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Convergence of Values between Islamic Finance and Socially Responsible Investment (SRI): What are the Limits of SRI Sukūk Issuance?

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Abstract. Ethical investments, such as socially responsible investment (SRI), and faith-based investments, such as Islamic finance, have become commonplace in the economic development discourse. Given that SRI bonds dominate SRI markets, one might ask why SRI *Sukūk* (Islamic bonds) have not contributed more to certain social or sustainability-related causes or sectors to achieve the objectives of *Sharīʿah* (Islamic law). This study will mainly examine the aspects considered ethically or socially responsible as incorporated in SRI and Islamic finance. In doing so, this study will compare the values or principles of SRI bonds and the SRI *Sukūk* framework to enable Islamic finance players to make good use of the opportunity of the segment. This study further examines what limits the involvement of Islamic financial market participants in socially responsible investment. Drawing on the 2014 SRI *Sukūk* framework and other SRI legislation, this study reveals that both have similar qualities, characteristics and objectives. However, SRI *sukuk* are challenged by investors' appetite for a profitable return, lack of awareness of social investment and lack of data and methodology associated with the Triple Bottom Line or 3Ps (people, planet and profit) approach. These problems have, to some extent, limited the Islamic financial market players from investing in social responsibility programes.

Keywords: *Sukūk*, socially responsible investment, *Sharīʿah*, Islamic finance, ethical investment

JEL CLASSIFICATION: N20
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1.0 Introduction

Ethical investment, such as socially responsible investment (SRI) and faith-based investment, such as Islamic finance (Reddya, Mirzab, Naqvic, & Fu, 2017) have become widespread in the economic development discourse. These two ma rkets are the fastest growing areas of finance, where total Islamic finance assets grew by 7%,and were valued at US$2.2 trillion in 2016 (United Nations 2018). Globally, SRI assets soared from US$18.3 trillion in 2014 to US$23 trillion in 2016 (Global Sustainable Investment Alliance, 2015). This rapid growth has triggered a discussion regarding the convergence of SRI and Islamic finance, as both strive to exclude certain industries considered unethical from their investment strategies, including alcohol, tobacco, arms, pornography, etc. (Binmahfouz & Hassan 2013; Binmahfouz 2012). Meanwhile, many studies have shown that Islamic ethics are compatible with business ethics which is the theoretical foundation of SRI practices (Beekun & Badawi, 2005; Brammer, Williams, & Zinkin, 2007; Dusuki, 2008; Dusuki & Abdullah, 2007; Mir, Hassan, & Hassan, 2017). The principles of Islamic finance emphasize equitable risk-sharing and the prohibition of interest-based financing. To date, SRI has focused on equity investments rather than fixed income, as financial intermediaries have found it easier and more direct to invest in SRI products in equities rather than fixed income (Bennett & Iqbal, 2013).

The "similarities" of SRI and Islamic finance, with a strong focus on ethics, have raised opportunities to consolidate the position of Islamic finance in a market dominated by conventional finance. Many have considered that among Islamic financial instruments, *Sukūk* or Islamic bonds are a financial model that bridges the gap between the two markets (Azman & Ali, 2016; Bennett & Iqbal, 2013; Noordin, Haron, Hasan, & Hassan, 2018). This could explain many similarities in the structure of *Sukūk* coupled with social impact bonds that potentially meet the demands of *Sharīʿah* (Islamic law) and SRI investors (Azman & Ali, 2016; Kassim & Abdullah, 2017). Moghul and Safar-Aly (2014) have established some criteria and guidelines for green *Sukūk* and proposed "how" integration between SRI and Islamic finance can be made possible. While the proposal sounds very appealing, in reality there is a contentious divide between the two markets and joint initiatives seem to be rare. This distinction reflected in *Sukūk* to date is only in a small number of SRI *Sukūk* successfully issued in global capital markets (Richardson 2019). A recent report by Standard & Poor's shows that the amount of *Sukūk* that takes into account environmental issues is still poorly addressed compared to the global green bond market, which saw US$168 billion of issuance in 2018, and subsequently social aspects seem to have taken a back seat (Damak, Roy, Bendersky, & Gorce, 2018). A review of the *Sukūk* market to date suggests that the objectives of those participating in *Sukūk* certificate issuances have not always been directly focused on the impacts of these instruments on society or collective welfare in general (Idraki, 2016).

The philosophy of Islam as a religion emphasizes the betterment of society and goodwill among humans. All activities of Muslims should be centered on the highest ethics and social responsibility. At the same time, Islamic economists believe that the norms of their religion provide clear guidance in every conceivable area of economics. They are also convinced that these norms would be equally effective in all Muslim societies, regardless of their size, history, level of economic development and institutional framework (Chapra, 1985; Kuran, 1983, 1995). The philosophical underpinnings of an Islamic financial system go beyond the interaction of production factors and economic behaviour (Iqbal, 1997). Financial aspects are emphasized as part of the broader Islamic ethical system since these factors in Islam are considered part of the "religion", and all business activities, wealth creation, economic activities, wealth distribution, and human welfare are the "affairs of religion" (Furqani, Laldin, & Mulyany, 2016). While the conventional financial system mainly focuses on economic and financial issues of transactions with their material outcomes, the Islamic system gives equal importance to various ethical, moral, social and public good dimensions to enhance equality and equity as well as the state's role (Iqbal, 1997). Therefore, one of the reasons for this acceptance could be due to its ethical promises. Islamic finance is perceived as an ethics-based system that operates with a set of moral precepts in financial transactions (Laldin & Furqani, 2013)**.**

Ideally, if *Sukūk are* structurally aligned with the ethical principles of Islamic finance, they should have an established place within the broader responsible finance or SRI market.

Unfortunately, as this is not the case in practice, this has led to at least two significant problems. Firstly, Islamic finance is based on a religious worldview, and is therefore often considered ethical *in itself* (Nienhaus, 2011). Similarly, the basis or root of SRI is found in religious law. Many consider the close and substantial connection with the Christian religion to have long been the driving force behind the growth of SRI (Paranque & Erragragui, 2016). Although the two share many convergences and have their roots in religion, many argue that ethics and social responsibility in business and investment are complex issues. It has not been clear to what extent business ethics should depend on some general ethical codes universally applicable to all social structures. Nor is it clear to what extent it should rely on individuals' personal values and moral commitments to the social good, or to what extent it is simply a contradiction in terms or definitions (Hellsten & Mallin, 2006). These gaps have motivated this study to examine what is considered ethical or socially responsible as incorporated in SRI and Islamic finance. This analysis further compares the values or principles of SRI bonds and the framework or standards of SRI *Sukūk*, to enable Islamic finance players understand the real scope and purpose of SRI. Furthermore, it is important so as to match the segment opportunity available in SRI (MIFC, 2015).

