

[1] Investopedia, extracted 13 January 2019
[2] The 13 founding members were Allianz SE, Banca Commerciala Romana, Banco Santander SA, Credit Suisse, Danske Bank A/S, Deutsche Bank AG, Landsbankinn (NBI hf.), Royal Bank of Canada, Royal Bank of Scotland Group, Scotiabank (Bank of Nova Scotia), TISCO Financial Group Public Company Limited, UBS AG and Westpac Banking Corporation
[3] Extending Our Horizons: Assessing Credit Risk and Opportunity in a Changing Climate: Outputs of a Working Group of 16 Banks piloting the TCFD Recommendations, Part I: Transition-related Risks & Opportunities, April 2018. UNEP FI, Oliver Wyman and Mercer.

Responsible finance and its role in bringing value to society

Over the past decade, a growing advocacy for ethical and socially responsible investments has led to a proliferation of financial instruments that cater to both financial and societal objectives. More importantly, this has moved beyond negative screening, to approaches involving the adoption of ESG considerations in investment and business decision-making. These efforts have had a still greater impact and have served to align risk and reward in a more sustainable manner.

The social dimension of ESG assesses three distinct aspects of a corporation's business – its supply chain, its workforce, and its impact on the community. The business is thus evaluated firstly on whether its supply chain shares the values that the company itself upholds. It is then assessed with regards to whether its workforce is sufficiently diverse across gender, ethnic and generational lines and whether the company shows a high regard for its employees' health and safety. The next assessment is of corporate social responsibility, including in the provision of social good through donations of a given percentage of profits to the community or in performing volunteer work. ESG thus looks at the extent to which different stakeholders' interests are taken into consideration.

The criteria adopted by investors who subscribe to sustainable investing, responsible investing, impact investing or socially responsible investing become part of their governance structures and systems. Therefore the extent of a company's impact on climate change or carbon emissions, water use or conservation efforts, anti-corruption policies, board member diversity, human rights efforts, and community development are important precursors for investment decisions.[4] These considerations have become aligned to the ultimate goals to be achieved by the corporations.

It is also encouraging to note that in the pursuit of social inclusion, all forms of responsible finance are intensifying efforts to reduce poverty and enhance social empowerment through financial inclusion. This in turn has led to growth in the microfinance industry, which is rooted in an understanding of the unique circumstances confronted by the 2 billion people around the world who remain excluded from the formal financial sector. Provision of financial services to the underserved and unbanked requires a delicate balance between doing social good and economic viability for providers. Additionally, to harness trust, providers with strong and socially responsible governance practices infuse their values into their financial products and services. Institutions that have emerged with aspirations to achieve these goals face the challenges of finding the technical expertise needed to best serve low-income and vulnerable segments of society as well as properly understanding the risks involved. They also require a mechanism to manage the costs of providing such

[4] Environmental, Social and Governance (ESG) Criteria, Investopedia, extracted 13 January 2019

financial products and services that takes into account affordability for users.

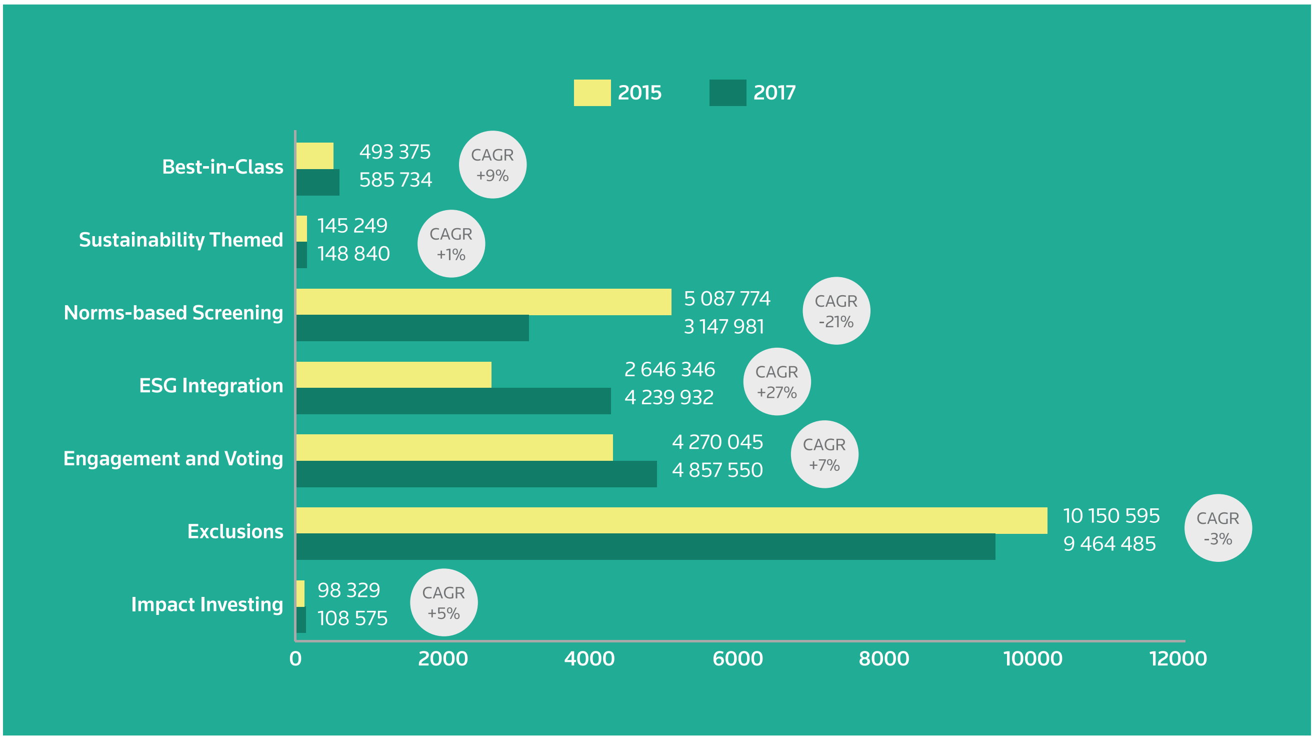
Sustainable and Responsible Investment (SRI)

Sustainable and Responsible Investment (SRI) is a long-term-oriented investment approach that integrates ESG factors into the research, analysis and selection process of securities within an investment portfolio. It combines fundamental analysis and engagement that incorporates an evaluation of ESG considerations in order to better capture long-term returns for investors, and to bring benefit to society by influencing companies' behaviour.[5] This generic term thus includes sustainable, responsible, socially responsible, ethical, environmental, and social investments and any other investments that incorporate ESG considerations. In essence, this investment approach considers ESG factors in portfolio selection and management, which generally adopts the following screening:

1. Negative/exclusionary screening,
2. Positive/best-in-class screening,
3. Norms-based screening,
4. Integration of ESG factors,
5. Sustainability themed investing,
6. Impact/community investing, and
7. Corporate engagement and shareholder action.

According to a recent study by European Sustainable Investment Forum (EUROSIF) in collaboration with academia, SRI has shown strong signs of becoming an integral consideration for European fund managers. The study indicates that ESG Integration is by far the preferred strategy, recording a commendable growth of 60% between 2015 and 2017 across more than EUR 4 trillion of assets under management.[6] Also gaining ground was Engagement and Voting, which rose 14% over the same period. Exclusions remain the most dominant strategy in terms of assets, being applied across EUR 9.4 trillion of AuM. Divestment from tobacco was the most popular exclusion criterion. Across the six years from 2013, impact investing registered growth of 52%, with assets rising to EUR 108 billion from just EUR 20 billion in 2013. EUROSIF expects growth to gather still more momentum as the alignment with the UN's Sustainable Development Goals (SDGs) intensifies.

[5] European SRI Study 2018, November 2018, EUROSIF
[6] European SRI Study 2018, November 2018, EUROSIF



Source: EUROSIF 2018 Study

SRI has become a major pillar of sustainable finance. On the global front, for every US$4 of funds under management, US$ 1 is now invested sustainably. This translates into more than US$ 22.9 trillion invested sustainably in 2016. The European Action Plan is clearly redefining sustainable finance as an indispensable narrative in the role of finance to support future growth.

Fortune magazine's Change the World list, which identifies fifty Fortune 500 companies across the world that are "doing well by doing good", was topped in 2016 by pharmaceuticals giant GlaxoSmithKline, which put doing social good at the heart of its innovation strategy, while also reinventing itself to serve not just patients in wealthier nations but also "the other 6 billion consumers" in less developed countries. The company based its drug pricing on the gross national income per capita of each of the 150 countries where it does business including in the least developed nations. It brought further value to society by reinvesting 20% of its profits in local health infrastructure and worker training. Its products were also priced competitively, while its sales strategies focused on volume to generate sustainable profitability.

Of the SRI strategies listed, impact or community investing generates a measurable, positive social or environmental impact while pursuing positive financial returns. Capital is directed towards underserved individuals or communities by providing financing to businesses with a clear social or environmental purpose.

It is interesting to note that in 2017, Fortune's Change the World list was topped by JP Morgan. Realizing that bank profits don't grow when the economy stalls, JP Morgan thought more should be done to revitalize cities hobbled by lost manufacturing jobs. The bank now channels US$ 250 million annually into community-building investments for small-business development, job skills training, and neighbourhood revitalization. A 'service corps' of advisers has also been deployed to assist those investments in yielding results. In Detroit, JP Morgan has contributed to create 1,700 jobs and seeded more than 100 new businesses since 2014.[7] It is understood that the bank intends to expand the model to other cities. A virtuous cycle would then be created as healthier cities breed healthy businesses, which in turn transform the environment for the financial industry.

Faith-based Investing and Creating Value for Society

Long before these developments, religious prescriptions had impacted individual investment decisions for centuries. Financial ethics can be found in all major religions, whether 'doing social good' or 'providing social good'. The table below provides a summary:[8]

Religion	Doing social good	Providing social good
Islam	Financial activities must directly assist individuals or society to enhance their living or environmental conditions. This in turn supports the real economy.	Islamic economy has the instruments and mechanisms which enable the provision of social good through the use of waqf, zakat and sadaqa funds where the governance and administration processes are clear and transparent
Christianity	Focuses on the individual's moral responsibility to use money consistent with one's faith	
Judaism	Passages of the *Talmud* support using investment to promote ethical activities and achieve social good	

Source: Adapted from Bennet & Iqbal (2013)

[7] Extracted from Fortune Change the World website on 17 April 2018

[8] Adapted from Michael S Bennett and Zamir Iqbal, "How Socially Responsible Investing Can Help Bridge the Gap between Islamic and Conventional Financial Markets," International Journal of Islamic and Middle Eastern Finance and Management 6, no. 3 (2013): 211–25, doi:10.1108/IMEFM-Aug-2012-0078.

All three religions denounce 'sinful' industries, including weapons, gaming and alcohol, given the social harm they may bring. At the same time, all religions subscribe to the provision of social goods such as clean air, clean water, literacy and healthcare.

Islamic Finance and Bringing Value to Society

Islamic transactions require strict adherence to the permissible (halal) and abstinence from the prohibited (haram). The term 'halal' encompasses everything that brings value, whether by doing social good or providing social good, without causing harm, whereas the term 'haram' encompasses everything which promotes or leads to harm and is bad for society. Islam prescribes that social gains have priority over private benefits.

In Islamic finance, investments should pass a screening process where permissibility and compliance with social and ethical responsibilities are verified according to the basic principles of Shari'ah. While the Islamic financial system by its very nature supports economic activity and entrepreneurship, it also addresses poverty and inequality, ensures financial and social stability, and promotes fairness and human development. In all permissible Islamic financial activities, four main features exist: that it must be backed by real economic activity or assets; it must be ethical in the sense that it supports the principles of Shari'ah; it must be participatory, as risks must be commensurate with returns; and there must be good governance and clarity around the transacting parties' accountability.

Islam also advocates promoting social trust, cooperation, and solidarity. In doing so there must be a balance between the rights of individuals, society and the state. While achieving the greater good is strongly encouraged, Islam does not subscribe to encroachment on other people's property rights. Social responsibility from the perspective of Islam lies in activities having to directly assist individuals or societies in enhancing their living or environmental conditions or to better comply with religious rules and norms. Social responsibility, or the duty of care, derives itself from core principles in the Noble Qur`an. Three major foundational principles for social responsibility are the vicegerency of mankind on earth, divine accountability, and the duty on mankind to enjoin good and forbid evil.

Vicegerency entails mankind as the representative of Allah on earth and as such Allah has entrusted mankind with stewardship of Allah's possession, and thus with the responsibility to safeguard worldly resources. Allah states this principle in the Qur`an: "...Verily, I am going to place (mankind) generations after generations on earth..." and further states: "And it is He who has made you generations coming after generations, replacing each other on the earth...". This means that mankind is not only entrusted with doing good for the present generation but also for future generations. The principle of divine accountability is also a spill-over of vicegerency.

Individuals will be accountable to Allah for all of their actions on the Day of Judgment. This principle is expounded in several verses of the Qur`an, two of which are: "…Certainly, Allah is ever a careful account taker of all things", and, "So whosoever does good equal to the weight of an atom (or a small ant) shall see it. And whosoever does evil equal to the weight of an atom (or a small ant) shall see it." It is mentioned in the hadith: "All of you are guardians and are responsible for your wards." This is where social responsibility is articulated as both an individual and collective responsibility. The principle of enjoining good (amal ma'ruf) and forbidding evil (nahi munkar) encapsulates the responsibilities that Allah places on Muslims as trustees and vicegerency. Additionally, there is a famous saying attributed to the Messenger (SAW) in which he says: "If the hour erupts (judgment day begins) and one of you is holding a shoot and he is able to plant it before he moves, then he should," [narrated by Ahmed].

Providing and doing social good is part of Islamic economy. Islamic trust (waqf), alms (sadaqa) and tithes (zakat) are some of the ways that the Qur`an has expressed as a means of bringing value to society. Prestigious universities like Al-Azhar in Cairo, Egypt, would not have been possible were it not for waqf. It is also believed that a permutation of waqf was responsible for the founding and establishment of Merton College, Oxford University,[9] and by the same token, the development of the similar concept of endowment led to the establishment of Cambridge, Harvard and Yale Universities, to name just a few.

