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PRE-FEASIBILITY STUDY FOR GREEN SUKUK ISSUANCE IN THE REPUBLIC OF UZBEKISTAN

UZBEKISTAN 2021

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AAOIFI Accounting and Auditing Organization for Islamic Financial Institutions
ABS Asset-Backed Security
ADB Asian Development Bank
ASEAN Association of Southeast Asian Nations
AuM Assets under Management
CAGR Compound Annual Growth Rate
CBU Central Bank of Uzbekistan
CIBAFI General Council for Islamic Banks and Financial Institutions
CMDA Capital Market Development Agency
CMI Capital Market Infrastructure
CSD Central Securities Depository
DMO Debt Management Office
DVP Delivery versus Payment
EBRD European Bank for Reconstruction and Development
ESG Environmental, Social and Corporate Governance
FAO Food and Agriculture Organization
FDI Foreign Direct Investment
GBP United Kingdom Pound
GCC Gulf Cooperation Council
GCF Green Climate Fund
GDP Gross Domestic Product
GEF Global Environment Facility
GHG Greenhouse Gases
GIIRS Global Impact Investing Rating System
GTFS Green Technology Financing Scheme
ICD Islamic Corporation for the Development of the Private Sector
ICMA International Capital Market Association
ICT Information and Communication Technology
IDA International Development Association
IFI International Financial Institution
IFRS International Financial Reporting Standards
IICPSD Istanbul International Center for Private Sector in Development
IFSB Islamic Financial Services Board
IIFM International Islamic Financial Market
IILM International Islamic Liquidity Management Corporation
IIRA Islamic International Rating Agency
IMF International Monetary Fund
INDC Intended Nationally Determined Contributions
IOSCO International Organization of Securities Commissions
IPO Initial Public Offering
IRIS Integrated Risk Information System
IsDB Islamic Development Bank
ITFC International Islamic Trade Finance Corporation
KPI Key Performance Indicator
KRX Korean Exchange
KYC Know Your Client
LLC Limited Liability Company
MAF Majid Al Futtaim
MAS Monetary Authority of Singapore
MDB Multilateral Development Bank
MSME Micro, Small and Medium-sized Enterprise
MYR Malaysia Ringgit
NBU National Bank for Foreign Economic Activity of Uzbekistan
NDC Nationally Determined Contributions
OTC Over the Counter
PPA Power Purchase Agreement
PPP Public Private Partnership
SDGs Sustainable Development Goals
SGD Singapore Dollar
SME Small and Medium-sized Enterprise
SOB State Owned Bank
SOE State Owned Enterprise
SPO Secondary Public Offering
SPV Special Purpose Vehicle
SRI Socially Responsible Investment
SROI Social Return on Investment
SSEI Sustainable Stock Exchanges Initiative
SWF Sovereign Wealth Fund
UCSD Uzbekistan Central Securities Depository
ULI Uzbek Leasing International
UN United Nations
UNEP United Nations Environment Programme
UNDP United Nations Development Programme
US$ United States Dollar
USTC Unified Systems Technology Complex
UZEX Uzbekistan Commodity Exchange
UZRCE Uzbek Republican Currency Exchange
UZRSE Uzbekistan Republican Stock Exchange
UZS Uzbekistan Som

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EXECUTIVE SUMMARY

The achievement of the targets set by the 2030 Agenda for Sustainable Development, embodied in the 17 Sustainable Development Goals (SDGs), requires significant financial resources. The current gap in financing for the SDGs in developing countries amounts to US$ 2.5 trillion annually[1], which is far beyond the funding capacities of individual countries. In all, between 1.5 percent and 2.5 percent of the global gross domestic product (GDP) needs to be invested if the SDGs are to be achieved. If this gap is not addressed by mobilizing more public and private funding, developing countries around the world could miss out on the SDGs. Thus the realization of the SDGs calls for new alternatives to traditional development financing. Indeed, the shortage of funds for sustainable development has led to the introduction of new, greener and more sustainable financial instruments and products. One financial mechanism for funding the SDGs which has started to attract attention in many countries is the green sukuk. Over the past few years, the green sukuk has come to be perceived as one of the most promising instruments available, bringing Islamic finance and impact investing together as a bridge to achieve the SDGs.

By definition, green sukuk represent Sharia-compliant securities backed by a specific asset pool, aimed at financing green infrastructure, and are used for financing renewable energy production, waste management, sustainable agriculture, the construction of energy-efficient buildings, natural resource management etc[2]. Since it was first introduced to capital markets, the green sukuk has played an increasingly important role in financing private and public green initiatives, and more and more countries are now introducing it to their capital markets as a vehicle for financing their current and future sustainable development efforts.

In recent years, Uzbekistan has shown significant commitment to promoting the growth of a green and sustainable economy. Through comprehensive national strategies and initiatives, it has formulated definitive visions and targets for the future. The failure to mitigate climate change could have severely detrimental effects on both the economy and the environment in Uzbekistan. The country aims to make the transition to a green domestic economy by 2030 while simultaneously contributing to the realization of the SDGs globally by defining its Nationally Determined Contribution. Although its initiatives and strategies have coordination between the various sectors of the Uzbek economy at their core, some sectors are especially important for the transition to a green economy. The two most critical sectors are energy and agriculture, as these are the sectors with the greatest environmental impact, and hence the largest potential for implementing projects related to the transition. The housing and water sectors are also identified in this report as areas with considerable potential for promoting a green economy, as a number of green projects have been launched and implemented in the areas of construction and water management.

Alongside the government's political commitment to green development, the issuance of green sukuk could enable the Uzbek government and Uzbek corporations to leverage the opportunities provided by the international green finance ecosystem. One factor that favours the development of green sukuk in Uzbekistan is the increasing presence of international financial institutions. Uzbekistan is one of the leading countries in Central Asia in terms of

[1] Islamic Financial Services Board. 2020. Islamic Financial Services Industry Stability Report. Kuala Lumpur, Malaysia, July.

[2] Climate Bonds 2020 (https://www.climatebonds.net/projects/facilitation/green-sukuk)

the amount of financing allocated by the international financial institutions (IFIs) in the area of climate finance. Furthermore, the use of green sukuk would represent a strong signal of Uzbekistan's determination to increase its presence both in the green market and in the US$ 2.5 trillion global Islamic finance industry.

Since Uzbekistan is seeking to attract international investors and diversify its capital markets, but is not currently involved in the green bond market or other markets for Islamic finance, a pilot green sukuk issue would represent a key step towards engaging with a new set of investors and mobilizing foreign and local capital. 27% of people in Uzbekistan do not have an account with a bank or any other formal financial institution for reasons related to religion. This indicates that there is potential demand for Islamic financial products and services. The development of Islamic finance in Uzbekistan could provide this currently unserved segment of society with access to financial services, thus enhancing financial inclusion, while at the same time helping to raise local capital for a green economy. The global green sukuk market is a rapidly growing one with a rising volume of issues, and as such has the capacity of attracting conventional investors interested in ESG investments.

Despite the growing demand and positive momentum in favour of Islamic finance and green development, there are several challenges that need to be addressed for the development of a green sukuk ecosystem in Uzbekistan. Firstly, the growth of Islamic finance in the country is still in its early stages. The existing Islamic finance practices rely on the conventional legislation, and Islamic finance instruments are still to be recognized at the levels of policy and legislation. In view of Uzbekistan's very brief experience in Islamic finance, a substantial effort will be needed to issue a sukuk, which would come as a novelty to investors and might well be considered more complex than a traditional bond. Secondly, the capital markets in the country are underdeveloped and immature. Although the government of Uzbekistan has recently taken important steps towards increasing the role of capital markets, strategies still need to be implemented to raise the number of issuers and increase the demand from investors. The financial markets are largely dominated by the banking sector, and the banks' engagement in capital markets is restricted by the legal and regulatory environments. This leads to the third obstacle to the issuance of a sukuk: the lack of a regulatory framework. As an emerging sector of the economy, Islamic finance requires the necessary enabling environment. Certain elements of the existing legal framework may be instrumental in the growth of Islamic finance, but specific Islamic contracts such as sukuk call for legal and regulative changes. Even though the financial effect of a sukuk is similar to that of a conventional bond, they differ with respect to the transfer of ownership and adherence to Islamic Law. These differences call for the adoption of a more comprehensive legal framework reflective of the distinctive features of sukuk. Moreover, the Uzbek tax system does not currently provide for Islamic finance products. The fourth factor that might undermine the introduction of green sukuk is the general lack of knowledge and awareness both of Islamic finance and of green investments. Finally, one must acknowledge the risks associated with the instrument and the ecosystem. As green projects are capital intensive and require long investment horizons, they are riskier and more expensive for investors. Green sukuk themselves are exposed to risks related to inflation and interest rate fluctuations as well as to liquidity, credit, industry and market performance risks.

These challenges are complex and creating an environment more conducive to green sukuk will have to be a gradual process. This report recommends the adoption of the following steps towards the introduction and use of green sukuk in Uzbekistan:

- **Establishing a legal and regulatory framework for green sukuk:** Given the long-term horizons of green projects, it is important to provide clarity on legal, tax, and regulatory issues. Establishing the necessary legal and regulative frameworks for sovereign and corporate issuance, in both local and hard currency, is crucial for the introduction of green sukuk in Uzbekistan. In addition, the development of standardized green criteria, reporting, impact assessment and monitoring tools could enhance the credibility of green sukuk and thereby widen the ethical investor base. The tax regulations of Uzbekistan also need to be amended to promote green sukuk and ensure equal treatment for sukuk and conventional bonds.

- **Building a pipeline of green energy projects:** One of the main issues facing green financing is to identify projects that are not only sustainable and green but also measurable and adequate in size and scope. Project pipelines are central to the efforts of countries to achieve their climate and development goals, and building a pipeline of bankable projects can help crowd in private investment. The Uzbek government has been making efforts to attract private investors and promote public-private partnerships (PPPs). However, more still needs to be done to create a clear environment for investments and ensure the availability of a strong pipeline of bankable projects that both generate positive financial returns and benefit the environment.
- **Encouraging financial innovation:** Since the sukuk is a relatively novel instrument for the capital markets, there is considerable room for innovation in the sukuk market. Large scale green projects call for substantial initial investments during the development phase, requiring the development of alternative instruments and funding sources.
- **Providing economic incentives:** Issuing green sukuk entails additional costs associated with green certification and the external assessment of the use of the proceeds. In order to enhance cost-effectiveness for investors and issuers, the government may therefore consider offering subsidies, tax exemptions and preferential tariffs. In addition, green projects often require the use of green technologies. The development of these technologies could be incentivized through a tax allowance for investments in the purchase of green technological assets and an income tax exemption for the use of green technology.
- **Raising awareness:** The introduction of green sukuk in Uzbekistan will require a better understanding of green investing among all stakeholders and an increase in their competencies in this area. It will be very important to improve the financial literacy of the public with a particular emphasis on climate related issues and sustainable financing. At the organizational level, information programmes will need to be developed to increase the awareness of capital markets among potential issuers and investors with a view to increasing the demand for sustainable financial services.

The action plan proposed here for the implementation of green sukuk in Uzbekistan contains five distinct yet highly integrated steps. The first step is to establish a task force representative of the various stakeholders involved in green sukuk implementation. The second step will be to identify and select projects with positive impacts to be the focus of green sukuk investing. Creating capacity building platforms will constitute the third step, while the fourth step will be to identify the practical policy and legislative measures needed, and the instruments with the highest potential for scaling up green sukuk practices. The final step will be to structure and issue a green sukuk in Uzbekistan.

INTRODUCTION

Over the course of the past several years, climate change mitigation has become a central focus of international development efforts, reflecting the detrimental social and economic impacts that climate change has had around the world. While it is not a major contributor to global emission levels, Uzbekistan is highly vulnerable to the negative impacts of climate change. As of 2014, total greenhouse gas (GHG) emissions in Uzbekistan amounted to 214 million metric tons of carbon dioxide equivalent, representing 0.44 percent of total GHG emissions worldwide. The energy sector is the dominant source of GHG, releasing almost 90 percent of the total national GHG emissions. The energy sector is followed by agriculture, with 13 percent of emissions, industry with 2.7 percent, and waste management with 2.4 percent[3].

According to the World Health Organization, if climate change is not addressed in a timely and appropriate manner, Uzbekistan is likely to experience severe rises in average temperatures followed by a decline in the availability of water in most regions of the country. Without proper mitigation and adaptation measures in place, Uzbekistan faces the risk of a higher burden of waterborne diseases together with other health issues resulting from desertification[4]. One region that has been profoundly affected by negative climate change externalities is the Aral Sea region, which has suffered a major loss of biodiversity. The rising frequency and severity of natural disasters in Uzbekistan only adds to the urgency of responding to climate change adequately. The numbers of avalanches and landslides are expected to rise significantly and continuously between now and 2050[5].

The alarming trends in environmental conditions and ecosystems and the urgency with which they need to be addressed have contributed to the adoption of global initiatives such as the United Nations (UN) Sustainable Development Goals (SDGs) and the Paris Climate Change Agreement with the goals of improving social wellbeing on earth and strengthening the multilateral response to the threat of climate change. These frameworks are structured as overarching agendas against which signatory nations can set measurable targets for higher levels of social welfare, economic development and ecological stability. Specifically, the Paris Agreement on climate change asks member states to determine and declare their respective Intended Nationally Determined Contributions (INDCs). In its INDC, Uzbekistan has set a carbon intensity target, pledging to reduce GHG emissions per unit of GDP by 10 percent between 2010 and 2030[6]. If this target is achieved, it will foster greater economic growth as well as reducing environmental degradation and making economic development more sustainable. To this end, Uzbekistan will need to mobilize various groups of stakeholders to set out measures and targets in a variety of areas, such as political commitment, energy efficiency, scientific research and development, and training and education, and to monitor

[3] World Bank Group (2019). Greenhouse Gas Emissions Factsheet: Uzbekistan (https://olc.worldbank.org/content/greenhouse-gas-emissions-factsheet-uzbekistan)

[4] World Health Organization (n.d.) Climate change adaptation to protect human health: Uzbekistan (https://www.who.int/globalchange/projects/adaptation/en/index7.html)

[5] UNDP Climate Change Adaptation (n.d.) Uzbekistan (https://www.adaptation-undp.org/explore/central-asia/uzbekistan)

[6] World Bank Group (2019). Greenhouse Gas Emissions Factsheet: Uzbekistan (https://olc.worldbank.org/content/greenhouse-gas-emissions-factsheet-uzbekistan)

and report on the efforts made to achieve the targets[7]. Globally, comprehensive national strategies are considered vital for mitigating climate change. In this context, multiple initiatives are already under way in Uzbekistan. These are discussed in more detail later in this report. Although they differ in their specific goals, they all share a common baseline objective – enabling and supporting the transition towards a green economy and more sustainable economic development in Uzbekistan.

These objectives require substantial financial resources and investment. The existing financing gap, and the inability of the conventional finance mechanisms to mobilize enough funds for the achievement of the SDGs and the NDCs, has led to a rise in alternative financing mechanisms and instruments. In this respect, Uzbekistan is no exception to the global trend. Islamic finance has emerged as a particularly promising alternative financing avenue for sustainable development, given its foundational premises of protecting the wellbeing of people and nature, grounded in Islamic Law. As such, Islamic finance shares ideological ground with ethical or green finance, which in itself has become a central development finance counterpart.

One specific instrument, the green sukuk, merges the premises of Islamic and green finance, and has therefore been recognized as an especially viable financial instrument for supporting sustainable development agendas globally. In a nutshell, the green sukuk is a financial instrument that complies with Sharia law and has the purpose of financing environmental projects while simultaneously providing a financial return to the investor. In the light of the aforementioned environmental degradation and the existing gap in sustainable development financing, as well as the fact that the majority of the population of Uzbekistan are Muslim, the green sukuk emerges as a promising potential tool for Uzbekistan's efforts to address climate change and make the transition to a green economy.

Acknowledging this potential, the present report aims to perform a pre-feasibility analysis for the introduction of green sukuk in Uzbekistan. The report seeks to identify the opportunities and challenges and to recommend a course of action for the issuance of green sukuk. In order to develop this report, the United Nations Development Programme (UNDP) conducted interviews with key government bodies and agencies and other relevant institutions (Appendix 2). The report is structured in the following manner. Chapter One reviews the current state of the financial sector and capital markets in the country. Chapter Two presents an overview of the principles and instruments of Islamic finance, along with statistics, describes the sukuk instrument, and explains how Islamic finance may contribute to sustainable development. Chapter Three elaborates on the green sukuk as an important instrument for addressing sustainability challenges, and discusses green sukuk frameworks and structures. Chapter Four summarizes the government's visions and targets in the area of green development, identifies potential green sectors, and makes a country-level assessment of opportunities and challenges for introducing green sukuk in Uzbekistan. Finally, Chapter Five formulates recommended strategies for green sukuk issuance, and proposes a series of steps to be taken towards launching the instrument in the country.

[7] World Bank Group (2019). Greenhouse Gas Emissions Factsheet: Uzbekistan (https://olc.worldbank.org/content/greenhouse-gas-emissions-factsheet-uzbekistan)

CHAPTER 1: OVERVIEW OF THE ECONOMY AND FINANCE SECTOR IN UZBEKISTAN

This chapter provides a summary of the "Capital Market Development Strategy and Roadmap" report, dated 16 December 2019, which was prepared by ISC for the Asian Development Bank (the ADB/ISC report). The report in question also references the "Uzbekistan: Equity Market Development Strategy and Roadmap for Uzbekistan" report, dated 28 November 2019, which was prepared by BTA Consulting Limited for the European Bank for Reconstruction and Development (EBRD).

1.1 OVERVIEW

Uzbekistan is a lower middle-income country located in Central Asia and bordered by Kazakhstan, Kyrgyzstan, Tajikistan, Afghanistan and Turkmenistan. Since the breakup of the Soviet Union and its independence in 1991, its population has grown from 21 million to 33 million (2018). Since the mid-2000s Uzbekistan has enjoyed robust GDP growth, averaging at 8% annually. During 2017 and 2018 the ecomony grew at the rate around 5 % and in 2019 at the rate of 5.6%. The GDP reached US$ 57.9 billion in 2019[8]and GDP per capita was US$ 2,459 (US$ 6,999 at purchasing power parity) as of the end of 2019.

The Uzbek economy is characterized by high levels of informality. As much as 60 percent of the working population was employed informally in 2018, and only 37 percent of the adult population had bank or mobile-money accounts (as of 2017), leading to large amounts of fiduciary money in circulation. This high level of informality represents a significant barrier to the development of capital markets, which by nature need to be highly regulated.

The high level of inflation (consumer price inflation is between 15 percent and 20 percent) has led to a high degree of dollarization, since it has incentivized economic agents to hold foreign currency (mostly US$), rather than local currency-based financial instruments, as a protection against inflation and the devaluation of the local currency. High inflation also makes capital markets too expensive for issuers, whereas state-owned banks provide loans at subsidized rates. A large part of the economy is still in the hands of State-Owned Enterprises (SOEs).

The financial sector is dominated by the largely state controlled banking sector. The banks provide basic banking services and are subsidized through policy lending but are disconnected from the capital markets. The insurance sector is in a fledgling state, providing protection policies rather than long-term investment policies. It therefore prefers bank deposits, real estate and bank shares and has little need for long-term investments in other financial instruments.

The most active segment of the Uzbek financial markets is the foreign exchange market. Commercial banks trade wholesale with the Central Bank of Uzbekistan (CBU) on the Uzbekistan Republican Currency Exchange (UZRCE) and retail investors are active and trade in foreign exchange through the intermediation of the commercial banks (In 2018, the volume of foreign currencies purchased by commercial banks from individuals corresponded to 26 percent of the foreign exchange traded on the UZRCE, and the volume of foreign cur-

[8] World Bank data

rencies sold to individuals by commercial banks to 10 percent). Other factors contributing to rather active foreign exchange markets are the large volumes of US dollars bought and sold in informal trade, foreign remittances received from abroad, and personal savings in US dollars. The securities markets, on the other hand, are still under-developed, with only two issuers in foreign capital market - Ministry of Finance and Sanoat Qurilish Bank, both debuting in 2019 with Eurobonds. In December 2018, the government resumed to issue treasury bills and bonds in local currency. The outstanding value of treasury bills and bonds purchased by commercial banks at auctions on the UZRCE stood at US$ 241 million as of July 2019. The corporate bond market is very small; there were only nine outstanding issues with a nominal value of US$ 40 million as of July 2019. The equity market is extremely shallow. As of December 2018, 186 companies were listed on the Uzbekistan Republican Stock Exchange (UZRSE), with an overall free float of only 9.56 percent. The volume of equity trading on the UZRSE is very low: most of the stocks do not trade daily, and only 12 stocks trade regularly. Of the 40 licensed brokers, only 10 were trading regularly in 2018.

1.1.1 DEMAND

The demand for financial instruments is weak, the only exception being the foreign exchange market. There are few investors in the fixed income market – mostly state-owned, commercial banks purchasing government securities through auctions held on the UZRCE and/or corporate bonds through private placements. As for the equity market, the Uzbekistan Central Securities Depository (UCSD) reports nearly 800,000 depository accounts. About half of these belong to shareholders in listed companies and only a small proportion belong to active investors. In 2018, there was only one Initial Public Offering (IPO), which was undersubscribed, and one Secondary Public Offering (SPO).

The institutional investor base comprises eight active investment funds. The total volume of their Assets Under Management (AuM) was US$ 124,335 as of the end of 2018, and the AuM of the largest investment fund accounted for over 99 percent of the total AuM. The investment funds are required to be joint stock companies. The current regulatory framework prohibits other, more flexible kinds of funds such as contractual or trust funds. There are no pension funds or private equity funds or firms active in the capital markets. The insurance sector is rather small and equally inactive in the capital markets. Foreign institutional investors are present only through Uzbek eurobonds, which have been listed in international markets since 2019.

1.1.2 SUPPLY

The supply of securities on the Uzbek market comes from the state. This will continue to be the case in the near future. In the current environment, the private sector does not have any economic incentive to issue either debt or equity securities, since they would be more costly than subsidized policy loans from state-owned banks (SOBs).

In line with its commitment to a more liberal and market-based economic model, the government has ambitious privatization plans. Privatization via public offerings in the local market constitutes the main potential source of supply for the equity capital market .

While the government resumed issuing local currency debt securities in local markets in 2018, the amounts issued are not clearly determined by borrowing needs. Uzbekistan is a country with a moderate debt burden and its current fiscal plans indicate that deficit financing is to be eliminated. As government policy does not envisage deficit financing, it will not contribute to the supply of local currency debt instruments.

1.1.3 LEGAL, REGULATORY AND TAX FRAMEWORK

The current legal framework for the capital market in Uzbekistan consists of a cumbersome patchwork of fragmented laws and presidential and ministerial decrees. It is complex and far from providing investors with comfort and assurance. There is currently no legal "certainty" regarding settlement transactions. The regulatory powers of the Capital Market Development Agency (CMDA) are limited in coverage, hampered by significant omissions, which constrain its ability to supervise all aspects of the conduct of market infrastructures and participants. The current legal framework does not allow for private equity and does not impose internationally accepted standards of corporate governance. Regulations provide a limited choice of legal structures for the formation, regulation and supervision of investment funds. The current legal architecture of the capital market does not meet the international standards set out in the International Organization of Securities Commissions (IOSCO) Objectives and Principles of Securities Regulation. This is an additional obstacle to confidence and the development of the market.