Second, if Islamic finance has similarities with SRI, why are SRI *Sukūk* still absent from the financial sector? One may ask why the Islamic finance sector has not contributed more to certain sectors of society, as required by the principles of *maqasid al Sharīʿah* (higher objectives of *Sharīʿah*). Given the 'gap' between the principles and practices of Islamic finance, this could be due to different cultural traditions, differences in target markets, preoccupation with their own economic growth, perception and reputation issues, lack of initiative by industry leaders, or simply a lack of understanding each other (Hayat, 2013). However, these factors unfortunately remain ambiguous as any survey-based study has not proved them. Therefore, this study will examine "what" limits Islamic financial market players in issuing and structuring SRI *Sukūk*. It does so by collecting qualitative data from semi-structured interviews with *Sharīʿah* advisors in Malaysia, as the country is currently the largest *Sukūk* issuer in the world and has become the leading player in *Sukūk* development (IIFM, 2018). Moving beyond the academic discourse that has primarily focused on 'how' to align *Sukūk* with SRI, this study rather seeks to broaden the discourse by examining 'what' restricts or discourages Islamic financial market participants from participating in social responsibility investing.

The significant contribution of this study is to develop Islamic finance to cover the shortfalls that jeopardize the future Sustainable Development Goals 2030. The United Nations Conference on Trade and Development (UNCTAD) has argued that achieving the Sustainable Development Goals (SDGs) by 2030 will require the investment of \$3.9 trillion in developing countries each year (United Nations, 2018). Mindful of this funding, *Sukūk* are considered appropriate for SRI investors as they offer investors a high degree of certainty that their money will be used for a specific and meaningful purpose. In order to comply with the underlying principles of *Sharīʿah*, the funds raised through the issuance of a *Sukūk* must be applied to the investment in identifiable assets or businesses (Bennett & Iqbal, 2013). For this reason, if *Sukūk are* structured to provide funds to a specific development project that attracts SRI investors, such as a renewable energy project or a low-cost housing scheme, there is little chance that investors' money will be diverted and used for another purpose (Bennett & Iqbal, 2013)**.** However, the issuance of *Sukūk* still faces a number of obstacles related to the legislative framework of *Sukūk*. The issuance of *Sukūk* often requires the issuing entity to create a special purpose vehicle (SPV) and transfer the assets underlying the *Sukūk* to that SPV. This can result in additional taxes and stamp duties.

For decades, conventional capital markets have been used to channel investments into development projects in poor countries (Standard & Poor's in Bennett & Iqbal, 2013). The World Bank, as a pioneer, issued its first bond in 1947 and used the proceeds to finance projects in developing countries, followed by other supranational institutions. While Islam has a long historical tradition of ethical practice, social issues have not been of great concern to Islamic financial institutions and the banking sector. It is not uncommon to find claims in the Islamic finance literature is failing to achieve the goals for which it was initially designed (see Azman &

Ali, 2016; Mohamad, 2014; Mohamad, Lehner, & Khorshid, 2016). Such conclusions invite the key question: has Islamic finance fulfilled the objectives of *Shari'ah*? This question means that assessments need to be made on the roles played by Islamic finance in, for example, poverty alleviation, income distribution, equal and expanded access to finance, and economic productivity and efficiency (Ibrahim, 2015). Therefore, this study argues that the role of *Sukūk* remains important insofar as the ideals of Islamic ethics need to be put into practice.

This paper uses the content analysis approach to examine the aspects that are ethical or socially responsible in SRI and Islamic finance. For comparison, three standards were considered, namely (i) the SRI *Sukūk* Framework 2014 published in Malaysia, (ii) the Social Impact Bond Act 2014 in the United States and (iii) the principles published by the International Capital Market Association (ICMA) for the European market. Content analysis is used to help researchers quantify and analyse the presence, meanings and relationships of certain words, themes or concepts. To examine what constrains Islamic financial market participants in the issuance and structuring of SRI *Sukūk*, semi-structured interviews were conducted with four *Sharīʿah* advisors working for the Sharīʿah Advisory Council, Securities Commission, Malaysia. All of them have worked for 10 years or more in this sector. The questions to be answered relate to the challenges and limitations of structuring SRI *Sukūk*.

This paper is structured as follows. First, the concepts of ethical investment in SRI and Islamic finance will be explained and compared. Then, a more in-depth examination of the facets that are considered ethical investment as reflected in SRI bonds and *Sukūk* standards or framework is presented. Next, aspects that limit Islamic financial market's participants in social responsibility investement are examined, focusing on SRI *Sukūk*.

2.0 The concept of ethical investment in SRI and Islamic finance: a comparison of social bonds and SRI Sukūk

In the world of SRI *per se*, defining this ethical investment is a somewhat difficult task, as there is no consensus on the "ideal" characteristics that SRIs should possess. In fact, its principles and limitations are still debated in the literature (Gillet & Salaber-Ayton, 2017; Miglietta & Forte, 2007; Statman, 2005). It is often used loosely with other general terms such as 'socially responsible' or environmentally friendly investment, ethical, social, green, alternative, divergent, focused, creative, developmental, strategic, etc. which have been used interchangeably (Cowton, 1998). However, from a practitioner's perspective, sustainable investing is the process of integrating environmental, social and governance (ESG) factors into investment decisions. Sustainable investors choose to invest in companies, organisations and funds with the aim of generating measurable and beneficial social and environmental outcomes, not just financial returns (Ernst & Young Global Ltd, 2020). On this issue, the paper discusses the aspects that are considered ethical in SRI based on its development (Lewis, 2010) and the investment criteria of SRI practices established in various countries (Gillet & Salaber-Ayton, 2017).

The development of SRI has taken place in three stages, from avoidance of sinful practices to positive screening to sustainable investment. The roots of SRI in the Western world go back to the 17th century, when the Quakers in the United States refused to make a profit from the arms and slave trade. The founder of Methodism, John Wesley (1703-1791), stated in his sermon "The Use of Money" that people should not engage in sinful trade or profit by the exploitation of others (Renneboog, Horsta, & Zhang, 2008). However, at the initiative of the Methodist Church, the first investment fund with ethical screening criteria, the Pioneer Fund, was established in 1928. This entity was reserved exclusively for a restricted religious community and prohibited investments in so-called "sinful" (in the biblical sense) companies, i.e. those involved in activities such as brewing, tobacco, weapons and gambling (Paranque & Erragragui, 2016). At this point, ethical investing is essentially built around negative screening - the exclusion of investments considered harmful and inconsistent with the values of investors or fund managers.

Originating from religious doctrine, SRI gradually expanded to include anti-war projects, promote human rights, and implement environmental protection policies (Abdelsalam, Duygun, Matallín-Sáez, & Tortosa-Ausina, 2014). Discontent among students and other youth led to protests against the Vietnam War in the 1960s, and the boycott of companies that supplied weapons used in the war meanwhile issues involving civil rights and racial equality arose and became very important. Community development banks set up in low-income or minority communities were part of a movement that gave rise to the Civil Rights Act of 1964 and the Voting Rights Act of 1965 in the United States. SRI entered the mainstream when Dreyfus, a major mutual fund distributor, launched its Third Century Fund, which included stocks of companies known for their sensitivity to the environment and their local communities (Knoll, 2002). Based on this positive screening, this second stage of SRI investment sought opportunities in industries that positively impact the economy, the environment and other relevant areas of society.

