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<th>Description</th>
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<tbody>
<tr>
<td>AAOIFI</td>
<td>Accounting and Auditing Organization for Islamic Financial Institutions</td>
</tr>
<tr>
<td>ADB</td>
<td>Asian Development Bank</td>
</tr>
<tr>
<td>AfDB</td>
<td>African Development Bank</td>
</tr>
<tr>
<td>ANDE</td>
<td>Aspen Network of Development Entrepreneurs</td>
</tr>
<tr>
<td>AUM</td>
<td>Assets Under Management</td>
</tr>
<tr>
<td>BOP</td>
<td>Bottom of the Pyramid</td>
</tr>
<tr>
<td>CAGR</td>
<td>Cumulative Adjusted Growth Rate</td>
</tr>
<tr>
<td>ESG</td>
<td>Environment, Social and Governance</td>
</tr>
<tr>
<td>ETF</td>
<td>Exchange Traded Fund</td>
</tr>
<tr>
<td>CGAP</td>
<td>Consultative Group to Assist the Poorest</td>
</tr>
<tr>
<td>CSR</td>
<td>Corporate Social Responsibility</td>
</tr>
<tr>
<td>DFI</td>
<td>Development Finance Institution</td>
</tr>
<tr>
<td>EBRD</td>
<td>European Bank for Reconstruction and Development</td>
</tr>
<tr>
<td>GIIN</td>
<td>Global Impact Investing Network</td>
</tr>
<tr>
<td>GIIRS</td>
<td>Global Impact Investing Rating Standards</td>
</tr>
<tr>
<td>GIZ</td>
<td>Deutsche Gesellschaft für Internationale Zusammenarbeit (German governmental agency for international development)</td>
</tr>
<tr>
<td>IADB</td>
<td>Inter-American Development Bank</td>
</tr>
<tr>
<td>IBRD</td>
<td>International Bank for Reconstruction and Development</td>
</tr>
<tr>
<td>ICCR</td>
<td>Interfaith Center for Corporate Responsibility</td>
</tr>
<tr>
<td>IDB</td>
<td>Islamic Development Bank</td>
</tr>
<tr>
<td>IFC</td>
<td>International Finance Corporation</td>
</tr>
<tr>
<td>IRIS</td>
<td>Impact Reporting &amp; Investment Standards</td>
</tr>
<tr>
<td>ISFD</td>
<td>Islamic Solidarity Fund for Development</td>
</tr>
<tr>
<td>IICPSD</td>
<td>Istanbul International Center for Private Sector Development</td>
</tr>
<tr>
<td>IFSB</td>
<td>Islamic Financial Services Board</td>
</tr>
<tr>
<td>KFW</td>
<td>Kreditanstalt für Wiederaufbau (Reconstruction Credit Institute - German bank for international development)</td>
</tr>
<tr>
<td>MDG</td>
<td>Millennium Development Goals</td>
</tr>
<tr>
<td>MFI</td>
<td>Microfinance Institution</td>
</tr>
<tr>
<td>PPP</td>
<td>Purchasing Power Parity</td>
</tr>
<tr>
<td>REIT</td>
<td>Real Estate Investment Trust</td>
</tr>
<tr>
<td>SASB</td>
<td>Sustainable Accounting Standards Board</td>
</tr>
<tr>
<td>SCM</td>
<td>Securities Commission of Malaysia</td>
</tr>
<tr>
<td>SRI</td>
<td>Socially Responsible Investment</td>
</tr>
<tr>
<td>SME</td>
<td>Small and Medium Enterprise</td>
</tr>
<tr>
<td>SSB</td>
<td>Sustainability Supervisory Board</td>
</tr>
<tr>
<td>SVN</td>
<td>Social Venture Network</td>
</tr>
<tr>
<td>UN</td>
<td>United Nations</td>
</tr>
<tr>
<td>UNDP</td>
<td>United Nations Development Programme</td>
</tr>
<tr>
<td>UNEPFI</td>
<td>United Nations Environment Program Financial Institutions</td>
</tr>
<tr>
<td>UNPRI</td>
<td>United Nations Principals for Responsible Investing</td>
</tr>
<tr>
<td>UNGC</td>
<td>United Nations Global Compact</td>
</tr>
<tr>
<td>USAID</td>
<td>United States Agency for International Development</td>
</tr>
</tbody>
</table>
INTRODUCTION

Undoubtedly, the worlds of Islamic finance and impact investing are growing daily, and rapidly. This report attempts to provide a brief and indicative overview of both universes: conventional impact investing and Islamic financing. The areas in this report focus on the relevant topics to provide context for recommendations for ways in which the IICPSD is well-suited to act as leader, and are not meant to be exhaustive. There are many topics only briefly touched upon here or that require extensive research beyond the scope and limited timeline of this project.

For the purposes of this report, emphasis was placed on the IICPSD’s goals of fostering private sector development. Additionally, guidance was provided by the IICPSD, to focus on recommendations for growing Islamic impact investing not for those “Below the Poverty Line” typically making $1-2 USD PPP per day, but the economically empowered with roughly an $8-10 USD per day PPP.1

The overall strategy for this scope of work involves 4 main parts, divided into 8 sections. In section 4, indicative recommendations are made for IICPSD to consider to promote and grow the area of convergence to create dialogue around Islamic impact investing. These four main parts include:

- Background on and outlining the universe of impact investing
- Providing context for Sharia investments
- Identifying areas of current overlap
- Devising strategies to grow the area of overlap.

The approach to the fulfillment of this goal is illustrated in the Venn diagram below.

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CONVENTIONAL IMPACT CONSIDERATIONS

Undoubtedly, the phrase “impact investing” elicits various responses from euphoria to confusion to disdain. As an evolution of the more mature market for Social Responsible Investing (SRI) that started 25 years ago, impact investing is a newer frontier that goes beyond negative screens and positive intent to actively seek out investments for which there are both social and financial returns.

According to the Global Impact Investing Network (GIIN) website (www.thegiin.org), Impact investments are “investments made into companies, organizations, and funds with the intention to generate social and environmental impact alongside a financial return.”2

JP Morgan Chase takes a broader definition as: “Impact investments are investments intended to create positive impact beyond financial return. As such, they require the management of social and environmental performance in addition to financial risk and return.”

GIIN further expands the characteristics of impact investing to include:

- “Intentionality – The intent of the investor to generate social and/or environmental impact through investments is an essential component of impact investing.
- Investment with return expectations – Impact investments are expected to generate a financial return on capital and, at a minimum, a return of capital.
- Range of return expectations and asset classes – Impact investments generate returns that range from below market (sometimes called concessionary) to risk-adjusted market rate.
- Impact measurement – A hallmark of impact investing is the commitment of the investor to measure and report the social and environmental performance and progress of underlying investments. Impact measurement helps ensure transparency and accountability, and is essential to informing the practice of impact investing and building the field.”3

For this report, there will not be a focus on defining impact investing. The examples here are given to provide context and background for the discussions and standards currently happening in the impact investing arena. This will become important when comparing to the discussions in Islamic finance, and ultimately, to the recommendations made for IICPSD with respect to growing the Islamic impact investing space.

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3 www.thegiin.org
**Intent**

Intent to have a positive social impact is critical in impact investing such that it is pro-active and an important part of the return paradigm. The intent reflects different levels of commitment on the part of the investor or the investor; however pro-active intent to make an actively socially responsible investment or company is crucial. Investments or companies that coincidentally or unintentionally provide a socially responsible investment are not considered impact investing.

Intent on a spectrum with those investments that employ negative screens is the most basic level of impact investing, while investments whose primary purpose is to provide socially responsible capital even at the expense of financial returns are at the other end of the spectrum.

**Measurement For Impact Investing**

**Financial Returns**

For conventional impact investing, financial returns are typically measured using metrics like Return on Equity (ROE), Return on Assets (ROA), or ROI (Return on Investment) or based on the amount of interest is paid/earned for debt funding.

- \( \text{ROE} = \frac{\text{Net Income}}{\text{Amount of Total Shareholders' Equity}} \)
- \( \text{ROA} = \frac{\text{Net Income}}{\text{Total Assets}} \)
- \( \text{ROI} = \frac{\text{Gains}}{\text{Costs to achieve those gains}} \)

Conventional debt funding -loans- is typically based on a contractual amount of interest that will be paid by the client or business owner to the bank or financial intermediary in return for an advance on capital. The interest can be paid in regular increments, or in a lump sum; it can be variable or fixed; it can be calculated based on the original loan amount or the outstanding principal.