The tax regime is not conducive to capital markets, as it is complex, sometimes unclear and inconsistent. Low risk investments may be exempt from tax whereas riskier investments may be subject to double taxation. Earnings from corporate bonds are not subject to the tax exemptions that apply to earnings from government bonds or bank deposits. Capital gains from equity securities are exempt from tax, while dividends are subject to different rates of withholding tax and personal income tax depending on residency status.

1.1.4 INFRASTRUCTURE AND CAPACITY

In terms of capital market infrastructure (CMI), similar functions are handled by different institutions for different types of capital market instruments. There are four institutions in the securities market, three of which serve the corporate securities market, and one the government securities and wholesale foreign exchange transactions markets. The current structure does not benefit from economies of scale and is far from meeting international standards in the areas of potential conflicts of interest and proficiency in the provision of the services in question.

For corporate securities, the UZRSE organizes trading for listed securities whereas the Elsis Savdo system handles Over the Counter (OTC) trading for unlisted securities. The UCSD is the depository and cash settlement is handled by the National Bank for Foreign Economic Activity of Uzbekistan (NBU). DVP (delivery vs payment) settlement is not available for corporate securities, and there are major deficiencies in the handling of corporate actions. There is no infrastructure for trading in derivatives.

The trading and clearing of government securities and foreign exchange, as well as central security depository functions for government securities, are handled by the UZRCE. The commodities market is operated by the Uzbekistan Commodity Exchange (UZEX), which currently only handles spot transactions, although there are plans to start trading futures in 2020. There are no separate clearing houses.

The Uzbek capital market operates in a dematerialized environment where trading, clearing and the settlement of custody of securities all take place digitally. All the Information Communication Technology (ICT) solutions for the CMI in question, as well as for the CMDA and the brokers, are housed in the Unified Systems Technology Complex (USTC), which is a state enterprise. The main platform utilized is the Korean Exchange KRX platform, which is more than sufficient in terms of its design, functionalities, compliance and best practices. However, the platform is licensed rather than owned, and depends on Korean companies for its maintenance and for the modifications that may be required by future developments. Another major risk is the absence of business continuity measures and back-up sites. Any breakdown in the USTC's hardware or software systems would probably cause the corporate securities markets to shut down entirely.

In terms of human capital, there is a need for qualified and experienced staff in the financial sector in general and in capital markets and ICT (fintech) in particular. While the CMDA requires market participants to pass certain exams in order to be employed for specified positions, the need for qualifications and experience extends beyond the participants regulated by the CMDA. The training needs of intermediaries and corporates (especially SOEs) need to be met if they are to understand their risk management and corporate governance obligations. The CMI institutions – the CMDA, the UZRSE and the USTC – need to prioritise investments in ICT in particular.

1.2 DEVELOPMENT STRATEGY

After assessing the needs, the ADB/ISC report outlines a strategy for the development of the Uzbek capital markets in line with international standards and best practices. However, some areas, such as changes in monetary policy, are considered out of scope.

The proposed development strategy involves increasing the number of issuers and securities while creating new types of investor and incentivizing existing potential investors to participate in the capital markets. This requires extensive reorganization of the CMI, the acquisition and/or development of human resources with the necessary skills and experience, and the adoption of all the legal and regulatory amendments required.

1.2.1 DEMAND

Uzbekistan needs to develop all types of investors – i.e. retail investors (local and diaspora), local institutional investors (pension funds, a sovereign wealth fund, life insurance companies, mutual funds and private equity funds), and foreign qualified and international institutional investors. All the demand segments need to be developed concurrently and with equal effort, as the capital markets require a diverse investor base with various investment needs.

Local Institutional Investors

A key driver for the development of local demand will be the pension reform. Currently the Uzbek pension system is based on pay-as-you-go principle; over the past few years the government has been making attempts in reforming the pension system to ensure its sustainability. The current non-budget pension system is neither equitable nor sustainable. The recommendation is to introduce a multi-pillar pension system (universal pension funded by the state, national mandatory benefit pension system funded by employer and employee contributions, and optional employer-sponsored pension funds). A legal framework and governance arrangements need to be put in place that would allow the pension funds to be administered by independent boards and staff without government intervention and to invest in different asset classes with a view to enhancing the local capital markets (equity securities listed on the UZRSE, local fixed income securities – government and corporate – and local private equity).

Another key strategic initiative that would help to develop local institutional investors is the creation of a Sovereign Wealth Fund (SWF). The SWF could be funded with a portion of the revenues that the state derives from natural resources, and could possibly be opened to other investors. It could invest in several asset classes such as equity securities listed on the UZRSE, local fixed income securities – government and corporate – and local private equity.

The insurance regulatory agency needs to be supported in its efforts to modernize the industry through a new regulatory framework. The insurance companies need to switch to risk-based asset and liability management, which would encourage them to diversify their assets and purchase financial instruments. Privatizing the state-owned insurance companies and offering incentives for the listing of insurance companies would support the growth of the insurance sector and accelerate its transition to market-based practices. The insurance companies would invest mostly in fixed income securities, and later in equities, in line with the development of new insurance products.

A new legal foundation compliant with best international standards and practices needs to be established for collective investment schemes to permit the emergence of mutual funds, investment funds and private equity funds.

Foreign Qualified / International Institutional Investors

Instead of raising capital from international investors via international markets, it is suggested that Uzbekistan should seek to attract them to the local market. To achieve this, international investors need to be provided with attractive investment opportunities, sound infrastructure and a fair and reliable regulatory framework. Consistent policies should be adopted when giving mandates to international capital market players. These players could be asked to make a commitment to the development of the Uzbek market and to set up some of their operations in Uzbekistan.

Retail Investors

Privatization and the development of infrastructure, such as mobile connectivity, are essential factors for the development of the retail investor segment. Whenever possible, it is advised that privatization should be carried out through the stock exchange. Financial intermediaries could be offered incentives to distribute shares to the public, and incentives could be introduced in public offerings to attract retail investors (such as underpricing IPOs/SPOs from strong companies, or introducing price incentives for targeted groups). The rapid development of the retail investor base requires the creation of a device-independent e-commerce app and the adoption of a legal framework making it possible to open accounts with the UCSD and to participate in public offerings without a physical presence.

1.2.2 SUPPLY

Government bonds

It would be useful to spell out the responsibilities of the Debt Management Office (DMO) through a new law or charter to make clear that its sole responsibility is debt management. It is recommended that monetary management be left entirely to the Central Bank of Uzbekistan (CBU), which should shift to managing monetary policy through the short-term asset market as the availability of repos and other short-term instruments increases. Consideration could be given to developing the regulatory and technical infrastructure needed to support a repo market. As the market develops, the DMO should try to diversify the instruments which it issues in accordance with investor appetite and financing needs. These instruments could include infrastructure bonds, local government/municipality bonds and sukuk/Islamic bonds, among others.

Corporate bonds

As large parts of the economy (the overwhelming majority of the banking sector and substantial parts of the industrial and service sectors) are in government ownership, capital market activities often involve lending between different arms of the government. It is recommended that government participation be reduced through privatization. Policy-driven lending to companies should also be reduced, and the market should be allowed to determine interest rates in line with a developing repo market. Investors' understanding of risk can be improved through education, the enforcement of KYC (know-your-client) rules, the strict implementation of disclosure requirements and the impostion of rules preventing investments incompatible with the investor's risk profile. Debt instruments may be enhanced over time as the market develops.

Equities

Privatization will be the major driver for the supply of equities. If privatization is to be successful, it needs to be done in a free market environment with legal and commercial frameworks that promote competition and profit maximization. Moreover, share offerings may need to be promoted and marketed intensively, while access to them should be simple and electronic. Listing requirements need to be re-written according to international standards. In addition, the structure of the UZRSE board should be revised to classify issues clearly. The board might comprise:

- a Premium Segment that should require (i) companies to comply with the EU Prospectus Directive, (ii) a high minimum float (about 25 percent of the shares), and (iii) a high minimum number of shareholders (e.g.: 1,000);
- a Growth Segment where companies outside the Premium Segment would be listed;
- a Qualified Institutional Buyer Segment which would enable private companies to raise capital from sophisticated investors such as private equity funds, and
- an Unlisted Board for companies not complying with listing requirements. It is also recommended that the current OTC market (Elsis Savdo) should be integrated into the UZRSE. The Unlisted Board will need to have a rule book encompassing continuous disclosure obligations and rule enforcement procedures.

A further recommendation envisages extending the range of products traded on the equity markets to increase the choices available to issuers and investors alike. Following the adoption of the necessary legal and technical infrastructure and the conduct of essential training, a full range of products could be offered – namely, equities (ordinary and preferred), open-ended investment funds, closed-ended investment funds, other equity and equity-like products, and private equity.

The number of issuers will expand as a result of privatization efforts. The best companies in the privatization portfolio should be selected for offering to the public and listing on the UZRSE. This will trigger trust and interest in the equity markets. Attention should be paid to restructuring the selected SOEs so as to change their business models to highlight profit maximization, ensure the use of IFRS as the operational method of accounting, and introduce modern international corporate governance standards. It is advised that all the companies should be listed on the UZRSE and that the IPOs should start with those that are to be listed in the Premium Segment. All the companies should comply with all the listing requirements of their respective segments, without exception. Dual-listing and foreign listing should be avoided, and the equity securities should only be available on the UZRSE. The IPOs and the incentives provided to investors should be designed with the overall goal of over-subscription in mind, to ensure a positive aftermarket. There should be a single offering price applicable to all, with the exception of the share price incentives made available for groups such as employees, customers or long-term investors. All the incentives should be disclosed transparently in the offering documents (prospectus), together with the methods to be used for allocating the shares, and these commitments should be enforced by the CMDA.

1.2.3 LEGAL, REGULATORY AND TAX FRAMEWORK

According to the advice given, the legal and regulatory framework for the capital market should be clear and precise and should overtly establish the regulatory, supervisory and enforcement powers and duties of the regulatory authority vis-à-vis infrastructure institutions, market participants, and providers of ancillary services and the investment instruments and services they provide. The current legal architecture could be replaced by one similar to the international drafting model that gives the regulatory authority wide ranging powers to issue detailed underlying regulations for the capital market as it develops. This would provide all market participants with an enabling legal environment without imposing an unnecessary legal burden on them, since the regulations would develop as the market develops.

It is recommended that a new Capital Market Law should be drafted and enacted to replace the entire current patchwork of laws, regulations and decrees. All other laws and regulations, including the Constitution and the Civil, Criminal and Commercial Codes, which are not directly related to the capital markets, should be reviewed and revised to eliminate any possible conflicts with the new Capital Market Law and make sure that the responsibilities and powers of the CMDA do not overlap or conflict with those of other regulatory bodies.

The new Capital Market Law should establish the legal and operational independence of the CMDA and endow it with full authority and accountability for the development and promotion of efficient capital markets. The purview of the CMDA should be clearly defined as follows:

Protection of Investors: (i) making it possible for investors in equity or debt to identify with certainty and in advance the substantive law that will govern their rights, (ii) protecting investors from misleading, manipulative or fraudulent practices on the part of intermediaries or issuers, including insider trading and the misuse of client assets, (iii) preventing and detecting conflicts of interest, and ensuring that intermediaries offering investment services deliver a high quality of service by adopting and adhering to rules for the efficient conduct of business, (iv) ensuring that the corporate governance of issuers and all other capital market players meets international standards, and that minority interests are protected, especially in the case of takeover bids or material corporate actions of companies listed on the UZRSE.

Creation of Fair, Efficient, Competitive and Transparent Markets: (i) promoting market practices that ensure the fair treatment of orders and quotations and a price formation process that is reliable, timely and symmetrical, (ii) ensuring the widespread dissemination of relevant information including listing prospectuses and periodic and *ad hoc* information provided by issuers, and maintaining market transparency, including the public availability of pre- and post-trade information and real-time data.

Reduction of Systemic Risk: (i) promoting and supporting the effective management of risk by enforcing and monitoring ongoing capital and other prudential requirements, (ii) ensuring that clearing and settlement processes are efficient, accurate and properly supervised with effective and legally secure arrangements in place for handling defaults, (iii) facilitating stability by taking precautions against the financial failure of market intermediaries and ensuring that cases of insolvency of intermediaries do not result in losses to customers or other parties.

Cross-border legal compatibility: to include the detection and prevention of cross-border financial crime.

With respect to the tax framework, it is recommended that the tax laws and regulations should be revised with a view to preventing double taxation, whether of residents or non-residents, ensuring transparency for all collective investment schemes, making sure that revenues from investments of a similar nature – such as interest earnings from deposits and corporate bonds – are treated similarly for tax purposes, encouraging longer-term investments that carry greater risks, bringing the tax system into line with the new Capital Market Law and regulations, and providing tax exemption for funds (at fund level, not investor level).

1.2.4 INFRASTRUCTURE AND CAPACITY

The CMI institutions need to be organized in such a way as to make sure that each function is housed in a centre of excellence, free from conflicts of interest with other functions. At the same time, the duplication of resources and investments should be avoided and economies of scale should be created. Based on these principles, the following steps are recommended for the re-organization of the infrastructure institutions in the medium term:

Removal of conflicts of interest: The CMDA should not be the operator of any service; it should only regulate. For example, the information centre Openinfo.uz and all the ICT that serves the corporate segment should be transferred from the CMDA to the appropriate institutions.

Consolidation of all securities trading in the UZRSE: This would involve converting Elsis Savdo into a department and merging or grouping the UZRSE and the UZRCE.

Creation of a single CSD to provide all post-trade clearing, settlement and registry functions, starting with the merger of the UCSD and the CSD department of the UZRCE.

At the heart of modern CMI operations are appropriate technology and software solutions including innovative straight-through processing covering both trading and post-trade services. The CMI institutions should own, or at least have extensive control over, the technology that constitutes their core operating business.

Besides separating out the ICT systems and placing each system under the infrastructure institution concerned, backup sites need to be formed and business continuity plans put into place. The issue of dependency on the extensively-used KRX platform needs to be resolved either by developing new proprietary systems – which would be a slow and expensive process – or by negotiating a new model with KRX that allows for the transfer of know-how.

Human capital also needs to be developed by putting training systems in place and introducing capital market education in the universities. These are also needed for the long term. Attracting foreign players into the market, obliging them to open local offices and having them bring expat personnel from abroad will accelerate the accumulation of experience and know-how in the capital market.

Finally, the above-mentioned concerns are also directly valid for the development of the Islamic finance market, including Islamic capital market instruments such as sukuk. Given the current, under-developed state of the Uzbek capital markets, the high proportion of the population that opts out of the traditional financial and banking systems for religious or ethical reasons, and the increasing interest of the government in making the transition to a greener economy, Islamic finance and financial instruments, particularly green sukuk, have considerable potential for contributing to a more active capital market by bridging all these issues. This may constitute an attractive avenue for developing a new investor base and diversifying and deepening the capital markets of Uzbekistan.

CHAPTER 2: ISLAMIC FINANCE AND SUKUK

2.1 OVERVIEW OF THE ISLAMIC FINANCE SYSTEM

Islamic finance, which has grown at a remarkable pace since 1970s, is a financial system that functions according to Islamic law (also referred to as Sharia). Similar to the conventional financial system, Islamic finance features banking, capital markets, asset management and insurance. However, these institutions are regulated both by Islamic law and by the rules and regulations that are applicable to their conventional counterparts in the finance industry.

While the Islamic finance sector is relatively young, Islamic theories of economics date back more than a millennium. Many Muslim scholars proposed key concepts of Islamic economics that are still valid today. Islam provides guidelines to Muslims in every sphere of life including their socio-economic activities. All human relations and activities must be subject to the notions of equity, justice, fairness, morality and the other values which underpin the Islamic system. Working within these established limits reduces uncertainty and favours both coordination and development, with reduced rates of poverty. This can create thriving and socially just economies. Based on the foundational roots of Islamic economics, the Islamic financial system goes beyond the approach of the conventional financial system that purely focuses on the economic and financial aspects of transactions to include ethics, wealth distribution and social and economic justice, as well as encouraging risk-sharing modes of transaction (see Table 2.1).

Table 2.1: Basic Principles of the Islamic Financial System

Prohibition of interest	The central tenet of the system is the prohibition of riba, a term literally meaning "an excess" and interpreted as "any unjustifiable increase of capital whether in loans or sales." The direct implication of prohibition of interest is the prohibition of pure debt securities with a predetermined interest rate. In Islam, interest *(riba)* is considered an exploitative practice that favours the lender at the expense of the borrower and creates societal injustice. Social justice demands that borrowers and lenders share gains and losses equally, and that the process of accumulation and distribution of wealth in the economy be fair and reflective of true productivity.
Risk sharing	Since interest is forbidden, pure debt securities are eliminated from the system and the suppliers of funds therefore become investors rather than creditors. The provider of financial capital and the entrepreneur share business risks in return for shares of the profits and losses.
Asset-based transactions	Prohibiting debt and promoting risk sharing suggests a financial system where there is a direct link between the real and the financial sector. As a result, the system promotes the concept of "materiality", which requires the financing to be linked directly to the underlying asset, so that the financing activity is clearly and closely identified with the real sector activity. Strong linkages exist between the performance of the asset and the return on the capital used to finance it.

Money as "potential" capital	Money is considered "potential" capital and can only become actual capital when it is combined with other resources to engage in a productive activity.
Prohibition of speculative behavior	The Islamic financial system discourages hoarding and prohibits transactions that feature gambling *(maisir)* or extreme uncertainties and risks *(gharar)*. As a result, Islamic financial institutions cannot be involved in contracts where ownership of goods is dependent on a future uncertain event. As gharar is observed in derivative contracts and short-selling, these contracts are forbidden in Islamic finance.
Sanctity of contracts and preservation of property rights	In Islam, contractual obligations and the disclosure of information are upheld as a sacred duty. This feature aims to lower the risk of asymmetric information and moral hazard. Islam places great importance on the preservation of property rights: it defines a balance between the rights of individuals, society and the state, and strongly prohibits encroachment on anyone's property rights.
Prohibition of unethical activities and industries	Islam does not allow products and industries that it considers harmful to society and which violate the rules of the Sharia. Examples include alcohol, pork, pornography, tobacco, destructive weapons and any products based on uncertainty or gambling.

Source: IFSB, 2020[9]

As Islamic finance is based on a number of principles and limitations that do not exist in conventional finance, special types of financing arrangements have been developed for sales, trade financing and investment. Basic instruments include, but are not limited to, cost-plus financing *(murabaha)*, *profit-sharing (mudaraba), partnership (musharaka)*, leasing *(ijara),* and forward sale *(bay' salam or salam)*. These instruments, which are explained in Table 2.2, are considered to constitute the fundamental building blocks for the development of a broad variety of more complex financial instruments, indicating that there is great potential for financial innovation and growth in Islamic finance markets.

Table 2.2: Widely Used Islamic Financial Instruments

Trade with mark-up or cost-plus sale *(murabaha)*	This is one of the most popular instruments used in trade and asset financing. It is based on the traditional notion of purchase finance. The investor undertakes to supply specific goods or commodities in return for a mutually agreed contract for the re-sale of the goods to the client at a mutually negotiated margin. Most Islamic financial transactions today are based on *murabaha*.
Profit-sharing agreement *(mudaraba)*	*Mudaraba* is a profit-and-loss sharing partnership agreement in which one partner (the financier or *rab-ul mal*) provides the capital to another partner (the labour provider or mudarib) who is responsible for the management and investment of the capital. The profits are shared between the parties according to a pre-agreed ratio.
Equity participation *(musharaka)*	A *musharaka* is similar to a joint venture in which all partners contribute capital and share the profit and loss on a pro-rata basis. Both entrepreneurs and investors contribute to the capital (assets, technical and managerial expertise, working capital, etc.) of the operation in varying degrees and agree to share the returns (as well as the risks) in proportions agreed to in advance. Traditionally, this form of transaction has been used for financing fixed assets and working capital of medium- and long-term duration.

[9] Iqbal, Zamir, and Mirakhor, Abbas. 2011. An Introduction to Islamic Finance: Theory and Practice. 2nd ed. Singapore: John Wiley (Asia).

Leasing *(ijara)*	Another widely used instrument in Islamic finance transactions is leasing. In this type of financing arrangement, the lessor (who must own the property) leases the property to the lessee in return for a stream of rental and purchase payments, ending with the transfer of ownership of the property to the lessee.
Sales contracts	In addition to spot sales, deferred-payment sale *(bay' mu'ajjal)* and deferred-delivery sale *(bay'salam or salam)* contracts, are used for the conduct of sales with credit. In a deferred-payment sale, delivery of the product is taken on the spot, but delivery of the payment is delayed for an agreed period. Payment may be made in a lump sum or in instalments, as long as there is no extra charge for the delay. A deferred-delivery sale is like a forward contract where delivery of the product will be in the future in return for payment on the spot market.

Source: Iqbal 1997[10]

BOX 2.1. SHORT HISTORY OF ISLAMIC FINANCE AND BANKING

Some of the early practical initiatives in Islamic finance were the establishment of Lembaga Tabung Haji in Malaysia and the Egypt-based Mit Ghamr project in the 1960s. Both were social and developmental projects: the Mit Ghamr Savings Bank is known as the first Islamic bank catering to rural farmers in Egypt, while Tabung Haji, the Pilgrims Saving Corporation of Malaysia, was set up in 1963 to enable Muslims to save up to pay for their Hajj (pilgrimage to Mecca) expenses. In 1975, Dubai Islamic Bank was established as the first commercial Islamic bank. In the same year, the Islamic Development Bank, a multilateral development finance institution based in Saudi Arabia, gave the Islamic finance industry an international presence. Today, Islamic finance is no longer a niche mode of financing but has become an important and integrated part of the global financial system. Many non-Muslim countries, including European countries, Singapore and the United States, have actively entered the Islamic finance markets, either through sukuk issuances or through the establishment of Islamic windows, which refer to services that are based on Islamic principles provided by a conventional bank.

In most of the countries where Islamic finance is present, the Islamic financial institutions have been operating within a dual financial system. Iran and Sudan are the only two countries that have adopted Islamic finance as the only financial system countrywide. Other countries, such as Malaysia, Indonesia, Turkey, Egypt and the Gulf Cooperation Council (GCC) countries have adopted a dual financial system, where Islamic banks operate side by side with conventional banks, thus increasing competitiveness in the banking industry.

The Islamic finance sector has developed to different degrees in each country. The GCC is seen as one of the key drivers of the expansion of Islamic finance due to the high percentage of Sharia-compliant global financial assets in the region. Bahrain, for example, has a strong Islamic finance industry with a well-developed regulatory framework. The country has a history of Islamic banking and finance going back more than forty years and hosts infrastructure institutions such as the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), the International Islamic Financial Market (IIFM), the Islamic International Rating Agency (IIRA) and the General Council for Islamic Banks and Financial Institutions (CIBAFI). Bahrain was the first country to issue Islamic banking and inusrance regulations, enforce mandatory AAOIFI standards, issue sovereign sukuk and launch an Islamic liquidity management programme. As of the third quarter of 2019, Islamic banking accounted for 15.5 percent of the total banking assets in Bahrain.[11] While the growth of Islamic finance in other GCC countries is industry-driven, in Malaysia political support and a sound regulatory framework have contributed to the industry's

[10] Iqbal, Zamir. (1997). Islamic Financial Systems. Finance and Development. 34. 42-45.