The third stage of SRI development occurred in the late 1990s and early 2000s, when SRI was increasingly defined as a means to promote environmental sustainability (Lewis, 2010). Coinciding with the increasing use of sustainability reporting, sustainable investing strives to identify and select the most sustainable companies in their sector through best-of-breed or best-of-class investing. Quantitative and qualitative measures are used to determine the environmental, social, governance (ESG) or ethical performance of companies, using criteria such as adherence to principles of good corporate governance, use of resources, treatment of employees, approach to customers and suppliers, and community involvement and contribution. These factors are often summarised by the acronyms ESG and corporate social responsibility, although all three approaches (ethical, environmental and sustainable) are concerned with environmental outcomes, albeit with different emphases.

Given the increasing globalization of financial markets, the foundation of the ethical criteria for SRI investment differs from country to country. For example, in the United States, socially responsible funds favour product exclusions of alcohol, tobacco, weapons and gambling companies (Social Investment Forum, 2007), while in Belgium, France and Switzerland they follow a combined best-in-class and standards-based selection approach (Eurosif, 2012). Elsewhere in Europe, the boundaries of SRI diverge significantly. The exclusion of alcohol companies from ethical funds is common in Denmark, Spain and Sweden, but not the case in Austria, France and Germany. Nuclear power plants are excluded from most socially responsible funds in Austria, Germany and Spain, but are not automatically excluded in other European countries. These product-based exclusions are more popular in continental Europe than in the UK, where they are mostly used by the church, charities and private investors (Gillet & Salaber-Ayton, 2017). Therefore, in SRI, the investment decision is based solely on what the company or a group of people perceive and believe to be ethical, sustainable and promoting good governance.

In Islam, ethics is referred to as *akhlāq* (plural *khuluq*), a term defined as the standards of right and wrong that prescribe what people should do, as taught in the *Qur'an* and demonstrated in the exemplary life (actions and words) of the Prophet (pbuh) (Furqani et al., 2016; Hashi, 2011). In the *Qur'an*, many terms describe the concept of ethics such as *khayr* (goodness), *maslahat* (public interest), *birr* (righteousness), *qist* (fairness), *'adl* (balance and justice), *haqq* (truth and righteousness), *ma'ruf* (known, approved), *nahi munkar* (avoidance of evil and harmful things), and *taqwa* (godliness) (Zarug, 1999). In short, the *Qur'an* wants all Muslims to do good and not engage in evil deeds; therefore, defining characteristic of finance, including investment, lies in the ethical principles embodied in *Sharīʿah* (Islamic legal and ethical system), the same source from which theological beliefs are derived. *Sharīʿah* originates from the rules dictated by the *Qur'an* (the holy scriptures of Islam) and its practices, as well as the explanations given (more commonly known as *Sunnah*) by the Prophet Muhammad (pbuh). For all aspects that are not covered by *Sharīʿah* but by *fiqh* or jurisprudence, the rulings are specified by Islamic jurisprudence scholars within the framework of the *Qur'an* and *Sunnah*.

Based on an ongoing exchange between some renowned banking experts and renowned Islamic scholars in the context of Islamic economies, five fundamental "pillars" that oversee the regulation and religious validity (*Sharīʿah* compliance) of any financial activity have been defined over the past two decades (Güller & Leins, 2010). Four pillars represent the fundamental prohibitions of Islamic finance, namely *riba* (usury), *gharar* (uncertainty), *maysir* (speculation) and investment in prohibited or *haram* activities, while the fifth pillar encourages the sharing of risks and returns. Prohibited activities include mainly alcohol, pork, tobacco, pornography, gambling activities, arms, non-mutual insurance and conventional banking, where some of these activities are tolerated on a minimal basis. In addition to filtering out exclusions, the Islamic investment process includes 'purification', which comes in response to the lack of fully *Sharīah-compliant* businesses worldwide. The objective is to exclude companies characterised by unacceptable levels of conventional debt, liquidity, interest-based investments and/or impure income, subject to the discretion of the *Sharīʿah* board in determining the tolerance level of ratios.

The pillars, including *Sharīʿah,* are all important in shaping Islamic economic transactions (Hayat, 2013). For a minimum requirement, any type of Islamic financial investment is considered *Sharīʿah-compliant* if it complies with this theological framework (Yusof, Bahlous and Kassim, 2010). The pillars must be combined together to preserve balance, distributive justice and equal opportunity and must always be honored in any transaction that is consistent with Islamic practice. *Sharīʿah* is not only about Islamic rules or legal principles, but also about values and ethics. All *Sharīʿah* prohibitions in financial activities are aimed at removing *mafsadah* (harm) that could be inflicted on the transacting parties, and these prohibited actions are in fact ethically harmful. Similarly, any *Sharīʿah* injunction aims to ensure the realization of benefits (*maṣlaḥah*) - positive values that would ensure fairness, justice and benevolence in a transaction (Laldin & Furqani, 2013). Therefore, if an investment is in line with *Sharīʿah* principles, it should be fundamentally ethical (Mohamad Damak in QInvest, 2017). At this point, the existence of the *Sharīʿah* Supervisory Board plays the most crucial role as a guardian to preserve the legitimacy of Islamic banking operations and products, which explains why the Islamic financial system is primary an ethical system.

It is clear that the ethics of Islamic finance are based on sacred revelation, whereas the ethics derived from the social values of SRI are inevitably more transitory. Islamic finance relies on *Sharīʿah* as an authoritative ethical and legal reference. The ethics of an Islamic system differ from those of a conventional system, as the ideals, theories and ethical practices of the former are shaped by the respect for Allah (SWT), while those of the latter are based on transient customs.

This unchanging basis creates a stable set of parameters for contemporary Islamic finance. Muslim jurists sometimes interpret *Sharīʿah* in different ways, which affects the scope of permissible investment products and transaction structures, resulting in flexibility and difficulties. On the one hand, the flexibility of *Sharīʿah is* supposed to help Muslims resolve problems and circumstances that arise in interpreting *Sharīʿah*. However, the flexibility offered by *Sharīʿah* in product development must be understood within the framework of Sharīʿah's rules and principles. On the other hand, different interpretations by Muslim scholars have led to a lack of standardization of *Sharīʿah* rules within the same jurisdiction and in various regions. This can create confusion and problems in presenting the Islamic industry brand to consumers and investors. Nevertheless, as long as the benchmark for Islamic investment is derived from *Sharīʿah,* there are clear rules about what is allowed and what should and should not be included in the investment. SRI, on the other hand, while reflecting much of the theological framework that shapes Islamic finance, does not use a single reference point, and the reasons for its sectoral exclusion are not systematically normative and may evolve in response to social issues[1]. There is a wide range of interpretations and inconsistencies as to what is considered ethically and socially responsible according to people's consciences and beliefs. However, the extent to which these 'interpretations' diverge from Islamic ethics explains the 'gap' between the two markets. The following section provides a more in-depth comparison of what is considered ethical investing, as reflected in their standards or framework.

3.0 Social Impact Bonds and SRI Sukūk: what aspects are considered ethical?

As concerns about social impact investment grow, SRI bond markets have developed a range of securities attached to individual SRI bond issues, in which the security used is usually linked to the nature of the projects to be funded with the bond proceeds (Richardson, 2019). From a practitioner's perspective, green bonds are more about environmentally beneficial projects, and social bonds fund projects that seek positive social outcomes. Meanwhile, sustainability bonds finance projects that have both green and social objectives. Another category of SRI instruments is social impact bonds, but these are not, strictly

[1] For example, French SRI managers do not exclude the nuclear industry, but it may be excluded in other countries (Paranque & Erragragui 2016).

speaking, a bond as repayment and return on investment are dependent on achieving the desired social outcomes, which is known as pay-for-success (International Capital Market Association, 2019).