In Islamic finance, there is also the element of cleansing of 'tainted' income, which entails inadvertently channelling income earned from activities that do not comply with Shari'ah towards social good and charity.

Momentum has been gathering in growth of the halal economy, which refers to products and services that are not tainted. The value of the halal economy is now estimated to have reached US$ 2.1 trillion in 2017. This includes the food and beverage sector (US$ 1.3 trillion), clothing and apparel (US$ 270 billion), media and entertainment (US$ 209 billion), travel (US$ 177 billion), pharmaceuticals (US$ 87 billion), and cosmetics (US$ 61 billion). [10]

Similarities in the different forms of responsible finance in bringing value to society

Socially responsible investments in the West began as far back as the 18th century, while Islamic finance has evolved in the Middle East and Asia since the 7th century, when lending based on Shari'ah or Islamic principles included moral directives in the conduct of business. Reinforced by globalisation, such forms of responsible finance have

[9] "The Influence of the Islamic Law of Waqf on the Development of The Trust in England: The Case of Merton College" Monica M. Gaudiosi, University of Pennsylvania Law Review, 1988, Vol 136, p1231
[10] State of the Global Halal Economy Report 2018/2019, October 2018, Salaam Global Islamic Economy Gateway

spread across borders to bring value to and uplift the wellbeing of society.

Regardless of the approaches, ethical and Islamic finance share several commonalities in bringing value to society:

- They focus on long-term effects – both forms of finance propagate bringing value not only to current but also future generations.

- They are inclusive – in the pursuit of financial and economic gains, there is a duty to do the greatest good to society at large, whether by doing social good or providing social good.

- They are based and focused on values – as they place responsibility on the private sector to do good, there is a higher moral purpose, including making finance accessible to all in a manner that elicits a shared prosperity.

- They are supported by a robust governance framework – in both the mobilization and utilization of funds, the two forms of finance are guided by strong governance.

On the path to achieving stronger, more balanced, and sustainable growth, the potential of ethical finance and Islamic finance has become even greater. These forms of finance are specifically aligned towards the ultimate goal of serving humanity and raising social wellbeing. Such finance today therefore has the distinct potential of catalysing and shaping social outcomes. This is more than merely performing finance's role as a passive intermediary of funds. As mobilisers of funds and by channelling such funds towards socially empowering activities in the economy, the financial sector can become a "social multiplier", significantly expanding the positive impact of finance on society.

The need for responsible and sustainable forms of finance is well recognised – and even deeply desired – throughout the world. Nonetheless, while ethical and Islamic finance have flourished in many communities, the next phase of development is for them to be brought into the global mainstream, to become a core part of the efforts to forge more sustainable financial systems for the future. Additionally, such solutions to finance also need to be considered on a global scale and not confined to any specific society or nation. Finally, there has to be greater leverage on technology and digitalisation. This will increase efficiency and scale, as well as the extent of sustainable finance's reach.

04 CHAPTER

Finance and Environmental Sustainability

This chapter will look at the manner in which environmental sustainability has been incorporated and addressed in the respective forms of responsible finance. The past decade has seen the international community significantly strengthen the environmental sustainability agenda. A major milestone was achieved with the conclusion of the Paris Agreement, which came into force on November 4, 2016. As of October 2019, 186 parties of the convention's 197 signatories had ratified the agreement.[1] This has led to an increased emphasis on integrating issues of environmental sustainability within finance, as has the growing recognition of the risks that climate change pose for macroeconomic conditions and financial systems.

Environmental sustainability has been identified as one of the three key supporting elements of the sustainability agenda, the others being economic and social sustainability.[2] Of the three, however, the most attention has been given to the environment. This is particularly focused on reducing carbon footprints and wastage of resources, increasing recycling and the use of renewal energy, and having an overall positive impact on the planet. There has also been more attention paid to addressing climate change as extreme weather conditions continue to be experienced in different parts of the world. Equally important to this objective is that in the endeavour to achieve economic goals, this should not be at the expense of future generations.[3]

This chapter will first examine the value proposition of the various forms of ethical and responsible finance that address the issue of environmental sustainability. It will then discuss the manner in which the different forms of finance achieve this objective. For the most part, this has been through the adoption of defined principles and by the strategies pursued through certain screening practices and processes. It is also being achieved by the creation of markets, institutions, product offerings and instruments in addition to financial arrangements and schemes, with an environmental purpose. The chapter will next discuss the progress that has been achieved in terms of the growth of such assets. Finally, it will discuss the increasing role of financial regulatory authorities in driving the environmental agenda, before concluding on the need to address some of the prevailing challenges and benefits that might be derived from greater collaboration between the ethical and Islamic finance.

[1] Extracted from "United Nations: Framework Convention on Climate Change" website on 15 October, 2019. https://unfccc.int/process/the-paris-agreement/status-of-ratification based on the number of signatories of the Paris Agreement.
[2] Brundtland Report (1987) United Nations
[3] ibid

The Value Proposition of Finance and Environmental Sustainability

The value proposition of the different forms of responsible finance on the issue of environmental sustainability is essentially outlined in their stated intent. This proposition provides the indication and the motivation driving their specific agenda. It may also be seen in terms of the impact such finance may have and its ability to deliver intended outcomes. In this particular case, it concerns the positive impact that finance delivers on the environment.

In its early history, SRI made no explicit mention of environmental sustainability. However, after the Brundtland Report on sustainable development published by the United Nations in 1987 there was a clear articulation that such investments were founded on ESG considerations. It was specifically indicated that in a long-term-oriented investment approach, priority needed to be given to the environment. SRI specifically states that the essence of sustainability is that there should not be any compromise on the ability of future generations to meet their own requirements.

Many private sector corporations including banks and financial institutions now issue sustainability reports alongside their annual reports so that their environmental stance and efforts to contribute to environmental sustainability are disclosed together with other business plans. SRI also specifically states that investments in businesses that have little or no regard for pollution, deforestation or wildlife should be avoided. At the institutional level, banks and financial institutions publish the criteria that are used to assess, monitor and report on the green impact of the investments they undertake.

There are now a number of international collaborations to advance the sustainability agenda with particular regard to environmental issues. The Global Alliance for Banking on Values (GABV), founded in 2009, represents a network of banking leaders who are committed to advancing positive change in the sector, including environmental sustainability. This is mainly achieved through greater transparency and disclosure in terms of the banks' assets that are committed to meeting the needs of the planet.

Fortune magazine's Change the World list of Fortune 500 companies that are "doing well by doing good" also includes companies that are working to reduce damage to the environment.

Then there are the various international market indices that have been developed around the world which include as their stated intent environmental sustainability and the criteria used to evaluate their constituent companies' impact on climate change and their environmental management. The Dow Jones Sustainable Indices (DJSI), for example, select leaders from all sectors based on a wide range of sustainability metrics, among which is environmental performance including climate change mitigation. The DJSI tracks the performance of the top 20%

of companies in the Dow Jones World Index (DJWI) that are leading in the field of sustainability, with thematic funds included in specific targeted sub-classes such as the environment that are assessed according to specific environmental sustainability criteria. In the UK, the FTSE4 Good Index includes companies that meet stated requirements for addressing ESG issues. For the environmental criteria, for example, companies are evaluated against their efforts on climate change mitigation and environmental management.

Finally, there are the targeted, or impact, investments made in private financial markets where capital is specifically channelled to clearly defined purposes aimed at solving environmental challenges. These include cases in which the intent of the environmental purpose is clearly explicit.[4] Such impact investments are defined as funds deployed with the aim of having a positive environmental impact while also generating a financial return.[5]

Islamic finance, which operates according to Islamic law, specifies that permissible financial transactions are those that do good for others, while those that do harm to others and are not good for the community should be avoided. The specific intent of environmental sustainability is expounded in the broad requirement of duty of care as stated in the Noble Qur'an. More specifically, it is derived from the foundational principle of the vicegerency of mankind on earth. This principle states that mankind is the representative of Allah on earth and as such the Almighty has entrusted mankind with the stewardship of the Almighty's possession and thus with the responsibility to safeguard worldly resources.

Allah states this principle in the Qu'ran: "*Verily, I am going to place (mankind) generations after generations on earth...*"[6] It is also written that "*He brought you forth from the earth and settled you therein...*",[7] meaning He trusted mankind with the task of developing the earth.

There is a famous saying attributed to the Messenger (SAW) in which the importance of doing good for mankind and the environment is stated even in the event there are only a few moments left to live.

..."*if the hour erupts (judgement day begins) and one of you is holding a shoot and he is able to plant it before he moves, then he should.*"[8]

In Islamic finance, it is the core set of values which overrides other criteria that becomes the defining parameter. It is thus consistent with the achievement of sustainability, including environmental sustainability. Also explicit is the principle that in pursuing any economic activity there is a duty not to inflict harm on others and not to withhold what is their due, as well as to make the best use of resources.[9] It is these principles in the Quran and Hadith that promote values for the conduct of economic activities, including environmental sustainability.

Among these principles is the Hadith that concerns justice (adl), in which mankind as the custodian of the world

[4] GSIA, Global Sustainable Investment Review
[5] Global Impact Investing Network (GIIN) at https://thegiin.org/impact-investing/
[6] Al-Baqarah (The Cow):30
[7] [Hud (The Prophet Hud):61]
[8] Hadith narrated by Ahmed

is duty-bound to protect it against harm from the actions of others in their quest for gains and profit due to their greed.[10] This includes treating the environment in a just and fair manner. There is also the practice of moderation, or the middle path (wasat), in which the Qur'an enjoins avoidance of excess and wastage.[11] This is reinforced by the principle of 'rahmah', that all mankind and other living beings including plants must be treated with mercy.[12] The principle of custodianship and trust further states that the earth and all its contents are entrusted to mankind so that it can be protected from harm for the next generations.[13] These broad principles of sustainability are embedded within Shari'ah contracts and govern the relationship between Islamic financial institutions and their customers.

Approaches and Strategies

Different strategies have been adopted by the different forms or responsible finance to contribute towards achieving the objective of environmental sustainability. Ethical finance has generally adopted a negative screening process and wide-ranging investment strategies. The largest sustainable investment strategy globally is founded on negative, or exclusionary, screening, which assesses potential damage to the environment. In this process, business activities which are not compliant with the environmental criteria are excluded. The ESG integration approach involves the exclusion from a fund or portfolio of certain sectors, companies or practices based on specific ESG criteria.[14] Negative screening is the predominant strategy adopted in Europe, while ESG integration now dominates in the U.S., Canada, Australia and New Zealand, and Asia.

The process is also achieved through investment managers adopting the systematic and explicit integration of environmental considerations in their financial analysis. These considerations are incorporated into investment selection. Environment-conscious investors screen such investments to see which issues have been considered. Examples of the environmental criteria followed include impact on climate change, pollution, bio-diversity and endangered species, energy efficiency, and deforestation. For the FTSE4 Good Index, both negative and positive screening of companies based on their stated requirements is applied.

Then there is the 'best-in-class' approach, which tracks companies that operate according to a set of corporate sustainability considerations. The DJSI follows this method. The index is based on an analysis of criteria that include environmental considerations. Companies that do not operate in a sustainable and ethical manner are excluded. General as well as industry-specific sustainability is included for each criterion across 58 sectors defined according to Dow Jones' and FTSE's Industry Classification Benchmark. This includes 'thematic funds' targeting specific investments based on factors such as the environment, which is a sub-class of the approach.

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9 Al-Quran, Asy-Syurad':183
10 Essence of Al Quran, Sura [Al-Nisa' (The women):58]
11 Essence of Al Quran, Al, Surah Al A' raf 31
12 ibid
13 Essence of Al Quran, Surah Al Baqarah:30
14 For a detailed discussion on the latest development of SRI, please refer to Chapter 2 of this report

A more explicit approach is through the assessment of the impact that such investments have on the environment. These are generally applied to investments typically made in private markets aimed at addressing environmental problems. Capital or financing in such cases is provided to businesses with a clear social or environmental purpose.[15]

The final strategy is through corporate engagement and shareholder action. This is the dominant strategy in Japan.

For Islamic finance, a screening process is undertaken to assess the permissibility and compliance with requirements that include social and ethical responsibilities. Anything that contradicts these principles or is potentially harmful has two layers of Shari'ah screening: sector screening and financial sector screening.[16] In sector screening, Shari'ah non-compliant business activities are not allowed. This is similar to the negative/exclusionary screening strategy of SRI. Other than a negative screening process that excludes activities that are harmful to the environment, a detailed framework for the assessment of environmental impact has yet to be developed. Financial screening covers the financial aspects of the company involved in the investment.

A growing topic of discussion is finance that is both value-adding and value-based. Value-adding finance makes a meaningful contribution by intermediating and facilitating real economic activity, while in value-based finance the focus is on the benefit to society.[17] The reliance is on professionalism, ethics and governance to achieve these objectives. The "display of such commitment through the measurement and disclosure by the financial institutions' non-financial performance that includes its impact in social, environmental and governance is a powerful tool for change."[18] Thus a means by which this can be achieved is for financial institutions to disclose their 'corporate value-intent' and to provide a performance measure of their commitment to the cause.