[11] Islamic Financial Services Board. 2020. Islamic Financial Services Industry Stability Report. Kuala Lumpur, Malaysia, July.

expansion. The country is considered a pioneer in the international Islamic finance sector, with a comprehensive regulatory and legal infrastructure. The government has supported the development of the industry since it first emerged in the 1980s, and Bank Negara Malaysia, the central bank, has been implementing the country's Islamic finance strategy. An Islamic finance ecosystem has been established, including a strong regulatory framework, a wide variety of products and markets, and well-developed knowledge and expertise. As of the third quarter of 2019, Islamic banking accounted for 28.4 percent of total banking assets in Malaysia. In terms of its share of global Islamic banking assets, Malaysia follows Iran and Saudi Arabia with a market share of 11.1 percent.

In addition to the Islamic Development Bank, other multilateral institutions such as the International Monetary Fund (IMF) and the World Bank have become involved in Islamic finance. The World Bank Group is working with Islamic finance in line with its mandate to reduce poverty, expand access to finance, develop the financial sector, and build financial sector stability and resilience in client countries. The IMF is working on the implications of Islamic finance for macroeconomic and financial stability in countries where Islamic finance has a significant presence.

International standard-setting institutions have been established to guide the operations and standards of the rapidly-evolving Islamic finance sector. These institutions have been the main catalysts in the dissemination of knowledge and expertise in the area of Islamic finance, as well as in the exchange of best practices among supervisors and regulators in different countries. Some of the key institutions and the roles which they play are described below in Box 2.2:

BOX 2.2. INTERNATIONAL STANDARD SETTING BODIES IN ISLAMIC FINANCE

The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI): Established in 1991, the AAOIFI is primarily responsible for the development and issuance of standards for the global Islamic finance industry. It has a total of 110 standards and technical pronouncements concerning issues in the areas of Sharia, accounting, auditing, ethics and governance for international Islamic finance. Based in Bahrain, the AAOFI is supported by over 200 institutional members, including central banks and regulatory authorities, financial institutions, accounting and auditing firms, and legal firms, from over 45 countries.

Islamic Financial Services Board (IFSB): The IFSB, which is based in Malaysia, was set up in 2002 to serve as an international standard-setting body of regulatory and supervisory agencies that have a vested interest in ensuring the soundness and stability of the Islamic financial services industry. The work of the IFSB complements that of the Basel Committee on Banking Supervision, the International Organization of Securities Commissions and the International Association of Insurance Supervisors. The IFSB has 187 members, operating in 57 jurisdictions.

The International Islamic Financial Market (IIFM): In 2001, the Bahrain-based IIFM was established with a mandate to focus on the standardization of Islamic financial contracts and product templates relating to the capital and money markets, corporate finance and trade finance segments of the Islamic finance industry.

International Islamic Liquidity Management Corporation (IILM): The IILM is an international organization established by central banks, monetary authorities and multilateral organizations to create and issue Sharia-compliant financial instruments to facilitate effective cross-border Islamic liquidity management. Established in 2010, the IILM aims to enhance cross-border investment flows, international linkages and financial stability by creating more liquid Sharia-compliant financial markets for institutions offering Islamic financial services.

2.2 CURRENT STATUS OF THE ISLAMIC FINANCE INDUSTRY AND THE SUKUK MARKET

According to the IFSB, the Islamic finance industry's assets grew to US$ 2.44 trillion in 2019 from US$ 2.19 trillion in 2018 – a rise of 11.4 percent. Even though all segments of the Islamic finance sector contributed to the increase in value, Islamic capital markets and Islamic banking were the two segments that performed best, with steady growth in prominent Islamic banking jurisdictions as well as emerging markets. This rate of growth is commendable considering the geopolitical and economic factors at play in 2019, which included increased uncertainties within the global economic landscape, negative sentiment in the financial sector and the depreciation of local currencies against the US$ terms in some jurisdictions.[12]

In terms of their geographical outreach, Islamic finance assets are concentrated in the GCC (Saudi Arabia in particular), Iran, and Malaysia. Iran has the highest volume of Islamic finance assets (US$ 575 billion) followed by Saudi Arabia (US$ 541 billion) and Malaysia (US$ 521 billion).[13]

Table 2.3. Breakdown of the Global Islamic Finance Industry by Sector and Region (US$ billion, 2019*)

Region	Islamic Banking	Sukuk Outstanding	Islamic Funds' Assets	Takaful Contributions	Total	Share
GCC	854.0	204.5	36.4	11.70	1,106.6	45.4%
South-East Asia	240.5	303.3	26.7	3.02	573.5	23.5%
Middle East and South Asia	584.3	19.1	16.5	11.36	631.3	25.9%
Africa	33.9	1.8	1.6	0.55	37.9	1.6%
Others	53.1	14.7	21.1	0.44	89.3	3.7%
Total	1,765.8	543.4	102.3	27.07	2,438.6	100%
Share	72.4%	22.3%	4.2%	1.1%	100.0%	

**Data for sukuk outstanding and Islamic funds are for full-year 2019; for Islamic banking, they are as at 3Q19; and for takaful, they are as at end-2018.*

Source: IFSB 2020 [14]

Islamic banking is the largest sector in the Islamic finance industry, accounting for US$ 1.77 trillion worth of assets, or 72.4 percent of all Islamic finance assets. Currently, there are over 520 Islamic banks, including Islamic windows, operating in more than 72 countries. The Islamic banking industry continues to grow. Islamic banks and windows in a number of jurisdictions are undergoing reorganization or consolidation, while new banks and windows are entering the market. Islamic funds, which account for just over 4 percent of the Islamic finance industry, have reached US$ 102.3 billion in terms of assets under management. This is a noteworthy performance when compared to the US$ 67.1 billion recorded in 2018, indicating that the segment has grown by 29.8 percent. In 2019, there were 1,545 Islamic funds. This figure includes mutual funds, exchange traded funds, insurance funds and pension funds. The *takaful* (Islamic insurance) sector accounts for 1.1 percent of the Islamic finance market, with 335 *takaful* operators, including 122 windows, providing *takaful* services. Although the *takaful* sector has great potential, the sector is very small and concentrated in key markets.

Sukuk, which is one of the fastest growing segments of the Islamic finance industry, is defined by the AAOIFI as "certificates of equal value representing undivided shares in ownership of tangible assets, usufruct and services or (in the ownership of) the assets of particular projects or special investment activity".[15] Sukuk are similar to bonds in the conventional market, but while bonds represent a debt that the issuer owes to the bondholders, sukuk

[12] Islamic Financial Services Board. 2020. Islamic Financial Services Industry Stability Report. Kuala Lumpur, Malaysia, July.

[13] ICD - Refinitiv Islamic Finance Development Report 2019.

[14] Islamic Financial Services Board. 2020. Islamic Financial Services Industry Stability Report. Kuala Lumpur, Malaysia, July.

[15] AAOIFI Sharia Standards, Standard 17

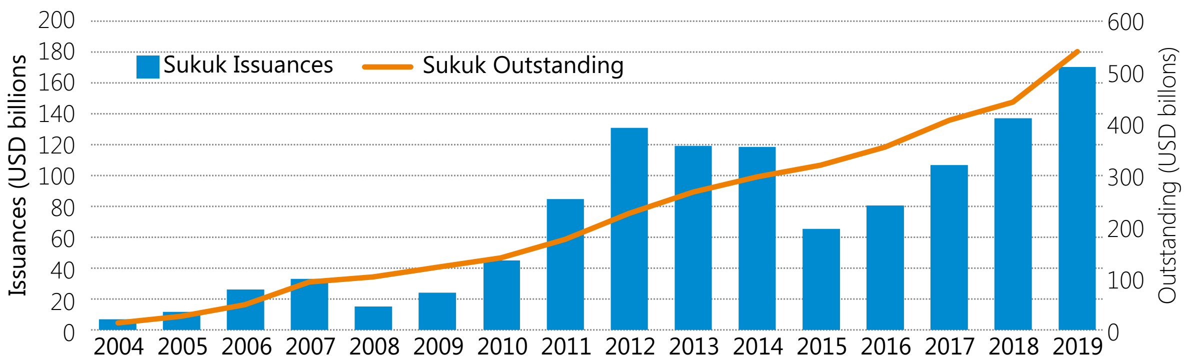
certificates represent the investors' ownership interest in the underlying sukuk asset, business, enterprise or project which entitles them to receive a share of the income generated thereby.

The world's first sukuk was issued in Malaysia by Shell MDS in 1990. It is interesting to note that the first sukuk issue, worth MYR 125 million, was carried out by a conventional company. It was not until 1996 that another company in Malaysia raised financing through a sukuk. In 2001, Bahrain issued the first sovereign sukuk, through the Central Bank of Bahrain. There followed a number of sovereign sukuk issues in Malaysia, Qatar, Pakistan and Dubai. These issues drew international attention to sukuk and set the stage for the global growth of the sector.

The attractiveness of sukuk extended beyond the Muslim world and in 2014, the UK became the first Western country to issue a sovereign sukuk. The GBP 200 million sale was heavily oversubscribed by investors in the UK, the Middle East and Asia, attracting orders of GBP 2.3 billion – ten times more than the amount sold[16]. Following the UK's debut issue, Hong Kong and Luxembourg issued their first sovereign sukuk in the same year. Other countries such as France and Germany have also issued sukuk and have made changes in regulations to promote the issuance of sukuk in their countries. Sukuk issues have also gained momentum in Africa, as African countries have turned to sukuk as an alternative source of funding, especially for infrastructural development. As Islamic finance is a relatively new and developing industry, the market has significant room for growth and innovation. This has enabled the emergence of new innovative sukuk forms and structures in recent years. For example, Indonesia and Turkey have pioneered the issuance of sovereign waqf-linked and gold-backed sukuk respectively, providing a more cost effective alternative for tapping international debt markets while deepening their domestic markets.

By 2019, the value of outstanding sukuk had risen to US$ 543.4 billion compared to about US$ 7 billion in 2004. The market has grown steadily apart from slight slowdowns in late 2007, early 2009 and 2015. The drop in sukuk issues in 2008-2009 was due partly to a debate surrounding the Sharia compliance of some sukuk structures and partly to the global financial crisis, which resulted in increased borrowing costs and a general lack of investor confidence in capital market securities. The slowdown in 2015 was due to a decision of the central bank of Malaysia, which dominated the global sukuk market, to discontinue the issuance of short-term investment sukuk. This decision did not reflect the weakness of the sukuk market, but rather a change in the bank's strategy.

Figure 2.1. Global Sukuk Issues and Value of Outstanding Sukuk (2004–2019)[17]



Source: IFSB, 2020

[16] Financial Times. UK Sukuk bond sale attracts £2bn in orders. 25 June, 2014. https://www.ft.com/content/7c89467e-fc4e-11e3-98b8-00144feab7de

[17] Islamic Financial Services Board. 2020. Islamic Financial Services Industry Stability Report. Kuala Lumpur, Malaysia, July.

In 2019, the sukuk market recorded significant expansion due to strong sovereign and multilateral issuance aimed at supporting government spending and environmental preservation initiatives, among other factors. As a result, the compound annual growth rate (CAGR) of the sukuk market over the 15 years from 2004 to 2019 worked out at 26 percent[18]. Sukuk represented 22.3 percent of the global Islamic finance sector.

2.3 THE DEVELOPMENT OF ISLAMIC FINANCE IN UZBEKISTAN

One of the regions in which the growth of Islamic finance and banking has displayed the greatest momentum is Central Asia. Central Asia is considered to have an immense potential for Islamic finance due to the fact that the majority of the population are Muslims, coupled with the strong engagement of international Islamic financial organizations. In recent years, some Central Asian countries have made significant progress in establishing Islamic finance regulations and have expanded the range of their financial and banking services by incorporating Islamic financial instruments into their capital markets. Kazakhstan has been a leader in this endeavour, and has ambitions to become the pioneer and hub of Islamic finance and banking in the region. Other countries in the region, such as Kyrgyzstan and Tajikistan, are following Kazakhstan's lead[19]. Even those countries which have historically been less receptive towards Islamic finance, including Uzbekistan, are increasingly recognizing its potential, especially as a mechanism for addressing the issues of sustainable development.

Interest in Islamic finance in Uzbekistan has been increasing gradually ever since the country's independence. The first important steps towards making Islamic finance a more equal contender in the capital markets were taken when Uzbekistan joined the Islamic Development Bank (IsDB) and the Islamic Corporation for the Development of the Private Sector (ICD) in 2003 and 2004 respectively, making Islamic finance more accessible for financing public and private development initiatives. Since then, the IsDB has implemented a number of projects in Uzbekistan. Some of the most prominent investments involved funding the acquisition of aircraft for the Uzbek national airline in 2013 and financing rural housing construction and the country-wide water and transport infrastructure in 2017. More recently, in 2019, the IsDB and the Uzbek government collaborated on the strategy for Uzbekistan for 2019-2022. This strategy centres on a US$ 1.3 billion programme for the development of the local education, energy, transport, health, and agriculture sectors, primarily through private-public partnerships.[20]

In addition to public sector and SOE initiatives, the ICD has supported the integration of the private sector into Islamic finance and banking by specifically focusing on providing lines of financing to small and medium-sized enterprises (SMEs) and private banks. Another important player in the private sector is the International Islamic Trade Finance Corporation (ITFC), with its overall aim of partnering with Uzbekistani commercial banks and working closely with the private sector.[21] Since Uzbekistan became a member in 2019, the ITFC has allocated around US$ 96 million to the country. With the advisory support of the ICD, several Uzbek commercial banks, including Asia Alliance Bank, KapitalBank and Ipak Yuli Bank, have developed plans to launch Islamic windows. Despite these successful cases of collaboration with international Islamic finance organizations, a more general expansion of Islamic finance and banking in Uzbekistan requires changes in the legal and regulatory environment.

[18] Islamic Financial Services Board. 2020. Islamic Financial Services Industry Stability Report. Kuala Lumpur, Malaysia, July.

[19] Islamic Financial Services Board. 2020. Islamic Financial Services Industry Stability Report. Kuala Lumpur, Malaysia, July.

[20] Islamic Finance News. Volume 16 Issue 30. 31 July 2019.

[21] Lexology (2019), Islamic finance and markets in Uzbekistan.

Historically, one feature of the Uzbek economy has been conservatism with regards to foreign borrowing. As a result, the country has rarely engaged with global capital markets in order to invest in local development. This conservatism, and the underlying principle of incremental economic reforms, are reflected in the country's position on Islamic finance and banking. However, the growing demand of the Uzbek population for financial inclusion, existing gaps in financing for Micro, Small and Medium Sized Enterprises (MSMEs) (US$ 11.79 billion) and SMEs (US$ 10.16 billion), coupled with a desire to open up its capital markets to foreign investors, led Uzbekistan to issue eurobonds in 2019, following two decades of financial isolation and abstinence from participation in the global capital market.[22] The same conditions have highlighted the need for Islamic financial instruments.

The legal and regulatory environment in Uzbekistan is inconsistent with the rising demand. The existing legal and regulatory frameworks cannot accommodate Sharia-compliant financial instruments and are hindering the expansion of Islamic finance. If Islamic finance is to develop further in Uzbekistan, it is important to formulate a sound legal and regulatory framework. Amendments need to be made to the Tax Code, the Civil Code and major banking and investment laws to create a legal environment in which the Islamic finance industry can flourish. Such changes would allow commercial banks to set up Islamic windows, permit the establishment of independent Islamic finance and banking institutions, and pave the way for Islamic finance activities in the capital markets. In addition, high priority should be attached to the development of the skills and capacities of public and private stakeholders to ensure the sustainable development of the Islamic finance industry.

In 2018, the government announced plans to introduce Islamic finance regulations and set up an Islamic finance institution to expand its banking sector and tap foreign markets. This was followed in 2020 by an agreement between the CMDA, the IsDB and the UNDP which aims to establish institutional and legal structures conducive to the launch of Islamic financial products in Uzbekistan by as early as 2021. Thus while Islamic finance and banking in Uzbekistan is still in its inception phase, and is yet to be legally recognized, the steps taken so far clearly indicate the government's willingness to tap into the US$ 2.5 trillion global Islamic finance market. Plans to launch Islamic securities of different tenures (primarily green sukuk) and to introduce Islamic insurance (Takaful) will surely put the Uzbek capital markets' readiness to the test.[23]

2.4 ISLAMIC FINANCE AND THE LINK WITH SUSTAINABLE DEVELOPMENT

Islamic finance has the potential to make an important contribution to achieving sustainable development. The sector differentiates itself by its promotion of justice, ethical finance and risk sharing, by its close relationship with economic activity, and by its offer of a more stable financial system that generates mutual gains accompanied by social inclusion. It is rooted in Islamic economics, which seeks to establish a prosperous and egalitarian economic and social system in which all the members of society can maximize their intellectual capacity, preserve and promote their faith, health, and wealth across generations, and actively contribute to the economic and social development of society. As such, Islamic finance shares common ground with sustainable finance principles and aims to extend these principles further. Social and environmental well-being is seen both as a driver and as an outcome of economic prosperity. These similarities in aim and scope make Islamic finance a natural tool for achieving some of the major sustainable development goals, such as poverty alleviation, gender equality, quality education, climate action and more resilient socioeconomic ecosystems.

[22] Nicholson & Pronina (2019), Uzbekistan Emerges from Isolation with 1 Billion Bond Sale, Bloomberg

[23] Lexology (2019), Islamic finance and markets in Uzbekistan

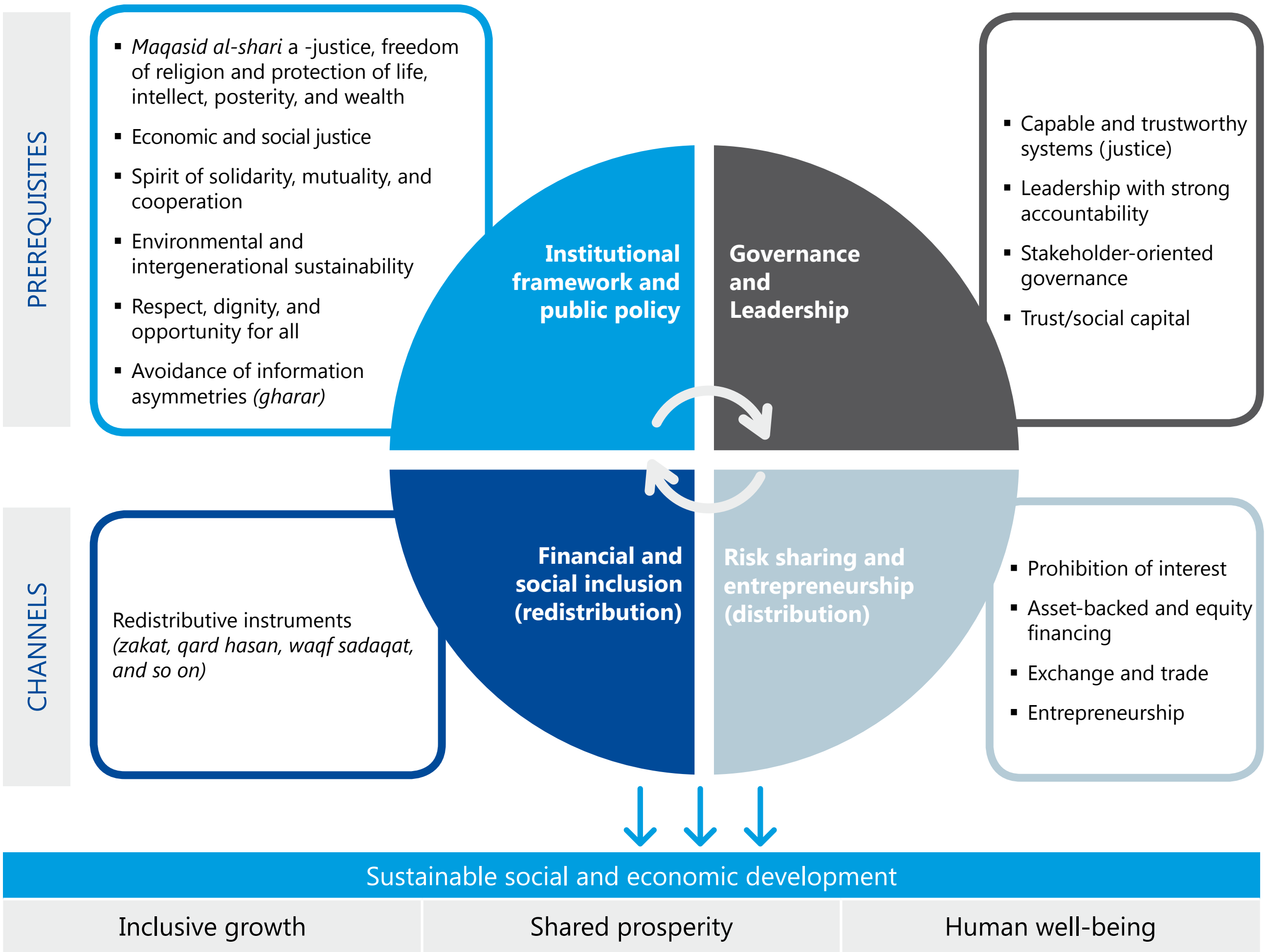
Innovative products and instruments can be particularly helpful for mobilizing Islamic finance as an alternative for financing international development and achieving the SDGs. Green sukuk, which support environment friendly investments, Islamic endowment funds, which provide for long-term investments, Islamic financial technology (FinTech) and Islamic microfinance can all go a long way towards ending poverty, protecting the planet and ensuring that all people enjoy peace and prosperity.

A conceptual framework to identify the mechanisms through which Islamic finance can cater for shared prosperity and sustainable development needs is presented in Figure 2.2. The first two pillars are prerequisites, while the last two are channels for the achievement of sustainable development with equitable distribution of both opportunities and wealth – the main objectives of the concept of economic development in Islam. The first pillar is important, since a sound institutional framework and appropriate public policies constitute the foundation upon which the other pillars must rest if they are to function efficiently. The second pillar focuses on establishing a governance structure and an accompanying compliance system based on the objectives and institutions in the first pillar. This helps to increase the transparency and accountability in the public, private, and social sector institutions of the overall economic system, and thereby strengthens trust in the system. The third pillar is the distribution channel, which functions at both the individual and organizational level. Key features include the advocacy of risk sharing and the promotion of entrepreneurship, which are among the most important aspects of Islamic finance, differentiating it from the conventional approach of over-reliance on debt-dominated risk-shifting or risk-transfer mechanisms. The objective of the fourth pillar is to ensure that the fruits of higher growth are distributed inclusively to every segment of the society, either through involvement in economic growth or through the redistribution instruments of Islam.[24] By analyzing the current positions of various countries with respect to each of the pillars, one may identify, in a realistic way, the gaps, distance and road blocks that need to be removed to move forward in the direction of each of these pillars. This process will provide policy makers with a true picture of the intensity of the efforts under way to transform Islamic finance into an approach that can have a broader appeal in achieving the goal of sustainable development.

However, even though Islamic finance is now being viewed as a promising alternative for achieving growth and prosperity, many regulatory and policy-related hurdles still stand in its path. If policy makers are to fully unleash the potential of Islamic finance to contribute to planetary sustainability, they first need to overcome the challenges and solve the issues that are currently hindering the development of the industry. Policies should be clear and relevant to the stakeholders. Robust regulatory and supervisory frameworks need to be implemented at the national level, with a particular focus on the legal aspects of Islamic financing instruments and the development of innovative products. On a global level, there is a need to standardize and harmonize Sharia rulings and contracts by developing international standards and promoting their adoption.