Relatively new to the capital market is the SRI *Sukūk*, which aims to provide financing for societal welfare and environmental protection in accordance with Islamic principles (Securities Commission Malaysia, 2016).

Clearly, what characterises SRI bonds is the link between the use of their proceeds and the green and/or social project being funded. However, the categories of projects that can benefit from this funding have not been universally accepted (Hedley, Brown, Menon, Zaman, & Basu, 2015), which is similar to the concept of 'social' in SRI, and falls under social interpretation (Richardson, 2019).

By comparing projects deemed ethical from the SRI and Islamic finance perspectives, the SRI *Sukūk* Framework 2014 emerged as the first global standard for SRI *Sukūk*. The Social Impact Bond Act 2014 in the US and the principles published by the International Capital Market Association (ICMA) for the European market are equally important to consider because about half of all SRIs are assets under management in Europe, and more than a third of them exist in the US[2].

In addition to eligible projects, this study also provides an analytical comparison of the due diligence aspects of the respective frameworks or guidelines in structuring SRI bonds or *Sukūk*.

As shown in Table 1, the SRI *Sukūk* Framework 2014 was issued by the Securities Commission, Malaysia, which expands the existing *Sukūk* framework (or *Sukūk* guidelines) by including an eligible issuer, use of the product, eligible SRI projects, independent assessment and reporting requirements.

The framework was issued by the Commission to facilitate the creation of an enabling ecosystem for SRI investors and promote sustainable and responsible investment, in line with the growing popularity of green and social impact bonds (MIFC, 2015).

These government regulations are to be mandatorily implemented by foreign companies and governments when issuing SRI *Sukūk* in Malaysia[3] .

In the US, the announcement of H.R. 4885, otherwise known as the Social Impact Bond Act, was introduced by the U.S. Congress in June 2014, with the aim of improving the lives of those in need by funding social programs that work.

The bill will encourage and support public-private partnerships to improve the American nation's social programs and other purposes. In the European market, the International Capital Market Association (ICMA) published the Green Bond Principles (GBP) in 2014, followed by the Social Bond Principles (SBP), and the Sustainability Bond Guidelines (SBG) in 2018.

Very similar to the 2014 SRI *Sukūk* Framework, ICMA's principles provide guidance on four core elements: (i) use of the product, (ii) project evaluation and selection process, (iii) product management, and (iv) reporting. Unlike the Securities Commission of Malaysia and the U.S. Congress, ICMA is a voluntary, self-governing body, and therefore all types of issuers in the debt capital market can choose to join; in other words, membership is not imposed by the government.

While the London Stock Exchange (LSE) does not require that listed green/social bonds meet specific standards, it does require that the products be used for a class of eligible projects. Furthermore, a second opinion is required to certify projects, which is similar to the ICMA components.

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[2] In terms of where sustainable and responsible investment assets are domiciled in the world, Europe continues to manage the largest proportion, with almost half of global sustainable investment assets in 2018. The proportions of global sustainable investment assets in the US (39%), Japan (7%), Canada (6%) and Australia/New Zealand (2%) have remained largely stable over the past two years (Global Sustainable Investment Alliance 2017).

[3] Eligible issuers of SRI *Ṣukūk* are companies within the meaning of sub-section 2(1) of the Capital Markets and Services Act (CMSA) 2007 and foreign governments, as set out in paragraph 3.1 of the *Ṣukūk* Guidelines.

Table 1 Comparison of eligible SRI projects and requirements under different SRI frameworks and legislation

Countries / criteria	Malaysia	US	European countries
Guidelines/ Framework	SRI *Sukuk* Framework 2014	The Social Impact Bond Act 2014 (H.R.4885)	▪ Green Bond Principles 2014 ▪ Social Bond Principles 2018 ▪ Sustainability Bond Guidelines 2018 By International Capital Market Association
Issuer	Corporation, foreign government	Public –private partnership	All types of issuer in the debt capital market
Eligible SRI projects	1. Natural resources 2. Renewable energy and energy efficiency 3. Community and economic development 4. *Waqf* properties/assets	1. Increasing work and earnings by individuals who have been unemployed in the United States for more than six consecutive months. 2. Increasing employment and earnings of individuals age 16 to 24. 3. Increasing employment among individuals receiving Federal disability benefits. 4. Reducing the dependence of low-income families on Federal means-tested benefits. 5. Improving rates of high school graduation. 6. Reducing teen and unplanned pregnancies. 7. Improving birth outcomes among low-income families and individuals. 8. Reducing rates of asthma, diabetes, or other preventable diseases among low-income families and individuals. 9. Increasing the proportion of children living in two-parent families. 10. Reducing incidences of child abuse and neglect. 11. Increasing adoptions of children from foster care. 12. Reducing recidivism among individuals released from prison. 13. Other measurable outcomes defined by the State or local government that result in positive social outcomes and Federal savings.	Green Bond Principles: Renewable energy, energy efficiency, pollution prevention and control, eco-efficient and/or circular economy adapted products, production technologies and processes, green buildings, terrestrial and aquatic biodiversity conservation, clean transportation etc. Social Bond Principles 2018 providing and/or promoting: affordable basic infrastructure, access to essential services, affordable housing, employment generation, food security, or socioeconomic advancement and empowerment Sustainability Bond Guidelines 2018 to finance or re-finance a combination of Green and Social Projects

Use of proceeds	▪ preserve and protect the environment and natural resources ▪ conserve the use of energy ▪ promote the use of renewable energy ▪ reduce greenhouse gas emissions ▪ improve the quality of life for the society	To overcome specified social illness and reduce federal government spending on social program	▪ Green Bond Principles 2018 - to finance or re-finance projects with clear environmental benefits ▪ Social Bond Principles 2018 - to address or mitigate a specific social issue and/or seek to achieve positive social outcomes, especially but not exclusively for a target population(s). ▪ Sustainability Bond Guidelines 2018 – to finance or re-finance a combination of green and social projects
Reporting and disclosure	i. prospectus or disclosure document (eligible SRI projects, objectives, compliance with the relevant ESG standards or best practices) ii. Annual reports to investors (original, utilized and utilized amount including impact objectives regarding the SRI project)	i. Progress report (Summarize progress of achievement, challenges, for each expected outcome including information on the improved future delivery) ii. Final report (evaluates whether social obligations have been fulfilled, challenges faced and unique factors that contributed to the success or failure of the projects)	Annual reports (lists of project which bonds proceed have been allocated, brief descriptions of the projects, amounts allocated and expected impact)
Appointment of assessor	▪ Appointment of *Shariah* advisors to advise on all aspects of *Shariah* ▪ Independent party	Independent evaluator	External Review
Assessment of the project	Use specified pre-determined key performance indicators (KPIs)	Use of experimental design using random assignment	Qualitative performance indicators and quantitative performance measures (where feasible)

Sources: Guidelines on *Sukuk* 2014, Social Impact Bond Act 2014 (H.R.4885), Green Bond Principles 2018, Social Bond Principles 2018 and Sustainability Bond Guidelines 20