**Social Returns: Outreach, Output, Outcomes and Impact**

Historically, humanitarian and development organizations have used outreach to determine the effectiveness of an intervention. This can be the number of people directly affected by a project, the number of meals or books provided or the number of women receiving care and similar indicators that lend scope and scale of human impact for a specific project.

Outputs are activities carried out by an organization or project. They are relatively easy to measure, although the output is usually meaningless without context. For example, building a school to educate 350 girls in Kano, Nigeria is a hypothetical output of a project to support education for girls.

Outputs are short or intermediate-term, tangible effects observed by or on behalf of the beneficiaries of a project, usually at the level of the individual. They are slightly more difficult to measure. An example would be that the girls in the Kano school are more literate because of the education they are receiving at the school.

Impacts are broader, more long-term and sweeping changes as the result of a project, usually affecting change on larger groups of people or on a community. Measuring impact is the extent to which a project can observe—and ideally quantify—changes as a direct result of the project. Among all social returns impact is the most difficult to measure as it requires proof and analysis, holding constant other factors to eliminate confusion from causality, correlation or other influences. In the example of the girls at the Kano, Nigeria school who are more literate, the impact might be that they are now also having children at an older age. The difficulty in this case is to determine if there is a correlation between higher literacy rates and delayed childbearing, or if a higher literacy rate causes delayed childbearing. Perhaps they are learning to read elsewhere, or, culturally, women who are educated are less attractive partners so are, therefore, marrying and having children later. Furthermore, both of these effects have to be directly linked to the project for building a school to educate the girls in Kano, Nigeria for there to be measurable impact.

As the industry evolves, there is increasing focus in impact investing on measuring outcomes instead of “impact” or outreach as a measure of the true benefit of an investment.

**Standards, Monitoring & Evaluation**

Consistent standards, metrics and monitoring tools are critical to the measurement of impact investing. The two leading standards for monitoring and evaluation are the Global Impact Investment Rating System (GIIRS) and IRIS. Environmental, Social and Governance (ESG) standards have also evolved into a common global vernacular.

GIIRS is a robust system of rating criteria to assess, benchmark and report data on private companies. Data is independently verified and transparent. GIIRS ratings and reports are meant to serve as a rating system similar to those provided by Moody’s, Standard & Poor’s or Morningstar. GIIRS is a non-profit organization that provides services to investment advisors and funds, institutional investors, and companies based near Philadelphia, Pennsylvania in the USA.

GIIRS is supported by and has become the exclusive rating system for many of the larger networks of conventional impact investors and impact funds.

IRIS, part of the GIIN, is the full menu and definitions for the catalog of generally-accepted performance metrics used by leading impact investors to measure the social, environmental, and financial performance of their investments. Unlike GIIRS, IRIS is not a rating system, but a set of metrics. These metrics align with other globally accepted standards, and proprietary metric sets. These metric sets represent a range of functional areas, industries, sectors and beneficiaries and have been adopted by and are endorsed by many leaders in impact investing.4

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4 Based on outlines and examples given at http://www.tacticalphilanthropy.com/
5 Based on examples and discussion at http://meera.snre.umich.edu/
6 www.giirs.org
7 https://iris.thegiin.org
ESG standards evolved out of concern for the three biggest themes that emerged about a decade ago as SRI became more mainstream. In many respects, ESG standards came about as a result of large donor and governmental call for standardization. Efforts were catalyzed by UNEP and US-based OPIC (Overseas Private Investment Corporation). Currently, many investors and companies are implementing some version of ESG. As shareholder advocacy becomes more prevalent, an increasing number of firms are adopting basic ESG principles as part of good corporate governance.

The most material and standard ESG Factors is outlined in Figure 1.

<table>
<thead>
<tr>
<th>Material ESG Factor</th>
<th>Social (S)</th>
<th>Governance (G)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Biodiversity/land</td>
<td>Community relations</td>
<td></td>
</tr>
<tr>
<td>Use carbon emissions</td>
<td>Controversial business customer relationship/product</td>
<td></td>
</tr>
<tr>
<td>Climate change risk</td>
<td>Diversity issues</td>
<td></td>
</tr>
<tr>
<td>Energy usage</td>
<td>Employee relations</td>
<td></td>
</tr>
<tr>
<td>Raw material sourcing</td>
<td>Health and safety</td>
<td></td>
</tr>
<tr>
<td>Regulatory/legal risks</td>
<td>Human capital management</td>
<td></td>
</tr>
<tr>
<td>Supply chain management</td>
<td>Human rights</td>
<td></td>
</tr>
<tr>
<td>Waste and recycling</td>
<td>Responsible marketing and R&amp;D</td>
<td></td>
</tr>
<tr>
<td>Water management</td>
<td>Union Relations</td>
<td></td>
</tr>
<tr>
<td>Weather events</td>
<td>Accountability</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Anti-takeover measures</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Broad structure / size</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Bribery and corruption</td>
<td></td>
</tr>
<tr>
<td></td>
<td>CEO duality</td>
<td></td>
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<tr>
<td></td>
<td>Executive compensation schemes</td>
<td></td>
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<tr>
<td></td>
<td>Ownership structure</td>
<td></td>
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<tr>
<td></td>
<td>Shareholder rights</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Transparency</td>
<td></td>
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<tr>
<td></td>
<td>Voting procedures</td>
<td></td>
</tr>
</tbody>
</table>

Figure 1 Material and Standard ESG Factors

The most material and standard ESG Factors is outlined in Figure 1.

Impact investing can be focused in a particular country, region or city or can create impact in multiple countries or regions. Within the context of impact investing, there are seven sectors generally considered core to the philosophy of development and impact as illustrated in Figure 2.

Agriculture & Food Security
The supply of adequate and appropriate food sources for communities in a manner that is affordable, consistent and appropriate to meet basic human needs. This includes not only food and foodstuffs, but sustainable practices that help to ensure land and crops will be able to support future generations.

Healthcare
The provision of consistent access to affordable and quality healthcare, medication and professional medical advice to the population in an efficient and consistent manner and according to their need, and appropriate for the local conditions.

Clean Energy
Development and delivery of sustainable energy sources for people and businesses to meet the needs of the present population without compromising the ability of future generations to meet their energy needs. This usually excludes extractive energy sources and includes solar, geothermal, hydro and wind energy.

Water & Sanitation
The provision of water and sanitation facilities of sufficient quantity and quality to meet minimum standards of living. This includes potable water for consumption and access to water for meeting basic needs.

Housing
The provision of affordable, long-term housing of an appropriate quality and type to accommodate people in an affordable manner. This is distinct from short-term shelter used in relief efforts. Housing is highly contextual based on climate, geography and materials.

Education
The provision of affordable, consistent and quality education to all children in a manner appropriate for the local context. This usually implies free primary education for both girls and boys.

Financial Services
Access to financial services that are appropriate for the income level and needs of the client in order to improve economic empowerment and encourage contribution to the formal, financial sector through the use of retail or business products and services.
The universe of impact investing is increasingly large and complex. There are a variety of actors and influencers in the space as it grows rival to, in some cases, absorb, conventional investing. As previously discussed, definitions and standards for impact investing and determining “impact” are ever evolving. However, it is clear that impact investors and socially responsible businesses occur on a spectrum.

Outlined in Figure 3 are the major components to the continuum of the philosophy of impact investors and impact businesses.

On one end of the spectrum are conventional purely profit maximizing businesses and investors; on the other are conventional pure charitable and humanitarian-oriented organizations. In between is the range of philosophies, investors, and businesses as they approximately fall on the spectrum.

Within impact investing there are a variety of actors that play a role in the development of and participation in impact investing, as illustrated in Figure 4. Most of these actors participate both in the conventional and impact investing arenas.

Outlined in Figure 4 is a representative description and examples of the major actors, although this is by no means exhaustive and is meant to illustrate some of the more prominent players.

**Public Sector**

Public sector actors rely on public funding to deploy. Typically, most OECD countries and many others have established development agencies (domestic and international) to promote social development and capacity building. Furthermore, most governments contribute funding to Development Finance Institutions (DFI) to support development goals. In order to deploy this capital and effectively provide technical and capacity building assistance, there are a multitude of service providers that implement the contracts and programs funded by donors and DFIs.