[24] Global Report on Islamic Finance 2016: A Catalyst for Shared Prosperity? World Bank Group and Islamic Development Bank Group. February 2017.

Figure 2.2. Islamic Framework to Achieve Sustainable Development and Shared Prosperity



Source: Islamic Development Bank Group and World Bank Group, 2017[25].

In addition to providing an alternative financing source, Islamic finance can also complement the traditional means of financing the achievement of the SDGs. One Islamic financial instrument that has been receiving more attention recently has been sukuk, the second biggest asset class in Islamic finance[26]. Since its introduction to capital markets, it has played an important role in financing private and public initiatives

[25] Global Report on Islamic Finance 2016: A Catalyst for Shared Prosperity? World Bank Group and Islamic Development Bank Group. February 2017.

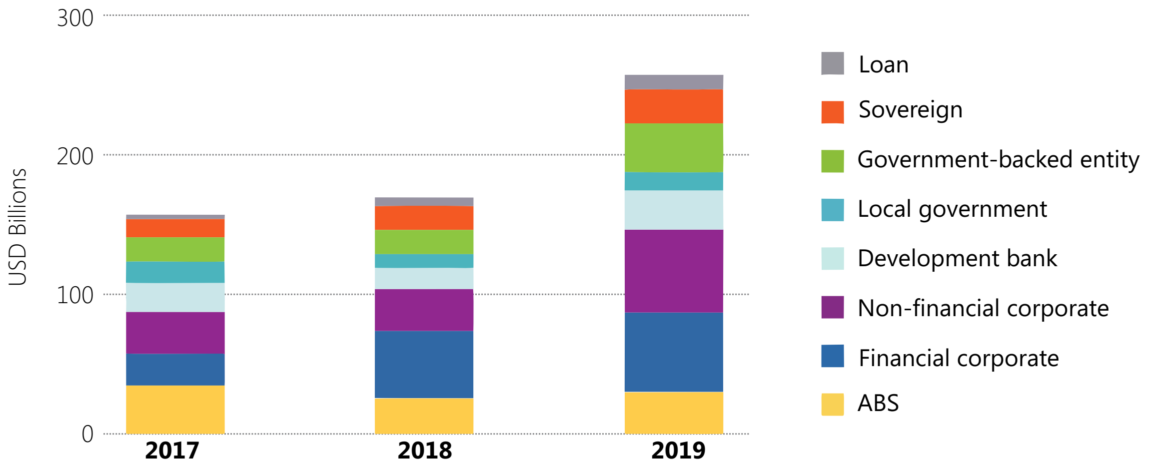
[26] Aassouli, D., Asutay, M., Mohieldin, M., & Nwokike, T. C. (2018). 'Green Sukuk, Energy Poverty, and Climate Change: a Roadmap for Sub-Saharan Africa.', Working Paper. World Bank Group, Washington D.C.

CHAPTER 3: GREEN SUKUK CONCEPTUAL FRAMEWORK

3.1 OVERVIEW OF GREEN BONDS AND SUKUK

As a response to the lack of the funding needed to support green development, a number of new, green and sustainable financial products and instruments have been proposed and introduced. One of the proposed solutions for financing green infrastructure is the "green bond". Green bonds have been one of the flagship instruments of impact finance in the last decade and are regarded as an investment option that could assist countries to meet their financial commitments to mitigating environmental change[27]. They have gained importance in many jurisdictions, and the international green bond market has grown to attract local administrations, corporations, financial institutions and multilateral development banks (MDBs) alike (Figure 3.1).

Figure 3.1. Evolution of Green Bonds By Type of Issuer (US$ billion)



Source: Climate Bonds (2020)

By definition, green bonds are any type of bond instrument of which the proceeds are exclusively used to finance or re-finance, partly or in full, new and/or existing eligible green initiatives, such as renewable energy, low-carbon transport, and other low-carbon projects that can contribute to climate change adaptation or mitigation[28]. Green bonds are a financial instrument that combines the fiduciary element of fixed-income instruments with an awareness of mitigation and adaptation to climate change. They are ordinary debt instruments, upon the issuance of which the issuing borrower receives a fixed amount of capital from investors and uses it for its own corporate needs, repaying the capital to the investor together with an agreed amount of interest for the period of its maturity. Technically, green bonds have very similar characteristics to traditional bonds, but with specific obligations on the use of the proceeds. Unlike traditional types of bond, green bonds are primarily defined with respect to the projects they are intended to finance, rather than on the issuer's activities in general, and any type of issuer can issue them. The concept of green bonds is based on five pillars: simplicity, governance, credibility, traceability and transparency[29]. Green bonds

[27] Aassouli, D., Asutay, M., Mohieldin, M., & Nwokike, T. C. (2018). 'Green Sukuk, Energy Poverty, and Climate Change: a Roadmap for Sub-Saharan Africa.', Working Paper. World Bank Group, Washington D.C.

[28] Green Bond Principles, 2018

[29] Aassouli, D., Asutay, M., Mohieldin, M., & Nwokike, T. C. (2018). 'Green Sukuk, Energy Poverty, and Climate Change: a Roadmap for Sub-Saharan Africa.', Working Paper. World Bank Group, Washington D.C.

bring benefits to both the issuer and the investors. The issuer can integrate sustainability into its portfolio and thereby attract a new category of younger, eco-conscious investors without having to compromise on the returns. The investors gain access to green investment in a fixed-income market. By financing environmental, energy-efficient and low-carbon projects, they demonstrate their commitment to, and focus on, long-term sustainable development. It is reasonable to assume that many investors, especially those who position themselves as socially responsible, prefer such instruments to regular bonds. The Climate Bonds Initiative distinguishes several categories of green bond (Table 3.1)[30].

Table 3.1. Classification of Green Bonds

Type	Proceeds raised by bond sale are…	Debt recourse
"Use of Proceeds" Bond	Earmarked for green projects	Recourse is to the issuer. The same credit rating applies as to the issuer's other bonds.
"Use of Proceeds" Revenue Bond or ABS	Earmarked for or used to refinance green projects	Revenue streams from the issuers (fees, taxes etc.) serve as collateral for the debt.
Project Bond	Ring-fenced for the specific underlying green project(s)	Recourse is only to the project's assets and balance sheet
Securitization (ABS) Bond	Used to refinance portfolios of green projects or earmarked for green projects	Recourse is to a group of projects that have been grouped together (e.g. solar leases or green mortgages).
Covered Bond	Earmarked for eligible projects included in the covered pool	Recourse is to the issuer and, if the issuer is unable to pay, to the covered pool
Loan	Earmarked for eligible projects or secured on eligible assets	For unsecured loans there is full recourse to the borrower(s). Secured loans provide recourse to the collateral and may also feature limited recourse to the borrower(s).
Other debt instruments	Earmarked for eligible projects	

Source: Climate Bonds Initiative.

Recently, the sukuk market has witnessed an increase in thematic sukuk issues, including socially and/or environmentally sensitive sukuk. The trend towards thematic sukuk issues has the potential to influence the future of the sukuk market and give rise to thematic sukuk markets comparable to the existing thematic bond markets in which bonds have been issued that address environmental protection, water access, microfinance, and gender equality[31]. Modelled on the green bond market, the market for green sukuk has been put forward as one of the potential solutions for filling the SDG financing gap.

Green sukuk are Sharia-compliant instruments designed to finance green infrastructure. They may be used for financing renewable energy production, waste management, sustainable agriculture, the construction of energy-efficient buildings, natural resource management and similar activities. Momentum has been growing since the first green sukuk was issued in Malaysia in 2017 (Box 3.1).

The development of green sukuk markets addresses the following objectives:

- Contributing to the achievement of the SDGs in the fields of renewable energy, energy efficiency, sustainable housing, and other eco-friendly industries;

[30] Climate Bonds Initiative : https://www.climatebonds.net/market/explaining-green-bonds

[31] Aassouli, D., Asutay, M., Mohieldin, M., & Nwokike, T. C. (2018). 'Green Sukuk, Energy Poverty, and Climate Change: a Roadmap for Sub-Saharan Africa.', Working Paper. World Bank Group, Washington D.C.

BOX 3.1. DEVELOPMENT OF THE GREEN SUKUK MARKET

Following the issue of the first green bond over a decade ago, the green bond market has grown rapidly, setting a new global record of US$ 258 billion in 2019 – 51 percent higher than the final 2018 figure of US$ 170.6 billion. The green sukuk market emerged much more recently, but has also shown rapid growth, driven not only by investors but also by issuers seeking alternative funding sources for green infrastructure projects.

Southeast Asia has taken the lead in the use of green sukuk to finance renewable energy projects. A number of pioneer transactions have gone ahead in Malaysia and Indonesia, all of which have been oversubscribed. In 2017, Tadau Energy of Malaysia issued the first green sukuk in the world, worth US$ 64 million, to finance a solar power plant. In March 2018, the Government of Indonesia issued the very first sovereign green sukuk in US dollars. The five-year issue raised US$ 1.25 billion. Interestingly, 30 percent of the investors in the Indonesian green sukuk were conventional green investors. Green sukuk soon came to be issued in other regions of the world as well. In May 2019, Dubai-based real estate developer Majid Al Futtaim (MAF) issued the GCC's first green sukuk. In November of the same year, the IsDB issued its maiden green sukuk, raising 1 billion euros (Table 3.2).

Table 3.2. Landmark Green Sukuk Issues

Project Name / Issuer	Issue Size (millions)	Issue Date	Utilization of Proceeds	Average Tenor (Years)	Type of Sukuk
Tadau Energy Sdn Bhd	MYR 250	July 2017	Construction of a 50MW solar PV power plant	2-16	Corporate
Quantum Solar Park (Semenanjung) Sdn Bhd	MYR 1,000	October 2017	Construction of three 50MW solar PV power plants	1.5-17.5	Corporate
PNB Merdeka Ventures Sdn Bhd	MYR 2,000	December 2017	Real estate development in Kuala Lumpur complying with certain green building accreditations	15	Corporate
Sinar Kamiri Sdn Bhd	MYR 245	January 2018	Construction of a 49MW solar PV power plant	18	Corporate
Republic of Indonesia / Perusahaan Penerbit SBSN Indonesia III	US$ 1,250	March 2018	Various green projects	5	Sovereign
Republic of Indonesia / Perusahaan Penerbit SBSN Indonesia III	US$ 1,750	March 2018	Various green projects	10	Sovereign
UiTM Solar Power Sdn Bhd	MYR 222.3	April 2018	Solar power project	18	Corporate
Pasukhas Green Assets Sdn Bhd	US$ 49	February 2019	Hydropower plant	18	Corporate
Telekosang Hydro	MYR 470	August 2019	Hydro power	14	
Islamic Development Bank (Green Sukuk)	US$ 1,102	November 2019	Green projects in IsDB Member Countries	5	Quasi- Sovereign
Majid Al Futtaim Green Sukuk	US$ 600	May 2019	Financing and re-financing of the company's new and existing green projects, including green buildings, renewable energy, sustainable water management, and energy efficiency	10	Corporate
Majid Al Futtaim Green Sukuk	US$ 600	October 2019	Financing or re-financing renewable energy projects or projects related to energy efficiency.	10	Corporate
Republic of Indonesia (Sukuk Tabungan Seri)	IDR 1.459 trillion	November 2019	Financing projects related to renewable energy, energy efficiency, sustainable transportation, and waste and energy management.	2	Sovereign (Retail)
Saudi Electricity Company	US$ 1,300	September 2020	Various green projects	5 and 10	Corporate
Leader Energy	MYR 260	July 2020	Renewable energy	17	
Republic of Indonesia	US$ 750	June 2020	Financing sustainable development projects	5	Sovereign

Green sukuk issues are expected to continue, helping to mobilizing capital markets to take up green financing and support the growth of the sustainable economy. The COVID-19 pandemic and efforts to adapt to the "new normal" have added to the importance of investments with a focus on sustainability. This trend is likely to persist, stimulating the development of sukuk instruments linked to environmental, social and corporate governance (ESG) and the SDGs.

Source: IIFM 2020 [1]; World Bank.[2]

[1] IIFM Sukuk Report. A Comprehensive Study of the Global Sukuk Market. July 2020 (9th Edition).

[2] World Bank. Pioneering the Green Sukuk: Three Years On. 2020.

- Positioning Islamic finance as an inclusive and socially responsible mode of finance;
- Developing domestic capital markets, attracting institutional investors, and accessing a new investor base;
- Creating awareness of Islamic financing modes and environmental responsibility.

The receipts from both green bond and green sukuk issues are allocated to predefined projects with social or environmental impacts. However, the two instruments differ in several ways:

- Green bonds are securities that represent the debt of the issuer to their holders, whereas green sukuk represent ownership (legal or usufruct) of the underlying assets.
- Green sukuk have to be backed by a minimum of tangible assets in order to be tradable, and the value of the underlying assets must be greater than or equal to the value of the issue.
- Sukuk do not pay interest. The profits paid to investors are linked to the financial flows generated by the underlying assets.
- While both green bonds and green sukuk require the certification of the environmental impact by a third party, green sukuk also require a fatwa issued by a Sharia committee on compliance.

3.2 GREEN SUKUK STRUCTURES

Financing environmentally sustainable projects in areas like renewable energy, energy efficiency and sustainable housing via green sukuk can diversify and broaden the market as well as contribute to the convergence of Islamic finance and the SDGs. Sukuk are structured based on a specific pool of assets, ensuring a close link with the real economy and expanding the range of sectors that can be financed as well as appealing to both sukuk investors and conventional investors that prioritize environmental investments.

The issue of a green sukuk is a similar process to the issue of a regular sukuk and involves the parties listed in Table 3.3. The issue of a green sukuk first requires the involvement of a principal adviser to facilitate the overall transaction. The responsibilities of the adviser include appointing the financing parties, drafting the agreement on the terms and conditions of the issue, conducting due diligence, making arrangements for the certification of the green sukuk, the acquisition of a Sharia approval and the sukuk rating process, marketing the instrument to investors and finally issuing the sukuk.[32]

Table 3.3. Required Parties in Sukuk Issuance and Their Roles

Parties	Roles and Responsibilities
Issuer	The entity which offers and issues the sukuk. In most cases, this is the special purpose vehicle (SPV).
Obligor	The entity which needs the funding and is responsible for paying the sukuk holders' coupon payments and the principal amount at redemption.
Originator	The entity which sells the asset(s) to the SPV, where the issuer is an SPV, and receives the proceeds from the sale of the sukuk. The originator may be the obligor or a party related to the obligor.
Sukuk holder	The owner of the sukuk. The holder may be either a primary subscriber or a secondary investor.

[32] Malaysia SC & World Bank, Islamic Green Finance: Development, Ecosystem and Prospects, 2019

Primary subscriber	An entity or individual that subscribes to the sukuk offering and is a first holder of the sukuk.
Special- purpose Vehicle (SPV)	An entity incorporated in an onshore or offshore jurisdiction to nominally own the assets, and/or facilitate other aspects of the sukuk issue and structure, for reasons such as tax efficiency or asset protection.
Sharia adviser	The formal authority which approves the sukuk structures in terms of Sharia compliance. This authority may exist at the level of the institution issuing the sukuk and/or at the central level.
Regulator	The sovereign approving body. All capital market offerings need to be approved or exempted by a regulator. Typically, the main regulator is in the country where the primary issue takes place (the country of the obligor). However, international-currency issues will need to be approved by the relevant regulators.
Credit enhancer	A third party (e.g. a government agency, bank or takaful company) or a related party (holding company) that provides a guarantee or some form of credit enhancement.
Investment bank	A single or small group of investment banks which primarily act as: lead arranger (arranging the sukuk offering, advising the issuer/obligor on market conditions, and coordinating the offering, including marketing); rating adviser (providing advice on how to achieve an optimal rating); book runner (managing the fundraising, approaching potential investors, providing guidance on pricing, market conditions and appetite, and monitoring sukuk demand and orders), and lead manager (in some cases a significant subscriber to the sukuk issue that provides credibility).
Trustee	A professional firm or unit of a bank or law firm which holds the assets in trust on behalf of the Sukuk holders and in the event of default by the issuer it can exercise its rights as per the trust deed to sell the assets. However, the proceeds are held for the benefit of all creditors on a pari-passu basis unless the sukuk is asset backed.
Facility agent	A professional firm or unit of a bank or law firm which manages the operational aspects of the sukuk, such as the disbursement of the securities and payment of profits to investor accounts. A facility agent can also act as a security agent/trustee.
Security agent/ trustee	A professional firm or unit of a bank or law firm which manages the assets securitized/collateralized under the sukuk deal (e.g.: holds specific assets in security for the benefit of the holders, and realizes/liquidates any mortgage or other collateral in the event of a default).
Credit rating agency	A pre-approved professional firm which examines the parties in the transaction and the structure of the sukuk and issues an opinion on the credit risk. Credit rating opinions are published upon or soon after issuance and updated throughout the life of the sukuk.
Legal adviser	A law firm which advises on legal and regulatory matters (e.g.: by giving a legal opinion on the structure of the sukuk and its enforceability). The responsibilities of the legal adviser may also include legal due diligence, which may be a requirement, and guidance on commercial matters.

Источник: ISRA, 2017.[33]

Provided the key criterion of Sharia compliance is met, sukuk can be structured on several types of contract. Examples include lease-based, agency-based, sale-based and partnership-based sukuk. The AAOIFI, which issues standards for accounting, auditing, governance, ethical principles and Sharia compliance, has identified 14 different types of contract on which sukuk may be structured. These can be used singly or in hybrid sukuk structures. The choice of structure depends on factors such as the nature of the underlying assets, tax and regulatory considerations, tradeability considerations, the return (fixed or floating), the type

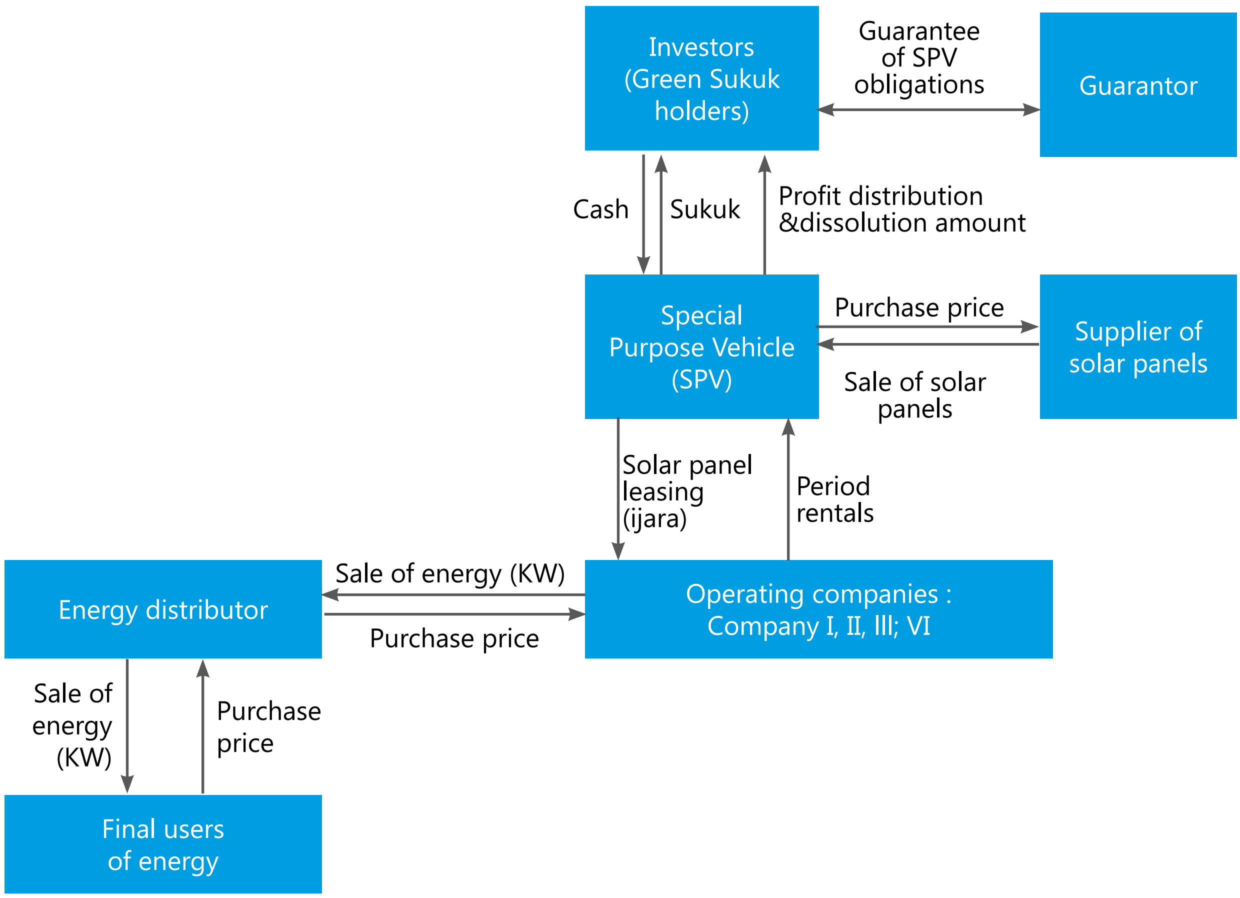
[33] ISRA, 2017. Sukuk: Principles & Practices. Kuala Lumpur: International Shari'ah Research Academy for Islamic Finance and Securities Commission Malaysia.

of issuer (sovereign or corporate), the targeted investor base and the Sharia approach of the scholars who approve the sukuk issue. Currently, the most commonly used green sukuk structures are *ijara* and *wakala*.

Istisna-ijara Green Sukuk Structures

The *istisna-ijara* green sukuk has emerged recently as a hybrid model based on two types of underlying contract: *istisna* and *ijara*. An *istisna* contract can briefly be described as a sales contract under which the purchaser orders the seller to manufacture an asset according to particular specifications. *Istisna* sukuk are usually issued for funding large construction, manufacturing and infrastructure projects. Since the issue of an *istisna* sukuk is based on a sales contract with the price to be paid on a future date, the sukuk are issued to represent the investors' rights to the debt owed by the sukuk issuer. An *ijara* contract is essentially a leasing arrangement. An *ijara* sukuk is a security the holders of which share in the right to the revenues from certain assets which have been leased by the owner to another party in exchange for the payment of rent. An *istisna* structure is usually combined with a forward lease in order to generate returns for sukuk holders during the construction phase of projects. From a Sharia perspective, *istisna* sukuk may not initially be tradeable, since the underlying assets are still under construction. Some Sharia boards require that at least a third of the underlying assets be in a tangible form in order for the sukuk to be traded. In the case of *istisna-ijara* sukuk, a tangible asset is added to the portfolio during the first stage of the project (Figure 3.2).[34]

Figure 3.2. Istisna-Ijara Green Sukuk Structure for Solar Energy Financing



Source: Aassouli, D., Asutay, M., Mohieldin, M., & Nwokike, T. C. (2018).

[34] Aassouli, D., Asutay, M., Mohieldin, M., & Nwokike, T. C. (2018). 'Green Sukuk, Energy Poverty, and Climate Change: A Roadmap for Sub-Saharan Africa.', Working Paper. World Bank Group, Washington D.C.