3.1 Eligible projects and use of revenues

The 2014 SRI *Sukūk* Framework states that proceeds from the issuance of SRI *Sukūk* should only be used to finance eligible projects, specifically natural resources, renewable or efficient energy, community projects, economic development and *waqf* (endowments). The Social Impact Bond Act of 2014, however, explicitly outlines 13 social issues to be addressed as eligible SRI projects, which are consistent with the U.S. government's national programs to address several problems, largely based on increasing employment and eradicating social scourges. From ICMA's perspective, based on these principles, several categories have been defined as eligible green projects, social projects and a combination of these two categories as sustainable projects, as summarized in Table 1. Most of these projects deemed ethical are similar in these three standards or framework for socio-economic development projects, though with minor differences in emphasis. The SRI *Sukūk* Framework 2014 and the ICMA Principles are similar in considering renewable energy, environment and natural resources as eligible SRI projects. The guideline also covers eligible projects that aim to improve the quality of life for all members of society. This social objective emphasizes community and economic development projects related to public hospital/medical services, public education services, community services, urban revitalization, green building projects, or affordable housing. However, the difference between the SRI *Sukūk* Framework 2014 and other legislations lies in the former's unique provisions to channel *Sukūk* proceeds towards *waqf* development. In Malaysia, these eligible SRI projects are substantial and aimed at developing unused *waqf* land[4]. This provision is expected to achieve the potential of *waqf* in *Sharīʿah-compliant* SRI projects.

3.2 Reporting and Disclosure Requirements

The public disclosures are very comparable across the standards, including brief descriptions of eligible SRI projects, the amounts allocated and the expected impact of these projects. This relevant information to be prepared by the issuer is included in an annual report as described by ICMA. However, the Social Impact Bond Act of 2014, requires two reports to be submitted. In the progress report, the independent assessor summarises the progress and challenges in achieving each outcome, including information on improvements to the future delivery of those social impacts. In the final report, an assessment is summarized as to whether the state or local government awarded the social impact bond contract fulfilled each obligation and any documented factors that contributed to the success or failure of the project. However, the reporting requirement of the 2014 SRI *Sukūk* Framework is a bit more stringent than the other two. The disclosure requirements of the framework require details of qualifying SRI projects in the issued prospectus, as well as a statement that the project has complied with relevant environmental, social and governance standards and recognised best practices relating to the qualifying SRI project. However, there does not appear to be any further guidance on what these best practices should be, or whether (and if so which) international standards may be applicable. Similarly, when reporting to investors, the issuer must provide annual reports or other forms of disclosure regarding the amount of initial capital, the amount used (or not used) for the SRI project.

3.3 Appointment of Evaluator and Project Delivery

All of these standards include requirements for independent evaluators to provide an independent and valid assessment of the progress of these SRI projects. The ICMA principles require that the external valuation provider(s) confirm the alignment of their bond or bond program with the four core components in which the valuation takes place before and after the bond issue. ICMA further states that an issuer may seek the advice of consultants, institutions and/or rating agencies that provide more than one type of service, separately or in combination, in the form of an opinion, verification, certification or green bond rating. To communicate the expected impact of projects, ICMA recommends using qualitative performance indicators and, where possible, quantitative performance measures. ICMA does not specify in detail the qualitative and quantitative measures to be used, but issuers should nevertheless report on whether their green, social, sustainable or sustainability bond(s) remain aligned with all the key elements of the Green Bond Principles (GBP), Social Bond Principles (SBP) and Sustainable Bond Guidelines (SBG). Issuers will be exposed to significant reputational risk if their green, social, sustainable or environmental bonds fail to meet their environmental or social commitments and cease to be aligned with the GBP/SBP/SBG.

Meanwhile, the Social Impact Bond Act 2014 requires a local government that has secured a social impact bond as an approved project under the act to conduct an independent evaluation to determine whether it has achieved its intended outcomes. The law also emphasizes that the evaluator must have substantial experience in determining the effectiveness of the program. In terms of the techniques used, the evaluator must employ random assignment or other research methodologies that provide the strongest possible causal inferences. The metrics used to determine whether the proposed outcomes have been achieved and how these metrics are measured should be reported, but do not detail the qualitative and quantitative indicators to be used.

The SRI *Sukūk* Framework 2014 requires an independent party to undertake the assessment of eligible projects using a number of predetermined key performance indicators (KPIs). To report on the impact or expected impact of eligible SRI projects, the issuer may use qualitative performance indicators and, where possible,

[4] These properties and lands are underdeveloped, which is largely due to their location, as much of the *waqf* land is rural, scattered over large areas, so the potential for development is low. Current statistics indicate that of the nearly 13,500 hectares of *waqf* land in Malaysia, only 2% of the total area has actually been redeveloped (Nazrin, in New Straits Times, 2018).

quantitative performance measures, but again, the precise details of what these should be are missing. The framework does not appear to focus on the relevant institution with recognized expertise in social and/or environmental issues to provide an independent and valid assessment of the progress of SRI projects. Instead of appointing an independent party, SRI *Sukūk* must be reviewed and approved by *Shari'ah* advisors to ensure that the structures are *Shari'ah* compliant in all aspects including: structuring, documentation, investment, administration and operations. As the SRI *Sukūk* Framework 2014 is an extension of the existing *Sukūk guidelines*, all other requirements of these guidelines continue to prevail, which demonstrates that, Islamic finance, given its emphasis on avoiding excessive *riba* and *gharar*, is also concerned with how to structure the finance. This is not an ethical concern in socially responsible investing.

By comparing projects deemed ethical from an SRI and Islamic finance perspective, this study finds that the SRI *Sukūk* framework provides a comprehensive list of eligible SRI projects, and to some extent, the projects are similar to the ICMA principles that cover both environmental and social aspects. The Social Impact Bond Act 2014 explicitly describes 13 social projects that focus on addressing social and employment issues in the US, in which most socio-economic projects are deemed ethical and similar to these three standards or frameworks. Other due diligence aspects of the respective frameworks or guidelines present, to some extent, a comparable approach in the formulation of their respective methodology when issuing *Sukūk* or SRI bonds, although with slightly different emphases. However, this comparison highlights the substantial difference between the SRI *Sukūk* Framework 2014 and the specific reference to *waqf* property development as one of the important categories of SRI projects. Another difference between eligible SRI *Sukūk* projects and their conventional counterparts is compliance with *Sharīʿah* principles, which requires *Sharīʿah* advisors to oversee *Sharīʿah* issuances.

In conclusion, with the exception of *Sharīʿah*, *Sukūk* and SRI bonds are based on guidelines with essentially similar qualities, characteristics and objectives and are considered ethically and socially responsible. Given the broad definition of SRI, their ethical investment motives are largely similar to Islamic finance, which is also necessarily accurate for social impact bonds. Although social impact bonds do not have a unique approach in their implementation, they all share four necessary characteristics (Nicholls & Tomkinson, 2013):

i. A contract between a commissioner and a legally separate entity called a "delivery agency";

ii. A particular social outcome that, if achieved by the delivery agency, will activate a payment from the commissioner;

iii. At least one investor that is a legally separate entity from the delivery agency and the commissioner; and

iv. Investors to bear some or all of the financial risk of non-performance.