Technical assistance (TA) is provided for both general capacity building as well as for specific technical areas in the impact investing sectors outlined in the previous section. However, DFIs can also provide TA directly. Many of the support organizations and TA providers are structured as non-profit organizations. Examples include:

- **DFIs:** EBRD, World Bank Group, ADB, AfDB, IADB, IDB, KW, GIZ, Danida, USAID, DFID, Sovereign Wealth Funds (SWFs)
- **TA providers:** USAID, GIZ, KW, Danida, EFSE/FII, Grameen Foundation, Gates Foundation, Clinton Global Initiative, REGMIFA, Okocredit, Triple Jump, Incofin, World Bank Group, OPIC, Population Services International (PSI), World Vision, Catholic Relief Services
- **Support Organizations:** GIIN, WEF, GIIIS, SVN, ANDES, SASB, European Venture Philanthropy Association, OPIC, Impact Assets, Kiva, Bloomberg

**United Nations**

As a well-respected global peaceful development-oriented organization, the UN family plays a large role in supporting the agenda for impact investing. This support comes in numerous ways, from numerous groups and organizations within the UN family. An exhaustive list of such efforts is outside the scope of this project; however there are two organizations and projects within the UN universe that are particularly worth noting: UNPRI United Nations Principles for Responsible Investment (UNPRI) (www.unpri.org) and United Nations Global Compact (UNGCU) (www.unglobalcompact.org).

UNPRI was founded a decade ago with partners UNGC and UNEPFI. They have developed a set of 6 Principles for Responsible Investment (PRI) around ESG requirements according to which businesses, asset managers and service providers voluntarily sign an agreement to adhere. Currently, UNPRI has 1260 signatories representing $45T in assets under management (AUM). UNPRI is also a nexus of information on responsible

---

investing, and a leader in developing guiding principles and frameworks to move the industry forward on a global scale.

UNPRI has developed a graphic to illustrate the impact investing universe as it relates to UNPRI, shown here as Figure 5.

Currently, the main group of signors is comprised of asset owners, followed by DFIs and pension funds.

### Negative Exclusionary Screening and Positive or Best-in-Class Screening based on ESG Criteria

#### Responsible Investment

<table>
<thead>
<tr>
<th>Traditional</th>
<th>Responsible Investment</th>
<th>Impact Investing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Screening</td>
<td>ESG Integration</td>
<td>Themed</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Impact First</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Philanthropy</td>
</tr>
<tr>
<td>Targeted Social and/or Environmental Impact</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Comprehensive Exclusions**

<table>
<thead>
<tr>
<th>Environmentally or socially significant negative issues which create investment opportunities with some financial trade-off</th>
</tr>
</thead>
<tbody>
<tr>
<td>Focuses on one or a cluster of issues where social and environmental needs require 100% trade-off</td>
</tr>
</tbody>
</table>

#### Impact Funds


#### Retail

- Calvert, RSF

### Bonds

Bonds are becoming increasingly popular in the impact investing space as a way to provide relatively risk-free, long term annuities or investments to investors. Bonds are key to diversifying an investment portfolio away from equities, short term investments or higher risk investments. As impact funds continue to proliferate the market, fund managers are looking for more bond options that qualify as “impact” to balance portfolio composition and risk profiles.

In particular, “green bonds”, or bonds backed by underlying assets in renewable energy or for brownfield projects are proliferating the market. As of June 2014, $6.6B in green bonds had been issued in the first 6 months of 2014 alone. If that pace holds through the rest of 2014, the green bond market is set to triple in size year-on-year from 2013. However, this would still only represent a miniscule part of the overall bond market, with around 1% of the total bond market volume. Increasingly, corporations and banks are issuing self-proclaimed ‘green’ bonds which create a significant contribution to this rapidly growing market.10

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Not surprisingly, the largest green bond issuers are DFIs. As of October 2013 (and beginning in 2007), the DFI bond issuance is shown in Figure 6.

<table>
<thead>
<tr>
<th>Rank</th>
<th>Issuer</th>
<th>Total Value of issues 2007 to 2013</th>
<th>Number of issues</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>World Bank: IBRD</td>
<td>$3,845M</td>
<td>11</td>
</tr>
<tr>
<td>2</td>
<td>European Investment Bank</td>
<td>$3,725</td>
<td>15</td>
</tr>
<tr>
<td>3</td>
<td>World Bank: IFC</td>
<td>2868</td>
<td>8</td>
</tr>
<tr>
<td>4</td>
<td>Asian Development Bank</td>
<td>1241</td>
<td>14</td>
</tr>
<tr>
<td>5</td>
<td>African Development Bank</td>
<td>505</td>
<td>1</td>
</tr>
<tr>
<td>6</td>
<td>Export-Import Bank of Korea</td>
<td>300</td>
<td>1</td>
</tr>
<tr>
<td>7</td>
<td>Kommersialbanken Norway</td>
<td>404</td>
<td>14</td>
</tr>
<tr>
<td>8</td>
<td>Nordic Investment Bank</td>
<td>209</td>
<td>2</td>
</tr>
<tr>
<td>9</td>
<td>EBRD</td>
<td>55</td>
<td>6</td>
</tr>
</tbody>
</table>

Figure 6: DFI Bond Issuance as of October 2013.

- Bond issuers: DFIs (See above), Bank of America, Toyota, Solar City, Hannon Armstrong, a variety of national banks (Germany, Sweden) and local banks (US, Europe)

Crowd funding aggregates small amounts of capital from a large number of people to place into a particular venture or idea that requires funding. Crowd funding can be debt, equity, charitable contributions or performance-driven investing. Not all investments charge interest or provide a guaranteed rate of return.

- Crowd funding: Kickstarter, Kiva, Funding Circle, Indiegogo, Seeds, Tilt, Quirky, Crowdwise, BloomVC, Thrdplace, Crowdfunder, Nesta, Bank to the Future, Abundance

Most large banks and asset managers have departments working to build impact-based investment platforms and funds for eligible High Net Worth (HNW) investors. 11

- HNW platforms: JP Morgan, Morgan Stanley, Credit Suisse, Deutsche Bank, Barclays, ABN Amro, Citibank, HSBC, Goldman Sachs, BNP Paribas, Bank of America

### Foundations

While grants are not themselves impact investments, they can play an important role in enabling impact investing – for instance, through incubating early-stage business models, providing certain forms of credit enhancement, providing technical assistance, or funding needed research and development.


Increasingly, foundations are using targeted mechanisms to deploy capital into impact investing from within the endowment or based on demand or goals of a sub-set of contributors to the larger endowment. Two such vehicles are Program Related Investments and Donor Advised Funds.

### Program Related Investments (PRI)

PRIs are investments made by foundations, through endowment funds, that support charitable activities involving the potential return of capital within a defined time period. They use financing methods commonly associated with banks or other private investors, such as loans, loan guarantees, linked deposits, and even equity investments in charitable organizations or in commercial ventures. 12

The purpose is to provide capital, at a subsidized rate, usually for more innovative initiatives that align with the mission of the foundation, and for those projects that are potentially financially self-sustaining.

PRIs were pioneered by the Ford Foundation in 1968. Even though a small fraction of endowments use PRIs, they are becoming an increasingly common tool for impact investing. PRIs can be part of an annual allocation or one-off.

### Donor Advised Funds (DAF)

A DAF is an investment or charitable giving vehicle contained within a larger fund or organization, created to directly manage a particular investment or donation in a targeted manner on behalf of organizations, families, or individuals who contribute to the larger organization. To participate, an individual or group opens a separate account within the fund and deposits cash, securities, or other financial instruments that will be invested or donated. They surrender ownership of anything put into the fund, but retain control over how their account is invested, and how it distributes money to charities.

Although pioneered in the US over 70 years ago, Calvert Foundation was the first to use DAF in the context of impact investing, with Calvert Giving Fund, now spun off as Impact Assets.

11 HNW is usually considered a “qualified” investor with at least $1M in liquid assets.

12 www.grantspace.org
FOUNDATIONS OF SHARIA

Qu’ranic principles guide the Islamic financing space. Many people misunderstand Islamic investing to mean that only no interest is charged, and often feel that the financial constructs are a facade for charging “interest” through other mechanisms. In fact, Islamic investing is guided by several basic tenets, for which the “Sharia-compliance” is overseen by Muslim scholars and Sharia Supervisory Boards (SSB).

Sharia Principals

For many conventional investors and financial services practitioners, Islamic, or Sharia-compliant investing is synonymous with restrictive interpretations of the Qur’an. As applied to the financial sector, Sharia-compliance extends to a way of structuring financial transactions such that money has no intrinsic value alone, and the transaction promotes a large social good through risk sharing. These are actually not restrictive guidelines, but a framework that differs from conventionally structured financial products. The key tenets of Sharia principals are summarized below.