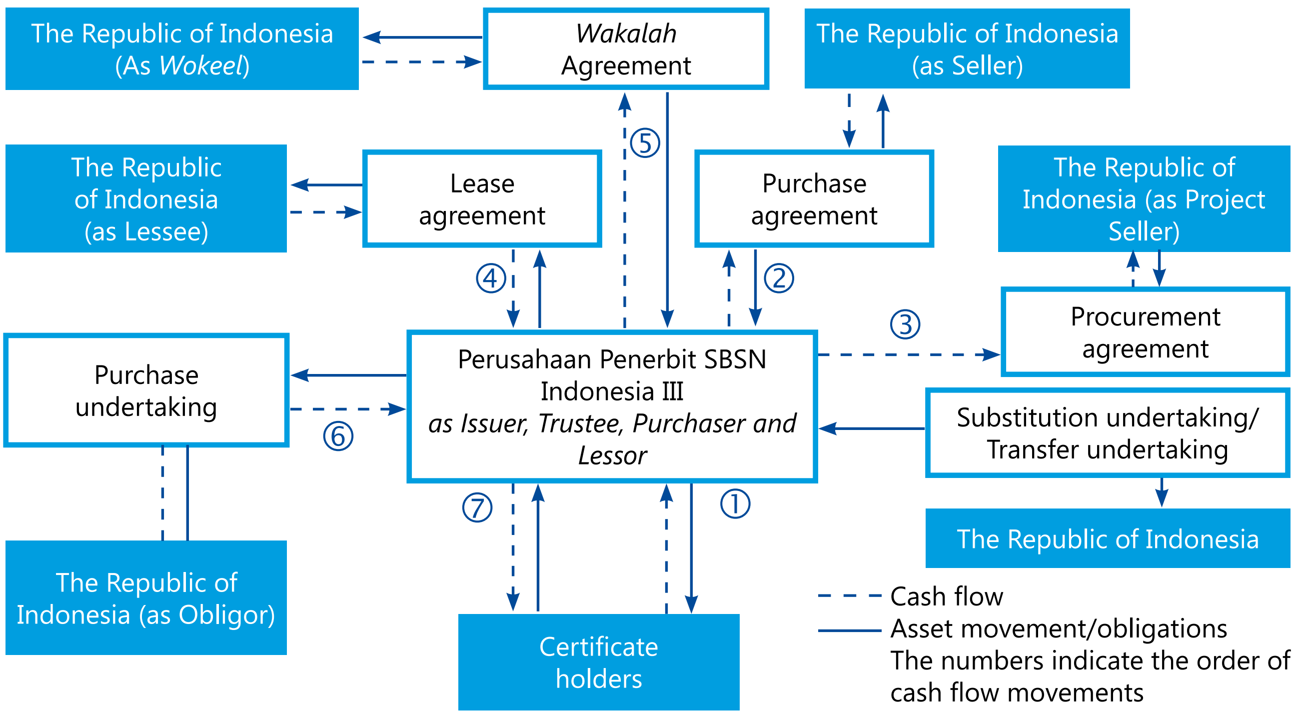
Wakala Green Sukuk Structure

A *wakala* sukuk is an arrangement whereby one party entrusts another party to act on its behalf, as in an agency agreement. A principal (investor) appoints an agent (*wakeel*) to invest funds provided by the principal into a pool of green investments. The agent then makes use of its expertise to manage the investments on behalf of the principal for a specific period of time and to generate a targeted profit return. The principal and agent enter into a *wakala* agreement which governs the appointment of the agent, the scope of the services and the fees payable, if any.[35]

Green bond issuers in conventional markets have aggregated and securitized small projects, including mortgages on green buildings, loans for energy efficiency upgrades, and cash flows arising from solar and wind assets, in order to access capital at a lower cost. In the case of green sukuk, the *wakala* based sukuk enables governments to pool small projects like biomass, clean cooking energy or solar energy projects and to benefit from economies of scale to provide competitive and inclusive financing. The underlying assets of a *wakala* sukuk can be a portfolio of mixed tangible or intangible assets that can expand over time, providing issuers with the flexibility to choose the underlying assets.[36]

The world's first sovereign green sukuk, issued by the Government of Indonesia in 2018, was structured on a *wakala* contract (Figure 3.3). The underlying assets consist of state-owned assets including land and buildings (accounting for 51 percent of the asset pool) and project assets that are under construction or to be constructed (accounting for the remaining 49 percent of the asset pool).

Figure 3.3. Indonesia Sovereign Green Sukuk Structure – *Wakala* Series



Source: Malaysia Securities Commission and World Bank, 2019.[37]

[35] https://islamicmarkets.com/education/sukuk-al-wakala

[36] Aassouli, D., Asutay, M., Mohieldin, M., & Nwokike, T. C. (2018). Green Sukuk, Energy Poverty, and Climate Change: A Roadmap for Sub-Saharan Africa', Working Paper. World Bank Group, Washington D.C.

[37] Malaysia SC & World Bank, Islamic Green Finance: Development, Ecosystem and Prospects, 2019

The US$ 1.25 billion green sukuk has a maturity of five years and its proceeds are allocated to climate or environment-related projects such as renewable energy, sustainable transport, waste management and green building projects.

3.3 GREEN BONDS/SUKUK FRAMEWORK

Pursuing sustainable development financing through instruments like green bonds and sukuk requires clarity on green standards and the classification of green assets. The issue of green bonds and green sukuk has been paralleled by a number of global initiatives to ensure proper standards for green finance. Examples include the Climate Bonds Standard set by the Climate Bonds Initiative, the Green Bond Principles set by the International Capital Market Association (ICMA), the SRI (Socially Responsible Investment) Sukuk Framework set by the Malaysian Securities Commission, and the ASEAN Green Bond Standards set by the ASEAN Capital Markets Forum. All these initiatives share a common purpose: ensuring that green projects are adequately defined, and that issuers deliver on their promises.

Typically, a green sukuk framework covers four core areas: the use of proceeds, procedures for project evaluation and selection, the management of proceeds, and reporting. The principles set out in these areas constitute voluntary guidelines that contribute to higher levels of transparency and integrity in issuing green sukuk. The principles apply to all stakeholders involved in green sukuk issuance: they guide issuers in the process of launching their green sukuk, allow investors to evaluate the environmental impacts of their investments, and help underwriters by directing the market towards standard, predictable instruments, so facilitating transactions[38]. External reviews are also recommended. The principles adopted by the ICMA will be discussed in more detail here (Figure 3.4):

Figure 3.4. Key Components of the Green Bonds/Sukuk Framework

Use of proceeds	Project evaluation and selection	Management of proceeds	Reporting	External Review
Ensures that the proceeds raised from the issue are utilized only for financing activities related to eligible projects	Provides key information about the internal processes of evaluation and selection of the eligible projects	Traces and monitors whether the proceeds allocated for the projects are credited into appropriate accounts	Requires reporting on the impact of the eligible projects, at least annually	Entails an unbiased review of all stages of project execution through an independent external assessment

Source: World Bank (2019)[39]

Use of proceeds

The way in which the proceeds from green sukuk are to be used should be outlined clearly in the legal documents concerning their issue. Investors should be fully aware and informed as to how the green sukuk proceeds will be invested. Several areas or sectors are specifically recognised as eligible for green sukuk. These include renewable energy, energy efficiency, sustainable transportation, green buildings, pollution prevention and control, the environmentally sustainable management of land, sustainable water and wastewater management, the conservation of terrestrial and aquatic biodiversity, and eco-efficient products, production technologies and processes.

[38] ICMA (2018). Green Bond Principles – Voluntary Process Guidelines for Issuing Green Bonds

[39] World Bank (2019). Islamic Green Finance - Development, Ecosystem and Prospects

Project evaluation and selection

Investors must also be fully informed about how the issuer evaluates and selects projects to finance. To this end, investors should be informed about the environmental sustainability objectives, the process by which the issuer determines whether the projects fall into the eligible green project categories, and the related eligibility criteria. Issuers should disclose this information as part of their overall environmental sustainability strategies. Additionally, for the sake of transparency, it is advised that the issuer's process of project selection and evaluation is coupled with an external review (see below).

Management of proceeds

Issuers must account properly for the sukuk proceeds. Proceeds allocated to eligible projects or sectors should be credited into a designated account or appropriately tracked. In other words, the "net proceeds of the green bond/sukuk, or an amount equal to these net proceeds, should be credited to a sub-account, moved to a sub-portfolio or otherwise tracked by the issuer in an appropriate manner, and attested to by the issuer in a formal internal process linked to the issuer's lending and investment operations for Green Projects"[40]. Unlike traditional bonds, the issuers of green sukuk need to inform their investors specifically about how the project balance sheet unfolds. This practice keeps investors informed about the progress of each stage of the project and guarantees that the project is sustainable or green in its entirety, and not solely in terms of its final impact[41].

Reporting

Issuers are required to maintain and provide up-to-date information on the use of the proceeds from green sukuk and to produce annual reports encompassing: the original amounts allocated to projects, together with descriptions of the projects and their expected impacts; the amounts used for eligible projects, and unused amounts and their location pending utilization[42]. In addition to the crucial auditing role, reporting also includes providing investors with a review and details of the impact of the project on the environment[43], which is not a prerequisite for traditional finance. When reporting on achieved impacts, issuers are advised to look at both quantitative and qualitative measures wherever feasible, and to describe the methodology used in their assessments[44].

External review

Finally, in order to monitor the alignment of green sukuk issues with specific local, national or international guidelines, issuers are advised to hire an independent, third-party expert to perform the aforementioned external review. In this case, an external reviewer is appointed to examine and/or oversee the issuer's compliance with the requirements of the sukuk agreement as well as to assess the eligible green sukuk projects. Prior to this, issuers are also advised to adopt internal green sukuk frameworks in accordance with the specific guidelines applying to their projects[45].

[40] ICMA (2018). Green Bond Principles – Voluntary Process Guidelines for Issuing Green Bonds

[41] World Bank (2019). Islamic Green Finance - Development, Ecosystem and Prospects

[42] ICMA (2018). Green Bond Principles – Voluntary Process Guidelines for Issuing Green Bonds

[43] World Bank (2019). Islamic Green Finance - Development, Ecosystem and Prospects

[44] ICMA (2018). Green Bond Principles – Voluntary Process Guidelines for Issuing Green Bonds

[45] Malaysia SC & World Bank, Islamic Green Finance Development, Ecosystem and Prospects, 2018

CHAPTER 4: GREEN SUKUK DEVELOPMENT IN UZBEKISTAN – OPPORTUNITIES AND CHALLENGES

4.1 GOVERNMENT VISION AND TARGETS FOR GREEN FINANCE

In recent years, the government of Uzbekistan has declared its commitment to promoting the growth of a green and sustainable economy and has formulated specific visions and targets to be achieved both in the short term and in the long term. In 2017, the government adopted a five-year strategy for development entitled the Action Strategy on Five Priority Directions for the Development of the Republic of Uzbekistan 2017-2021. The purpose of the strategy is to set the stage for strategic national reforms in key priority areas and to define the responsibilities of each government agency and stakeholder. The five priority areas addressed in the strategy are: economic liberalization, development of the social and environmental spheres, constructive foreign policy, the rule of law, and good governance. The Action 3.3 of the Strategy relates to pursuing a holistic approach and systematic measures in the area of adaptation to climate change, application of water and resource conservation technologies in the agricultural sector and etc.

The Concept Note for Ensuring Electricity Supply in Uzbekistan in 2020-2030 aims to meet the growing demand for power and to reduce the existing electricity deficit while simultaneously promoting balanced development and paying due attention to sustainability and the green economy. The Concept Note also spells out the need to reconstruct and modernize the existing power-generating and power-distributing utilities to increase energy efficiency, to improve the power metering systems, and to diversify fuel sources and further promote and develop the use of renewable energy. The Concept Note looks at best international practices in the area of sustainable development and attempts to replicate them in the specific context of Uzbekistan. The note sets out both medium-term and long-term targets for the power sector. Specifically, it sets out the following objectives:

- *the satisfaction of the country's electrical power demand in full through domestic generation, avoiding dependence on energy imports and ensuring energy security;*
- *the improvement of the energy efficiency of the economy and a reduction in its energy intensity, including through the creation of economic mechanisms to stimulate rational use of electrical power by consumers;*
- *an increase in the energy efficiency of the generation, transmission and distribution of electrical power to satisfy the growing demand;*
- *a reduction of power equipment wear-and-tear through constant renewal and an increased reserve of generation and transmission assets;*
- *the development and expansion of the use of renewables and their integration into the unified power system;*
- *the development of an efficient basic electricity market model.*

As can be seen from these objectives, one of the issues highlighted in the Concept Note is the development of renewable energy generation, especially wind power and solar energy. Projects in these areas are expected to be financed solely by investors or independent energy producers. The Note contains specific renewable energy generation targets for the period 2020-2030. Calculations based on these targets suggest that 3 GW of wind power capacity and 5 GW of solar energy capacity need to be constructed by 2030. In order to achieve these targets, solar plants will be equipped with large storage systems. Aware that attracting foreign direct investment (FDI) will be instrumental in reaching the targets, the government is working on promoting FDI in the renewable energy sector through the introduction of competitive bidding processes. The government is dedicated to working with the IFIs during the initial stages of the implementation process in order to identify potential investors under the Build-Own-Operate framework and to sign long-term Power Purchase Agreements (PPAs) for the supply of renewable energy.

In addition to these large scale projects and frameworks, several small scale solar power plants, which are not connected to the central grid, are to be constructed in remote areas. The plan also calls for the construction of medium scale solar power facilities to cover the power needs of individual producers and industrial hubs. Residential renewable energy installations supplying individual houses and residential complexes are expected to be constructed in the form of independent power units. Overall, the government's commitment to the fulfilment of all the listed objectives and targets rests on the implementation of these key priorities:

- *the modernization and construction of the new power sector assets required to ensure the efficient functioning of the domestic market, and the improvement of the power metering assets system and despatch controls, through the introduction of modern information and communication technologies;*
- *improvement of the efficiency and rational use of electricity at all stages of technological processes through the use of energy saving technologies and optimization of generating assets;*
- *the diversification of the power and heat energy sectors through an increase in the share of renewable energy sources, the development of renewable energy investment project mechanisms utilizing PPP approaches, the enhancement of government policies related to the development of renewable energy sources, and the demonstration of renewable energy projects;*
- *the development of a comfortable administrative environment, based on the rule of law, for power investments and wholesale power sales with a view to attracting long-term investments, particularly foreign direct investments;*
- *the enhancement of corporate governance and an increase in the transparency of the financial and economic operations of state-owned power enterprises;*
- *the expansion of trans-boundary trade and strengthening of regional cooperation through the restoration and modernization of transmission lines connected to neighbouring countries' power systems;*
- *the development of market relations through a step-by-step process of liberalization and a reduction in the role of the government, the creation of a new market model based on a clear division of rights and responsibilities between the actors in this sector at all levels from the single bu*yer upwards, and the establishment of competitive wholesale and retail markets.

The intensity of GHG emissions in Uzbekistan is among the highest in the world at 3.85 kg of CO_2e per US$ of GDP in 2012[46]. In 2018, Uzbekistan ratified the Paris Climate Agreement and committed itself to help mitigate climate change by adopting an Intended Nationally Determined Contribution (NDC) envisaging a reduction of 10 percent in its GHG emissions per unit of GDP between 2010 and 2030. The commitment promises efforts to promote more widespread use of energy-saving technologies in industry, to increase the use of renewable sources of energy, and to alleviate the consequences of the environmental damage in the Aral Sea region. The existing lack of energy efficiency, coupled with irresponsible use of natural resources, is obstructing the transition to a green economy and the fulfilment of Uzbekistan's sustainable development commitments. To address these issues, the Uzbek government is dedicated to a fundamental transformation of the use of energy and natural resources by instilling the principles of the green economy into the overall process of economic growth and development, including de-carbonization, resource conservation and sustainable agriculture[47].

In 2019, the President of Uzbekistan approved the Strategy for Transition to a Green Economy in order to support the Action Strategy of 2017 and the NDC, as well as to provide a long-term comprehensive framework for sustainable development. This strategy is discussed in more detail in section 4.3. The accompanying resolution states that the strategy should achieve the following results by 2030:

- *a 10 percent reduction in GHG emissions per unit of GDP by comparison with 2010;*
- *a twofold increase in energy efficiency indicators and a decrease in the carbon intensity of GDP;*
- *further development of renewable energy sources, which are to account for more than 25 percent of the total volume of electricity generation;*
- *an increase of at least 20 percent in the energy efficiency of industrial enterprises;*
- *the development of electrical vehicles;*
- *the introduction of drip irrigation technology over a total area of up to 1 million hectares and an increase of 20-40 percent in the yield of the crops cultivated in these areas;*
- *a neutral balance in land degradation;*
- *an increase of 20-25 percent in the average productivity of the main agricultural food products.*[48]

4.2 IDENTIFICATION OF POTENTIAL GREEN SECTORS

Although the initiatives referred to above have coordination between different sectors at their core, some sectors are particularly central for a successful transition to a green economy. The two most critical sectors are energy and agriculture, as these are the sectors with the greatest environmental impact and consequently the largest potential for the implementation of projects related to the transition. The housing and water sectors can also be identified as areas with vast potential for promoting a green economy, as a number of

[46] OECD (2019) Sustainable Infrastructure for Low-Carbon Development in Central Asia and the Caucasus : Hotspot Analysis and Needs Assessment. Chapter 9. Uzbekistan's sustainable infrastructure investments. (https://www.oecd-ilibrary.org/sites/5fd38a3d-en/index.html?itemId=/content/component/5fd38a3d-en)

[47] Resolution of the President of the Republic of Uzbekistan on the Approval of the Strategy for the Transition of the Republic of Uzbekistan to a "Green" Economy for the period 2019-2030

[48] Dentons (2019) Transition of the Republic of Uzbekistan to a Green Economy (https://www.dentons.com/en/insights/alerts/2019/october/30/transition-of-the-republic-of-uzbekistan-to-a-green-economy)

green projects have been launched and implemented in the areas of construction and water management. These four sectors are discussed in the following sub-sections.

4.2.1 OVERVIEW OF THE ENERGY SECTOR

In Uzbekistan, 82.1 percent of all power generation comes from natural gas, with 13.6 percent coming from hydroelectric power and slightly less than 4 percent from coal. The share of wind power and solar energy in power generation is minimal. The country has abundant resources of solar energy, as there are between 2,410 and 3,090 hours of sunshine annually in every region. Sources of wind energy are much more limited as winds are relatively weak in most regions of Uzbekistan. The average annual wind speed does not exceed 3 metres per second, and this value is exceeded in only a few places. In 2018, the total installed capacity was only 4 MW in the case of photovoltaic solar power and 1 MW for wind energy.

Table 4.1. Government Targets for the Development of Green Energy (MW)

	2018	2019	2020	2021	2025	2031
Solar energy	100.0	200.0		300.0	450.0	4,000.0
Wind				102.0	302.0	
Hydropower	60.7	157.7	382.5	601.9	12,140.0	

Uzbekistan's renewable energy market is attractive to investors because of government support. Recently, the President of Uzbekistan signed a decree that provides homeowners with a 30 percent discount on their first purchase of a photovoltaic system, up to a maximum amount of UZS 3 million, as a way of increasing the use of rooftop solar panels.

In June 2017, the Government of Uzbekistan set targets for increasing the use of renewable energy by 2025 and announced policy measures to accelerate the development of this sector. The measures included guaranteed access to power grids and priority distribution for power from renewable sources. In May 2019, the President signed a law envisaging further benefits for renewable energy. These included the following:

- Companies that install renewable energy generation equipment will be exempt from corporate income tax and land tax provided their output is 0.1 MW or more.
- Companies manufacturing equipment for energy generation are exempted from all taxes for five years from the date of their registration.
- Individuals using power from renewable energy sources only will be exempted from property and land tax for three years.

4.2.2 OVERVIEW OF THE AGRICULTURAL SECTOR

Agriculture remains one of the most important sectors for Uzbekistan's development. According to the UN Food and Agriculture Organization (FAO), agriculture accounts for about 18 percent of GDP and has an annual growth rate of 1.7 percent. Crop production accounts for 54 percent of agricultural production and livestock breeding for the remaining 46 percent. The agricultural sector also employs 27 percent of the working population (approximately 3.4 million people in 2017). This means that the incomes of almost 15 million people, many of them underemployed, depend largely on agricultural activities. In addition, almost 50 percent of the country's entire population resides and works in rural areas. The total area of Uzbekistan is around 44 million hectares, of which 4.5 million hectares is arable land and 4 million hectares is under irrigation. The main crops cultivated in the country are cotton, wheat, rice, vegetables and fruits. Wheat and cotton occupy 80 percent of the irrigated area. In recent years, the area of irrigated land has increased significantly, which in turn has stimulated the use of advanced technologies such as certified seeds and improved agronomic management. All this has resulted in a higher level of food security[49].

The agricultural sector is also one of the most heavily regulated sectors, with very weak protection of producer property rights. Additionally, the markets for agricultural products remain underdeveloped, and there is an urgent need to reform the agrarian sector. Efforts at reform have been made, but the necessary paradigm shift has not yet come about. Annual wheat production is about 8 million tons, making the country fully self-sufficient in grain[50].

In addition to self-sufficiency in food production, Uzbekistan has a considerable potential for agricultural exports, since its topography is conducive to growing a variety of foods and industrial crops. However, there are various environmental concerns, particularly with respect to deteriorating water quality and the loss of biodiversity. The government has acknowledged these issues and is striving to incorporate the rational and responsible use of natural resources into its agricultural development strategies. Water used for crop irrigation is supplied through an extensive and inefficient grid of dams, canals, and pumping stations. Irrigation consumes around 90 percent of total water extraction for all industries. Demand for water is expected to rise further with the increase in the population. Simultaneously, climate change may further exacerbate the imbalance between water demand and supply.[51]

To address these issues and ensure more sustainable use and management of agricultural resources, the Strategy for Transition to a Green Economy sets the following specific targets for agriculture, which are to be accomplished by 2030:

- *the restoration of degraded pastures and the introduction of sustainable pasture management mechanisms;*
- *the introduction of organic farming methods;*
- *the re-sowing of crops to ensure continuous coverage of cropland surfaces;*
- *the diversification of crops (expansion of crops of perennial tree plantations and perennial grasses);*
- *the encouragement of investment in production and processing and the creation of value chains for agricultural and food products;*
- *the proper storage / processing of organic animal waste;*
- *the prevention of the pollution of water sources with agricultural waste;*
- *the development of highly productive animal breeds and varieties of plants resistant to salinity, drought and other hazards and risks, and the preservation of the gene pools of local animal breeds and plant varieties and of wild ancestors of cultivated plants.*

4.2.3 OTHER POTENTIAL SECTORS

Water Management

The water supply and sanitation systems in Uzbekistan require extensive rehabilitation. Providing reliable water supply and sanitation services to the population is a key priority for the government. At the same time, the sector displays a number of inherent problems

[49] UNFCCC (2016) Uzbekistan: Preparation of the Third National Communication under the UN Framework Convention on Climate Change (UNFCCC)

[50] FAO (2018) Organic Agriculture in Uzbekistan: Status, Practices and Prospects

[51] FAO (2018) Organic Agriculture in Uzbekistan: Status, Practices and Prospects

including worn-out infrastructure, financial instability and weak institutional capacity. The situation is compounded by the outdated sectoral strategy, limited planning mechanisms and ageing standards. In many rural settlements, households are provided with water supply services for only a few hours a day. Only 19 percent of consumers receive water for 24 hours a day. Another 18 percent of consumers receive water for 12 hours a day, and the vast majority of consumers (60-65 percent) have water available for no more than 6 hours a day. The situation in small and medium-sized cities can be even worse.