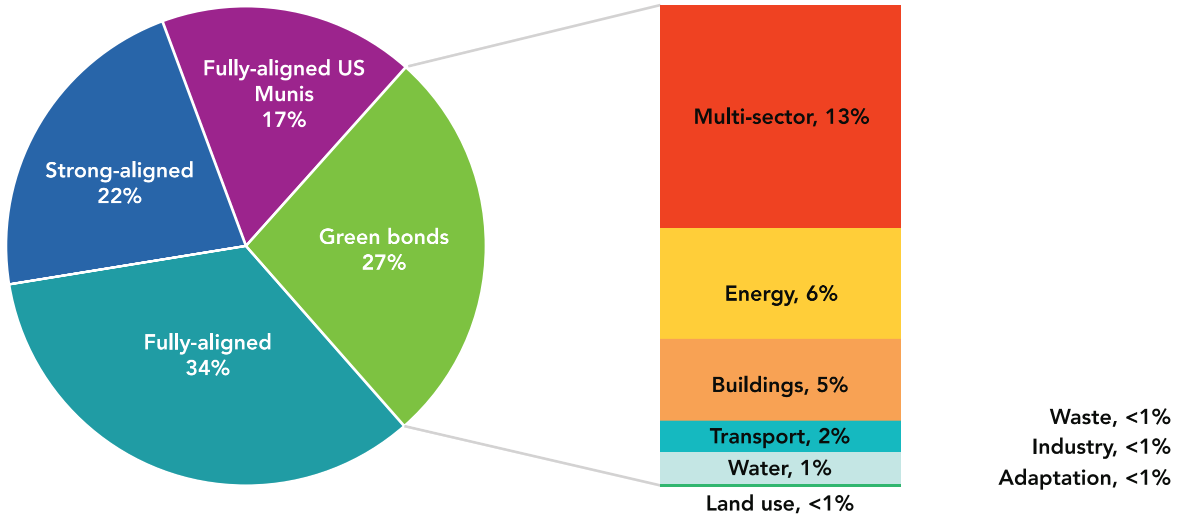
A further approach for enhancing the role of finance in supporting environmental sustainability is the development of dedicated markets or financial instruments. The past few years have seen the issuance of climate-aligned bonds, for example, the proceeds of which support environmental sustainability.[19]

It should be noted that climate-aligned bonds essentially comprise:

- Green bonds: raised for climate change solutions and labeled as green by the issuer;
- Bonds issued by fully aligned climate issuers: where issuers derive more than 95% of their revenues from climate-aligned assets and green business lines, including fully aligned US Muni issuers; and
- Bonds issued by strongly aligned climate issuers: where issuers derive 75-95% of revenues from climate-aligned assets and green business lines.

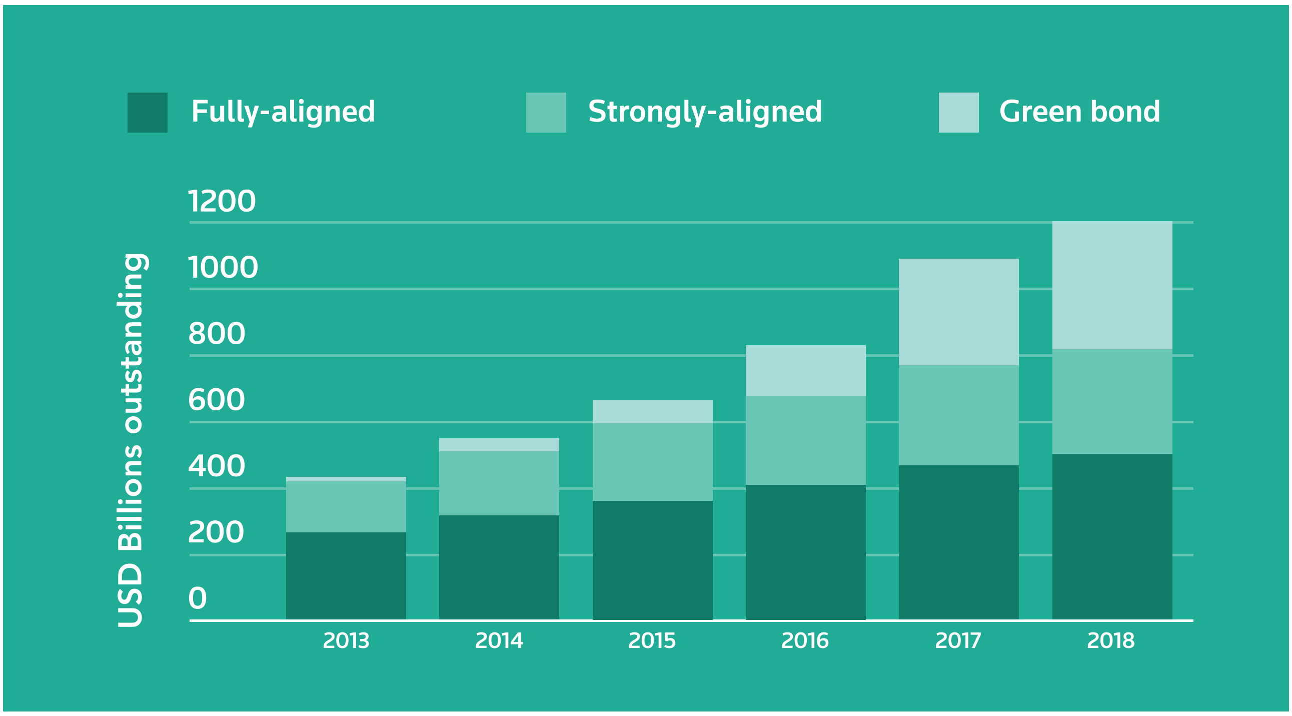
[15] GSIA, "Global Sustainable Investment Review", P6
[16] ISRA: Islamic Financial System: Principles & Operations, 2nd ed (Kuala Lumpur: International Shari'ah Research Academy for Islamic Finance, 2016) p.481
[17] This is discussed in Zeti Aziz (September 2015) Building Financial Systems for Sustainable Development. Paper presented at the Global Ethical Finance Forum organized by RFI
[18] ibid
[19] Bonds and Climate Change: The State of the Market 2018, Climate Bond Initiative, September 2018

The climate-aligned bond universe

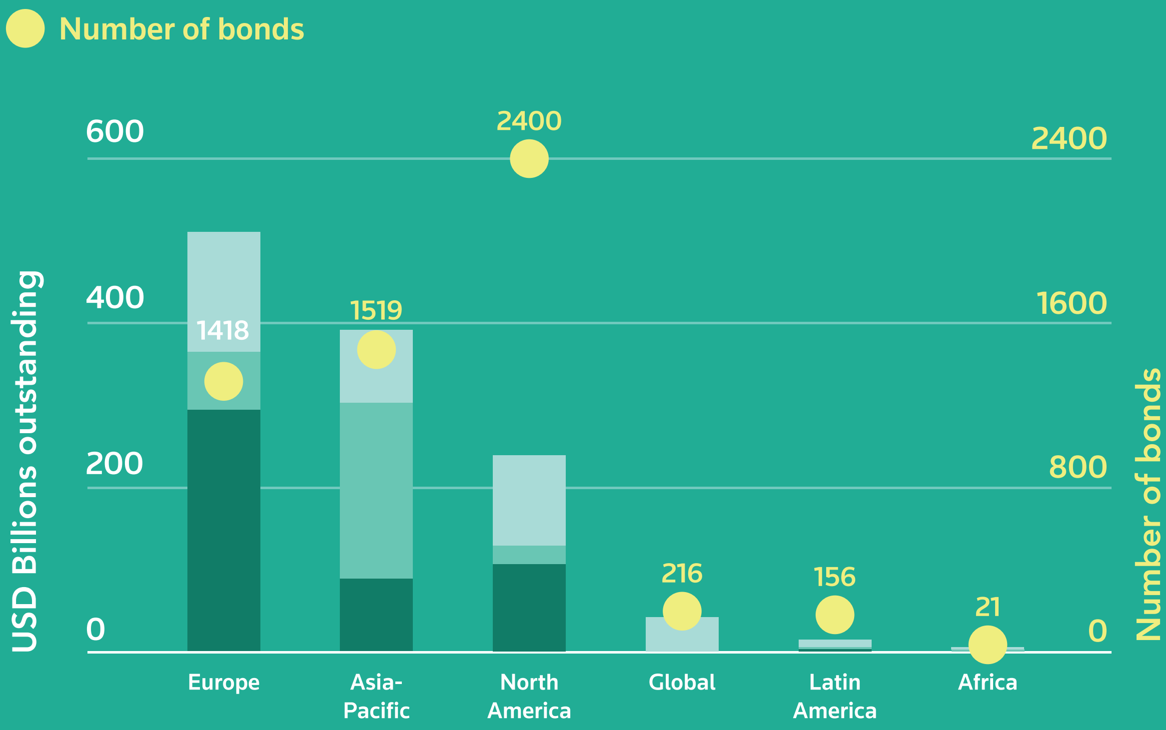


By the first half of 2018, the climate-aligned bond universe had 869 issuers with a total US$ 1.45 trillion outstanding. Of these, 34%, or US$ 497 billion, are from fully aligned climate issuers, 27% (US$ 389 billion) are green bonds, 22% (US$ 314 billion) are from strongly aligned climate issuers, and the remaining 17% (US$ 250 billion) are from fully aligned US Muni issuers.[20]

A climate-aligned bond universe of USD1.45tn



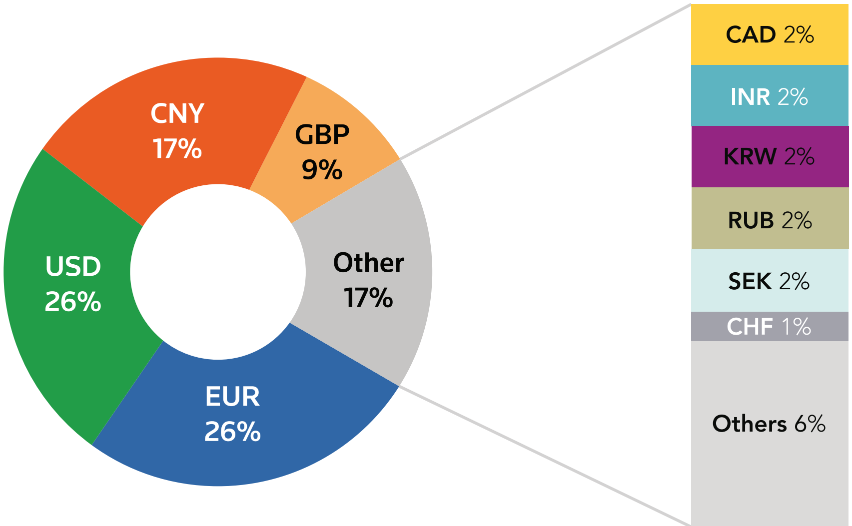
[20] ibid



Source: Climate Bond Initiative, data as at H1 2018

By region, Europe had the highest volume of climate-aligned bonds at US$ 509 billion, followed by Asia-Pacific with US$ 338 billion and North America with US$ 241 billion. North America had the most such bonds, with 2,400 issued, followed by Asia-Pacific with 1,519 and Europe with 1,418. Asia-Pacific had the highest number of issuers at 312, followed by Europe with 309 and North America with 229.[21]

The US dollar and euro were the chief currencies for issuances, followed by the Chinese renminbi and British pound. International financial institutions have begun diversifying into ASEAN currencies.



GLOBAL ISSUANCE BY CURRENCY

International financial institutions have started issuing green local ASEAN currency bonds

		IFC	EBRD	IBRD	ADB	EIB
IDR	Green bond	✔	✔			
	Vanilla bond	✔	✔	✔	✔	✔
SGD	Green bond					
	Vanilla bond	✔	✔	✔	✔	
PHP	Green bond	✔				
	Vanilla bond	✔	✔	✔	✔	✔
MYR	Green bond			✔		
	Vanilla bond	✔	✔	✔	✔	
THB	Green bond					
	Vanilla bond			✔	✔	

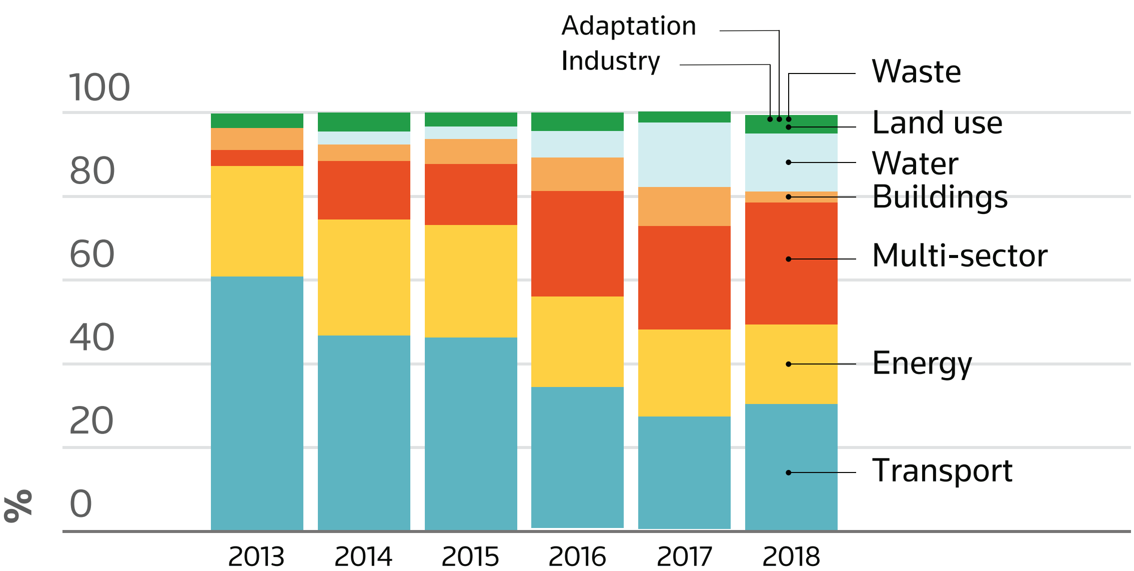
Source: Climate Bonds Initiative from Thomson Reuters data

[21] ibid

From a sectoral perspective, transport was dominant at US$ 532 billion outstanding, although its 30% share of the total is down substantially from the 61% share recorded in 2013, indicating a steady diversification into other sectors.

Green bonds issued to raise funds for projects that provide solutions for environmental issues are gaining momentum. The first widely subscribed green bond was issued in 2007 by the European Investment Bank. Such issuances have soared from US$ 800 million in 2007 to US$ 167.3 billion in 2018. The U.S. (US$ 34.1 billion), China (US$ 30.9 billion) and France (US$ 14.2 billion) are the leading three markets in this area, with a total 48% of global issuance in 2018. Emerging markets accounted for a fifth of issuances in 2018 at US$ 40 billion. China accounts for 78% of the emerging market share.