Application of screens and filter

• Riba (interest) is prohibited. This refers to an increase in capital without any real services provided, or the growth of money by the mere passage of time. Riba is prohibited on both sides of the transaction – giving as well as taking.
• Gharar (speculation or chance) is not allowed. This includes pure speculation, gambling, hedging, or any financial transaction or contract which includes an element of chance.
• Haram (forbidden) businesses or industries. Examples include companies that derive significant income (defined as more than 5% of their total income) from the processing or sale of alcohol, tobacco or pork. Other prohibited industries are defense/weapon, gambling, pornography and financial firms that charge or pay interest. AAOIFI guidelines also recommend not investing in companies whose debt ratios are greater than 30%, whose accounts receivables ratios are greater than 45%, or whose income from interest is greater than 5%.13

Risk sharing by both financier and client

Financiers are those providing funding. They are not creditors in the conventional sense that are guaranteed or expecting a certain financial return, measured by interest, fees, or any other form of payment. Financiers are investors who share the risk with the client or business owner; those risks are shared by mutual repercussions of distribution of profits or losses.

Money has no inherent value alone.

Money has no value on its own, and cannot be a commodity with value to be bought or sold. Money increases or decreases in value only when joined with other resources for the purposes of productive activities. Money, unless backed by other assets, cannot increase in value over time; profits or losses cannot be had due to the time value of money.

All transactions must be based on a real economic activity. Investments must be made in real, durable assets, directly or indirectly and transactions must also be backed by real assets.

Clear contractual terms

Contracts must be explicit in terms of expectations and contributions by both parties for sharing both up and down-side risk. All parties must have an acute awareness of the tangible products or services being bought or sold and it’s material value. Contracts must be agreed to mutually, and are for a defined time period.14

Zakat (Charitable giving)

One of the Qu’ranic principals that manifests in Islamic investing is the concept of zakat, or charitable giving. This goes beyond conventional impact investing negative screens for SRI or ESG, or Sharia screens for Halal. This is meant to be an active response to helping those in need. However, the inclusion of Zakat in Sharia principles does not necessarily make all Islamic investments impact investments.

Since investment income is forbidden, and Zakat is one of the key tenets of Islamic investing, most of the modern Islamic investment managers provide mechanisms for purification for Muslim clients. Purification principles require that any investment income be given to charity if it may have been generated from activities defined as unlawful according to Islamic investing principles. This extends to all types of investors and investments. Azzad Funds, based in the US, even has a purification calculator on their website for real-time, daily calculations for purification and to act as a guide for zakat.15

Key Structures for Investment

There are a variety of Sharia-compliant investment structures. For the purposes of this report, focus will be given to those most suitable for Islamic impact investing and most widely used currently for Islamic investment: Sukuk, Musharaka, Murabaha, Istisna, and Ijarah.

It is worth noting that this report does not focus on Qard-e-Hasan since it is most commonly considered a benevolent loan as a form of charity (Zakat). It should be free of anything more than nominal charges or fees, is forgiven fully without penalty in cases of default, and there is often no expectation of repayment. There are some MFIs building business models around Qard-e-Hasn, but it is yet unclear whether these are profitable, scalable or sustainable. Despite being a potentially important tool for development of financial

13 www.azzadfunds.com
15 www.azzadfunds.com
inclusion for the BOP, it is not a priority mechanism for increasing the Islamic impact investing space at this
time, therefore it is not under consideration for this report.

Sukuk
A sukuk is a certificate of ownership applied to an underlying asset. Sukuks are not without controversy
since some feel that the time value of money (and the making of money from it) is inherent in the long term
nature of a sukuk. In a sukuk, the issuer sells the certificate of ownership to a buyer. The buyer rents it back
from the issuer based on a pre-determined rental fee. The issuer also makes a contractual obligation to buy
back the bond, the contractual instrument, at a future date at par value.

Sukus can have a variety of underlying assets from which revenue streams derive. Effectively, ownership
in a sukuk is partial ownership in a debt (Murabaha), asset (Ijarah), project (Istisna), business (Musharaka) or
investment (multiple structures)\(^n\).

The first government to issue a sukuk was Bahrain in 2001, which opened the floodgates. As of July 2014,
sukuk amounts outstanding were approximately $296B, with sovereign issuers accounting for 36% of the
total market by volume. The largest issuer is Malaysia. In June of 2014, Great Britain became the first western
country to issue a sovereign sukuk, which was greatly oversubscribed. Orders of £2.3 billion were placed on
an issuance of £200m ($322m)\(^{17}\).

Between 2002 to 2012, annual sukuk issuance
grew at an average rate of 35%, from $4 billion
to $83 billion. Although most sukuks are
intended for local markets (and issued in local
currency), international issues are growing
rapidly from 10% (2010) to 20% (2014) of the
sovereign-issued sukuk market.

Figure 7 shows a graph from the Economist\(^{16}\)
that illustrates the current structure of sukuk
issuers, with sovereigns no longer the clear
leader in issuing sukuks.

Murabaha
Murabaha is the most widely offered Sharia-compliant contract. It is an asset-based debt structure used to
finance goods needed as working capital structured as a cost-plus-market sales contract. The financed asset
remains owned by the financier until full payment is made by the buyer. The ownership is fully transferred
after full payment is made by the buyer; it is not a loan, but a sale.

Ijarah
Ijarah is a leasing contract used for equipment financing, vehicles, construction or mortgages, with pre-
specified duration and related payments. Ownership of the asset remains with financier until the obligations
of the contract have been fulfilled. Lease payments are agreed to in advance over a specified period of time.

Istisna
Istisna is a purchase order to produce or build a specific product or commodity for a buyer. It is commonly
used for project finance to finance long term, large scale facilities like manufacturing plants, power plants,
airports, roads, and extractive resource operations. The bank finds suitable contractors on behalf of the
buyer and a 3-way contract is issued between financier, buyer and contractor. Upon completion, the
contractor delivers the product to the bank, which then provides them to the buyer based on the fulfillment
of the contractual terms.

Musharaka & Mudaraba
Both musharaka and mudaraba are profit and loss sharing schemes and investment mechanisms that are
the least contested by Sharia scholars.

Musharaka is a joint entity formed for the purpose of equity participation. Parties share the profits or losses
according to a predetermined ratio. Musharaka can be used for assets or for working capital. In Diminishing
Musharaka, the bank takes share in the ownership of a specific asset or for working capital with the client
and gradually transfers complete ownership to the client based on a pre-determined schedule and profit
sharing arrangement, and subject to the actual business performance.

Mudaraba is a partnership in which one partner gives money to another for investing in a commercial
table. The financier recovers a management fee for services, but no other compensation. Profits are
shared in pre-agreed ratios, where financial losses are borne entirely by the financier.
**UNIVERSE OF ISLAMIC INVESTING**

The universe of Islamic investing is still nascent in many respects, but growing and changing rapidly. Once primarily niche financial services, it is growing more mainstream with many global banks developing subsidiaries or windows for Islamic financing. What were once mainly retail banking services are now evolving into commercial banking, retail banking, investment banking and investment services for both debt and equity, insurance companies and other types of financial service intermediaries and service providers. In addition to equities, markets also trade sukukis and an increasing number of Exchange Traded Funds (ETF) and Real Estate Investment Trusts (REIT).

As of 2013 and the first part of 2014, global Islamic investing had total assets over $2 trillion, most of which is kept in Islamic banks or Islamic windows of conventional banks. Sukukis comprise approximately 15% of the market by volume, with Sharia-compliant investment funds at 4% and takafuls at 1%. Geographically, in 2012, Iran accounted for 43% of the world’s Islamic banking assets, with Saudi Arabia (12%) and Malaysia (10%) ranking second and third, respectively.19 There are hundreds of Islamic investment funds that follow Sharia principles, the vast majority of which are also profitable.

A variety of large, multinational, conventional support services organizations have Islamic units including KPMG, PWC, Deloitte, Ernst & Young, Dow Jones, Standard & Poor’s, Bloomberg and many law firms. These units specialize in Islamic markets and nuances of Islamic related investments like tax implications, accounting differences, indices and data collection. Most of these organizations also publish at least one report a year on topical issues important to the development of the Islamic investing universe.