In this public-private partnership, private investors provide initial capital and the government agrees to repay them when good social outcomes are evident. In this scenario, the commissioner repays the investors their capital plus returns based on the level of success. If results are not forthcoming, investors may not get their investment and return back. With regard to the guarantee of capital and returns, coupled with returns dependent on the outcome of the programme or project, such features are inherent in the *Sukūk* structure. Looking more closely at the objectives of social impact bonds that go beyond economic returns, similar intentions embody the Islamic concepts of *maqasid al-Sharīʿah* (higher *Sharīʿah* objectives) and *maslahah* (public interest) (Dusuki, 2008). Therefore, it is not surprising that some scholars argue that the general model of social impact bonds does not violate *Sharīʿah* principles *(*Mujahid & Adawiah, 2015). Similarities therefore exist, however, until today, *Sukūk* have not yet been issued to specifically address financial inclusion issues as discussed in the previous section. The following section discusses the limitations of such issuance.

4.0 What are the limitations of Islamic financial market players in terms of socially responsible investment? The case of SRI Sukūk

In the context of the domestic *Sukūk* market, the Malaysian government, through the Securities Commission and the Central Bank of Malaysia, has provided the regulatory framework, infrastructure, and fiscal incentives for the growth of the nascent green and/or sustainable *Sukūk* segment. This infrastructure allows Malaysia to lead the *Sukūk* market with combined domestic and international issuance totalling US$612 billion from January 2001 to December 2017 (IIFM, 2018). However, it is important to note, for the further discussion on the challenges for SRI *Sukūk*, the following fact: historically, financial services, infrastructures and utilities sectors have been the main drivers of the Malaysian domestic *Sukūk* market, and historical trends show that these sectors have been the main drivers of the Malaysian domestic *Sukūk* market (RAM, 2019), while the number of SRIs remains low (Richardson, 2019). Although the Malaysian *Sukūk* market has grown significantly since the world's first *Sukūk was* issued in 1990, the issuance of *Sukūk* focusing on social and moral issues has not seen the same growth. The exploration of what hinders Islamic capital market players in social responsibility investing, will be based on what emerges from semi-structured interviews with several *Sharīʿah* advisors working for the *Sharīʿah* Advisory Board, Securities Commission of Malaysia.

In Islamic finance, *Sharīʿah* law governs the industry, hence it is important to understand the role of religious scholars in ensuring the industry's credibility and integrity, and that their role is no longer limited to *Sharīʿah* consultancy and products' approval. With the development of the Islamic financial market, *Sharīʿah* advisors are now involved in product development and innovation, in addition to overseeing Islamic finance transaction, as well as, on some occasions, policies and regulations. In exploring the limitations of Islamic financial market players in investing in social responsibility, various limitations were identified, which can then be classified as investors' appetite for good financial returns, lack of awareness of social investment, and of data and methodology associated with the business model - Triple Bottom Line or 3P (people, planet and profit). It should be noted, however, that this analysis is purely academic and is not intended to challenge the decisions made by *Sharīʿah* advisors.

4.1 Investors' appetite for financial returns

The glaring difference between *Sukūk* and SRI *Sukūk* is that *Sukūk* can fund a variety of commercial projects, whereas SRI *Sukūk*, as discussed in the previous section, aims to improve the quality of life of society, including a greener and better environment. Despite this difference, *Sharīʿah* advisors believe that when it comes to structuring *Sukūk* or even SRI *Sukūk*, the process and *Sharīʿah* considerations are quite comparable. Even if it is a simple structure, *Sukūk* can involve a complex task that includes a cash flow diagram riddled with multiple boxes and diagrams; however, the complexity of setting upSRI *Sukūk* is not an issue for them, as in the case of the Malaysian *Sukūk* market. The main obstacle to structuring the SRI *Sukūk* market is that most investors are still motivated primarily by financial returns.

Some *Sharīʿah* advisors point out that investors in *Sukūk* market still see *Sukūk as an* alternative to conventional bonds. In other words, they still want their profits and capital to be guaranteed and rewarded without taking any risk. The pressure on investors' "appetite" for a fixed return has meant that the vast majority of *Sukūk* in the market are structured to mimic conventional unsecured bonds, based on guaranteed income and principal, which can be reflected in the preference for the structure of *Sukūk* in practice. According to the International Islamic Financial Market, Annual *Sukūk* Report 2018, based on data from 2001 to 2017, *wakalah* (investment agency) and *ijārah* (lease) are the two most preferred structures required by issuers where *Sukūk wakalah* shares have increased to 75%. For example, in the case of corporate *Sukūk*, the issue size of *wakalah*, *ijārah*, *musharakah* (joint venture), *murabahah* (cost plus financing), *mudharabah* (profit sharing between the entrepreneur and investors) was one in which *Sukūk* amounted to more than 90% (IIFM, 2018). Given that Malaysia has long dominated global and domestic *Sukūk* issuance worldwide (Wright, 2016), it is reasonable to assume that *Sukūk wakalah* and *ijārah* structures reflect investor preferences in the Malaysian *Sukūk* market. 'Replication', however, uses Islamic legal contracts in a novel way to develop *Sharīʿah-compliant* financial products, in which the system differs from the conventional one. This approach has provided a practical solution to prevent Muslims from practicing *ribā* when dealing with conventional banking and financial institutions. It has also facilitated the development of a viable Islamic finance sector in the modern economic landscape (Laldin & Furqani, 2013).

Looking more closely at the types of *Sukūk* as described by the AAOIFI [5], *Sharīʿah* Standards

[5] AAOIFI (Accounting and Auditing Organization for Islamic Financial Institutions) is a non-profit organization that was established to maintain and promote *Sharīʿah* standards for Islamic financial institutions, participants and the industry as a whole. It was established on February 26,

No. 17 provides for 14 permissible *Sukūk* structures, of which Financial Accounting Standard No. 25 distinguishes between debt-type *Sukūk* and equity-type *Sukūk*. Debt-type instruments are defined as "investments whose terms provide for fixed or determinable payments of profits and capital." On the other hand, equity-type instruments are defined as "investments that do not have the characteristics of debt-type instruments and include instruments that prove a residual interest in the assets of an entity after deducting all of its liabilities." In the case of a debt contract such as *ijārah*, the structure most closely resembles a conventional lease and offers the flexibility of fixed and floating rate payments. The cash flows from the lease, including rental payments and principal repayments, are passed on to investors in the form of coupon and principal payments. In this context, *ijārah* can be used to ensure regular payments throughout the term of a financing agreement, while offering the possibility of adapting the payment profile. These features make the *ijārah* relatively straightforward, as it has similar characteristics to bonds, which is part of the reason why these structures are so popular in the *Sukūk* market. Similarly, for equity-based *Sukūk* that include *wakala*, including *musharakah* and *mudharabah* partnership-based *Sukūk*, the capital preservation structure, frequency of periodic distributions and rate of return also replicate conventional bond structures. The fundamental characteristics of equity-based *Sukūk*, which are anchored in the two capital bases, cannot be guaranteed. The periodic returns - which depend on actual earnings - may be variable and therefore not attractive to risk-averse investors with a conventional mindset. Based on this preference in the structure of *Sukūk*, *Sukūk* holders or institutional investors are looking for a stable cash flow over time, fixed payout of profits with little or no risk, whereas investment bankers should rely on on these two structures that best meet these expectations. Arguably, with such preferences and practices, the Islamic finance sector may create problems for SRI *Sukūk* in their development, as at some point the spirit and higher objectives (*maqasid al-Sharīʿah*) of Islamic finance are neglected.