Growth in the ASEAN region continues to gain momentum with the introduction of the ASEAN Green Bond Standards in late 2017. Indonesia and Thailand have entered the market, and there has also been growth in Singapore.[22] The Philippines' AP Renewables became the first such issuer in the region with a PHP 10.7 billion (US$226 million) Climate Bonds Standard-certified green bond in February 2016 to finance a geothermal project. The Asian Development Bank guaranteed 75% of the bond. A year later, Malaysia and Singapore joined the market with three and two deals, respectively, while Indonesian issuers debuted in the first quarter 2018 and the first Thai issue followed in the second quarter. The US$ 1.25 billion green sukuk issued by Indonesia in March 2018 made it the fifth country in the world to have placed a green sovereign issue, and the first to have issued a sovereign green sukuk. The sukuk accounted for a quarter of total ASEAN issuance as of November 2018.[23]



Source: Climate Bond Initiative, 2018

[22] 2018 Green Bond Market Summary, Climate Bonds Initiative, January 2019
[23] ASEAN Green Finance State of the Market, Climate Bonds Initiative, 30 Nov 2018

Source: Climate Bond Initiative

The most widely accepted standards in the area are the Green Bond Principles issued since 2014 by the International Capital Market Association.[24] The Climate Bond Initiative has also issued a Climate Bonds Standard and Certification Scheme.[25]

While there has been an acceleration in the issuance of green bonds offered by SRI, and strong demand from institutional investors, the challenge is to ensure that the entire proceeds of an issuance are segregated for the specified green purpose, in this case, for environment-related activities. Sukuk issuance has a built-in due diligence process whereby Shari'ah boards or committees provide the necessary approvals. This raises the degree of certainty concerning the use of an issue's proceeds. While there is a tendency in Islamic finance to focus on negative screening, its

[24] ICMA Website at (https://www.icmagroup.org/green-social-and-sustainability-bonds/)
[25] www.climatebonds.net

reliance on capital markets to support environmental sustainability puts the focus more squarely on the positive value-add it contributes.

A number of initiatives to advance the development of such Shari'ah-compliant financial products include the Green Sukuk and Working Party launched by the Climate Bonds Initiative, the Clean Energy Business Council of the Middle East and North Africa, and the Gulf Bond and Sukuk Association to develop best practice and promote the issuance of green sukuk in the Middle East. In Malaysia, Bank Negara Malaysia, the Securities Commission and the World Bank established a technical working group in 2017 with the objective of creating a new market for financing green projects in Malaysia and fostering innovation in funding for green projects, such as green sukuk.

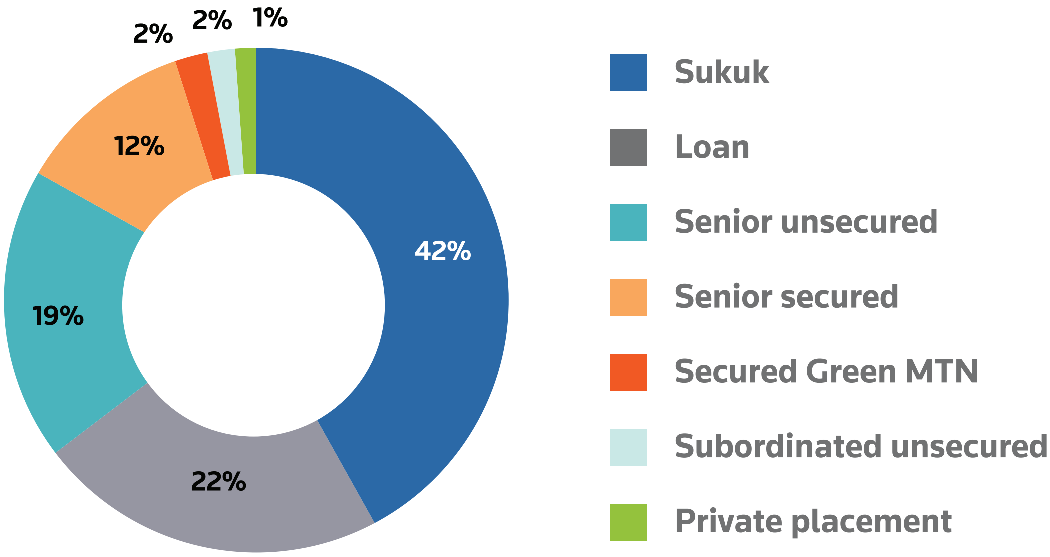
The world's first green sukuk was issued by Malaysian renewable energy firm Tadau Energy in July 2017 to finance a large-scale solar power project. The MYR250 million (US$ 60 million) sukuk adopted the SRI framework.[26] This was followed by a MYR 1 billion (US$239 million) issue of green sukuk by Quantum Solar in October 2017 to fund another large solar project. The first green medium-term notes facility was issued in 2018 by Malaysian joint venture Segi Astana to finance a green building at Kuala Lumpur International Airport, thus providing an avenue for repeat issuances. In 2018, a MYR 57 million (US$ 14 million) green SRI sukuk was issued by UiTM Solar Power to finance a solar power plant near Kuantan, in Pahang state.[27]

For the broader regional market, the ASEAN Capital Market Forum launched its ASEAN Green Bond in November 2017. This was a major breakthrough in which the ten Southeast Asian countries that make up ASEAN reached a consensus on standards for green bonds and sukuk. The standards were based on the four components of the Green Bond Principles established by the International Capital Market Association concerning the use of proceeds, the process for project evaluation and selection, management of proceeds, and reporting.[28]

The first issuance under the SRI Sukuk Framework and aligned to the ASEAN Green Bond Standards was by PNB Merdeka Ventures in December 2017. The MYR 2 billion (US$ 478 million) 15-year green sukuk was intended to finance the construction of the Merdeka PNB118 Tower, a 118-storey green mega-skyscraper in Kuala Lumpur. This is the largest green sukuk issuance to date.[29] In February 2018, Indonesia issued the first sovereign sukuk in ASEAN to comply with the ASEAN Green Bond Standards, with an issuance size of USD1.25 billion for five years. Another green sukuk to finance a solar project was issued in January 2018: a MYR 245 million (US$59 million) green SRI sukuk issued by special purpose vehicle Sinar Kamiri. As of November 2018, 42% of the ASEAN green bond market was in the form of sukuk.[30]

[26] Media Release, Kuala Lumpur, 27 July 2017, Malaysia's First Green Sukuk under the Securities Commission Sustainable Responsible Investment Sukuk Framework
[27] http://cicero.oslo.no/file/142
[28] M. Rozani Osman, Green Sukuk, Financing the Future, ASEAN Capital Market Forum. World Bank Group, Global Knowledge & Research Hub in Malaysia November 2017
[29] Climate Bond Initiative, September 2018
[30] ASEAN Green Finance: State of the Market 2018, Climate Bonds Initiative

42% of ASEAN green bonds are in the sukuk



How to issue a green bond/sukuk/loan

Who can issue green bonds?

An entity which has suitable green assets can issue green bonds, green sukuk or obtain a green loan. Suitable green assets include renewable energy, low transport, low carbon buildings, sustainable water and waste management, sustainable. land use as well as climate change adaptation measures such as flood defences.

1 Develop a green bond framework

- Define eligibility criteria for projects/assets
- Create selection process
- Set up tracking & reporting

Available guidelines & standards:

International: Green Bond Principles (GBP), Green Loan Principles, Climate Bonds Taxonomy and Climate Bonds Standard

Regional: ASEAN Green Bond Standards

Country-specific: Sustainable and Responisble Investment Sukuk Framework (Malaysia)

2 Best practice: Arrange an external review

Assurance report: and external party confirmation of compliance with GBP/GLP

Second Party Opinion: an external assessment of the issuer's green bond framework, confirming GBP compliance and analysing the eligible asset categories

Green rating: an evaluation of the green bond and framework against a third-party rating methodology, which considers the environmental aspects of the investments. These include products developed by international and local rating agencies such as RAM Malaysia

Verification report for Climate Bond: third party verification, pre- and post-issuance, which confirms that the use of proceeds adheres to the Climate Bonds Standard and Sector Criteria and the Paris agreement to keep global warming to 2C and achieve full decarbonisation by 2050

3 Check for local subsidies & support mechanisms:

Singapore: Monetary Authority of Singapore's green bond grant scheme can absorb the full cost of external reviews

Malaysia: offers tax deduction of issuance costs for issuers and tax exemptions for investors until 2020 for socially responsible sukuk and green sukuk. The Green SRI Sukuk Grant Scheme is available to cover the cost of external reviews

4 Issue the bond, sukuk, loan!

5 Post-issuance reporting

Report annually: to confirm that the funds are allocated to green projects/assets

Best practice: Disclose the environmental impacts of financed projects in absolute terms and relative to an appropriate benchmark

A wide variety of green bonds has also been raised by corporates, supra-nationals and sovereigns. Investors in this market have included sovereign wealth funds and other institutional investors such as pension funds, insurance companies and asset management companies.

Exposure to green financial instruments such as these has risen strongly in recent years. This market has been particularly important for supporting the construction of green infrastructure and low-emission buildings.[31] Dedicated financial institutions such as green banks have also been established to support green financing. This can be found in developed financial systems including the U.S., UK and Europe.

Much of the encouraging development in the ASEAN

[31] Based on https://www.climatebonds.net

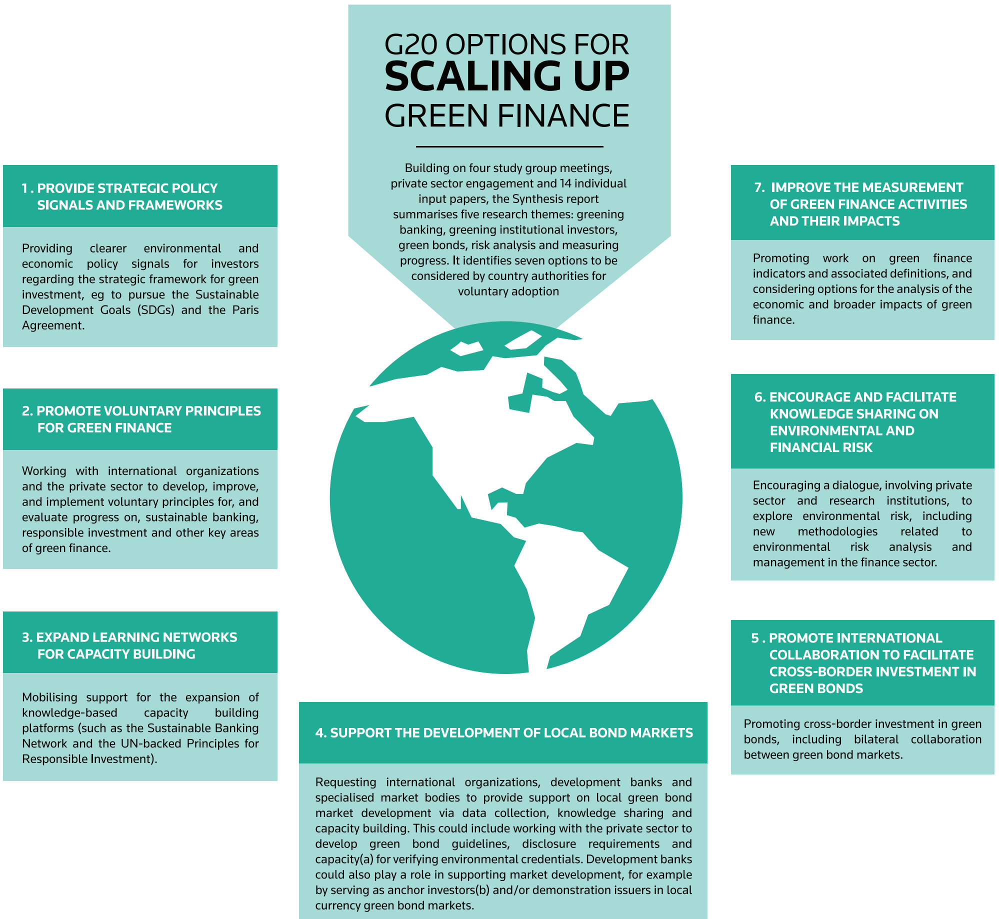
green bond market reflects the high volume of green investments estimated to be in the pipeline for the period 2016 to 2030,[32] as well as support from regional and national public sector bodies and regulatory authorities.

Financial Regulatory Authorities and Environmental Sustainability

Governments and regulatory authorities have over recent years begun to play a much greater role in supporting the environmental sustainability agenda. Climate change is recognised to not only be economically disruptive but to have implications for financial stability. Government and regulatory initiatives have been in the form of the development of financial markets, guidelines and regulations, institutional arrangements, and schemes and policies that support environmental sustainability.