In most rural settlements, water supply systems are operated intermittently, and a significant proportion of them have been abandoned or have collapsed. The number of rural water supply systems that have collapsed or are being operated intermittently is estimated to make up one-third of the total number of structures in the water and sanitation sector. As many as 33 percent of households use unimproved water from springs, rivers, canals and irrigation ditches as drinking water, while 9.9 percent of the population uses transported water, which costs UZS 25,000-50,000 per cubic metre. Some 2,000 km of inter-regional water supply pipelines have been built in order to supply water to regions lacking in sources that meet drinking water standards. About 40 percent of water is supplied through the inter-regional water pipelines, which are estimated to operate at 52 percent of their capacity. The use of electricity per cubic metre of water is also high due to the use of large quantities of outdated equipment to draw water from surface or underground sources and to transport, lift and pump water for consumers.

The government has issued a number of documents aimed at improving the coverage and efficiency of the water and sanitation systems. Among these are the Concept for the Development of the Water Sector of the Republic of Uzbekistan for 2020-2030 and a roadmap for the implementation of the tasks envisaged in the Concept. The priority areas identified for the implementation of the Concept are as follows:

- ensuring a sustainable and guaranteed water supply to all sectors of the economy in the medium and long term, making efficient and rational use of water and increasing the quality and safety of water through widespread implementation of the principles of integrated management of all surface, underground and return waters;
- further expanding the use of water-efficient irrigation technologies and increasing the efficiency of water use, and enhancing the system of state support and incentives for agricultural producers that have adopted water-saving methods and technologies;
- improving the reclamation of irrigated lands, increasing their fertility, maintaining optimal groundwater levels, and introducing effective methods to combat soil salinization;
- introducing market principles in the water sector, implementing public-private partnership and outsourcing mechanisms, and enhancing the financial sustainability of the water sector by increasing the share of foreign investment.

Housing

Over the past three years, 104,000 housing units have been built in Uzbekistan, 63,000 in rural areas and 41,000 in urban areas. However, there is an annual need for 145,000 apartments with a construction cost of about UZS 30 trillion. In recent years, the government has issued a number of resolutions related to the provision of affordable housing for residents of the country. In 2017, about 29,000 houses were constructed under state programmes. More than 20,000 of these were built in rural areas. The private sector constructed multi-storey buildings containing 16,000 apartments.

On 1 May 2020, the President of Uzbekistan signed the Decree on Additional Measures to Improve the Living Conditions of the Population and Further Expand the Mortgage Market.

This decree introduced new procedures based on market mechanisms for providing the population with housing through the allocation of mortgage loans. It is expected to create a favourable environment for the acquisition of housing and the improvement of housing conditions, contribute to the development of the mortgage market, and stimulate the private residential construction sector.

The government has also recently strengthened the implementation of measures to expand the use of energy-saving technologies in the design and construction of multi-storey buildings, and to promote foreign investment in improving the energy efficiency of social facilities. These activities are necessary because residential and public buildings accounted for 34 percent of primary energy consumption in 2005-2015. This corresponds to about 16.4 million tons of oil equivalent (toe). It is believed that savings of around 20 percent could be made in household energy consumption, as 400 kWh of electricity per year is used to heat one square metre in Uzbekistan, while in developed countries, this figure stands at 170 kWh.

At the same time, there is insufficient access to long-term financing and the capital markets are undeveloped. Commercial banks have limited access to long-term financing (more than one year). This makes them reluctant to finance mortgage loans. As a result, their internal capacity for the proper design, analysis, evaluation and servicing of mortgage loans also remains inadequate. The capital market is insufficiently liquid, as there is no active bond market through which long-term financing might be raised from institutional investors such as pension funds or insurance companies. Although the state-owned banks have significant portfolios of mortgage loans, these mortgages cannot be used by banks to issue corporate bonds or mortgage-backed securities due to the highly subsidized interest rates.

Finally, one of the projects the government is committed to work on, as part of its Strategy for Transition to a Green Economy, is the ''green mortgage" project. The Strategy calls for the ''development of a mortgage lending system for energy efficient renovation, in particular, the use of 'green' mortgage loans". A green mortgage loan is a bank product which allows home-buyers to purchase energy-efficient, low-carbon houses. It enables households to make savings on electricity and heating while GHG emissions are reduced. It also gives banks an innovative financial product that meets environmental requirements, allowing them to attract clients in rural areas, as well as a wider base of environmentally-conscious home-buyers.

4.3 OPPORTUNITIES AND CHALLENGES REGARDING THE DEVELOPMENT OF GREEN SUKUK IN UZBEKISTAN

4.3.1 OPPORTUNITIES

The introduction of green sukuk has the potential to support Uzbekistan in addressing climate change issues as well as generating funds for national development, which is aligned with the SDGs. Some of the opportunities for the engagement of Uzbekistan in Islamic finance and green sukuk in particular are highighted below.

Political Commitment to Transition to a Green Economy

As seen in section 4.1, the government of Uzbekistan is committed to making the transition to a green economy. Although there are several initiatives in this area, the specific steps to be taken are most comprehensively spelled out in the overarching Strategy for Transition to a Green Economy. These steps relate both to financial affairs and to non-financial issues. One of the government's primary concerns is to develop an institutional framework conducive to the adoption and use of green technologies by assessing the technology needs, supporting the development of the relevant green technologies and building mechanisms for the commercialization of green technologies and green innovation. The government is also committed to enhancing and adapting legal and regulatory frameworks in such a way as to facilitate the transition. Since increasing energy efficiency is a prerequisite for the transition to a green economy, the Strategy highlights the need to develop mechanisms for the control and regulation of energy efficiency in the country. To this end, the government is committed to developing energy efficiency targets, together with an accompanying monitoring system, and to fostering the implementation of a comprehensive energy consumption metering system encompassing all categories of users (individual users, industrial plants and power facilities).

In view of the commitments Uzbekistan has made in connection with its ratification of the Paris Climate Accord, the Strategy for Transition to a Green Economy calls for the development of a system for monitoring and tracking GHG emissions and other climate indicators. Such a system would require the development and use of advanced green technologies. Efforts are being made to promote public-private partnerships as a means of supporting the development of these technologies. The government also recognizes the need to raise the awareness of the general public concerning the green economy. It highlights the need to nurture a culture of responsible use of energy and resources, to consider including the principles of the green economy in the national educational curriculum and to promote research in areas related to climate change mitigation. Attention has also focused on raising the awareness of those working in industry and developing the specific set of professional skills which management and engineering staff will need in a green economy. Finally, the government's commitment to supporting green investments is especially relevant for the present study. Specifically, it is committed to introducing a system of green lending and venture financing, establishing green funds for energy saving, encouraging the private and banking sectors to contribute to the financing of the green projects envisaged for the transition, and using state fiscal policy to support the sustainable development of a green economy.

Leveraging Green Finance Options

Green finance has achieved promising results although it remains very small in comparison to traditional finance. Opportunities exist for the government of Uzbekistan and Uzbek companies to leverage the options provided by the nascent international green finance ecosystem. The following examples illustrate these opportunities:

The Government of Uzbekistan has the opportunity to prepare a national green sukuk framework in accordance with international and regional frameworks such as the Green Bond Principles, the Climate Bonds Initiative and the ASEAN Green Bond Standards. The alignment of the national framework with international frameworks would help to broaden the investor base for green sukuk.

The Green Climate Fund (GCF) aims to support the efforts of developing countries to respond to the challenge of climate change.[52] *Inter alia*, the GCF provides countries with support of up to US$1 million per annum to set up a regulatory green finance framework.[53]

The UN Sustainable Stock Exchanges Initiative (SSEI), a peer-to-peer learning platform, serves as a capacity-building space for stock exchanges and securities market regulators to promote responsible investment in sustainable development and advance corporate performance on ESG issues. One of the initiatives of UN SSEI is the green finance action plan,

[52] Green Climate Fund, https://www.greenclimate.fund

[53] Malaysia SC & World Bank, Islamic Green Finance Development, Ecosystem and Prospects, 2018

which intends to guide stock exchanges in the implementation of green finance strategies. This voluntary action plan provides exchanges with a checklist of 12 action points within four action areas. It can be used as a self-assessment tool to identify areas where stock exchanges can initiate or expand their activities related to green finance. Real world examples are provided for each action item to assist with implementation.[54]

There are several diversified and complementary tools and methodologies for measuring social and environmental impact. These tools were designed for conventional impact investing but can also be used for green sukuk. Examples include the Integrated Risk Information System (IRIS) metrics of the Global Impact Investing Network, the Global Impact Investing Rating System (GIIRS), Social Return on Investment (SROI) methodology and the Impact Management Project.

The Increasing Role of International Financial Institutions

One of the pillars of Uzbekistan's investment policy is cooperation with IFIs through the joint implementation of investment projects in areas like education, healthcare, agriculture and water management, the institutional development of government agencies, drinking water and sanitation, the development of energy efficiency, the environment, and SME support. In the area of climate finance, Uzbekistan is one of the top countries in Central Asia in terms of the amount of financing allocated by MDBs. As a result of its strong relations with IFIs, their annual investments in the Uzbek economy are increasing (Table 4.2).

Table 4.2. Climate Finance from Multilateral Development Banks (2015-2019, US$ million)

	2015	2016	2017	2018	2019
Kazakhstan	438	521	389	260	364
Kyrgyzstan	73	179	55	118	189
Tajikistan	149	34	232	192	116
Turkmenistan	1	1	6	5	–
Uzbekistan	61	55	270	1 162	823

Source: 2019 Joint Report on Multilateral Development Banks' Climate Finance[55]

Since Uzbekistan joined the IsDB in 2003, the bank has provided substantial development assistance. In 2018, the government of Uzbekistan and IsDB signed a Partnership Strategy for 2018-2021 which focuses on supporting sustainable socio-economic development in the country through several bilateral and regional initiatives. In addition to initiating leasing companies (based on *ijara*) and providing credit lines to local banks for the provision of Sharia-compliant finance, the IsDB is also committed to help its member countries "integrate climate mitigation strategies through specific investments that contribute to the transition to a low-carbon, green economy". Moreover, the Bank will "provide member countries with support that can help them translate their NDCs and/or sector-level strategies into an actionable, 'bankable' pipeline of investments."[56] In 2019, the Bank issued a green sukuk to encourage its member countries to engage in the green sukuk market.

IFIs have a mandate to support developing economies. This can be done through a blend of finance and credit enhancement mechanisms, reducing risk exposure and enhancing market incentives so as to mobilize private capital, especially for large-scale projects. In this context, IFIs can act as market facilitators by participating in first-time issues and assisting

[54] See https://www.sseinitiative.org/

[55] 2019 Joint Report on Multilateral Development Banks' Climate Finance. August 2020.

[56] Islamic Development Bank. Climate Change Policy. February 2019.

new issuers to attract investors. Similarly, IFIs can subscribe to private placements or act as anchor investors in green sukuk issues to help the company seeking funding build investor confidence and catalyse investment from a wider pool of private actors, both international and domestic[57].

Individual and Institutional Demand for Islamic Finance Products

According to the World Bank Findex Database for Uzbekistan (2014), 27 percent of adults do not have an account at a bank or with any other type of formal financial institution for reasons related to religion[58]. This is a significant figure, which points to a strong potential demand for Islamic financial products and services. The development of Islamic finance in Uzbekistan could provide a channel of access to financial services for the segment of the society which voluntarily avoids engaging in financial activities because they are not in accordance with their religious beliefs.

A consumer preference for Islamic finance can also be observed in the leasing sector. The first Islamic leasing company in Uzbekistan, Taiba Leasing, was established in 2010 as a 100 percent subsidiary of the ICD. The ICD has also provided lines of financing to other leasing companies in Uzbekistan with a view to supporting SMEs. The SMEs apply for funding with *murabaha*-based projects and are selected after screening and evaluation. While leasing companies are legally restricted to serving businesses and entrepreneurs, there is also a high demand from individual consumers for Sharia-compliant car and home financing. The authorities have therefore been called on to allow leasing companies to cater to individuals.

In the banking sector, rising demand from individual and institutional clients has led several conventional banks to embark on the process of establishing Islamic windows with financial and technical assistance from the ICD. It has been suggested that legal amendments should be made to authorize the operations of Islamic windows in order to enhance financial inclusion and to reach out to potential new clients. This would support the Strategy of Reforming the Banking Sector of the Republic of Uzbekistan for the period of 2020-2025, which includes improving financial inclusion as a priority. In addition, opening Islamic windows is an important early-phase practice for the development of an Islamic finance industry.

Signaling the Presence of Uzbekistan in the Green Market and the Global Islamic Finance Industry

Countries have adopted Islamic finance practices to generate alternative earnings, provide equal financial access to all their citizens, and encourage investment from other regions. The sukuk has proved to be a promising instrument for attracting new investors reluctant to invest in interest-based conventional bonds to the capital markets. At the same time, the green bond market has grown substantially, driven by the growth of socially responsible investing, in which investors seek to make a positive impact alongside their financial returns. The underlying principles of green bonds and sukuk are well-aligned, since both modes of financing raise funds for a specific purpose and both have environmental, ethical and social aims at their core. The principles of Islamic economics include "environmental stewardship", such as the protection of air, water, land and other ecosystems.

Investors with religious sensitivities and investors with environmental, social and corporate governance (ESG) concerns collectively constitute a wide investor base for green sukuk. As more and more countries translate their commitment to climate change issues

[57] Climate Bonds Initiative. Green Infrastructure Investment Opportunities Vietnam 2019 Report.

[58] Global Financial Inclusion (Global Findex) Database 2014.

into favourable policies, and the number of bankable projects increases, the green sukuk is expected to distinguish itself as a widespread alternative to traditional financing techniques.

Given that Uzbekistan is currently not involved in the green bond market or Islamic capital markets, and that it is seeking to attract international investors and diversify its capital markets, a green sukuk issue would constitute a landmark step to engage with a new set of investors and encourage the mobilization of foreign and local capital. A debut green sukuk issue would send a strong signal to the market, demonstrating commitment and presence in the global Islamic finance market as well as the green bond market.

A sovereign green sukuk issue would showcase the dedication and support of the government, make a sizeable liquid asset available to encourage investors to allocate capital to a green investment strategy, and pave the way for corporate issuers to enter the market.

4.3.2 CHALLENGES

Since the first green sukuk was issued in 2017, the market has been attracting growing interest from Islamic and conventional investors, and new sovereign and corporate issues have taken place in different regions of the world. As the green sukuk market becomes better-known, countries like Uzbekistan have set their sights on tapping it. Despite the opportunities available and the momentum that has been generated, there are several challenges that need to be addressed if the country is to develop a green sukuk ecosystem. These challenges are complex and call for a gradual process of change. Below are a few of the most salient challenges that need to be addressed for the integration of Uzbekistan into the green sukuk market.

The Absence of an Islamic Finance Market

The growth of the Islamic finance industry is at a very early stage in Uzbekistan. The existing Islamic finance practices, including the *ijara* financing provided by a number of leasing companies and the initiatives of the IsDB, are being carried out under the existing conventional legislation. Islamic finance instruments, whether in the banking system or the capital markets, are yet to be recognized at the levels of policy and legislation[59]. Without previous experience in Islamic finance, the issue of a sukuk will require a great effort, since this instrument is new to investors and may well be percieved as more complex than a traditional bond. In addition, the issue of green sukuk and the growth of the sukuk market depend on the development of all segments of the Islamic finance industry, including banking and *takaful*. The development of all these sub-sectors is essential if Uzbekistan is to build a robust Islamic financial sector. The CBU recognizes the interest in the implementation of Islamic finance mechanisms and indicates that the integration of Islamic finance principles requires a comprehensive revision of the legal and regulatory framework. In this regard, a working group has been set up, led by the Ministry of Foreign Trade and Investments, and is expected to prepare a report on the opportunities and challenges, together with recommendations, based on an in-depth analysis of the economic and legal aspects of Islamic finance integration.

A well-developed governance structure is important for the safety and soundness of financial institutions. In the case of Islamic finance, Sharia governance is an important component of this, underpinning the credibility of the Islamic financial institutions. The absence of an adequate Sharia governance framework in the financial market is a key impediment

[59] A draft resolution of the President of the Republic of Uzbekistan on measures to intoduce securities based on the principles of Islamic finance and facilitate issuance of sukuk in Uzbekistan was put forward for public discussion in October 2020.

to the growth of the sukuk market in Uzbekistan. There is a need for effective corporate governance and Sharia governance frameworks, based on the adoption of international best practices, to maintain trust, confidence and transparency on both the supply and demand sides of the capital markets.

Immature Capital Market

Although the government of Uzbekistan has embarked on an extensive reform programme to increase the role of capital markets in the development of the economy, these markets are still of an embryonic nature. Strategies still need to be implemented to increase the supply of issuers and create demand from investors, as detailed in Chapter 1.

The financial market of Uzbekistan is dominated by the banking sector and the engagement of banks with the capital markets is very limited due to a restrictive regulatory environment.

Currently, all issues of corporate and other bonds are governed mainly by the Rules of Issue of Securities No. 2000, which states that corporate bonds can only be issued by joint stock companies and banks. Moreover, the strict requirements imposed on the bond issuer make this instrument an unattractive source of financing for many banks and joint stock companies.

Unless otherwise provided for in the charter of the issuer, bonds are issued by a decision of the meeting of shareholders, or of the supervisory board if such authority has been vested in it by the meeting of shareholders. Corporate bonds may be issued subject to the following conditions:

- They are within the limits of the issuer's equity capital as of the date of the decision taken to issue them, as confirmed by the report of the auditor.
- The issuer has maintained positive indicators of profitability, solvency, financial stability and liquidity over the course of the past three years, as confirmed by the reports of the auditor, and has obtained an independent rating.
- Commercial banks are involved to act as agents for the issuer in the payment of the funds payable to the investors.

Corporate bonds are a convenient alternative to bank funding, but the legal and regulatory requirements considerably restrict the number of organizations that can turn to this tool. This has led to a sharp decline in recent years in the number and volume of corporate bonds outstanding. Between 2010 and 2018, the number of corporate bonds in circulation decreased from 41 to 17, and their total value fell from UZS 512 billion to UZS 198 billion.

The challenges created by the conditions that currently apply to the issue and registration of bonds include the following:

- The exact text of the prospectus must be approved at a meeting of shareholders, which takes around one month to arrange. If the regulator provides some feedback or adds some comments to the text, the issuer needs to hold another meeting, which takes another month.
- It is difficult for auditors to verify the amount of equity as of the exact date when the meeting of shareholders authorizing the bond issues takes place. The auditors must either conduct a full audit of the company or sign off on estimates. Conducting a full-scale audit in the middle of the year could require a lot of time and effort and prove costly for the company. Moreover, if the company has to organize a second meeting of shareholders, the date of the audit would have to be moved forward to the date of the second meeting.

- Solvency and financial stability ratios are not part of the standard audit report. The company must therefore order an additional report to reflect these indicators, once again adding to its costs.
- Aside from their own bond issues, banks have no experience in acting as payment agents for third parties. They usually charge high commissions, expecting a large amount of paperwork, since bank details for coupon payments in the Central Securities Depository database are usually outdated.
- The rating may be assigned by an international market actor or a local market participant. However, the former may be too expensive for the issuer, while in Uzbekistan there is only one rating agency that assigns ratings to companies other than insurance companies.

Until recently, corporate bonds other than bank bonds had to be secured with collateral. For this reason, only banks have issued corporate bonds in the past ten years.

The CMDA has drafted a law that would permit limited liability companies (LLCs) to issue bonds subject to the same requirements as joint stock companies, such as those regarding external auditing, financial reporting and the disclosure of information. The draft law would also abolish the rule that ties the amount of the bond to the company's equity capital, end the collateral requirement for corporate bond issues and soften the requirements for three years of positive financial reports and a rating.

By removing the unnecessary restrictions on the issue of bonds, the proposed amendments are expected to make the bond market an attractive alternative for companies, resulting in an expansion of the market. A well-developed and well-established bond market would pave the way for the development of alternative instruments, such as green bonds and green sukuk. These in turn would contribute to the scale and sustainability of the market by mobilizing a new investor base including both domestic savers and foreign capital.

Lack of a Regulatory Framework

Although Uzbekistan has adopted a number of targets regarding environmental issues, there is still no legal and regulatory framework in this area. This situation constitutes another major barrier to the promotion of green finance.

As an emerging sector, Islamic finance also requires the necessary enabling environment. Certain elements of the existing legal framework may be instrumental in the growth of Islamic finance, but specific Islamic contracts such as sukuk call for legal and regulative changes. Even though the financial effect of a sukuk is similar to that of a conventional bond, they differ with respect to the transfer of ownership and adherence to Islamic Law. These differences call for the adoption of a more comprehensive legal framework reflective of the distinctive features of sukuk. Box 4.1 identifies the various regulatory areas which need to be taken into consideration when seeking to introduce sukuk in Uzbekistan.

The tax system of Uzbekistan is unfavourable for capital markets, as it is complex and often unclear and inconsistent. In 2019-2020, Uzbekistan introduced a new tax system and adjusted the tax rates on coupon/interest earnings and bond yields. Key points include the following:

- There is inequality between external investors and residents. A rate of 10 percent applies to foreign investors compared to 5 percent for local investors;
- Capital gains from sales in the stock exchange are not taxed (All sellers pay a commission of 0.01 percent). In OTC market transactions, sales of shares are subject to the standard corporate income tax rates for the different categories of legal entity. Foreign investors are taxed at the rate of 20 percent.

BOX 4.1. AN OVERVIEW OF THE LEGAL FRAMEWORK FOR GREEN SUKUK ISSUANCE IN UZBEKISTAN

This box includes an analysis of the current legislation of the Republic of Uzbekistan, draws attention to barriers and shortcomings, and lists the amendments needed for the issuance of sukuk.

Review of the Legal Framework Regulating Relations in the Securities Market

The securities market in the Republic of Uzbekistan is subject to the following:

- Laws and codes adopted by Parliament;
- Presidential decrees and resolutions;
- Resolutions of the Cabinet of Ministers;
- Orders and resolutions of the authorized state body, the Capital Market Development Agency of the Republic of Uzbekistan;
- Orders and resolutions of other relevant ministries, regulators and agencies, such as the Ministry of Finance, the Central Bank and the Agency for the Management of State Assets.

The key item of legislation regulating the securities market is the Law on the Securities Market No. LRU-387of 3 June 2015. The Law applies to shares, bonds, treasury bills, certificates of deposit and derivatives of these securities and bills. The law establishes general rules for the issue, placement and circulation of securities, professional activity in the securities market, accounting of rights to securities, disclosure of information in the securities market, regulation of the securities market, and rights, obligations and responsibilities of participants in the securities market.

There are also laws which, although they mostly regulate other relationships, are indirectly related to securities. Examples of such laws are the Law on Investment and Mutual Funds and the Law on Joint Stock Companies and the Protection of Shareholders' Rights.

Presidential Decrees and Resolutions as well as Resolutions of the Cabinet of Ministers mainly affect administrative and organizational issues. For example, the Capital Market Development Agency of the Republic of Uzbekistan (CMDA) and the Agency for the Management of State Assets were established by the Decree of the President of the Republic of Uzbekistan on Measures to Radically Improve the Management System of Public Assets, Antimonopoly Regulation and Capital Markets. A Presidential decree on the organization of the CMDA approved the organizational structure and the structure of the central office of the Agency, and appointed it as the authorized state body for regulating the securities market.