Some of the more developed markets have Islamic stock exchanges, or exchanges that cover both debt and equity, insurance companies and other types of financial service intermediaries and service providers. In addition to equities, markets also trade sukukis and an increasing number of Exchange Traded Funds (ETF) and Real Estate Investment Trusts (REIT).

**Capital Markets**

Capital markets include both debt and equity. The main impediment to growth for Islamic investing is an efficient and effective capital markets system to allow scaling and with distribution channels to reach various types of institutional investors.

On the debt side, bonds (sukukis) can be issued without collateral by governments (sovereign, municipality), DFIs or corporates; the value and structure of these bonds is based on the reputation of the issuing organization that acts as an informal “guarantee” for the payment of the bond. Bonds can also be asset-backed, and in most cases, payments are tied to the cash-flows of an underlying performing asset.

In the Islamic investing space, as of 2013, only 80 funds managed over $100M in assets, with 80% ($59B AUM)20 of investors coming from retail. In the conventional investing space (not impact investing), we see the inverse: only 30% of investment comes from retail, with 48% from institutional investors—29% from insurance companies and 19% from pension funds. Typically speaking, retail investors have a shorter investment horizon and meeting the needs of these clients requires an extensive distribution network. If we look at the conventional institutions that invest in funds, they are divided such that 3% comes from banks, 27% from pension funds, 42% from insurance companies and 28% from other types of institutions.21 With so little institutional investment in Islamic investing, this perpetuates trapped capital within the sector of investors who prefer to or will only invest in Islamic financing instruments and vehicles. In order to create a better functioning infrastructure for Islamic investing, the current paradigm for Islamic investing needs to be reversed.

Moreover, the entrance of pension funds, especially in the GCC could double the size of the Islamic investing space. GCC pension assets are over $180B, or 5% of GDP. By channeling even 20% of those assets into Islamic impact investing, that represents $36B, which would substantially change the landscape for Islamic impact investing.22

Sharia compliant investment funds (mutual funds) have grown significantly in the last 10 years, with 94 new funds since 2010. 2013 saw the total number of Sharia compliant mutual funds reach 780, with 22 closures. GCC made up 20% of fund issuances, launching 19 new funds in 2013.23

The graphic in Figure 8 illustrates a division of the conventional impact investing space that highlights the role of capital markets, and is useful in understanding the deficiencies in the current Islamic financial markets. As illustrated in the examples in this report, the Islamic financial services sector lacks in depth and breadth of asset owners, asset managers and demand side actors.

The universe of Islamic funds is dominated by a few large players with increasingly squeezed profit margins, and with a cost structure that is forcing closure of smaller funds. The large funds lack diversified characteristics or product offerings (single product offerings is the norm), and there are no real distinguishing features between the various funds. This homogenous product offering encourages investment firms to compete on price and name to get to scale with large investors. In fact the largest 10 Islamic funds represent 44% of total fund AUM in the Islamic investing space.24

In the Islamic financing space, banks serve as gatekeepers of information, and impediments to both large institutional investment as well as keep investable capital trapped in inefficient market mechanisms. This perpetuates a top-sided, and risk averse intermediary for Islamic investing, in general.

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19 “Big Interest, no interest”. Economist Sept 13, 2014
20 Ibid
22 Ibid
23 Ibid
Islamic Finance and Impact Investing

26 “Sharia compliant funds: A whole new world of investment” PWC 2009

Islamic Finance Supervisory Board (Malaysia) (IFSB) is a global “standard-setting organization that promotes and enhances the soundness and stability of the Islamic financial services industry by issuing global prudential standards and guiding principles for the industry, broadly defined to including banking, capital markets and insurance sectors.” 27

IFSB conducts significant research into innovations and best practices, publishes extensively and coordinates industry events and seminars. They also have a technical advisory board comprised of Sharia scholars. As of April 2014, IFSB had 184 members, including 59 regulatory and supervisory authorities and 111 financial institutions and service providers.

At the end of 2012 and beginning of 2013, two important UAE-based structures were successfully launched, each with over $1B in the initial raise. They are both important because they were the first Islamic Basel III compliant Tier 1 structures for banks, requiring re-thinking and creative structuring to comply with the standards. Both the UN and AAOIFI are supporting efforts to ensure that Basel III & IV frameworks include modifications and allowances for Islamic banks.

Innovations

As in conventional investing, there are a variety of innovative projects that could potentially have a large impact larger than intended. Based on the focus of this report—Islamic impact investing—there are four worth mentioning here that have already been studied in some depth. There are numerous other projects that could be worthy of a case study, but outside the scope or time frame of this project.

- Pakistan Voluntary Islamic Pension system. Studied by Thompson Reuters.
- Tax treaty effects on Islamic investing markets and investments. Studied by KPMG.
- Oman regulatory framework. Permitted Islamic banking in 2012 and developed comprehensive, systematic framework for Islamic financing. Studied by E&Y.
- Wasil Foundation. Non-profit MFI in Lahore, Pakistan that is offering only Sharia compliant products like Musharaka and salama. Studied by CGAP.

<table>
<thead>
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<th>Asset owners</th>
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<th>Service providers</th>
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<td>• High net worth</td>
<td>• Investments advisors</td>
<td>• Corporations</td>
<td>• Networks</td>
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<td>• Individuals/families</td>
<td>• Fund managers</td>
<td>• Small and growing businesses</td>
<td>• Standards-setting bodies</td>
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<td>• Family offices</td>
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<td>• Employees</td>
<td>• Banks</td>
<td>• Microfinance institutions</td>
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<td>• Retail investors</td>
<td>• Corporations</td>
<td>• Community development finance institutions</td>
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Figure 8: A Division of the Conventional Impact Investing Space

Infrastructure Readiness

Regulation

Based on the evolution of the most successful Islamic markets, regulation plays a key role. Countries like Malaysia and Bahrain that have pro-active regulators to create a regulatory framework that encompasses Islamic financing in addition to conventional banking have accelerated growth and larger market share. Banking and finance are complicated, and therefore, highly regulated industries. Since Islamic financing is no less complicated than conventional financial services, it stands to reason that a clear and robust regulatory environment is needed for Islamic banking to flourish.

Sharia compliant investments are all certified by experts, generally through a panel or board made up of respected Sharia scholars, called Sharia Supervisory Boards (SBB). These scholars regulate through issuing “Fatwas” (religious rulings) on financial transactions. The SBB ensures full compliance of the investments and transactions with Islamic principles on an individual level but also through regular audits. 26

The Accounting and Audit Organization for Islamic Financial Institutions (AAOIFI), an independent non-profit organization, and sets the standards for the Islamic investment industry globally. In addition to building human capital and enhancing governance structures, AAOIFI also provides certifications, accounting and audit standards globally, including integration with IFRS and those that have been made mandatory by some regulators with Islamic financing jurisdiction. AAOIFI has 200 members in 40 countries, which includes financial institutions, support providers and central banks. To date, a total of 88 standards have been issued: (a) 48 on Sharia, (b) 26 accounting, (c) 5 auditing standards, (d) 7 governance, (e) 2 codes of ethics. 27

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Financial Intermediaries

Investment Platforms

There are hundreds of Islamic investment funds, and are too numerous to list here. However, there are a few worth noting separately for this report since they are impact-investing friendly or invest in assets in impact-friendly sectors.

- Abraaj: UNPRI signor and on the Board of UNGC. Although they are not overtly an Islamic investment fund, they are Islamic-friendly, and may very well be Sharia compliant. Twenty-five offices globally.
- Sedco: UNPRI signor and launched first Sharia+ ESG mutual fund. Based in Saudi Arabia.
- Azzad: not necessarily impact investing, but an award-winning leader in the field of impact investing, and impact-friendly. Based in the US (VA).

Banks

Arguably, the current amount of Islamic investing is only a drop in the bucket in investing for Islamic banks. Figure 9 illustrates the distribution of global Islamic banking assets, by volume as of 2012. It is estimated that in Indonesia, only $24B (4.9%) of assets are in Islamic banks and only $19B in England (among 6 Islamic banks).

Even so, Ernst & Young estimates that between 2013-1018, Islamic banking assets will grow with a CAGR of $1.6 Trillion on a base of $567B in six of the primary Islamic markets of Qatar, Indonesia, Saudi Arabia, Malaysia, UAE, and Turkey (QISMET). Furthermore, it is estimated that of the 38M Islamic banking clients worldwide, most of them only have a single deposit account.