G20 central banks and monetary authorities have also studied the green financing agenda. In their Synthesis Report of the G20 Green Finance Study Group co-chaired by the Bank of England and the People's Bank of China, with the United Nations Environment as the secretariat, seven recommendations were made to scale up the green financing agenda as follows:

Figure 3: G20 options for scaling up green finance from G20 GFSG Synthesis Report (2016)

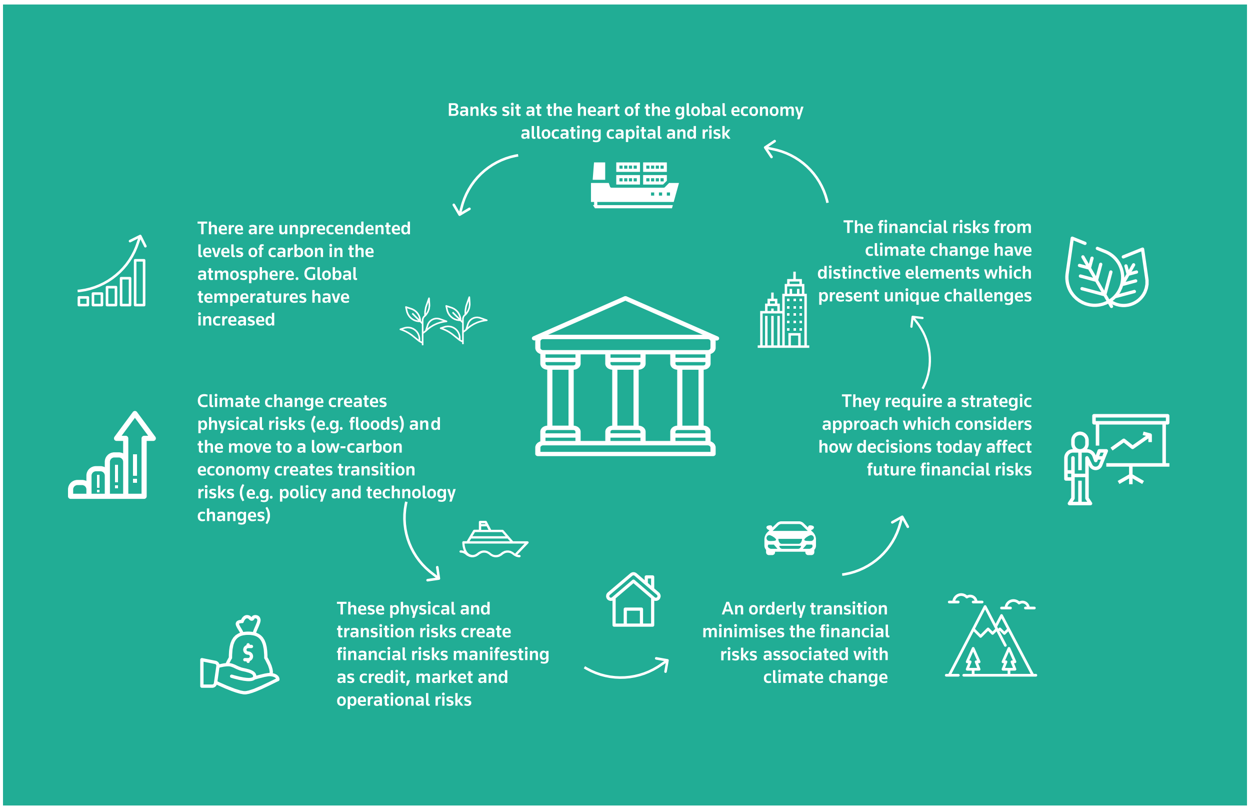


[32] Green Finance Opportunities in ASEAN, DBS and UN Environment Inquiry into the Design of a Sustainable Financial System, 2017, UNEPInquiry

The Bank of England has been a pioneer in this area, particularly in its recognition that climate change has direct implications for the mandates of central banks.[33] Stress tests are therefore being developed to incorporate climate risks so as to provide a basis to assess the ability of financial institutions to manage climate-related shocks. To support this, green definitions have been standardized while also building institutional capacity to address issues concerning environmental sustainability. To facilitate the efficient allocation of resources to green projects, the disclosure of information by companies on environment-related factors has been improved. This is aimed at facilitating the price discovery process and determining the appropriate pricing of such financing by investors.

The Bank of England in September 2018 produced a report on the impact of climate change on the UK banking sector.[34] The report identified the chief sources of financial risk emanating from climate change, assessed how banks are responding and managing such risks, and provided guidance on the supervisory approach of the Prudential Regulatory Authority at the Bank of England to those risks.

Climate change presents financial risks to the UK banking sector



Source: Bank of England, September 2018

[33] Bank of England Quarterly Bulletin June 16, 2017.
[34] "Transition in Thinking: The impact of climate change on the UK Banking Sector", Bank of England, September 2018

Other central banks have also issued guidelines incorporating environmental issues as well as introducing risk assessment processes for banking and financial institutions. The People's Bank of China has introduced a Green Credit Policy and Green Credit Guidelines, which require banks to include covenants in their loan documentation so as to comply with environmental standards. Banks are also required to monitor borrowers' compliance with environmental regulations.

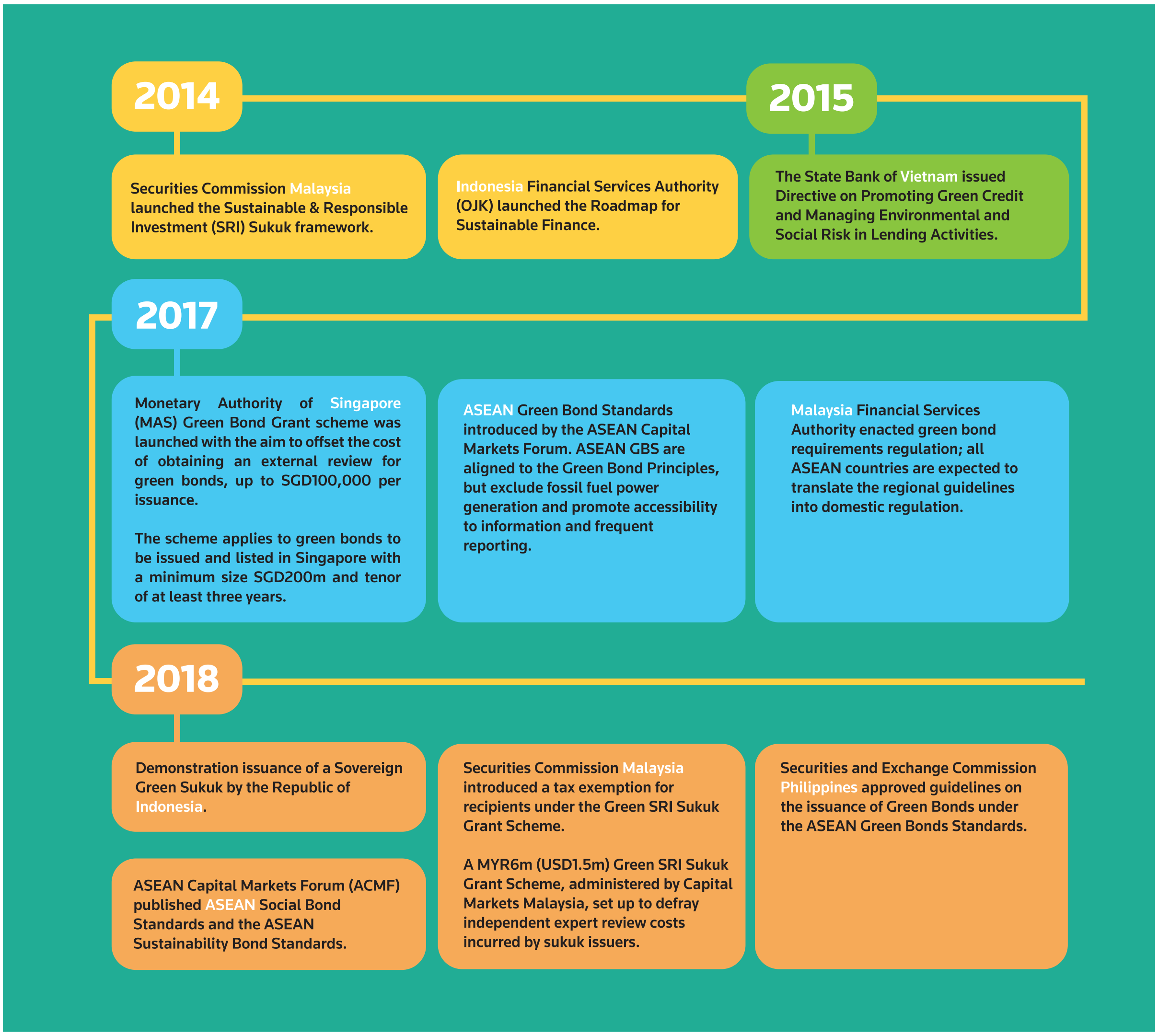
Elsewhere, Banco Central do Brasil has invoked Pillar 2 of the Basel III international banking standards framework to encourage banks to assess their exposure to carbon risks. This includes a regulation that provides guidelines for financial institutions to consider their exposure to environmental risks from their activities. It also requires banks to publicly make known their sustainability risks under the disclosure rules of Pillar 3 (with penalties for non-compliance).

Similarly, the financial regulation authority in Peru has introduced a requirement for banks to complete due diligence on projects seeking loans that includes consideration of environmental risks. Also, the State Bank of Pakistan has introduced a concessionary refinance facility for promoting investment in renewable energy. Under this facility, the central bank provides credit through banks for renewable energy projects on concessionary terms. It has also developed green banking guidelines and encourages domestic banks to gain accreditation under the UN Green Climate Fund.

A further role of regulators has been in the development of financial markets that incorporate a focus on green financing.[35] Several central banks have initiated steps in this regard, including in emerging economies such as China, Pakistan, Brazil and Malaysia. The planned green governance framework in Brazil is aimed at facilitating the issuance of green bonds and other forms of green finance. Meanwhile, the Securities Commission in Malaysia has established an SRI sukuk framework.[36] To complement this and promote the greater use of green sukuk as a fund-raising channel, several tax incentives have been accorded to eligible issuers provided assurance is given that the proceeds of the funds raised are used to finance SRI projects in natural resources, renewable energy and/or energy efficiency sectors. Issuers are encouraged to appoint independent experts to assess the eligibility of projects prior to issuance.

[35] OMFIF Green Finance for Global Public Investors 2017
[36] Media release Kuala Lumpur 27 July 2017 Securities Commission Malaysia, World Bank Group Global Knowledge & Research Hub Malaysia in Malaysia

10 regional and domestic measures across ASEAN in support of green bond issuance



Source: Climate Bond Initiative, January 2019

Climate change is also increasingly seen as a potential influencer on monetary policy, with several central banks grappling with sudden changes in their economies caused by unpredictable weather. The Bank of England was reported in 2018 to have delayed interest rate increases because it could not tell whether a first quarter slowdown was caused by an unusually severe winter or was the start of a more worrying trend. It eventually decided it was "due to the weather, not the economic climate". Similarly, the US Federal Reserve has for some years struggled to pin down the causes of weak first-quarter growth, which were widely blamed on freak snowstorms, though without conclusive evidence. Economists have also found it difficult to tell how much petrol prices in Germany were affected by a drought that limited shipments of fuel on the Rhine because of low water levels.[37] The World Bank

[37] "Central bankers plan for disruption caused by climate change", Delphine Strauss, Financial Times, 22 January 2019

has warned that an increase of 2.5° Celsius would shave 15% from global GDP, while 25% of GDP would be lost if temperatures increase by 3°.[38]

In December 2015, the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD) was formed to develop voluntary climate-related financial risk disclosure recommendations for companies in providing information to investors, lenders, insurers, and other stakeholders. The Task Force "considers the physical, liability and transition risks associated with climate change and what constitutes effective financial disclosures across industries." It is planned to help "companies understand what financial markets want from disclosure in order to measure and respond to climate change risks and will encourage firms to align their disclosures to investors' expectations."[39] The final recommendations were made in July 2017. The TCFD also provided guidance to support organizations in developing climate-related financial disclosures that are consistent with its recommendations.

One of the Task Force's key recommended disclosures focuses on the resilience of an organization's strategy when taking into consideration different climate-related scenarios, including a 2° Celsius or lower scenario. An organization's disclosure of how its strategies might change to address potential climate-related risks and opportunities is a key step to better understand the potential implications of climate change on the organization. The Task Force said it recognizes that the use of scenarios in assessing climate-related issues and their potential financial implications is relatively recent and practices will evolve over time, but it believes such analysis is important for improving the disclosure of decision-useful, climate-related financial information.[40]

Core Elements of Recommended Climate-Related Financial Disclosures

Governance
The organization's governance around climate-related risks and opportunities

Stragegy
The actual and potential impacts of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning

Risk Management
The processes used by the organization to identify, assess, and manage climate-related risks

Metrics and Targets
The metrics and targets used to assess and manage relevant climate-related risks and opportunities

Source: FSB-TCFD

[38] World Economic Forum 2019
[39] https://www.fsb-tcfd.org/about/
[40] https://www.fsb-tcfd.org/publications/final-recommendations-report/#

In April 2018, central bank governors from the UK, France and the Netherlands met in Amsterdam to discuss how to adapt regulation to the risks posed by climate change. Together with China, Germany, Mexico, Singapore and Sweden, the central banks formed the Network for Greening the Financial System' (NGFS). This has two objectives: sharing and identifying best practices in the supervision of climate-related risks; and enhancing the role of the financial sector in mobilizing green financing. The group also endorses the idea that central banks should promote green investment, though implementation can be challenging. The main central bank mandate of preserving financial stability may be in conflict with this.

NGFS produced its first report in October 2018. The report acknowledged that climate-related risks are a source of financial risk and that it is the mandate of central banks and supervisors to ensure the financial system is resilient to these risks. Among key gaps in the current policy framework of central banks and supervisors is the need to develop some new analytical and supervisory approaches, including those based on forward-looking scenario analysis and stress tests. NGFS points to the fact that climate or environment-related criteria are still not sufficiently accounted for in internal credit assessments or in the models of credit agencies.

So far, the integration of climate- and environment-related factors into prudential supervision has been limited. It also acknowledges that most NGFS central banks do not take into account climate-related risk in the conduct of their monetary policy, and cited the case of the ECB's corporate quantitative easing program, which currently subsidizes to the tune of EUR 170 billion (US$ 188 billion) many of the most polluting multinationals in Europe. The report also elaborated a comprehensive work plan towards enabling central banks to incorporate climate-related risks into supervisory models and the establishment of a robust approach in assessing the level of climate risk for each financial asset. Beyond supervisory activities, the NGFS wants to pursue a more ambitious goal, namely to make central banks and supervisors 'lead by example' in integrating climate-related criteria in their operations. However, the report's conclusion does not explicitly mention whether the NGFS's future work will include research into greening monetary policy tools such as collateral requirements and asset purchases.[41]

Conclusion

The attention being accorded to climate action and environmental protection has intensified in the past three years. Ethical finance and SRI based on ESG factors have made significant progress in terms of efforts to channel funds towards financing of environment-related activities. Challenges, however, remain. The first relates to the need to develop commonly accepted standards. The second lies in having bankable projects with robust project

[41] https://www.banque-france.fr/sites/default/files/media/2018/10/11/818366-ngfs-first-progress-report-20181011.pdf

management throughout their life cycles. This is particularly important in efforts to draw financing from the private sector. A third challenge is that such projects needs to have a developed governance process to facilitate coordination among the many stakeholders involved.

For Islamic Finance, while there is already a built-in centralised screening process that conducts the due diligence, it has, however, a tendency to look to the Shari'ah compliance process rather than the impact of the financing activity. More recently, however, there have been discussions around value-adding and value-based financial activities, where their impact is considered after Shari'ah rulings have been complied with.