The Resolution of the Cabinet of Ministers of the Republic of Uzbekistan on the Approval of the Provisions of the Capital Market Development Agency of the Republic of Uzbekistan and the Fund for Capital Market Development Support under the Capital Market Development Agency of the Republic of Uzbekistan approved:

- The Regulation of the CMDA, and
- Regulations on the Fund for Capital Market Development Support.

These regulations establish detailed procedures for the activities of the Agency and the Fund.

Detailed procedures for the operation of the capital market, including the procedures for issuing and circulating securities, are set out in the documents adopted by the CMDA as an authorized state body. For example, the Rules for Issuing Securities and State Registration of Issues of Equity Securities, approved by the Agency, is one of the main documents regulating the procedure for issuing securities. The document sets out a detailed procedure for issuing securities and their state registration. Similarly, the CMDA's Regulation on the Procedure for the Sale and Purchase of Securities on the Organized OTC Market defines the procedure for the sale and purchase of shares, corporate bonds and derivative securities on the organized OTC securities market.

In cases where relations regulated by a regulatory document fall under the jurisdiction of different ministries and agencies, joint documents may be adopted. An example of this is the Regulation on the Procedure for the Circulation of Securities in Foreign Currency in the Territory of the Republic of Uzbekistan, Acquisition by Residents of Securities in Foreign Currency and Acquisition by Non-Residents of Securities Issued by Residents, which was approved by a joint resolution of the CMDA and the Central Bank.

Assessment of legislation in terms of the presence or absence of norms that allow or prevent the issuance of sukuk in the Republic of Uzbekistan

Although the Civil Code of the Republic of Uzbekistan (article 96)[1], as the main document regulating civil law relations, does not limit or specify types of securities, it provides a legal basis for the issuance and circulation of traditional securities, as a basic framework for the current legislation. It mentions securities such as shares, bonds, treasury bills,

[1] Article 96 of the Civil Code of the Republic of Uzbekistan: "Securities include: bonds, bills of exchange, cheques, deposit and savings certificates, bills of lading, shares and other documents that are classified as securities by law".

certificates of deposit and derivatives of securities and bills, but does not limit the types of securities that may be issued. It states that other securities described in legislation may also be considered securities.

That said, the current legislation of the Republic of Uzbekistan does not provide a legal basis for the issuance of sukuk or other Islamic or alternative securities. Given the nature of the legal system, it will not be possible to issue a sukuk unless the current legislation is amended to establish a legal basis and framework.

Legislative amendments needed to establish a legal basis for the issuance and circulation of sukuk

Given that sukuk are based on contracts regulated by Sharia law such as *ijara, murabaha, mudaraba, musharaka, salam and istisna*, and the lack of legal norms specifically allowing the conclusion of such transactions, it is first necessary to recognize these types of contract in law.

At the initial stage, sukuk based on *ijara, murabaha, salam and istisna* are most likely to be implemented, since the existing rules governing leasing and trade relations may be found to be in accordance with the Sharia norms governing these relations. These rules should nevertheless be reviewed carefully in order to avert any possible conflicts between civil law and Sharia law that might come to light when issuing and handling sukuk.

The adoption of legislation that would permit the issuance of all types of sukuk – in other words, the inclusion of specific Sharia provisions in the legislation of Uzbekistan so as to create conditions for the issuance of sukuk based on all types of Islamic contracts – would be a very long and complex process requiring the involvement of Parliament as the main legislative body.

At the initial stage, the focus may therefore be limited to introducing rules for establishing a legal framework for the issuance of sukuk based on leasing and trade transactions.

In view of the above considerations:

- Amendments and additions need to be made to the Law on the Securities Market. The Law should define sukuk and permit the issue of this type of security.
- The amendments and additions to be made to the Law on the Securities Market will serve as a basis for reviewing subsidiary legislation, including resolutions of the Cabinet of Ministers and CMDA regulations.
- Amendments and additions will need to be made to the regulatory documents of the Cabinet of Ministers in order to expand the powers of the Agency for the Management of State Assets to enable this agency to be involved in the issuance of sukuk that require the involvement of the state.
- The CMDA will need to issue separate regulatory documents and/or make amendments and additions to its existing regulations to regulate the issuance and circulation of sukuk. This could be done in one of two ways. A new, separate regulation could be developed regulating the procedure for the issuance and circulation of sukuk, and the current regulatory documents could be amended accordingly. Alternatively, the procedure for the issuance and circulation of sukuk could be added to current regulations without adopting a separate document.
- In global practice, the introduction of sukuk begins with a pilot project involving the issue of a sovereign sukuk. Considering the legislative practice in Uzbekistan on the implementation of investment projects with state participation, it would be possible for Uzbekistan's initial sovereign sukuk issue to be governed by presidential resolutions. This was the procedure followed when the country issued its first international sovereign bonds.[2]
- It is important to create a level playing field for sukuk and conventional instruments with respect to tax legislation. Simplified tax mechanisms need to be adopted to ensure tax neutrality and simplify tax procedures. There is a particular need to address issues of double taxation, stamp duty, income tax and VAT.

Creation of a special purpose vehicle to issue a sukuk

The state can found or participate in legal entities through its ministries, agencies or other bodies. The main form of commercial organization created by the state is the unitary enterprise. The state may also retain ownership in strategic sectors of economy through equity participation in joint stock companies. In addition, there are cases when the state founds limited liability companies for the conduct of specific activities.

In cases where the state acts as the originator in the issue of a sukuk, a company created by the state in the form of a unitary enterprise, joint stock company or limited liability company could serve as the SPV. The rights of the state as a shareholder or participant in the company are exercised by the Agency for the Management of State Assets.

Appendix 1 includes more detailed information regarding the legislative amendments needed for sukuk issuance in Uzbekistan.

[2] Resolutions of the President of the Republic of Uzbekistan:
"On additional measures to diversify sources of external financing" dated 21 July 2018, No.PR-3877;
"On the effective use of funds received from the placement of the first sovereign international bonds of the Republic of Uzbekistan" dated 2 April, 2019, No.PR-4258.

- At the same time, foreign investors can use international agreements not to pay tax, or to reduce the amount of tax they pay, on capital gains and income from interest/dividends.

The Uzbek tax system does not currently provide for Islamic finance products. Addressing this is one of the first steps that should be taken in order to introduce sukuk into the country's financial system. The taxation of asset-backed sukuk can be problematic as the transactions imply multiple transfers of assets. To remove the additional tax burdens on sukuk, the existing taxation system should be amended to accommodate sukuk and ensure tax neutrality between sukuk and conventional bonds.

It is also critical to remove the obstacles or disincentives that stand in the way of establishing SPVs, the legal entities that hold the sukuk assets on behalf of the sukuk holders.

Lack of awareness

There is a general lack of awareness and knowledge about Islamic finance and green investments. Even though Islamic finance is seen as a promising avenue, given the large Muslim population and the recent interest of the government, the development of the industry is relatively new. The sector also faces a shortage of knowledgeable and competent human capital. It is therefore essential to address awareness at the policy level.

The notion of ethical, socially responsible and environmentally friendly investments is new to the country. Awareness and appreciation of this notion is low, the regulatory environment has not been put into place, and there is a lack of incentives. The lack of proven, readily available business models could lead to reluctance on the part of the government or potential private sukuk issuers, or they may fail to understand the business case with regards to innovative green projects.

More generally, the lack of awareness and local knowledge about green investments constitutes a critical barrier for the issuance of a green sukuk. There is hardly any awareness of green technologies and no clear understanding of how green financial instruments could achieve better financial outcomes. The new and unknown could easily be rejected, particularly in the light of potentially higher compliance and issuance costs, and a focus on traditional "brown" technologies could persist. The funding of projects currently relies overwhelmingly on bank financing and loans provided by IFIs, and there is a reluctance to invest in the capacity needed to verify, structure and advise on green sukuk, as each new instrument entails additional costs. There are further complexities in identifying the environmental criteria to be used in the determination of eligible underlying assets and in measuring the impact of the project.

Instrument and Ecosystem-Related Risks

Green projects are considered to be capital intensive and to require long investment horizons. Investments in such projects are constrained by factors such as higher up-front costs, higher perceived risk, longer investment timelines and the need for new, expensive and sophisticated technology. In addition, the lack of universally accepted standardized green bond principles and the absence of a local regulatory framework for green projects add to the risk of misconduct, which could severely undermine the credibility of the green financing ecosystem.

In addition to the risk associated with green investments in general, a green sukuk is exposed to risks specific to the sukuk instrument. Investors and issuers taking decisions about green sukuk need to consider a multitude of risks, including inflation, interest rates, and liquidity, credit, industry and market performance risks. This points to the need for robust risk management mechanisms for green sukuk structures.

If the issue of a green sukuk involves a higher cost than a traditional bond or sukuk, or if it has a short maturity that is not consistent with the life cycle of green projects, or suboptimal financial characteristics that could lead to interest rate, currency and liquidity risks, the instrument may be unattractive for issuers and/or investors, and could put the green sukuk market at risk.

4.4 LIST OF POTENTIAL BANKABLE PROJECTS FOR GREEN SUKUK

This section provides a list of potential bankable projects which could be classified as 'green' and/or 'potentially green'. The table below shows a pipeline of 64 projects, together with their planned locations, timeframes and overall costs in millions of US dollars. It is important to note that the list is a result of preliminary research, and that further analysis would be needed to determine their eligibility. The table focuses on the three specific sectors (energy, water resource management, and housing) which have the largest potential to attract green investments (as well as reduce the energy deficit) in Uzbekistan. Uzbekistan also has green projects in other sectors, such as transportation, forestry and ecotourism, but these are beyond the scope of the present study. Additionally, agriculture is highly relevant for sustainable development and has been identified as a potential sector for green financing. Even though Uzbekistan's Action Strategy for 2017-2021 recognises the importance of agriculture, no specific bankable projects that could be included in the table were identified in this sector. However, the Ministry of Agriculture is undergoing a transformation process to increase the involvement of the private sector. This in turn may enable the creation of bankable projects eligible for green financing.

Uzbekistan releases comprehensive biennial investment programmes. The most recent one, covering the years 2020-2022, was approved by a presidential decree in January 2020. The investment programme includes an exhaustive collection of projects across a variety of sectors, and was therefore taken as the main point of reference for the preparation of the table. Finally, it should be noted that the projects listed would need to be assessed against specific green sukuk eligibility criteria in order to be classified as eligible for green sukuk.

Name of the project	Location	Cost (US$ million)	Dates/duration of project
ENERGY			
Construction of a solar photovoltaic plant with a capacity of 100 MW	Navoi	100	25 years
Construction of a 200 MW solar photovoltaic station in the Jizzakh region on public-private partnership terms	Jizzakh	200	not specified
Construction of a solar photovoltaic plant with a capacity of 200 MW	Samarkand	100	25 years
Construction of a solar photovoltaic plant with a capacity of 400 MW	Samarkand region, Kattakurgan and Pastdargom	400-440	25 years
Construction of a solar photovoltaic plant with a capacity of 200 MW	Surkhandarys region, Sherobod	200	25 years
Construction of a wind power plant with a capacity of 200 MW	Karakalpakstan	200	25 years
Organization of production of modern energy-saving equipment for the production of greenhouses at Samsung Green House LLC (Bukhoro-Agro SEZ)	Peshkunsky district	5	not specified

Name of the project	Location	Cost (US$ million)	Dates/duration of project
Construction of a wind power station with a capacity of 100 MW	Zarafshan city	100	2019-2022
Construction of a 100 MW solar photovoltaic station under public-private partnership in the regions of the Republic	several regions	600	2020-2024
Construction of new hydro power stations	Hojikent, Yuqoripskem, Akbulak, and others	1,223.8	2021-2030
Construction of the Verkhnepskemskaya hydropower station on the Pskem river in the Bustanlyk district of Tashkent region	Tashkent region	200	2023-2028
Construction of the Mullalakskaya hydropower station on the Pskem river in the Bustanlyk district of Tashkent region	Tashkent region	480	2018-2025
Construction of the Khodzhikent pumped-storage hydroelectric station in the Bustanlyk district of Tashkent region	Tashkent region	320	2022-2026
Construction of the Akbulak hydropower station on the Akbulak river in the Bustanlyk district of Tashkent region	Tashkent region	160	2022-2026
Construction of a small hydropower plant at the Sichankul discharge in the Mirishkorsky district of Kashkadarya region	Kashkadarya region	53.2	2022-2024
Construction of a small hydropower plant on stake 39 + 19 of Dargom canal	Samarkand region	17.2	2025-2026
Construction of a small hydropower plant on stake 58 + 28 of the Dargom canal	Samarkand region	18.4	2027-2028
Construction of a small hydropower plant on stake 88 + 17 of the Dargom canal	Samarkand region	18.4	2028-2029
Construction of the Taligulyanskaya small hydropower plant No. 2 on the Dargom canal in the Pastdargom district of Samarkand region	Samarkand region	19.8	2027-2028
Construction of the Taligulyanskaya small hydropower plant No. 4 on the Dargom canal in the Pastdargom district of Samarkand region	Samarkand region	40.1	2026-2027
Modernization of the Unitary Enterprise "Cascade of Tashkent hydro power stations" (hydropower station-4) in the city of Tashkent	Tashkent city	28,6	2021-2024
Modernization of the Unitary Enterprise "Cascade of Chirchik hydro power stations" (hydropower station-8) in the Kibray district of Tashkent region	Tashkent region	42.8	2021-2025
Modernization of the Unitary Enterprise "Cascade of Kadirinskiye hydropower stations" (hydropower station-12) in the Kibray district of Tashkent region	Tashkent region	10.9	2022-2025
Modernization of the branch "Cascade of Samarkand hydropower stations" (hydropower station-3B) in the Pastdargom district of Samarkand region	Samarkand region	16.9	2028-2030

Name of the project	Location	Cost (US$ million)	Dates/duration of project
Modernization of the branch "Cascade of Samarkand hydropower stations" (hydropower station-5B) in the Pastdargom district of Samarkand region	Samarkand region	19.2	2025-2027
Modernization of the Unitary Enterprise "Cascade Urta-Chirchik hydropower stations" (hydropower station-28) in the Bustanlyk district of Tashkent region	Tashkent region	39.6	2020-2025
Modernization of the Unitary Enterprise "Cascade of Chirchik hydropower stations" (hydropower station-7) in the Kibray district of Tashkent region	Tashkent region	46.8	2020-2023
Modernization of the Unitary Enterprise "Cascade of Kadirinsky hydropower stations" (hydropower station-15) in the Kibray district of Tashkent region	Tashkent region	17.3	2026-2028
Modernization of the Unitary Enterprise "Cascade of Tashkent hydropower stations" (hydropower station-21) in Tashkent	Tashkent city	23	2025-2027
Modernization of the branch "Cascade of Samarkand hydropower stations" (hydropower station-1B) in the Pastdargom district of Samarkand region	Samarkand region	15.8	2021-2023
Modernization of the branch "Cascade of Shakhrikhan hydropower stations" (hydropower station-5A) in the Asakinsky district of Andijan region	Andijan region	22.4	2022-2024
Modernization of the branch "Cascade of Shakhrikhan hydropower stations" (hydropower station-6A) in the Asakinsky district of Andijan region	Andijan region	15.7	2022-2026
Reconstruction and improvement of energy efficiency of the centralized heat supply system of Samarkand	Samarkand region	30	2021-2025
WATER MANAGEMENT			
Water resources management in the Aral Sea basin, taking into account adaptation to climate change in the Republic of Karakalpakstan, Khorezm, Bukhara, Samarkand and Surkhandarya regions	Republic of Karakalpakstan, Khorezm, Bukhara, Samarkand and Surkhandarya regions	150	2022-2026
Construction of a water conduit and water supply networks to improve water supply in the settlements of Butakor, Yorboshi, Ok-Yor, Yangiobod, Guliston, Ayrilish and Orol in the Andijan district of Andijan region	Andijan region	24	2020-2023
Construction, expansion and reconstruction of the sewage treatment plant "PK-162" to improve the water supply of the Nishansky, Karshinsky, Kasbinsky, Mirishkorsky districts and part of the Mubareksky district of Kashkadarya region	Kashkadarya region	50	2020-2023

Name of the project	Location	Cost (US$ million)	Dates/duration of project
Construction and reconstruction of networks to improve water supply in the cities of Kasansay and Uychi and the village of Yarkurgan in the Uychi district of Namangan	Namangan region	18	2021-2025
Improvement of the drinking water supply system of the Bayavutsky and Mirzaabad districts in the Syrdarya region	Syrdarya region	45	2021-2025
Construction and reconstruction of networks to improve water supply in the Kumkurgan district of Surkhandarya region	Surkhandarya region	14	2021-2025
Reconstruction and expansion of water treatment plants from an open source in Chirchik with a capacity increase of up to 100,000 m3 per day	Tashkent region	18	2021-2025
Qizilsoy water reservoir construction in the Parkent district of Tashkent region	Tashkent region	34.9	33 months
Bulungur water reservoir construction in the Bulungur district of Samarkand region	Samarkand region	46	36 months
Obizirang water reservoir construction in the Sariasiya district of Surkhandarya region	Surkhandarya region	30	60 months
Construction of sewage system and wastewater treatment plant in Andijan region	Andijan region	24	2021-2025
Construction and reconstruction of sewage systems in the Asaki district of Andijan region	Andijan region	30	2021-2025
Construction of sewer systems and improvement of the water supply of the Khojaabad district in Andijan region	Andijan region	18	2021-2025
Construction and reconstruction of the sewer systems of the Sh.Rashidovsky and Gallaaral districts and the Dashtabad village in the Zaamin district of Jizzakh region	Jizzakh region	39.6	2021-2025
Construction and reconstruction of the water supply and sewage systems of the Dustlik, Zafarabad and Mirzachul districts of Jizzakh region	Jizzakh region	15	2021-2025
Construction of sewage systems in the cities of Uchkurgan, Khakkulabad, Kasansay and Uychi in Namangan region	Namangan region	55	2021-2025
Construction of sewer systems in the settlements of Umid, Tinchlik, Gulistan, Uzbekistan and Istiklol in the city of Navoi in Navoi region	Navoi region	45.6	2021-2025

Name of the project	Location	Cost (US$ million)	Dates/duration of project
Construction of sewer systems to ensure full coverage of the population with sewage services in the city of Termez in Surkhandarya region	Surkhandarya region	25	2021-2025
Construction and reconstruction of sewer systems in the district centres of the Kumkurgan, Sherabad, Altynsay and Shurchinsky districts of Surkhandarya region	Surkhandarya region	72	2020-2024
Improving the water supply of the Angora, Termez, Kizirik, Baysun, Altinsay and Kumkurgan districts of Surkhandarya region	Surkhandarya region	52.3	2020-2024
Improving the water supply of the Uzun, Sariasi, Denau, Shurchinsky, Zharkurgan districts of Surkhandarya region	Surkhandarya region	48.3	2020-2024
Construction and reconstruction of sewage systems in the Muzrabad, Kumkurgan, Sherabad, Oltinsay and Shurchinsky districts of Surkhandarya region	Surkhandarya region	28.2	2020-2024
Construction and reconstruction of sewerage systems in the Termez, Angora, Kizirik, Boysun and Uzun districts of Surkhandarya region	Surkhandarya region	32.2	2020-2024
Construction of a sewage system in the district centres of the Kuyichirchik and Akkurgan districts of Tashkent region	Tashkent region	65	to be determined
Construction and reconstruction of sewer systems in the district centres of Ferghana region	Ferghara region	72.4	2020-2023
Construction of sewage systems in district centres and urban settlements of six districts of Samarkand region	Samarkand region	117.5	2020-2024
Construction of sewage systems in Khorezm region	Khorezm region	30	2021-2025
Modernization and rehabilitation of 235 pumping stations of the Ministry of Water Resources of the Republic of Uzbekistan	not specified	406	not specified
Improvement of drinking water supply in the Sherabad district of Surkhandarya region	Surkhandarya region	26.7	not specified
Construction and rehabilitation of sewage systems in the Shargun, Denau and Jakurgan districts of Surkhandarya region (including the Sariasiya urban settlement)	Surkhandarya region	46	not specified
HOUSING			
Programme for the construction of energy-efficient housing in Samarkand	Samarkand region	60	not specified

CHAPTER 5: FORMULATION OF STRATEGIES FOR GREEN SUKUK ISSUANCE IN UZBEKISTAN

5.1 RECOMMENDATIONS

A number of recommendations may be made to pave the way for the issue of green sukuk in Uzbekistan with a view to meeting the country's development needs. The implementation of the recommendations will depend on the actions of several parties, ranging from regional constituencies to policy-making agents at the central level. The aim is to put into place the building blocks that will facilitate the issuance process and to align the needs of all the stakeholders. The main recommendations are listed below.

Establishing a Legal and Regulatory Framework for Green Sukuk

As green projects have a long-time horizon and rely on long-term financing, it is essential to provide clarity on legal, tax, and regulatory issues and to create a well-established market infrastructure. Establishing the necessary legal and regulative frameworks for sovereign and corporate issuance, in both local and hard currency, is crucial for the introduction of green sukuk in Uzbekistan. This would require the adoption of a national framework based on international best practices for the selection of eligible green projects, as well as a reporting methodology to assess the social and environmental impact of the projects financed.

Standardization is critical to the promotion of the development of any new financial instrument. The use of standard terminology to describe the environmental aspects of investments will facilitate investors' and issuers' understanding of green sukuk and assist the latter in asserting the "green" status of their issues and so attracting local and international environment-friendly investors. The development of green criteria and reporting, impact assessment and monitoring tools should enhance the credibility of green sukuk issuances and therefore attract a wider base of ethical investors.

The emergence of green sukuk will also require Uzbekistan's tax legislation to be amended in such a way as to promote the issuance of sukuk and attract local and foreign investors. Most importantly, a level playing field needs to be provided for sukuk and conventional bonds. Table 5.1 lists the various tax changes which selected countries have made to accommodate the issuance of sukuk.

Table 5.1. Tax Changes to Accommodate Sukuk

Country	Tax Changes
Malaysia	Tax neutrality is provided for in the Income Tax Act of 1967. Islamic securities issued within the Malaysia International Islamic Finance Centre are exempt from stamp duty until 2020. SPVs are exempted from administrative tax procedures. Expenses incurred during the issuance of sukuk are tax deductible. Withholding taxes have been liberalized to attract foreign entities to issue or invest in sukuk.
Hong Kong	Sukuk are treated as conventional bonds in terms of tax payments. Tax rebates are given to individual investors in retail sukuk. The Inland Revenue and Stamp Duty Legislation Ordinance of 2013 eliminated additional profit tax and stamp duty charges prior to sukuk issuance.

Nigeria	All categories of sukuk issued are exempt from corporate income tax, personal income tax, value added tax, capital gains tax and stamp duties. Sukuk holders are exempt from withholding tax, state and federal income tax and capital gains taxes.
South Africa	The government introduced tax neutrality laws for diminishing *musharaka, murabaha and mudaraba* contracts in the Taxation Laws Amendment Act of 2010, which recognizes these contracts as the equivalents of conventional contracts. In 2011, government sukuk were also recognized under the Act.
United Kingdom	The Alternate Finance Investment Bond (AFIB) introduced by the Finance Act of 2007 declared sukuk to constitute securities for tax purposes and eliminated value added tax and stamp duty on the transfer of certificates
Turkey	In 2011, Law No.6111 was issued to provide tax exemptions or favourable tax treatment for sukuk, reducing the withholding tax on sukuk and introduced tax neutrality on *ijara* sukuk issuance In 2016, the other sukuk structures – namely, *wakala, murabaha, mudaraba and istisna* – were granted tax neutrality under a law amending the laws on stamp duty, value added tax, and charges.
Indonesia	Withholding tax has been abolished on payments of interest on government securities, including equivalent arrangements for sukuk. In 2016, the Financial Services Authority (Otoritas Jasa Keuangan) lowered registration fees for corporate sukuk issues.