MFIs

There is no clear reason that would explain why Islamic MFIs are not more prevalent. Some rationalize that there is no client demand. There is further speculation that MFI clients don’t believe that Sharia compliant MFIs are legitimately Islamic, Muslim BOP clients have access to zakat or Qard-e-Hasn through mosques, or that the pricing is too high or not competitive. None of these hypotheses have been systematically studied or confirmed. In general, there is a feeling in the impact investing and MFI community that there SHOULD be more Islamic MFIs but there remains no satisfactory explanation for their significant absence.

There are some small organizations and projects tackling this issue globally, but no one has reached any sort of scale or developed a replicable model. CGAP published a Focus note (#49, August 2008) on Islamic Microfinance and GIZ has supported at least 2 projects for Sharia microfinance (Malaysia and Algeria). A pending CGAP focus note will discuss product costing in 2 Islamic MFIs offering Musharaka and Salaam products in Algeria, and Pakistan, respectively. The Islamic Development Bank (IDB) has a specialized Microfinance Support Fund. Furthermore, Universidad Autonoma de Madrid recently published article on Islamic Microfinance.
CURRENT AREAS OF OVERLAP

On a global level, there are not significant areas of current overlap between Islamic investing and impact investing. However, on a micro level, there are several areas that are aligned, and many more near convergence; these areas require a bit of finesse to bring about consistent overlap, and these areas are highlighted in the next section of recommendations.

A chart from the latest Thomson Reuters report on Global Islamic Asset Management, clearly illustrates the current areas of overlap between responsible (impact) investing and Sharia-compliant funds (Figure 10). 33

This chart helps to illustrate the point that even if an investment is made using structures and principals that meet Sharia principles, that doesn’t mean it’s socially responsible or an impact investment. It simply means that the investment meets the criteria for Sharia compliance. Furthermore, not all Sharia compliant investing overlaps with responsible investing. For example, there is significant Islamic investing in extractive resources, just as there is significant conventional investment in this sector.

In the conventional investing space, many extractive resource firms (oil & gas, minerals, mining), are increasingly employing negative and ESG screens and adhere to basic SRI principals. It is unclear whether extractive resource firms in the Islamic investing space also adhere to similar screens and principles.

Access to Finance

One large topic in which there are significant areas of overlap are around access to finance for the pockets of the world’s population that is directly or indirectly kept out of the formal financial sectors. This extends to both conventional and Islamic financing. Furthermore, it can be applied to a variety of sub-sectors and approaches including MFIs, SME banking, marginalized populations, religious groups and BOP, to name a few.

Values Based Investing

In any type of values-based investing, the core concept around which investments are made are a shared set of values present in the investment philosophy and the companies into which funds are deployed. This core set of values overrides other criteria and becomes a defining parameter, with intent to adhere to those core values paramount.

By definition, both the larger worlds of Islamic financing and impact investing are values-based initiatives. However, within these two worlds, there are three types of value systems that potentially overlap and are highlighted below.

ESG

ESG requirements are intentionally neutral—geographically, culturally and religiously. The core values focus on basic human rights, environmental sustainability, social good and prudential corporate governance, none of which is faith, country or industry-specific. ESG does not screen out interest-charging financial institutions, which is one area crucial for Sharia-compliance.

SRI

In addition to ESG, conventional SRI screens out extractive resources, companies that use unfair labor practices, and companies that overtly pollute or harm the environment. SRI is a more active and intentional philosophy that goes beyond “do no harm.” Some companies use SRI to eliminate certain types of industries or business practices.

By extension, many of the Sharia screens to exclude certain industries like gambling, defense/weaponry or prostitutions are very similar to SRI. It does not seem far of a stretch to imagine a category of SRI that extends to exclude financial services companies that charge or pay interest. In this way, there could be a category of SRI—within the existing and larger SRI frameworks (like UNPRI)—that is an SRI Sharia certification.

Figure 10: Current Areas of Overlap between Responsible Investing & Sharia-compliant Funds.
Faith Based

As indicated in Figure 10, faith-based investing is a sub set of the larger impact investing space that encompasses making investments that support or encourage particular principals held by faith based organizations or individuals for whom faith-based principals are important in an investing strategy. This approach can be applied to any faith, but is most commonly applied to Christian, Jewish Islamic investors. In fact, all Islamic investing is faith-based.

One notable organization promoting faith-based investment is the Interfaith Center for Corporate Responsibility (ICCR) in the US (NYC). The ICCR lobbies for responsible investment in the following areas: corporate governance, environmental responsibility, financial practices and risk, food safety and sustainability, healthcare, human rights, water sustainability. Members include faith based institutions, asset managers, academic institutions, foundations, NGOs, unions and pension funds. 34 They currently represent Christian and Jewish faith-based institutions and are actively seeking Muslim partners and members.

Bonds & Sukuk

Both bonds and sukuk are ways to structure fixed revenue streams based on the performance of an underlying asset. In the case of a sukuk, the underlying asset is also structured in a Sharia compliant manner commonly using a Musharaka, Murabaha, I istisna or Ijarah. For both bonds and sukuk, the demand for these instruments is driven by demand for the underlying assets and demand for relatively low-risk investment options.

Like conventional bonds, Sukuk offer investors a fairly safe investment option. They allow fund managers to diversify investment portfolios for risk, duration and asset class and are an important contribution to a well-functioning capital markets system.

Although Sukuk have grown rapidly in popularity in recent years (15% of total Islamic Funds by volume in 2013 vs. 12% in 2010)35, equity funds still amount to 51% of the universe of Islamic Funds. Money market funds represent the largest asset class within equity Islamic financing.

Green Bonds

As discussed earlier in this report, a green bond is one that ties the bond issuance proceeds to environmentally friendly investments. Green sukuk could be used for many of the same purposes as a green bond and, on a structuring level, the structuring of a green sukuk wouldn’t be much different from that of a conventional sukuk. The sukuk’s structure would largely depend on the assets that are available to support the sukuk and the project to be financed.

Green sukuk are gaining traction as issuers look to cheaper sources of Islamic financing to fund infrastructure projects. In fact, in August 2014, the Securities Commission of Malaysia published guidelines for the issuance of sustainable and responsible investment sukuk. Furthermore, within the GCC, Dubai Supreme Council of Energy has announced a partnership with the World Bank to develop a green investment strategy, which will potentially incorporate sukuk. 36

Another example, Morocco’s Ouarzazate 1, the world’s largest concentrating solar plant—currently under construction—is being financed by green bonds along with other development bank sources.

Charitable Giving & Grants

Charitable donations exist in both conventional and Islamic investing; however, it is a more central and encouraged component of investing for Islamic investing. Charity is an important component of many faiths; however that does not make it categorically Sharia compliant or impact investing. Some market segments, situations or humanitarian goals are best-suited for charitable giving with no expectation of any sort of financial return. Historically, many MFIs or other technical areas of impact investing such as healthcare, water and education started out as the domain and focus of many charitable organizations.

As microfinance has evolved, and alternative solutions to development problems have become a priority, impact investing is becoming one of the preferred interventions—even over microfinance in many cases—because it combines financial returns with socially-oriented goals at some level.

Implicit in any sort of investing—Islamic or conventional—is the underlying expectation of some sort of financial return. Impact investing is focused on those investors and businesses on the spectrum—those that are neither purely profit maximizing nor those purely donating funds to charitable causes.

While grants are not themselves impact investments, they can play an important role in enabling impact investing—for instance, through incubating early-stage business models, providing certain forms of credit enhancement, providing technical assistance, or funding needed research and development. PRI and DAF are also useful tools for foundations to use to deploy special funds to support specific types of investments.

Reaching Millennials

Globally, Millennials are potentially set to inherit $ 30 Trillion in the next 15 years. Like no generation before, Millennials are aware of the environment and sustainability issues and are driving much of the awareness and demand for conventional impact funds. Many Muslim countries have significant Millennial populations, proportionally greater than in non-Muslim countries.

As Millennials inherit generational wealth and create their own, it is most likely that impact investing will continue to be attractive to them. Similarly, as Muslim Millennials come of age as investors, they represent a great opportunity to encourage an entire generation to invest and use both Islamic and Impact investments.
CURRENT AREAS OF OVERLAP

GROWTH STRATEGIES

Globally, there are a variety of actors playing in the areas of overlap, both private and public sectors. Given the IICPSD’s unique position, the growth strategies outlined here focus on those areas for which IICPSD is best positioned to have an impact, either as a leader or in supporting the efforts of others. The recommendations do not focus on initiatives that UN or IICPSD can or should join as an addendum or as another voice in the choir, but on those areas where IICPSD and UN’s involvement—specifically and tangibly—could really have a large impact different than what other organizations can contribute.