The established ESG framework can therefore be adopted to achieve the desired social and environmental sustainability outcomes. The potential of this approach is highly significant, given that the ESG factors may be incorporated into the existing centralised governance framework for Islamic finance. This would allow for an evaluation and assessment of the impact, or value-added, being generated to support the environment given that this intent is clearly already embedded within its religious foundations. Working in collaboration with other forms of ethical finance and SRI will increase the potential to enhance the role of finance in environmental sustainability.

CHAPTER 05

Ethical Aspects of Finance

There has over the past decade been an increase in awareness of the vital role of ethics and trust in finance. The public loss of confidence in the financial services industry that followed the financial crisis in the developed world in 2008 has been in part due to a breakdown in values and lapses in ethics. Ethical misbehaviour in the financial services industry has included fraud, bribery, reference rates manipulation, insider trading, and disguising 'toxic assets' as highly rated, quality securities. Poorly aligned incentives have also enabled excessive risk-taking.

A sharp rise in these types of wrong-doing and numerous other financial scandals have severely damaged trust and confidence in the industry. Financial executives involved in these scandals frequently benefited from their misbehaviour through excessive compensation and remuneration packages. Despite regulatory and legal actions against the offenders, the 'huge fines' levied have represented only a fraction of the gains that were made. Gatekeepers including rating agencies, regulators and policy makers were unable to prevent the consequent collapse of financial markets during that period.

Several factors contributed to this widespread abuse of the financial system, among them a lack of personal and organisational accountability, weak governance and controls, and basic incompetence. Fundamental to this trend, however, is a breakdown in ethical values.

A decade has now passed since the Great Financial Crisis. This has allowed time to reflect on these weaknesses and to institute the reforms needed to rebuild and strengthen financial resilience and stability, while also looking to build sustainability. Having made important progress on strengthening financial stability, it is equally important to find more enduring solutions that can rebuild trust in the financial sector. This calls for a closer examination of the fundamental character of modern finance and the reintegration of ethical considerations at its heart.

This chapter focusses on this ethical aspect in finance. It begins with some observations on the evolution of financial systems and the trends that have increased its vulnerability to financial crises, while highlighting some of the issues that contributed to the breakdown of financial systems, including ethical factors. It will then discuss the ethical aspects of the different forms of responsible finance before concluding with a discussion on some possibilities for advancing the ethical and integrity agenda in the future of finance.

Ethical Aspects of Finance and the Erosion of Trust[1]

There is a large body of research that points to the benefits of financial development, recognising the economic value in financial intermediation that mobilises savings, catalyses investment, enables the efficient allocation of resources, reduces information asymmetries, and facilitates the management of risk. The role of finance in economic progress is evident throughout world history. Apart from bringing economic progress, finance has facilitated world trade and lifted millions out of poverty. Throughout history, finance was a common and powerful component in the rise of economies. More recently, the transformative role of finance can also be observed in the many emerging economies in different parts of the world as they transition to becoming a significant and important component of the global economy.

During the 2008 crisis, the degradation of finance rendered this noble economic function of intermediation ineffective, resulting in greater harm than good to the economic growth process. The factors contributing to the crisis have been extensively researched and discussed. In most cases, finance had become highly disconnected from real productive economic activity. There was frequently a breakdown in the relationship between creditor and borrower. Banks had become incentivised to focus on aggressively originating loans that were of compromised quality, largely due to poor underwriting standards. Information was no longer transparent, while inherent and obvious risks were not fully understood. Investors had essentially become deprived of the fundamental right to make informed decisions. Incentives for financial services professionals were also misaligned, as reflected in the compensation structures that rewarded short-term performance. There were also inadequate checks against overzealous risk-taking.

The widely practised misselling of complex financial products and predatory behaviour also contributed to the erosion of trust in financial institutions. There was a growing disembodiment of finance from consumers and the wider economy. When social bonds were reduced to merely profit measures, this provided a weak foundation for sustainable finance. In a world that had become increasingly uncertain, the demand for trust had, if anything, become even greater. When the promised improvements in economic well-being failed to materialise, this lessened confidence that the system would deal with these issues and deliver results. Among the underlying factors that

[1] Parts of this section are based on Zeti Akhtar Aziz, September 2015, "Global Ethical Finance Forum – Building Financial Systems for Sustainable Development" and Zeti Akhtar Aziz, September 2017, "Keynote Speech at the Building Trust Awards 2017".

contributed to this growing distrust is a breakdown in ethical values; an area that deserves greater attention.

There has been an over-focus on rules and compliance, with less focus on building a culture of ethical values. While rules are important, it is the principles behind the rules that are fundamental in preventing trust from eroding. Experience has shown that even corporations that are in full compliance with the rules are not immune from major financial setbacks caused by scandals arising from a breakdown in upholding the fundamental values of honesty, ethics and integrity.

Compliance with rules therefore needs to be reinforced by a strong culture of ethical values. This will involve ethical and integrity standards that are accompanied by a culture in which there is accountability and responsibility. In other words, it is less about complying because of the fear of sanctions and penalties, but more about complying even when no-one is looking. Initiatives to address this have included a focus on incentives and professional codes. They must also have the boundaries of responsibilities and accountabilities clearly outlined so they contribute towards building a stronger ethical culture. Also important is giving focus to greater transparency so as to reinforce accountability.

Ethical Aspects in Responsible Finance

Both ethical and Islamic finance are founded on ethical foundations. In addition to upholding their key values, with a focus on doing what is right, another key element of these forms of finance is the longer-term orientation that is integral to their activities. A focus on achieving short-term results increases the risks to the sustainability of their activities. By putting greater emphasis on a longer-term orientation, the prospects for a business's sustainability are significantly enhanced. There is also an undertaking that is beyond the domain of the business: to achieve outcomes that are for the greater good. Demonstrating an obligation to humanity, improving social well-being, and caring for the environment all help to build trust in these forms of finance.

Six principles have been proposed as the basis of a framework for addressing ethical issues in finance:[2]

- **Welfare** – Is anyone being harmed and, if so, can the harm be justified?
- **Duty** – What is my duty or obligation in this situation?
- **Rights** – Are anyone's rights being violated and, if so, can the violation be justified?
- **Justice** – Is everyone being treated fairly and justly?
- **Honesty** – Am I being entirely honest in my actions?
- **Dignity** – Am I showing respect for all persons involved?

While there is no standard nor universal definition of ethical banking

[2] JR Boatright (2014) Ethics in Finance, Third Edition, John Wiley & Sons, Inc

and finance, in its principal form, the European Federation of Ethical and Alternative Banks and Financiers has stated that an ethical bank must work for the common good and ensure the right to receive credit through a bank activity that consists of raising funds and reallocating them in the form of credits for cultural, social and environmental projects. Through their activity, ethical banks promote social inclusion, sustainable development, and the development of social economy and social entrepreneurship. Ethical banks also contribute towards raising public awareness on the role of money and the failures of an economy that is based on short-term approaches and on profit being the only objective.[3] There is also finance that is consistent with SRI, ESG principles, the Equator Principles and the UN's Sustainable Development Goals. A common thread in these various forms of ethical finance is the positive impact they have on "people, planet and profit".

This past decade has seen mainstream global banks re-balancing and re-aligning their business objectives and governance arrangements with ethical considerations. This is primarily through expanding this agenda beyond the usual corporate social responsibility (CSR) narrative. Increasingly, business targets are set for products and services to enable the underserved to save, to improve their creditworthiness and to grow their assets, thus elevating their financial inclusion. The same is also seen through the provision of enabling opportunities for business customers, particularly those operating small businesses, to better compete in an increasingly challenging environment.

From an Islamic perspective, ethics is an integral part of the Shari'ah, and is considered to be of high value and one of the objectives of legislation, as confirmed by the Hadith:[4] "I have been sent to complement the most noble morals."[5] In all dealings, Shari'ah calls for the following as the main foundations of ethics:

- **Integrity**

Integrity is the quality of being honest and having strong moral principles. Islam values integrity highly and says it should govern all acts, and this extends to financial dealings. This is confirmed in the saying of the Prophet (peace and blessings be upon him): "Every one of you is a shepherd and every one of you is responsible for his flock",[6] and "Give back the trust to whoever has entrusted you with it."[7]

- **Justice (Adl')**

Treating others fairly and according everyone their rightful place befitting their role is integral to all dealings. This is found in the Qur'an:

"In accordance with Al-Ihsan..." [i.e. to be patient in performing one's duties to Allah, totally for Allah's sake, and in accordance with the Sunnah (legal ways) of the Prophet in a perfect manner];[8] and "Verily! Allah commands that

[3] European Federation of Ethical and Alternative Banks and Financiers, extracted from its website on 19 May 2019 https://www.febea.org/febea/news/ethical-finance-0
[4] Saying of the Prophet Muhammad, peace and blessing be upon him
[5] Related by Ahmed in his Musnad, Al-Bayhaqi and Al-Hakim. Al-Bayhaqi said: "It has been related by Ahmed and its narrators are the same narrators of Al-Bukhari and Muslim." "Fayd Al-Qadir", Al-Manawi, [2: 573]
[6] Related by Al-Bukhari in his book "Sahih Al-Bukhari" [3: 115] and by Muslim in his book, "Sahih Muslim." [6: 8].
[7] Related by Al-Tabarani in his two Mu'jams, "Al-Saghir" and "Al-Kabir". Al-Bayhaqi said: "Its narrators are reliable." "Fayd Al-Qadir", Al-Manawi [1: 223].
[8] Sura [Al-Nahl (The Bee): 90]

you should render back the trusts to those to whom they are due, and that when you judge between men, you judge with justice…"[9]

It is for this reason that transparency and fair dealings between transacting parties are integral to every Shari'ah-compliant financial transaction.

- **Duty of Care/ The principle of vicegerency**

Allah expressed the principle of vicegerency in the Holy Qur'an: "Verily, I am going to place (mankind) generations after generations on earth…"[10] His saying: "He brought you forth from the earth and settled you therein…"[11] means He trusted mankind with the stewardship of the earth.

Islam views man's ownership of property not as an end in itself, but as a means to provide a decent life for the owner, his family and society in such a way that he owes a duty of care and will be held accountable for the way he acquired it and how he uses it, as recorded in the following Hadith:

"The feet of a servant will not slip until he is asked about four things:

- his life - how he spent it,
- his knowledge - what he did with it,
- his property - how he acquired it and how he spent it, and
- his health - how he consumed it."[12]

- **Self-Accountability**

In all dealings there is a requirement for self-accountability both in actions as well as inactions, as each has its own consequences. Allah, the Almighty, says: "So whosoever does good equal to the weight of an atom (or a small ant) shall see it. And whosoever does evil equal to the weight of an atom (or a small ant) shall see it."[13] Further, Omar ibn al-Khattab is quoted as saying: "Hold yourselves to account before you are held to account, for it is easier for your accounting, and measure your deeds before they are measured for you." He also says: "Certainly, Allah is ever a careful account taker of all things."[14]

Extended Maqasid

There are also various parts of the extended maqasid included within Islamic financial principles. These include:

- Promotion of economic well-being
- Economic and social justice
- Universal brotherhood
- Poverty alleviation
- Fulfilment of basic human needs
- Fulfilment of spiritual needs
- Optimisation of natural resource consumption.
- Adopting permissible and productive activities (halal) to promote public interests (maslahah) and to do what is right (amal ma'ruf).

9 Sura [Al-Nisa' (The Women): 58]
10 [Al-Baqarah (The Cow): 30].
11 [Hud (The Prophet Hud): 61]
12 Related by Al-Tirmidhi who stated that the hadith is good and sound. The hadith was also confirmed by Al-Munziri, "Tuhfat Al-Ahwazi" (A commentary on Al-Tirmidhi); Al-Munziri, "Al-Traghib Wa Al-Tarhib", [4: 198].
13 Al-Qur'an – 99:7-8
14 [Al-Nisa` (Women): 86].

- Rejecting prohibited and harmful activities (haram), to prevent what is reprehensible (nahi munkar) and prohibit evil (mafsadah).

From a Shari'ah viewpoint, ethics is related to several important Arabic terms: ma'ruf (approved), khayr (goodness), haqq (truth and right), birr (righteousness), qist (equity), 'adl (equilibrium and justice), and taqwa (piety). Good actions are described as 'salihat' and bad actions as 'sayyi'at'. However, the term that is most closely related to ethics in the Qur'an is akhlaq (morals).

Islamic social finance vehicles such as zakat (tithes), sadaqa (alms) and waqf (religious endowments) are founded on these principles and their principles have begun to permeate other areas of finance.

Similarities and Differences

It is evident that there are strong similarities between ethical finance and Islamic finance. Some of these may be summarised as follows:

Similarities between Islamic finance and ethical finance
Fairness – Emphasis on fair treatment of all stakeholders
Transparency – Clarity and disclosure of all relevant information in a manner that does not mislead or prevent stakeholders from making informed decisions
The greater good – Beyond profitability; ensuring that finance is conducted in a manner consistent with the greater good of society
Treatment of impermissible activities – 'Cleansing' of tainted income from impermissible activities is mandatory in both forms of finance
Social dimension – Both forms of finance require social considerations in business dealings

Yet, there are also several differences, including the following:

Key differences between Islamic finance and ethical finance		
	Islamic finance	**Ethical finance**
Faith	Must comply with Shari'ah	May be a criterion, though not necessarily a requirement
Foundations of ethics	Shari'ah (i.e., Al-Qur'an and Hadith as principle sources)	While initially faith based, principles are developed by contemporary communities
Interpretation of what is harmful	Whilst halal and haram are strictly defined, what is harmful (mafsadah) and what is required (maslahah) are based on extenuating circumstances	e.g., Non-renewable energy sources and companies that pollute the environment are measured by specific global standards and are considered harmful and therefore unethical
Ensuring strict adherence	Shari'ah governance oversight by Shari'ah committee	No specific requirement for an ethics committee
Segregation of income, funds and assets	A strict requirement (co-mingling of non-compliant sources and activities is prohibited)	A discretionary choice
Forms	Must contain no haram elements	Must not contain anything considered unethical
Forms of social finance	Charitable tools (e.g., zakat, sadaqa and waqf) must not be used to make profit	Charitable elements can be used to make profit

These differences have enabled many such forms of finance to be recognised and treated as ethical finance. These essentially include forms of finance that fulfil one or more of the ethical dimensions. This has allowed for the rapid expansion of ethical finance.