4.2 Early stage of awareness of market participants regarding socially driven investment

In general, the concern of an SRI instrument, whether *Sukūk* or bonds, is what motivates investment in social values rather than purely commercial considerations. It broadens the definition of return on investment to include both financial and social returns - and is a way to use finance and investment tools to create social change.

This type of investment represents the intersection between philanthropy and conventional finance. Judging from the comments of most *Sharīʿah* advisors, SRI investment in Islamic form, particularly SRI *Sukūk*, is still a fairly new concept in Malaysia. Awareness of the value proposition implicit in socially responsible investing (SRI) in Malaysia is still a new concept compared to more mature markets that have long traded conventional bonds or SRI bonds. Although SRI *Sukūk* have made progress, it will take some time for the market to gain momentum and become a mainstream asset class for Islamic investors**.** The SRI strategy is very different from conventional or traditional approaches, in which decisions are almost always based on economic considerations, which to some extent has led to the assumption that limiting the possible investment universe will necessarily inhibit financial returns. As a result, the common assumption that an investor must sacrifice financial returns in the name of reform or societal improvement is unquestioned. In addition to the big question for investors, whether SRI strategies involve accepting lower financial returns, *Sharīʿah* advisors respond that many players in the financial services industry have adopted a wait-and-see attitude, including Islamic players. Not only investors, but also *Sukūk* market players of all kinds, still regularly face a dilemma when it comes to weighing financial versus social returns in their investment decisions, and any development of *Sukūk* for SRI still remains weak.

This dilemma is necessarily true if one considers, for example, the structure of the SRI *Ihsan Sukūk*. It was the first *Sukūk* issuance for social and/or sustainable investment in the Malaysian *Sukūk* market, issued in 2015 with the primary objective of improving access to quality education in Malaysia[6], and follows a "pay for success" structure that measures success through several key performance indicators (KPIs) for a period of 5 years. If, at maturity, the KPIs are

1990 to ensure that participants comply with the regulations of the Islamic finance industry.

[6] The discussion is based on the *Ṣukūk Ihsan*, and the key terms and conditions and information memorandum were obtained from the Securities Commission of Malaysia website.

fully achieved, *Sukūk* holders will forfeit or contribute up to 6.22% of the face value due under the *Sukūk*, reducing the return to 3.5% per annum. If the KPIs are not or are only partially achieved, *Sukūk* holders will receive up to the face value due on the *Sukūk* as agreed at issuance. In this top-down approach, higher returns are given to investors if the programme does not achieve the stated KPIs. Yet, the investors' principal and returns are fully guaranteed by Khazanah Nasional Berhad as the debtor, despite the program's future and less than ideal performance. Arguably, in the absence of financial risk or default for investors, the principle of "risk sharing", often touted in Islamic finance, is virtually nullified. However, such a structure has been developed in response to the current state of SRI, which is still new in Malaysia, as well as the profit motive and capital retention of institutional investors, meanwhile this creates some tension for issuers to align their economic decisions with the social or sustainability pillars that characterize *Sukūk* issuance. On the supply side, it is argued that important decisions need to be made between ethical investment and marketing issues on the demand side.

The central principle of an Islamic economic system requires a balance between financial and social objectives, in other words a disciplined approach to long-term sustainability. Unfortunately, this is not the case in the way the current Islamic finance industry is practiced. In weighing the needs between financial and social returns, it seems that investors with significant influence in the *Sukūk* market have prioritized profit, while the real objectives take a back seat. Therefore, there is a lack of awareness and appreciation of the true nature and spirit of the real value that should be espoused by Islamic finance.

In a conventional sense, the Social Return on Investment (SROI) method is the most commonly used method for measuring social impact or return (Florman, Klingler-Vidra, & Facada, 2016). Launched in 1997 by Robert's Enterprise Development Fund (REDF), the SROI method was the first comprehensive quantitative social impact assessment method, as it can be used for three purposes: screening, external reporting, and retrospective evaluation. Since the introduction of this method, the number of social impact assessment methodologies has increased, such as Social Value Measures (in 1999), Balanced Scorecards (1999), Progress Out of Poverty Index (2005), Product Social Impact Assessment (PSIA) in 2013 (Florman et al., 2016). In order to assess the level of contribution of Islamic finance to social outcomes, there is a need to design accurate measurement tools. Given that Islamic finance itself represents a distinct field with a unique concept and underlying principles, Mohamad and Borhan (2017) made a recommendation of appropriate metrics to measure the social impact of the finance industry from an Islamic perspective. The selected parameters represent the aspects to be fulfilled by the Islamic finance industry in order to preserve the five objectives of *Sharīʿah*: protection of religion, protection of life, protection of lineage, protection of intellect, and protection of wealth.

4.3 Data and methodology associated with the 'Three Bottom Line' or 3P (people, planet and profit) business model are probably still insufficient for implementing social and/or sustainable investments.

Based on interview data, some *Sharīʿah* advisors believe that the limitations of issuing *Sukūk* as a form of social investment may be related to the concept of the "3Ps" (people, planet and profit), an economic model developed to encourage corporate social responsibility and sustainability worldwide. In general, the archetypal social responsibility fund is characterized by an equal emphasis on the "three Ps": people, planet and profit. This "Triple Bottom Line" asserts that financial considerations (profit) are on equal footing with social (people) and environmental (planet) concerns. In Islamic financial management activities, profit is only achievable when all religious conditions are met, and under *Sharīʿah* principles, it is forbidden to invest in activities related to alcohol, pork, gambling, weapons, tobacco, unethical media, "conventional" financial institutions, pornography and anything else considered "*haram*" (illegal). It also ensures that not only the underlying investments but also the contractual terms agreed between the investors and the investment manager are in line with Islamic principles. In this regard, *Sharīʿah* advisors stated that through the screening and purification process, most of social responsibilities towards people were largely met.

The screening criteria used by the *Sharīʿah* Advisory Council (SAC) of the Securities

Commission (SC) Malaysia focuses on business activities and financial ratios. The business review (or qualitative review or sector review) is conducted to examine the nature of the core business, by excluding companies whose main activity is ineligible according to *Sharīʿah criteria*. If the main activity is *Sharīʿah compliant*, but some secondary activities are not, the review focuses on whether or not these secondary activities are within Sharīʿah tolerance level. Meanwhile, the financial ratios or quantitative examination is carried out to check the income of the business and to conclude whether it is free from prohibited income and unassociated with it, according to the acceptable ratio allowed by the *Sharīʿah* scholars. In this way, a type of investment that could harm people can be avoided.

However, several issues related to responsibilities to the planet (or the environment) have been raised. First, the most difficult challenges facing social finance revolve around the question of how to measure social impact. Quantifying social returns is somewhat complicated because there is no precise method for measuring social impacts or for creating a "green" environment. The crux of the problem is that social progress cannot be represented by dollars or any other universally accepted numerical equivalent; in fact, it is not compatible with financial accounting standards. In this regard, there is no sound, reasoned methodology for "calculating" social and/or environmental benefit, as this is a subjective undertaking that depends on the assumptions underlying the input variables.