In summary, the main goals of the IICPSD’s include:

1. Support the development of inclusive and competitive markets and inclusive business models that engage poor people into value chains as producers, consumers, employees and entrepreneurs, with the end goal of poverty reduction, business growth and stability;
2. Foster private sector engagement and advocacy for the achievement of the Millennium Development Goals (MDG) (especially in focus sectors including health and nutrition, education, housing, water and sanitation as well as cross cutting themes such as youth, gender, and environment) and other internationally agreed development goals (IADG) such as climate change;
3. Become a center of excellence in terms of capacity development activities that harness Trilateral Development Cooperation and South-South partnership, promotes skills building, access of enterprises to sustainable finance, entrepreneurship and assistance to enabling actors;
4. Convene business and supporting actors to expand dialogue and create actionable partnerships between themselves, in support of a development agenda.

Given the IICPSD’s focus on engaging the private sector, businesses and development of marketplaces, the recommendations are focused on leveraging that focus and the strengths of the UN in these areas.

There are impact investors in both the conventional and Islamic spheres whose focus is on humanitarian and charitable interventions in terms of financial inclusion; these recommendations, however, do not focus on those approaches since that is not a focus for IICPSD, this report, or a core goal for standard investing. In reference to growing areas of current overlap between impact investing and Islamic investing, the recommendations here focus on those businesses and

Recommendations fall into 5 categories, as discussed in more detail in this section:

1. Enable
2. Advocate
3. Convene
4. Establish
5. Connect

investors with responsible investment philosophies, but not on those businesses or "investors" at either end of the spectrum who are pure profit maximizing or purely making charitable donations instead of investment.

Recommendations are based on considering current areas of convergence between impact investing and Islamic finance, the core strengths and goals of IICPSD, and considerations for the areas that are most likely to position IICPSD as a leader in the space in a way that differentiates it from other global, donor-funded institutions.

Enabling Environment: Supply and Demand

As previously identified, an effective capital markets system that supports distribution and is attractive to institutional investors is key to furthering Islamic impact investing. With respect to IICPSD Goal 1, this is perhaps the most significant contribution IICPSD can make. The conversations happening now about the lack of a capital market are similar to the ones faced a decade ago in conventional microfinance and impact investing. By engaging and enabling key actors in this area, IICPSD can work with regulators and market makers to create an inclusive capital markets system into which Islamic investing is part of the mandate, and not a peripheral actor.

Furthermore, by encouraging the development of effective intermediaries, this will free up institutional capital (through pension funds and HNW) which has already been identified as one of the critical factors to developing an effective capital markets system, and a current bottleneck in the Islamic investing space.

A robust system tackles both supply (companies, funds, indexes and other instruments in which to invest) and demand (individuals, institutions, organizations who want to invest) issues. Figure 12 highlights some of the fundamentals required for both efficient supply and demand sides, as well as intermediaries, focusing on the role of governments. Perhaps not coincidentally, IICPSD is well-positioned to provide support in multiple areas through influencing other actors, or in encouraging dialogue around the topics illustrated.
Supporting a shift such that asset managers become the gatekeepers of information regarding impact investing will fundamentally grow the conventional impact investing space, and have an exponential impact on Islamic impact investing. The current financial intermediaries who also control much of the information flow in conventional investing are asset managers.

Regulatory Environments

Well-thought out, systemic and comprehensive regulatory environments are necessary to facilitate growth in Islamic impact investing. There are innovations happening in the space, which should be studied, discussed and used as an example in dialogue to establish best practices and allow learning.

As mentioned in the report, Malaysia and Bahrain—arguably two of the most sophisticated and deep regulatory environments for Islamic investing—are also two markets leading the pack for sukukis, and even green sukukis. When the SCM published guidelines for green sukukis earlier in 2014, they were the first to pro-actively initiate guidance to pave the way for a more robust convergence of Islamic investing and impact investing.

Other examples are the case of Oman, who only began developing a framework for an Islamic financial market in 2012, and India just allowed the first case of a bank registering as a full Islamic bank with a view toward adapting the regulatory framework to allow for more.

Standards

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

Undertakings for Collective Investment in Transferable Securities (UCITS) have helped to achieve substantial scale in Europe. This same principle could be applied to Islamic impact investing opening the door for access to more investors and investments outside of local, Islamic markets. Conceptually, a CGG fund Passport, an ASEAN fund Passport could be incredibly effective in opening up both of these markets as leaders in Islamic impact investing and South-South markets. This could also open up Islamic markets to western investors who could be intimidated by unknown regulatory and compliance regimes.

Promoting dialogues, raising awareness of these possibilities and convening innovative leaders are all ways in which IICPSD can leverage the strengths of a UN-based organization to promote Islamic impact investing.

Capital Markets

Efficient capital markets determine price and volume of transactions, not structure; therefore, a truly efficient and effective global capital markets system will include both conventional and Islamic investing. As it manifests in capital markets functions, the underlying difference is structure, not mechanics. IICPSD can enable conversations around the fundamental similarities in conventional and Islamic markets, rather than promoting the differences.

In the Islamic financing space, banks serve as gatekeepers of information, and impediments to both large institutional investment as well as keep investable capital trapped in inefficient market mechanisms. This perpetuates a lop-sided, and risk averse intermediary for Islamic investing, in general.

Banks should serve as both investors in capital markets as well as financial intermediaries, which is currently a bottleneck in Islamic investing. A critical element lacking in both conventional and Islamic impact investing is the framework for asset managers to act as gatekeepers of information regarding whether an asset is ESG, SRI or Sharia compliant. Encouraging a shift in this direction will have a positive effect on impact investing, in general, but will have an amplified effect on Islamic impact investing. IICPSD is well-positioned to start these dialogues.

Enable

Create an enabling environment to promote Islamic Impact Investing as part of the larger dialogue on inclusive financial systems and responsible investing practices.

• Distribution channels for asset managers of all sizes
• Intra or inter-regional standards, policies and regulations for simplifying and
• creating access for all types of investments (UCITS, Passporting, tax equalization)
• Framework for attracting institutional investments

Capital Markets

• Inclusive financial services frameworks that allow for Islamic financing within the
• mainstream environment
• Cohesive intra-regional or inter-regional standards, policies or agreements

Regulatory Environments

• Inclusive and standardized screens in parallel with ESG & SRI
• Common nomenclature inclusive of Islamic investing
• Convergent standards for accounting (AARIFI, IFRS, SASB) and prudential banking
  practices (Basel III)
**Advocacy**

Although there are plenty of advocates globally for both Islamic financing and impact investing, there is yet a global advocate for the convergence of these two fields. The space lacks a single organization that is conversant in both field, and is focused on building more common ground through raising awareness and promoting a common agenda in both fields. IICPSD could be that advocate.

**Financial Inclusion**

There is already significant conversation around access to finance and financial inclusion in both the investment and development communities. Unfortunately, Islamic investing is often left out of those conversations, or considered a peripheral part of the conversation. In part, this has to do with lack of awareness and knowledge about what Islamic investing is, and its contributions to impact investing. Unfortunately, this also has to do with a negative perception of Islamic investing in the non-Muslim world.

Anecdotaly, the Consultant heard from more than one person who is knowledgeable and well-respected in the field that at a conference last year, a statistic was shown that illustrated that 60% of Islamic asset managers believe that Islamic investing isn’t becoming more mainstream because of the global misperception and negative connotations associated with Islamic financing principals; however, those surveyed also agreed that there shouldn’t be rebranding efforts.

**Awareness**

Raising awareness of the current level of convergence of Islamic investing and impact investing is important in promoting dialogue. As the conventional impact investing space evolves, and common standards and definitions develop, it’s important those standards and definitions include Sharia-compliant investing structures.

More than likely, those in the conventional investing space are not aware how their work towards common standards and definitions excludes Islamic investing. Now is the time to ensure that financial inclusion frameworks are inclusive for both conventional and Islamic investing frameworks.

For example, as discussed earlier in this report, although the core GIIN definition of impact investing could include Islamic impact investing, the four qualifying principles become problematic. One of those principles is a “range of return expectations and asset classes,” which would most likely not meet Sharia-compliant screens since it implies a guaranteed rate of return, potentially some sort of speculative investment structure, and no risk sharing. By raising awareness now, the natural tendency to create more specific definitions and standards can be created that also allow for the inclusion of Islamic investments and investors.