It has also been observed that there is growing interest in Islamic finance becoming both ethical and Shari'ah-compliant. In this regard, there is an increasing number of market participants and players that are incorporating ethical considerations clearly into their already Shari'ah-compliant business objectives. Shari'ah scholars are now discussing beyond halal/haram objectives and are focusing more on maslahah/mafsadah as well as amal ma'ruf and nahi munkar aspects before a transaction is considered Shari'ah-compliant. During the 13th International Shari'ah Scholars'[15] Forum in 2008 and the Kuala Lumpur Islamic Finance Forum 2019, Shari'ah scholars raised the possibility of Shari'ah rulings on the ethical aspects of the finance.

Advancing Ethics and Integrity Agenda in Finance

Financial systems have to be both value-adding and value-based - value-adding in that they contribute meaningfully by intermediating and facilitating real economic activity, and value-based in that they aim to benefit society. A functioning regime practising both value-adding and value-based finance would thus need to be built on a set of universal principles designed to create a sustainable model for finance within the international financial system.

It would also need to focus on ethics, professionalism and quality of talent that would contribute to the drive for positive change in the financial services industry. This commitment can be displayed through the measurement and disclosure of a financial institution's non-financial performance, such as its impact in ESG metrics, including customer-focused corporate information that would provide an account of its overall behaviour and values. Greater awareness among consumers and investors on the availability and viability of such positive finance would enhance awareness of ethical and Islamic finance. Education, engagement, incentives and the alignment of legal and regulatory frameworks on the utilisation of such finance will be key to achieving this.

This chapter has not discussed the potential role that digitalisation could play to boost ethical elements in finance. While digitalisation and other advances in technology can facilitate wrong-doing in the financial system, they can also improve the means to detect such activities. Greater demands for transparency, greater scrutiny by both regulators and non-regulators, calls for financial

[15] Organized by ISRA and IRTI

reform, and investments in new technology and systems by the financial industry, have all increased the potential for more robust surveillance.

There is, however, no substitute for having ethical standards in place and creating a corporate culture that gives due consideration to behaviour that will ensure clients' interests are put ahead of the company's own. This requires the industry to not only have a high level of professional competence, but also to embed within itself a culture of ethics and integrity. This would produce a financial industry that can genuinely serve the world economy and generate outcomes that are in the best interest of the global community.

06 CHAPTER

Responsible Finance and Financial Stability

The repercussions of the financial crisis experienced in this decade in both the emerging and developed world have been felt throughout the world. The effects have included volatile financial markets, stressed conditions in financial intermediaries, and the adverse implications on the performance of economies in different parts of the world. It has also impacted income distribution, resulting in rising income disparities, and perpetual disequilibrium and misaligned conditions in financial markets which have, in turn, contributed to a misallocation of resources. The severity of these conditions have prompted concerted efforts by the international community to address the issues relating to the functioning of the financial system. Attempts have been made to ensure its soundness and stability, to avoid disruptions in the intermediation process, and to thereby reduce the potential for such financial crises in the future. Efforts have also been directed to being better prepared for the effective management and resolution of any such future financial crises.

Much of the response by the international community has taken the form of regulatory reforms and the strengthening of the institutional arrangements and approaches for ensuring financial stability. Significant progress has been achieved on both these fronts. The regulatory reforms have largely focused on capitalisation and liquidity management by financial institutions. This has been reinforced by the strengthening of the regulatory powers accorded to regulatory authorities. Additionally, the measures at the disposal of the authorities to implement macro-prudential measures have been enhanced. The incentive structure at financial institutions have also been addressed with the aim of promoting a more medium-term orientation for financial activities by the industry. Another important initiative during this period has been the adoption of more robust and forward-looking supervisory oversight of the operations of the financial sector. This has involved regular and more stringent stress tests on financial institutions to assess their viability under extreme conditions. Finally, resolution regimes have been developed to facilitate the management of future financial disruptions and crises.

This chapter reviews the features inherent in Ethical finance and Islamic finance that contribute to financial stability. For each respective form of finance it starts with examining the inherent elements that support their sustainability as a form of finance. Beyond that, it includes the elements that contribute to their soundness and stability. This chapter also highlights the nature of the role of regulators in imposing discipline on the financial industry to achieve financial stability. This includes the international financial standards that have been developed, which also contribute towards maintaining financial stability.

Definition of Financial Stability

There is no universal definition or measure of financial stability. The difficulty arises from the diversity within a financial system, which includes financial intermediaries, financial markets, the payment and settlement arrangements, and the overall financial infrastructure. The activities of the multiple agents within these respective components of the financial system also have significant implications for financial stability. In many countries, the authorities who have the responsibility for financial stability are fragmented, each focusing on different component of the financial system. The result is that there are multiple goals to be achieved involving multiple targets and with multiple instruments and agencies involved for safeguarding financial stability.

Financial stability has generally been defined in terms of the specific financial stability objectives to be achieved. However, as a broad and multi-dimensional concept, stability does not lend itself to being described in a single consolidated measure. Moreover, achieving financial stability in any one component of the financial system would not ensure the delivery of financial stability on a sustainable basis for the entire financial system. It is essentially dependent on the effective collective functioning of the different parts of the financial system.

A common thread in the definition of financial stability is a sound and stable financial system in which financial intermediaries, markets and the financial infrastructure effectively function to facilitate the efficient flow of funds between savers and investors. It is alternatively described in terms of the risks to the functioning of the intermediation process including that of the money and foreign exchange markets. A further aspect of the definition concerns the risks that would affect public confidence in the financial system. These definitions allow for assessments to be made on a broad set of indicators that may be developed for the purpose of gauging the extent to which financial stability is being achieved.

Elements in Finance for Securing Financial Stability

Ethical finance focuses on a longer-term orientation for its activities. Essentially it avoids short-term transactions that are highly speculative or that entail high risks. These elements provide a built-in process that enhances its sustainability and thus reinforces the financial stability agenda. In the same vein, the value propositions of benefiting society and targeting environmental sustainability while still considering the maximisation of financial returns further support its sustainability and financial stability. In adopting the ESG framework, in which governance is a key factor taken into consideration, is also consistent with achieving financial stability. Another contributing element is the higher degree of financial disclosure and transparency required for its activities to achieve its stated goals of bringing value to society and for attaining environmental sustainability.

A final crucial component is also the emphasis on ethics, culture and values, which are key elements embedded in ethical finance. It has been demonstrated time and again that the breakdown of ethical values has contributed to the erosion of trust and confidence in the financial system. Experience has shown that, while compliance to rules and regulations is vital, the principles and values behind the rules are equally fundamental. An institution may receive high scores in terms of their compliance but may at some point suffer financial setbacks due to a scandal arising from a breakdown in the fundamental values of ethics, honesty and integrity. Ethical finance has brought into greater focus the ethical dimension in finance. It accords a fundamental role to these values for channeling resources to the most beneficial and appropriate projects. Additionally, governance is also brought to the forefront to develop a culture of accountability. The breakdown of ethical values, the lack of accountability, and weak governance are frequently key contributors to instability in the financial system. Thus, rules and regulations need to be reinforced by a culture of ethical values.

The value proposition of ethical finance, together with the adoption of the ESG framework, has provided greater clarity to this objective. Its implementation and operationalisation are, however, less structured across the different sectors and across borders. While ESG considerations have been integrated into the screening process (both exclusionary and inclusionary or best-in-class criteria), they have not been consistently applied. There is no single centralised authority to determine the manner in which the criteria are to be applied. Nevertheless, multilateral agencies, as well as private sector indexes that have been developed to identify activities eligible for such finance and investment, are transparent on their criteria and assessment process. The significant growth of ethical finance reflects the recognition garnered that it is not only a sustainable form of finance but also has the potential to support financial stability.

Islamic finance as a form of financial intermediation that also explicitly incorporates elements that encourage the discipline that contributes to ensuring financial stability. Essentially, these elements contribute to the viability and resilience of Islamic finance. Fundamental to its viability is the requirement that financial transactions must be supported by real economic activity. Secondly, rudimentary Islamic finance promotes profit sharing, which should be in turn supported by the sharing of risk. These arrangements limit the extent of leverage. Moreover, the feature of risk sharing also places emphasis on transparency and disclosure, which are explicitly required in the documentation of the contracts for Islamic financial transactions. These inherent features have served as a basis to address several of the issues concerning risk management and governance that usually surface during a financial crisis.

The key strength of Islamic finance is essentially derived from its tenet that financial transactions must be accompanied by an underlying productive economic activity. It is further reinforced by the injunction that financing or equity participation may only be in those activities that have economic value. Similar to ethical finance, the involvement in illegal and unethical activities is prohibited although what the considerations of what is illegal or unethical between ethical and Islamic finance differ. Speculative transactions must also be avoided. This provides the assurance that financial transactions will generate legitimate income and wealth. It is this close linkage between financial flows and productive flows that reduces the exposure to risks that are associated with imprudent risk taking and excessive leverage that could undermine financial stability. Under these arrangements financial assets are expected to expand in tandem with the expansion of the underlying economy.

While the other forms of responsible finance operate within a comprehensive conventional financial system that needs to meet with the overall regulatory regime for conventional finance; a key differentiating aspect of Islamic finance compared to the other forms of responsible finance is that it functions within a comprehensive financial system that complies to its specific regulatory requirements. This comprises all the key components of the financial system that includes the commercial banking and investment banking sector, the insurance (takaful) sector, the asset and fund management sector and the money and capital markets. The risk to financial stability could emanate from any one of these sectors including developments in the foreign exchange market. In this previous decade, the international dimension of Islamic finance has gained greater significance as cross-border financial activities have intensified. Operating in such a comprehensive financial system, Islamic finance has the advantage of allowing for portfolio adjustment and liquidity management, within the confines of the system, of which are important for maintaining financial stability.

A further element that is distinctive to Islamic finance is the oversight and review by the Shari‘ah boards or committees at both the institutional and national level. These provide a mechanism for ensuring that the financial product and service offerings are in accordance with the principles of Shari'ah. This process provides an additional safeguard against irresponsible and unethical practices. This feature allows for financial innovation while ensuring that such innovation adds value. Innovations are assessed against the Shari'ah parameters and tested against the objectives of the Shari'ah with the primary objective being the realisation of its benefits to society. This also ensures that the ethical principles are not compromised. Part of this process is the requirement for a high degree of transparency and disclosure to preserve the rights and responsibilities of the parties involved in the financial contract. Equally important are the market conduct disclosures and management of the customer relationship.

Additionally, the conduct of appropriate due diligence on the viability of the business concerned is a paramount part of the process. As part of the accompanying transparency and disclosure requirements, Islamic financial institutions are also required to disclose to investors how the funds are being managed. As part of the process, it ensures transparency on the risk management and the risk control mechanisms that are being practiced. Disclosure would thus be provided on the true and fair value of the operations. Key to Islamic finance is the assurance that the investments are undertaken in a Shari'ah-compliant manner. The Shari'ah board has the role of ensuring that all aspects of the business operations are in accordance with the Shari'ah principles. This provides a further level of oversight that inherently safeguards against the prospect for financial instability. These built-in elements of governance and risk management contribute towards safeguarding Islamic finance from activities that could undermine its functioning as a form of financial intermediation and thus strengthens the prospect for stability.

Similar to Ethical finance, ethics are explicit in Islamic finance since ethics are an integral part of the Shari'ah. These values are fundamental for ensuring that the right resources are being channeled to the most productive activities. When the ethical dimension in finance is compromised, the global experience has shown that the setbacks to the financial system and to the overall economy have been highly costly. Among the ethical values that are fundamental in Islamic finance are justice and fair treatment. Fair dealings between the transacting parties are integral to any financial transaction for it to be Shari'ah compliant. A further ethical value that is equally important for financial stability is that of integrity: being honest, having strong moral principles and moral uprightness. Such values of integrity must govern all financial dealings. The third ethical value important for preserving financial stability is that of self-accountability. There has to be accountability for the manner in which wealth and property are acquired and how they are utilised. For Islamic finance, the Shari'ah framework assesses the product offerings and transactions against these ethical elements, thereby reducing the potential for contributing to financial instability.

Financial Stability

The international regulatory reforms initiated in this recent decade have been mostly directed toward the operations of the different segments of the financial system rather than to any specific form of finance. There is therefore no specific regulatory regime for Ethical finance; rather, such responsible forms of finance are subject to the same prudential regulations as the rest of the financial system. More recently, however, there have been calls for the 'principle of proportionality' to be accorded to give recognition to the differential risks involved in the financial systems. In particular, it is for the cases of finance for smaller enterprises and for advancing the financial inclusion agenda. There have also been calls to incorporate the goals of sustainable development into financial standards.

A recent review of international financial standards it was found that, among the 15 standards reviewed, none explicitly incorporated the goals and mandate of sustainable development (SD).[1] The review concluded that, while SD is not explicitly stated in the core mandates, that should not prevent regulators or the financial sector from acting in line with SD. The report noted that financial standards were related to sustainable development issues in a fragmented manner. There was no overarching framework for agreement on the principles which could guide the SD efforts. It maintained that common themes such as financial inclusion, environmental sustainability and the strengthening of the principles on ethics and culture could be incorporated without undermining the soundness and stability of the financial system.

More recently, three specific areas have gained traction within the standard-setting community. The first relates to the environment and climate change. It has generally taken the form of climate-related financial disclosures as a voluntary requirement.[2] The second relates to financial inclusion and hence social inclusion. The principle of proportionality was an important step forward in supporting this agenda. It led to the integration of financial inclusion with the financial standards. It also encourages fostering greater equality and poverty alleviation through greater transparency. The third area relates to transforming culture and values with wide-ranging measures to promote higher standards of industry culture in the area of promoting ethics and trust.