Secondly, between the environment and socio-economic conditions, which one should be given priority for an investment decision? Simply put, how do you balance environment and social development, since both are considered SRI projects? The example of mining activities reveals the best aspects of opportunity cost and what can be achieved in monetary terms, as illustrated by the interviews with some *Sharīʿah* advisors. On the one hand, the development of the coal mining industry has undoubtedly created wealth and employment opportunities, and also contributes to local economic development, as mining companies provide and/or improve local infrastructures (e.g. roads, electricity and water supply). On the other hand, coal mining has led to significant environmental degradation, serious human health problems (e.g. directly through toxic or carcinogenic results) or indirectly, such as the reduction or contamination of water supplies. While SRI projects may ensure socio-economic development, they do not always guarantee a good future for the environment. *Sharīʿah* advisors have simply stated that if one prefers to preserve the environment, it means allowing the community to continue to live in darkness and remain poor, a decision that requires very reliable data and evaluation criteria.

It is clear that the SRI approach involves a high degree of subjectivity and requires much more in-depth data, beyond "extra-financial information", to evaluate the methodology and measure the results to determine the success level of specific social impact investment projects. According to the interviewees, it is quite difficult to issue SRI *Sukūk* without reliable data and proper environmental measurement. In Western economies or conventional finance, the social responsibility movement has a spectrum of approaches, including evaluation criteria to determine the marketing impact for business needs and the delivery of social improvements; these criteria are relatively easy to measure because they are based on raw data. However, in Islamic finance, to some extent, *Sharīʿah* advisors have stated that commonly accepted standards and a verification system for performance measurement are still limited; and the lack of a standard system for assessing and measuring environmental or social performance and of independent verification agencies in many Muslim countries has created an obstacle for investment market participants considering the benefits of SRI.

5.0 Conclusion

In analysing the ethical aspects of SRI and Islamic finance, we have highlighted that the ethics of Islamic finance are based on sacred revelation, as expounded in the *Qur'an* and *Sunnah*. The ethics derived from social values in SRI are inevitably more transitory, in which the SRI investment decision is based primarily on what the wider society or group of people perceive and believe to be ethical, sustainable and conducive to good governance. However, a closer look at the SRI *Sukūk* framework and other SRI legislation reveals that both have similar qualities, characteristics and objectives, given that SRI *Sukūk* are guided by *Sharīʿah* law. This is particularly true for the general model of social impact bonds, which do not appear to violate *Sharīʿah* principles.

While the objectives of the two forms of investment are similar, SRI *Sukūk* are challenged by investors' appetite for profit, lack of awareness of social investment and the absence of data and methodology associated with the Triple Bottom Line or 3P (people, planet and profit) approach. Indeed, *Sukūk* issuance focusing on social and moral outcomes for the economy and society has not been as successful in the Malaysian *Sukūk* market. This finding suggests that proper education on Islamic finance may be the key ingredient in making this work, especially at the postgraduate level, in order to raise awareness of the importance of the growth of Islamic finance in promoting and supporting an ethical and sustainable ecosystem and the environment globally. While academia engages in research, training and consulting through education, agencies will support the evaluation methodology and measure the results to determine some social impact investment projects' success (and payout).

Government policymakers, through central banks in Malaysia and other countries, should continue to engage with industry players to identify loopholes in business practices. Engaging investors in closer dialogue with borrowers demonstrate that there is a differentiating factor in pursuing the SRI path, which requires continued collaboration among local stakeholders to increase transparency and awareness among issuers and investors. There is also a need to find ways to increase investment returns and reduce the risk of *Sharīʿah-compliant* portfolios when they mimic Western or conventional portfolios.

Further research should therefore answer the question: how can these investors benefit from holding diversified portfolios or at what level should SRI *Sukūk* represent an appropriate risk-return ratio, comparable to conventional *Sukūk*/bonds?

Finally, given the wait-and-see attitude of investors and the lack of data and methodology for SRI projects, public-private partnerships could be considered as a form of start-up initiative to promote SRI *Sukūk* issuance. As this study points out, several overlapping sectors or projects are considered ethical from an SRI and Islamic finance perspective, and Islamic finance players can therefore look to the segmentation opportunities available in the SRI context. Nevertheless, this study considers only three standards or frameworks from three markets and embraces the views of Malaysian *Sharīʿah* experts, which may vary in terms of ethical aspects due to Islamic experts' different legal opinions in other countries.

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تقارب القيم بين التمويل الإسلامي والاستثمار المسؤول اجتماعيًا: ما هي حدود إصدار صكوك مسؤولة اجتماعيًا؟

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المستخلص. أصبحت الاستثمارات الأخلاقية ، مثل الاستثمار المسؤول اجتماعيًا (SRI) ، والاستثمارات القائمة على الدِّين، مثل التمويل الإسلامي ، شائعة في خطاب التنمية الاقتصادية. نظرًا لأن السندات المسؤولة اجتماعيًا تهيمن على أسواق الاستثمارات المسؤولة اجتماعيًا، فقد يتساءل المرء عن سبب عدم مساهمة الصكوك المسؤولة اجتماعياً (السندات الإسلامية) في بعض الأسباب أو القطاعات الاجتماعية أو المتعلقة بالاستدامة لتحقيق أهداف الشريعة الإسلامية. تناول هذه الدراسة بشكل أساسي الجوانب التي تعتبر مسؤولة أخلاقياً أو اجتماعياً كما هي مدرجة في الاستثمارات المسؤولة اجتماعيًا والتمويل الإسلامي. عند القيام بذلك ، ستقارن هذه الدراسة بين قيم أو مبادئ السندات المسؤولة اجتماعيًا وإطار عمل الصكوك المسؤولة اجتماعياً أو الصكوك لتمكين الفاعلين في التمويل الإسلامي من الاستفادة بشكل جيد من فرصة هذا القطاع. تتناول هذه الدراسة كذلك ما يحد من مشاركة المشاركين في السوق المالية الإسلامية في الاستثمار المسؤول اجتماعياً. بالاعتماد على إطار عمل الصكوك المسؤولة اجتماعياً لعام ٢٠١٤ وتشريعات الاستثمارات المسؤولة اجتماعيًا الأخرى ، تكشف هذه الدراسة أن كلاهما لهما صفات وخصائص وأهداف متشابهة. ومع ذلك ، فإن الصكوك المسؤولة اجتماعياً تواجه تحديًا بسبب شهية المستثمرين لتحقيق عائد مربح ، ونقص الوعي بالاستثمار الاجتماعي، ونقص البيانات والمنهجية المرتبطة بالنهج الثلاثي الأساسي أو نهج (3Ps = الأشخاص والكوكب والأرباح). أدت هذه المشكلات -إلى حد ما- إلى تقييد الجهات الفاعلة في السوق المالية الإسلامية عن الاستثمار في برامج المسؤولية الاجتماعية.

الكلمات الدَّالة: الصكوك، الاستثمار المسؤول اجتماعيًا، الشريعة الإسلامية، التمويل الإسلامي، الاستثمار الخُلقي

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