**Integration**

As mentioned in both sections above, many of the current and evolving global standards for impact investing like ESG, UNPRI, and SRI are nearly convergent with Sharia principles. This extends to much of the work being done by to create standards for monitoring and evaluation (IRIS and GIIRS) and accounting and audit (AAOIFI, IFRS, SASB).

By keeping Islamic investing at the forefront of the conversations around financial inclusion, as these systems, standards and metrics evolve, they will automatically be inclusive for Islamic investments, or at least have sub-categories that are Sharia-compliant. This will encourage an inclusive impact investing universe in which Islamic investing is part of the conversation, and not considered an alternative, but an addition to the universe.
Convene Key Players

There are a variety of key players in both the impact investing and the Islamic finance spaces. By convening some of these leaders and innovators together to either brainstorm with each other, provide panel presentations to others in the field, or to work towards research and solutions on specific topics, IICPSD will be positioned at the vortex of the convergence between Islamic finance and impact investing.

Islamic financing, in general, is evolving much the same way conventional investing has over the last 50 years. Furthermore, there have been many mistakes made in the evolution of the current impact investing space. By convening forums where leaders in Islamic impact investing can learn of best practices, innovations and mistakes made by those who came before them, the progress and path for growth for Islamic impact investing could be accelerated and strengthened at the fundamental level.

Finally, there are a variety of organizations, actors and innovations happening in both Islamic finance and impact investing concurrently. The most effective way to promote growth, evolution and development goals is to ensure that those who are forefront have a platform for which to encourage dialogue.

Convene & Collaborate

By definition, capital markets migrate towards efficiencies. By convening leaders in establishing and supporting efficient markets, IICPSD will support the spread and discussion of best practices. Convening could take the form of conferences, meetings, forums, symposiums, roundtables or capacity building exercises.

Private Sector

Private sector actors bring market and profit-oriented approaches to developing a robust framework for Islamic impact investing. Although there exist multiple private sector players in both Islamic finance and impact investing, IICPSD can focus on convening those actors already involved in the convergent space or most suited to contributing valuable insight towards growing the overlap. This could include investors, asset managers, leaders in key sectors for impact investing and support organizations like accounting firms, lawyers, rating agencies or consulting firms.

Support Organizations

There are many support organizations that have a unique perspective in either Islamic financing or impact investing. By convening this group of actors focused on building large and sustainable systems, IICPSD would support cross-pollination of ideas geared towards building frameworks and environments that support Islamic impact investing.

Public Sector

Public sector actors are most keen to ensure that the efficiencies of capital markets don't overtake social goals of equality and fairness by intervening to redistribute resources. It is the public sector that is responsible for creating the regulatory frameworks, guide development goals and that make the largest and most long-term investments in society and infrastructure.

In particular, convening public sector actors is critical to ensure that the appropriate framework and infrastructure is established to create efficient and effective capital markets and regulatory environments to ensure Islamic investing is part of the financial inclusion dialogue. Furthermore, this helps to position Islamic impact investing within the larger impact investing framework, and not peripheral or supplementary.
Establish a Center of Excellence

Undoubtedly, the UN is a hub for promoting excellence globally with respect to creating dialogues that promote peace, unification and development. In the same spirit, a Center of Excellence for Islamic impact investing within the IICPSD would be incredibly beneficial. Borrowing on the model used by UNPRI and UNGC, IICPSD could be very well suited to become the leading organization at the center of the convergence.

Unify

Simply by encouraging cohesion among seemingly disparate efforts between various groups would be a huge value addition in the space for which IICPSD is well-suited to coordinate. There are natural areas of overlap between Islamic investing and impact investing. As indicated previously in this report, the ESG, PRI and SRI principals are nearly convergent with Islamic investing principals, or so close that a category or these standards with a Sharia-approved carve out are within reach.

Publish

There certainly exists an abundance of material on Islamic finance and impact investing. However, there is no organization focusing on doing research, publishing or becoming a repository for examples of projects for the convergence of these two spaces. In order to encourage growth in the convergence, and as part of an awareness strategy, IICPSD is incredibly well-positioned to support such an effort.

Train

As best practices and global standards become pervasive, it will be critical that these practices are proliferated to build human capacity. In order to reach scale and promote a common lexicon, IICPSD could support training initiatives directly or indirectly, especially for women, under-represented populations and in countries with limited access.

Connect Innovators and Leaders

Connect

• Contact innovators and interested parties in the Islamic Impact Investing space to raise awareness and encourage cooperation; participate in industry events and partnerships to set an example on aligned interests

Internal to UN

• UNPRI
• UNDP/IICPSD
• UNGC

External Actors

• Private Sector
• Public Sector
• Support Services

Partnerships

• Private Public Partnerships
• Regional partnerships

Industry Events

• Conferences
• Meetings (UN, G8, GCC)
• Sponsorship of events
Internal to UN

There are several groups and organizations within the UN family promoting impact investing using the UN platform. Two of the most critical for IICPSD to leverage is the UN Principals for Responsible Investing (UNPRI) and UN Global Compact (UNGC). In fact, UNPRI is a cross-UN initiative supported by UNGC and UNEPFI.

Additionally, there are UN-sponsored conferences and meetings for which it would be ideal for IICPSD to leverage to raise awareness regarding Islamic impact investing including: Inclusive Finance Annual meeting (part of UN GC UNIFI), Sustainable Stock Exchange Initiative (UNPRI), International Integrated Reporting Council (UNGC), UNCTAD Conference on Trade and Development held every two years where policy makers and officials convene to discuss trade flows, UN supported Basel III forums, and the UN Annual meeting held every fall in New York City.

UNPRI

The UNPRI is a decade old initiative that has created a core of six principles for responsible investment, with supporting research, case studies and industry support. Signors to the UNPRI are voluntary and aspirational and include investors, asset owners and support organizations.

Currently, there are 1329 signors, of which 285 (21%) are asset owners, 861 (65%) are investment managers and 183 (14%) are professional service partners. Only one signor, Sedco Asset Management firm, is an Islamic investor. Interestingly, in the 2013 Sedco annual report, it was stated that between ESG and UNPRI screens, 90% of the investments also met Sharia screens (anecdotally, that is approximately 4-5 investments). If indeed the complete convergence is so near, finding a way to support UNPRI—or a special designation thereof—for Islamic investing could go a long way towards raising awareness and creating a global standard for Islamic impact investing.

UNGC

UNGC is a compact of ten basic policy principles for businesses committed to an alignment of operations and strategy in four areas: human rights, labor, environment and anti-corruption. UNGC sponsors a Leaders’ Summit as well as local network conferences to support innovation in the area, facilitate networking, cross-pollinate best practices and create a platform for the dissemination of publications and research supported by the UNGC.

With over 12,000 participants from 145 countries including a multitude of labor organizations, businesses and business networks, NGOs, academic institutions, public sector organizations and cities are members, UNGC has broad reaching effects on issues core to the compact. UNGC hosts a variety of events (nearly one a month) all over the world to convene local, regional or world actors in this space. These meetings and this platform are an ideal forum for IICPSD to raise awareness and promote financial inclusion for Islamic impact investing.

External Actors & Partnership Opportunities

A variety of partnership opportunities exist both for IICPSD to participate in, and that could be facilitated or supported by IICPSD. These include projects that research best practices, case studies or reporting frameworks. These partnerships could be between private sector organizations, public sector organizations or private-public partnerships or collaborations for specific projects.

Industry Events

There are a myriad of conferences, roundtables and events sponsored in both the fields of Islamic finance and impact investing that IICPSD could attend, sponsor or speak on panels. This will help to raise awareness of the convergent fields, educate a wider audience and raise the profile of IICPSD.
These reports, publications and websites represent concentrated sources of information. The Consultant recommends these publications be reviewed by IICPSD first, and before the Bosphorus Conference in order to have sufficient background and context.

- **Global Islamic Asset Management Report 2014.** Published by Thompson Reuters in conjunction and Lipper EMEA Research, 2013.
- **World Islamic Banking Competitiveness Report 2013-2014.** Ernst & Young 2012
- **“From the Margins to the Mainstream: Assessment of the Impact Investment Sector and Opportunities to Engage Investors.” World Economic Forum and Deloitte Touche Tohmatsu. September 2013.**

www.zawya.com (Thompson Reuters Islamic Finance portal)

www.sc.com.my (Malaysian Securities Commission)