The proposal that such financial standards incorporate the sustainable development goals would be in alignment with the financial stability agenda. This would be done by explicitly taking into account the issues surfaced by the sustainable

[1] United Nations (February 2017) "A Review of International Financial Standards as They Relate to Sustainable Development" UN Environment Inquiry/ Corporate Knights

[2] G20 Report (2016) FSB Taskforce on Climate Related Financial Disclosures.

development goals in terms of guidance for managing the consequent systemic risks. The SD issues could also be included in the governance standards. Improving transparency, widening the assessment of risk, and increasing malleability to include the commitment to pursue SD would also be consistent with building financial strength and resilience. Finally, it could be achieved through the transformation of culture so that good conduct would incorporate the sustainability values. That would shift behavior towards that which is consistent with financial stability.

The prevailing international prudential supervisory structures include the Financial Stability Board (FSB), the IMF/World Bank Financial System Stability Assessment (FSAP) and the IMF Reports on Observance of Standards and Codes (ROSC). The FSB in particular has had a pivotal role in bringing countries together in the area of financial stability. Recently the FSB commissioned a study on climate-related financial disclosures to facilitate better pricing of climate-related risks and opportunities. It has the potential to extend its role to incorporate sustainability and to also give recognition to considerations such as income inequality given that it could become a source of systemic financial risk.

The IMF/World Bank's FSAP has yet to incorporate SD as part of its assessment of financial stability. While the ROSC assesses countries' observance of international recognised standards, it does not take into account social, environmental and economic goals. While Basel III has made some reference to environmental risk in Pillar I, there is no mention of social or financial inclusion to be taken into account in the risk assessment and governance framework. It has also been noted that the capital and liquidity requirement under Pillar I can inadvertently adversely affect SD. This is because such financings are generally longer-term in nature and thus may attract higher capital and liquidity requirements.

Several central banks, including those of Brazil, China, and Peru, have taken their own respective initiatives to issue separate guidelines to incorporate environmental and social issues on lending as well as the risk assessment process for banking and financial institutions. The Banco Central do Brazil utilised Pillar 2 of Basel III to encourage banks to assess their exposure to carbon risk. Under this arrangement banking institutions need to consider their exposure to social and environmental risks arising from their activities. In addition, financial institutions are required to disclose their sustainability risk under the disclosure rules of Pillar 3. In Peru, the Financial Regulation Authority requires due diligence on projects that includes the consideration of social, environmental and economic risks related to the loan. In June 2017, the Bank of England published its position on climate change. Its report essentially acknowledges financing of investments that provide environmental benefits in the broader context. Such support for achieving strong, sustainable and balanced growth is based on the premise that it would in turn support financial stability.

In Islamic finance the inherent elements are underpinned by Shari'ah principles not only contribute to the soundness and stability of the Islamic financial system but are also reinforced by the regulatory and supervisory framework for Islamic finance. As part of the efforts to strengthen the international financial architecture of Islamic finance, the Islamic Financial Services Board (IFSB) was established in 2002. It represents international efforts to increase regulatory cooperation, encourage uniformity of regulatory regimes, and enhance the monitoring of risks in the Islamic financial systems in different jurisdictions. The IFSB has now introduced wide-ranging prudential standards in the areas of capital adequacy, risk management, corporate governance and Shari'ah governance.

These standards have taken into account the distinct characteristics and specifications of Islamic finance and the unique combination of risks associated with Shari'ah-compliant financial business. Increasingly, jurisdictions have already commenced the implementation of the prudential standards issued by IFSB. This moves us toward greater harmonisation of prudential standards, which promotes the soundness and stability of Islamic financial institutions. In addition, The Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) has issued wide-ranging standards in the areas of Shari'ah, accounting, auditing, ethics and governance for the international Islamic financial industry.

Conclusion

Ethical finance and Islamic finance have inherent elements that contribute to sustaining financial stability. Ethical finance's emphasis on activities that have a longer-term orientation and its avoidance of transactions of short-term nature reinforce financial stability. In adopting the ESG framework, its goals of bringing value to society, environmental sustainability and good governance are consistent with financial stability. Finally, the emphasis on institutional culture and the integration of ethical values and accountability heightens the building of trust and confidence in finance and hence on safeguarding financial stability. While there is great clarity in its value proposition, there is a less structured framework for its consistent implementation and operationalisation across different sectors and across borders. This has not, however, restrained the significant rate of growth of ethical finance during this decade.

Islamic finance's strong explicit linkage to the real economy and the avoidance of excesses serve as a basis for safeguarding financial stability. Additionally, being based on profit-and-risk sharing, it has embedded in the intermediation process the elements of risk management, transparency and governance, which are key to the financial stability agenda. Fundamental to Islamic finance is the Shari'ah framework, which provides a clear matrix for guidance that is reinforced by a rigorous and robust assessment of the adherence to these established rulings. The global dialogues on the Shari'ah rulings in this decade have generated a convergence and consistency of opinions on these issues.[3] Various portals established have created greater awareness on these rulings.[4] Importantly, innovation in Islamic finance is also subject to a screening process to assess the value it brings to society. There is therefore a highly structured process to ensure adherence to the requirements of this form of finance that addresses financial stability issues.

The ethical aspects embedded in both these forms of finance influences behavior with a focus on trust. This also bring them in alignment with the key elements of the financial stability agenda. For Islamic finance, this is directly further reinforced by the regulatory and supervisory oversight by authorities at the national level and by the international standards set by multilateral agencies that have now been established for the Islamic financial system. This has contributed towards the uniformity of application of these standards across jurisdictions with a view to supporting Islamic finance's resilience and sustainability and thus the financial stability agenda.

[3] ISRA for example has organized International Shari'ah Scholars Form regularly in this respect. 2019 will be the 14th time the event is organized. There is also the annual Majma' Fiqh, Dallah AlBaraka and Kuwait Finance House annual Shari'ah meetings where such dialogues take place

[4] ISRA has an online portal called iFIKR which archives a compendium of major Shari'ah rulings in Islamic finance

CHAPTER 07

Conclusion

Ethical finance and Islamic finance are responsible forms of finance that have strong commonalities and which share several common goals. Yet, these forms of finance are achieved in their own respective unique and distinctive manner. Both are gaining traction as the world demands for finance to have a more constructive role in supporting growth and development and in providing solutions to some of the challenges confronting the global economy. In the same vein is the need for a more sustainable global financial system which supports preservation of the environment in a manner that provides the platform to support efforts towards managing the adverse effects of climate change.

The shared common goals in both these responsible forms of finance can be viewed as having two sets of priorities. The first relates to the primary intent of attaining sustainability – in terms of its impact on the economy, on society and on environmental sustainability, while at the same time being financially profitable and thus sustainable. Both these forms of financial intermediation focus on the linkage to productive economic activity and to supporting enterprises that are able to generate a positive impact on society and on environmental sustainability. Whilst Ethical finance views these elements more explicitly in terms of the impact it has, and where people, profit and planet are closely interlinked, Islamic finance does this as a pre-requisite in every dealing. In Islamic finance the linkage to real productive economic activity lies at the heart of all its financial transactions. It is thus a form of finance that aims to be “value adding”. It explicitly aims to intermediate and facilitate to add value to economic activity. Embedded within this is also the duty of care or vicegerency that reinforces the principle that the intended economic activity is conducted in a sustainable manner so as to ensure that the environment is preserved not only for the present generation, but also for future generations.

In contrast to Ethical finance, in which the focus is more on the ex-post effect or on the impact of such the financing or investment on the environment and the value that it brings to society; the focus for Islamic finance on the ante requirement that ensures the intent is to add value to the economy. As such, Islamic finance avoids over leverage and it strengthens its linkage of finance to the economy. Of equal importance is that it must bring value to the community. This is ensured by the Shari’ah governance arrangements for the financial institutions whereby the rulings on Islamic finance on these respective issues are consistently being applied in all their business dealings. As Islamic finance now continues to evolve and expand, its next steps are to develop a consistent framework to assess the impact of its financing and investments on the economy, on the value it brings to society and to environmental sustainability. Collaboration among the responsible forms of finance will yield benefits from the knowledge and experience that has been gained thus far in assessing the impact of such financing and investments on the economy, society and on the environment. Of particular importance is greater clarity on environmental sustainability from the lens of Shari'ah so that what is implicit and embedded becomes explicit and obvious. Such guidance is indeed timely and welcomed.

The secondary intent that is also fundamental to both forms of responsible finance relates to ensuring fairness, transparency and inclusivity. In achieving fairness, both forms of finance acknowledge the importance of contributing to enhancing the wellbeing of every segment of the community and that inequalities have adverse implications on communities. Interests of stakeholders are essentially viewed from multiple lenses to ensure that fair treatment is being accorded to each respective group. This is where considerations relating to affordability and the balancing of profit optimisation with that of serving society become important. In Islamic finance, there is also an additional duty for those that are in a strong economic position to assist those in a vulnerable economic position. For this purpose, social financial tools such as of zakat (tithes) facilitates the distribution to those at the lower segment of the pyramid while there is also strong encouragement to do and provide social good which is achieved through the waqf (Islamic endowment) and sadaqah (alms). In conventional finance and among corporations, increasingly allocations are being made for the purpose of corporate social responsibility. Our interest here however is on the form of financial intermediation that gives attention to the consideration of fairness, transparency and to enhancing inclusion as critical requisites as compared to a choice which can be dispensed with.

As part of this agenda, Ethical finance calls for clear, unbiased, accurate and understandable information to be disclosed to savers and investors so that they know what, where, how and to whom their deposits or investments which have been mobilised are being utilised. In other words, ethical finance customers are given the right to know where their funds are being channelled to. In Islamic finance, the rights of customers are embodied in the respective Shari'ah contracts which clearly defines the banker-customer relationship. Transparency and disclosure are essentially driven by the respective Shari'ah contracts that governs each contract. The rights of the transacting parties are clearly laid out and cannot be violated without consequences. Recent products introduced have included elements of social finance whereby such deposit products have cash waqf features that enable depositors to indicate where their funds should be channelled to, for example, to their preferred social causes. The primary commonality that exists in both forms of finance is with respect to the high degree of transparency which is integral in these respective forms of finance. This in turn allows for ensuring greater fairness being applied and greater accountability.

The areas of differentiation between the intent of these respective forms of finance is primarily with respect to the focus. While Ethical finance gives priority to the environment and to adding value to society, Islamic finance is strongly anchored to the real economy. Additionally both forms of responsible finance also adopt different strategies in approaching and measuring the primary and secondary intent. This report has discussed at length the screening approaches utilised in Ethical finance that has garnered the largest following and those which are gaining traction. These include the ESG integration approach, the "best in class", the environmental impact assessment approach, as well as strategies through corporate engagement and shareholder action. In Islamic finance, the approach is through a screening process which is part of the Shari'ah framework. Economic activities that are harmful to the society and the environment are eliminated before undergoing a more detailed screening process on the financial aspects of the given investee company.

Although serving the economy and bringing value to society may be voluntary to those practicing responsible finance, the discipline imposed by the market and by regulators of these markets are important drivers that can transform such behaviours into these accepted norms. Lessons from the turmoil experienced during the Great Financial Crisis (GFC) have also taught us on the need to avoid having misaligned incentives and for policies to give attention to achieving a more inclusive financial system. This will in turn promote a more balanced global growth and development. There is a global consensus for finance to return to its basic function, to add value to the economy and to bring benefits to society. Greater recognition is therefore been accorded to those forms of finance that are well anchored to the economy. Important in this process is also to protect the economy from distortions and enhance the efficient allocation of resources.

A major agenda for finance in these recent decade has been the financial stability agenda, that is, towards ensuring the stability and soundness of the financial system. There has also been an enhanced role of regulators in imposing discipline on the financial industry towards achieving financial stability. This has primarily been through regulatory reforms, strengthening supervisory oversight, forward looking surveillance, enhancing resolution and crisis management capability, and adding further micro and macro-prudential tools. Both responsible forms of finance discussed here have fundamental elements that contributes to financial stability. For Ethical finance it is focus on the longer term orientation, the avoidance of high risk activities, the discipline in governance, the adoption of the ESG framework and having a high degree of transparency with an emphasis on a culture of ethics and values.

As the world undergoes a period of great uncertainties amidst digital disruption and profound climate change, there are potential areas that ethical finance and Islamic finance can collaborate to foster better synergies that will in turn benefit the international financial system. First, to collaborate to bring greater awareness of the potential role these respective responsible forms of finance can have in delivering a form of finance that is well anchored to the economy and which brings value to society and environmental sustainability. Such collaborations can encompass financial technology or fintech firms to enable greater use of technology to meet the rapidly evolving needs of customers in a way that strikes a balance between societal and environmental considerations. Additionally, to give recognition to the roles of both Ethical finance and Islamic finance in strengthening the financial system into becoming more a more sustainable one. The GFC taught several important and expensive lessons particularly when finance is fractured by an almost complete dislocation from the real economy. While the world has responded with regulatory and supervisory reforms reinforced with resolution and restructuring, financial systems now need to move beyond the regulatory regime to produce soundness and stability and to have a more catalytic role in supporting growth and economic development.

Beyond rules and regulations, there is also ethics and the moral compass. This is the backbone of trust and confidence in the financial system. Ethics which is integral in both forms of finance has a fundamental role in ensuring that funds are channelled to productive activities. A framework of cooperation will be helpful in articulating the stated intent of both forms of responsible finance to bring this greater awareness, appreciation and enabling an assessment on the impact of the various aspects covered by each type of responsible finance. While both Ethical finance and Islamic Finance integrate ethical values and the important virtues, it remains a voluntary behavioural norm. Islamic finance can benefit from infusion of Environmental, Social and Governance (ESG) into its assessment and screening framework so as to enable a more connected articulation of the intrinsic core values which in turn will create values-based finance.

Finally, is the need to foster strong leadership at the global level that can have an advocacy and facilitative role in resolving barriers and bringing together different stakeholders to work together in a coordinated and cohesive manner.

The Responsible Finance & Investment (RFI) Foundation, based in the United Kingdom, brings together responsible finance experts from around the world and has a unique role for this endeavour. The focus on collaboration and convergence between the diverse fields of ethical and responsible finance has great potential to harness the best practices of positive finance in its various forms to collectively wield a powerful force in shaping future finance.

Moving forward, stable and sustainable development can be best served by re-connecting the current gulf between finance and value creation that is reinforced by bringing benefit to society. With the financial reforms by the international community now much in place, the imperative for future finance is not only to become stable and resilient but also to become a deep anchor to its bedrock, the real economy, and generating a positive benefit to the greater society.

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