Source: COMCEC. 2018.[60]

Creating a favourable legal environment for corporate green sukuk issuance will further improve the business climate in Uzbekistan from the point of view of attracting funds, thereby reducing reliance on bank lending. It will also help to improve the ranking of the Republic of Uzbekistan in the World Bank Doing Business Report. At present, the government is encouraging domestic companies – especially companies in the energy sector – to align their financial statements with IFRS and obtain international credit ratings to engage in capital markets. A green sukuk issue could provide these companies with more sustainable, longer-term financing. Banks are also likely to be interested in issuing green sukuk once the appropriate regulatory framework is in place. At the moment, banks lack long-term domestic financing and have to borrow from foreign banks or IFIs. Banks do not have enough long-term deposits in local currency because people fear inflation and prefer to save in foreign currency. The issue of green sukuk in Uzbek som could help provide them with secure long-term financing from the domestic market.

It is also recommended that regulatory amendments should be made to permit the establishment of Islamic windows, considering the strong demand from clients and the willingness of several banks to be involved in Islamic finance. This would contribute to the development of the Islamic finance ecosystem in general.

Building a Pipeline of Green Energy Projects

One of the main issues facing green financing is to identify projects that are not only sustainable but also measurable and adequate in size and scope. Project pipelines have become central to the efforts countries are making to achieve their climate and development commitments, including their INDCs and the broader SDGs.[61] Building and promoting a pipeline of bankable projects can help crowd in private investment by

[60] COMCEC Coordination Office. The Role of Sukuk in Islamic Capital Markets. February 2018.

[61] OECD, 2018, Developing Robust Project Pipelines for Low-Carbon Infrastructure, OECD Publishing, Paris

making information available about the projects and ensuring their long-term visibility. Funding sources and mechanisms are sensitive to the depth and quality of the project pipeline.

The government has already been developing policies and undertaking reforms to attract foreign investment and introduce private participation. In 2019, the first law regulating public-private partnerships (PPPs) came into effect, providing guidance for such projects and aiming to promote foreign investment. The government has also approved an investment programme for 2020-2022 amounting to UZS 850.5 trillion. However, more needs to be done both to provide an open and clear environment for investment and to ensure the availability of a strong pipeline of bankable projects capable of generating good financial returns at the same time as benefiting the environment. With a green sukuk framework in place, the government can involve the relevant ministries and agencies in identifying the projects that deliver specific benefits in accordance with the country's climate objectives. The environmental contributions of projects could also be specified in the investment programmes released by the government.

Encouraging Financial Innovation

Since the sukuk is a relatively novel instrument for the capital markets, there is considerable room for innovation in the sukuk market, offering issuers the flexibility to develop innovative new sukuk structures to address their specific financing needs.

The increasing interest of investors in both environmental and social projects has generated momentum for green finance and resulted in the development and growth of innovative financial products. Innovative green sukuk structures must align the interests of Islamic and socially responsible investors. Innovative ways also need to be found to mobilize climate finance funds –including public, concessional, and philanthropic funds – effectively at the same time as drawing in private sector funds[62]. Large green projects, for instance, call for significant initial investments during the development phase, and this requires specific instruments, long-term funding and public-private partnerships.

Countries that have active local currency bond markets find it easier to promote sukuk as an alternative form of financing. In Uzbekistan, the majority of the corporate bonds issued have been denominated in local currency, as the legislative framework restricted foreign currency issues. Changes to the Securities Market Law in early 2019 made it possible to issue sovereign and corporate international bonds in foreign currency. In the same year, Uzbekistan issued its debut eurobond worth US$ 1 billion. However, the government continues to encourage local currency issues to avoid foreign debt and to support and stimulate the local capital markets. Since the proceeds of a green sukuk would be in local currency, it may be more appropriate for the sukuk to be issued in local currency as well. Another argument in favour of local currency sukuk relates to the mobilization of local currency savings. Remittances correspond to about 15 percent of Uzbekistan's GDP, compared to a global average of about 4 percent. The diaspora could therefore constitute an important investor base for local currency green sukuk.

Providing Economic Incentives

Issuing green sukuk entails additional costs associated with green certification and the regular external assessment of the use of proceeds. The costs of these certification and audit processes range from US$ 10,000 to US$ 100,000, constituting an important barrier for small companies. To enhance cost-effectiveness for investors and issuers, as

[62] Aassouli, D., Asutay, M., Mohieldin, M., & Nwokike, T. C. (2018). 'Green Sukuk, Energy Poverty, and ClimateChane: a roadmap for Sub-Saharan Africa.', Working Paper. World Bank Group, Washington D.C.

well as to help promote investment and tradeability, the government could consider the use of a push factor to assist the private sector in choosing green financing models. This could be done through economic incentives such as subsidies, tax exemptions and preferential tariffs. Such incentives could also help to reduce the costs of adopting green practices and certification.

Many government agencies are offering financial support in the form of tax exemptions in order to expand their emerging green bond or green sukuk markets. Brazil, for example, permits the issue of tax-free bonds for major infrastructure investments, building construction projects and wind farms. The United States has been providing tax incentives for bonds financing green buildings and renewable energy sources since 2009. The Monetary Authority of Singapore (MAS) offers a green bond grant scheme whereby issuers can claim up to SGD 100,000 (US$ 74,300) to offset their expenditures on the external reviews required to meet green bond standards. In Malaysia, issuers of green sukuk under the country's Sustainable and Responsible Investment Sukuk framework are entitled to certain tax deductions[63]. The Malaysian government also provides financing incentives under its Green Technology Financing Scheme (GTFS), which has a total fund allocation of MYR 5 billion up to 2022.

Like these countries, the Uzbek government could provide tax incentives to investors or issuers to promote a shift from conventional financing to green financing models and to increase the attractiveness of green sukuk. Examples might include tax neutrality, stamp duty exemptions and reductions in withholding taxes.

The adoption of environmentally friendly technologies also requires effective government support. Environmental legislation needs to be adopted, and the government needs to take the leading role in developing environmental strategies, endorsing green standards and providing incentives to green manufacturers. Incentives for the development of green technology can take the form of tax allowances for investments in green technology assets and income tax exemptions for the use of green technology services and systems.

Raising Awareness

The introduction of green sukuk in Uzbekistan will require deeper engagement and a better understanding of green investing among all stakeholders and an increase in their competencies in this area. The development of green sukuk requires two levels of awareness. The first level refers to individual awareness about ethical investing and environmental responsibilities. In this context, it is essential to improve financial literacy and to increase the awareness of the public about climate related issues, sustainable financing and how their investments can make a difference. The second level of awareness is the organizational level. This requires industry-wide mobilization. Training programmes should be provided to potential issuers and investors alike to raise their awareness of the capital markets. This could also result in increased demand for sustainable services. Green sukuk need to be explained and marketed to policy makers and senior managers in the corporate and public sectors as a complementary, innovative financial instrument based on risk sharing principles and an ethical and responsible means of raising finance. This would reduce the religiosity connotations of Islamic finance and broaden its appeal throughout the country. The government and the financial sector could also organize periodic conferences and seminars on Islamic

[63] Oxford Business Group. Demand for green bonds grows as investors in ASEAN seek ethical investment vehicles. https://oxfordbusinessgroup.com/analysis/growing-greener-asean-green-and-sustainable-bonds-are-rise-0#:~:text=In%20the%20case%20of%20Singapore,to%20meet%20the%20ASEAN%20GBS.

finance and green sukuk, and academic institutions could provide executive training and other courses in these areas, with a view to raising public awareness and increasing the level of knowledge.

5.2 PROPOSED FUTURE STEPS

In order to lay the groundwork for the promotion of the use of green sukuk in Uzbekistan, a nationally coordinated implementation strategy is needed. This could be developed and put into effect following the five steps illustrated and elaborated below (Figure 5.1).

Figure 5.1. Implementation Strategy Roadmap

1)Forming a task force	2) Shifting attention	3) Building capacity	4) Enabling policies	5) Issuing green sukuk
▪ A multi stakeholder green sukuk task force	▪ Focusing on impactful investments ▪ Identifying projects and assessing market size	▪ Guidelines ▪ Tool kits ▪ Workshops ▪ Communications	▪ Identifying enabling instruments ▪ Implementing from where possible	▪ Structuring and issuing green sukuk

Source: Adapted from UNEPA[64]

Step 1: Forming a Task Force

The first step consists of forming a multi-stakeholder task force composed of institutions with an interest in Islamic finance, regulators, green project developers, government authorities, NGOs and international organizations in order to learn from best international practice and local green experience, to exchange information and to identify innovative ways of overcoming possible barriers to the introduction of green sukuk. According to the interviews conducted with stakeholders, there currently exists a working group on Islamic finance at the governmental level which is working on developing the Islamic banking and financial system in Uzbekistan. This group could be expanded to include the aforementioned stakeholders for green sukuk. Alternatively, a sub-committee for green sukuk could be established under the working group.

Step 2: Shifting Attention to Impactful Projects and Initiatives

Once the task force is formed, it becomes crucial to create momentum for change by drawing attention and interest to projects with high net positive impact. This will require a comprehensive assessment of the green project potential of Uzbekistan. It will be important to identify and prioritize high-impact green initiatives that can be used to advocate for green sukuk and engage more stakeholders.

Step 3: Capacity Building and Awareness Raising

With respect to capacity building and awareness raising, it is important to ensure that active change agents possess adequate tools and competencies for achieving pre-defined targets. It is essential to develop guidelines, technical tool kits, case studies and communications materials to help disseminate the rationale behind both green and Islamic finance and to explain how they function. This knowledge can be disseminated

[64] Adapted from: UNEP, State of Green Finance in the UAE. UAE Green Agenda 2015-2030

to different target audiences and stakeholders through workshops, thematic training programmes and other events.

Step 4: Elaborating Enabling Policies

Multi-stakeholder consultations need to be held to identify the practical policy and legislative measures that are required in order to make it possible to scale up green sukuk practices. Once the policies or legislative amendments needed to support the launch of a green sukuk have been identified, the combined efforts of all the stakeholders will be crucial, since the first implementation of the initial measures will serve as a flagship experience on which to build a more comprehensive and empowering regulatory ecosystem.

Step 5: Structuring and issuing green sukuk

Conditional on completing all previously listed steps, and adopting the necessary legal changes that create a regulatory environment conducive of promoting green sukuk, the final step in the implementation strategy entails structuring the initial green sukuk issuance in the country, and subsequently introducing the green sukuk to both the capital markets and the wider public. It is envisaged that the process of green sukuk issuance will be guided by the Green Sukuk Framework which Uzbekistan will by then have established.

These steps, taken collectively, could serve as a strong starting point for the long-term process of developing a suitable ecosystem in Uzbekistan for the sustainable development of the capital markets – including the resolution of the difficulties that stem from the current state of the financial markets – and for a successful transition to a green economy.

APPENDICES

APPENDIX 1: LEGAL ACTS OF THE REPUBLIC OF UZBEKISTAN REGULATING RELATIONS IN THE SECURITIES MARKET

Number and date of adoption	Title	Content	Summary of required changes
		LAWS	
21 December 1995	Civil Code, Part One (Article 96)	The concept of a security (paper) is recognized and a sample list of securities is given.	At the initial stage, no changes are required, since the article allows for other types of document to be classified as securities by the law, in addition to the traditional securities listed in this article. This makes it possible to establish procedures for the issuance and circulation of sukuk by means of other regulatory instruments. For the further development of sukuk market, it will be necessary to review some provisions in order to create a legal framework for the conduct and and legal regulations of transactions on which sukuk are based and simplify the related procedures.
30 December 2019	Tax Code	The Code defines the concept of securities for the purposes of taxation of the income earned. Under article 49, securities are documents certifying ownership rights or the lending relationship between the legal entity that issues these documents and their holder, providing for the payment of income in the form of dividends or interest and the possibility of transferring the rights arising from these documents to other persons. Securities include shares, bonds, promissory notes, certificates of deposit, depositary receipts, options, futures and forward contracts, as well as other securities recognized as such in accordance with the national laws or applicable laws of a foreign country.	According to the Code, income received from securities can be in the form of dividends or interest. With a view to avoiding misunderstandings and disputes, it is recommended that this provision of the Code should be amplified to include an adequate definition of the nature and status of income received from the various types of sukuk, since in contrast to traditional securities (shares, bonds), sukuk are based on various contractual relationships (lease – *ijara*, purchase and sale – *murabaha*, delivery of goods – *salam, istisna*, etc.). For the development of the market, it is also necessary to ensure a level playing field for sukuk and other similar securities, and to introduce rules for optimizing the taxation of the operations and assets underlying the sukuk and preventing them from being taxed twice. The existing tax incentives for the green economy apply only to energy producers and operators and to green energy users. Providing tax benefits to holders of green sukuk would make them more attractive to issuers and investors.

Number and date of adoption	Title	Content	Summary of required changes
LRU-387 **3 June 2015**	Law of the Republic of Uzbekistan on the Securities Market	The purpose of this Law is to regulate relations in the securities market. The Law applies to the following securities: shares, bonds, treasury obligations, certificates of deposit, derivative securities and promissory notes. The Law establishes general rules for the issue, distribution and circulation of securities, professional activity in the securities market, accounting for entitlement to securities, disclosure of information in the securities market, the regulation of the securities market, and the the rights, obligations and liabilities of participants in the securities market.	Changes and amendments need to be made in order to create a legal framework for the issue of sukuk. The concept of sukuk needs to be included in the Law together with their main characteristics and conditions, based on the precepts of Sharia and taking due account of the AAOIFI Sharia rules. A detailed procedure for the issuance and circulation of sukuk can be established through subsidiary legislation. The Law should establish rules that protect the rights and interests of sukuk holders on a par with those of holders of traditional securities and other investors.
ZRU-392 **25 August 2015**	Law of the Republic of Uzbekistan on Investment and Mutual Funds	The purpose of this Law is to regulate relations in the field of investment and mutual funds activities.	This Law does not regulate the securities market directly and does not contain any rules or display any gaps that hinder the issuance of sukuk.
ZRU-370 **6 May 2014**	Law of the Republic of Uzbekistan on Joint Stock Companies and Protection of Shareholders' Rights	The purpose of this Law is to regulate relations in the field of the establishment, operations, reorganization and liquidation of joint stock companies, and to provide for the protection of shareholders' rights. In addition, the Law sets out some rules related to the issue and circulation of shares in joint stock companies.	This Law does not contain any rules that hinder the issuance of sukuk.
ZRU-598 25 December 2019	Law of the Republic of Uzbekistan on Investments and Investment Activity	This Law regulates relations in the field of investments and investment activities carried out by foreign and domestic investors. The Law defines financial investments as investments in: shares; corporate, infrastructure and government bonds, and other types of securities.	There is no need to amend this Law since it lists other types of securities along with traditional securities.

Number and date of adoption	Title	Content	Summary of required changes
DECREES AND RESOLUTIONS OF THE PRESIDENT OF THE REPUBLIC OF UZBEKISTAN			
RP-475 **27 September 2006**	Resolution of the President of the Republic of Uzbekistan on Measures for the Further Development of the Securities Market	This Resolution approved the securities market development programme for 2006-2007.	The Resolution does not contain any rules that hinder the issuance of sukuk.
PD-5630 **14 January 2019**	Decree of the President of the Republic of Uzbekistan on Measures for the Radical Improvement of the System of State Asset Management, Antimonopoly Regulation and the Capital Market	This Decree established the Capital Market Development Agency of the Republic of Uzbekistan (CMDA) as the successor to the Securities Market Coordination Centre and set out the main duties of the Agency.	The Decree does not contain any rules that hinder the issuance of sukuk.
PP-4127 **24 January 2019**	Resolution of the President of the Republic of Uzbekistan on the Organization of the Activity of the Capital Market Development Agency of the Republic of Uzbekistan	This Resolution addressed institutional aspects of the Agency's activities.	The Resolution does not contain any rules that hinder the issuance of sukuk.
RESOLUTIONS OF THE CABINET OF MINISTERS OF THE REPUBLIC OF UZBEKISTAN			
404 **15 May 2019**	Resolution of the Cabinet of Ministers of the Republic of Uzbekistan on Measures to Organize the Activity of the Agency for the Management of State Assets of the Republic of Uzbekistan	This Resolution had approved provisions governing the Agency for the Management of State Assets of the Republic of Uzbekistan. The Agency was given some authorities to manage securities owned by the state. One of the main tasks of the Agency is to develop a set of measures to attract investments, including both foreign direct investments and portfolio investments. The means for attracting investments specified include the issuance and trading of bonds and stocks of enterprises in which the state has a stake. In this context, the Agency is also responsible for the distribution of IPOs and SPOs among domestic and foreign stock exchanges.	This Resolution needs to be amended to expand the authorities of the Agency in such a way as to take the global practice of the issue of sukuk in which the state has a stake (including sovereign sukuk) into account, and to meet the need for a legal framework for state participation through the SPVs that are established in the process of issuing sukuk. Sukuk should be specifically included in the list of securities to be issued by the state-owned enterprises under the control of the Agency.

Number and date of adoption	Title	Content	Summary of required changes
650 **7 August 2019**	Resolution of the Cabinet of Ministers of the Republic of Uzbekistan on the Approval of Provisions on the Capital Market Development Agency of the Republic of Uzbekistan and the Fund for Promoting Capital Market Development under the Capital Market Development Agency of the Republic of Uzbekistan	The Resolution approved provisions concerning the procedures of the CMDA and of the Fund for Promoting Capital Market Development, which is administered by the CMDA.	The Resolution provides the Agency with sufficient authority to initiate the introduction of sukuk in Uzbekistan. With the aim of promoting the introduction of new types of financial instrument that make it possible to attract the necessary resources for the financing of investment projects, the Agency: • provides assistance in creating an effective securities market infrastructure; • develops and implements mechanisms that contribute to the development of the securities market, including on the basis of international experience; • develops legal and regulatory action concerning the introduction of new financial instruments such as debt securities and derivatives, and • conducts market analysis and monitors the securities market and other financial instruments. In the light of the above, there is no need to amend this Resolution.
239 **20 August 2014**	Resolution of the Cabinet of Ministers of the Republic of Uzbekistan on the Approval of the Provisions on Quotas and Procedures for the Admission of Securities into Circulation	The provisions approved establish quotas and set out the procedures for the distribution and circulation of securities issued by non-residents of Uzbekistan within Uzbekistan, and of securities issued by residents of Uzbekistan outside Uzbekistan.	There is no need for amendments since the Resolution does not restrict the types of securities that may be circulated.
284 **29 December 2008**	Resolution of the Cabinet of Ministers of the Republic of Uzbekistan on Measures for the Implementation of the Law of the Republic of Uzbekistan on the Securities Market	This Resolution approved provisions on the maintenance of the Unified State Registry of Stock Issues.	There is no need for amendments.

Number and date of adoption	Title	Content	Summary of required changes
215 **16 October 2006**	Resolution of the Cabinet of Ministers of the Republic of Uzbekistan on Measures for Ensuring the Effective Management of Enterprises with State Stakes in the Authorized Fund and for Proper Accounting of State Property»	This Resolution approved provisions on the procedures for transferring packages of state stocks (shares) into trust management.	There is no need for amendments.
DOCUMENTS OF THE AUTHORIZED GOVERNMENT AGENCIES **Capital Market Development Agency of the Republic of Uzbekistan** **(former Centre for Coordination and Control of Securities Market Functioning)**			
Reg. No. 351 **1 July 1997**	Provision on the Procedure for the Distribution and Circulation of Convertible Securities	This Provision regulates the procedures for the distribution and circulation of convertible securities, defined as preference shares and corporate bonds that can be converted into common stocks of the same issuer	In the initial stages of the introduction of sukuk, there will be no need for amendments. There may be a need for amendments in the future for the sake of the further development of the market and introduction of various types of sukuk.
Reg. No. 820 **21 September 1999**	Rules for Preventing Manipulation in the Securities Market	These Rules determine the procedures for preventing and responding to cases of manipulation in the securities market. They include requirements for the actions of securities market professionals. holders of securities and investors active in the securities market.	There is no need for amendments.
Reg. No. 844 **1 December 1999**	Unified Rules (Standards) for Depository Accounting and Reporting	These Rules establish unified principles for the way in which the process of accounting for securities in Uzbek depositories is organized and maintained. They specify procedures for conducting depository transactions, and for the organization of document management and internal control, and determine amounts and procedures for reporting.	The Rules need to be amended. Paragraph 7.3, for instance, reads as follows: "7.3. The following types of securities may be stored and accounted for in the Depository System: • shares of joint stock companies, taking into account the specifics of their circulation established by the law; • corporate bonds; • government securities, unless otherwise provided for by law; • derivative securities." Sukuk need to be added to this list.

Number and date of adoption	Title	Content	Summary of required changes
Reg. No. 860 **28 December 1999**	Provision on Underwriting Activities in the Securities Market	This Provision sets out standards, procedures and conditions for the underwriting of initial offerings of securities, and regulates the relations between the issuer and the underwriter including their liabilities .	There is no need for amendments.
Reg. No. 1384 **16 July 2004**	Order on the Approval of the Provisions on the Implementation of Securities Purchase and Sale Transactions on the Organized OTC Market	The Provisions establish the procedures for the sale and purchase of stocks, corporate bonds and derivative instruments on the organized OTC securities market.	Amendments are needed to include sukuk in the list of securities to be traded on the organized OTC securities market.
Reg. No. 1396 **6 August 2004**	Order on the Approval of the Provisions on Repo Transactions involving Securities	The Provisions set out the procedures for the conduct of repo transactions involving securities in Uzbekistan.	There is no need for amendments.
Reg. No. 1495 **15 July 2005**	Order on the Approval of the Provisions on the Activity of an Investment Consultant in the Securities Market	The Provisions establish the conditions and procedures governing the activities of professionals providing investment consultancy services in the securities market in accordance with the relevant legislation.	There is no need for amendments.
Reg. No. 1915 **7 March 2009**	Order on the Approval of the Provisions on Accounting by Professional Participants in the Securities Market for the Operations and Transactions which are Conducted by Them in the Securities Market and on the Storage of Documents on Their Accounting	The Provisions set out the procedure to be followed by professional participants in the securities market when accounting for their operations and transactions, including the documents they must maintain.	There is no need for amendments.

Number and date of adoption	Title	Content	Summary of required changes
Reg. No. 1919 **9 March 2009**	Order on the Approval of the Provisions on an Accounting Register of OTC Securities Transactions"	The Provisions concern the maintenance of an accounting register of OTC transactions involving securities conducted on the unorganized OTC securities market, and the registration of such transactions by professional participants in the securities market. These provisions apply to OTC transactions involving stocks, corporate and infrastructure bonds, and derivatives.	Amendments are needed to make the Provisions applicable to sukuk as well.
Reg. No. 2000 **30 August 2009**	Order on the Approval of Rules on the Issue of Securities and State Registration of Stock Issues	The Rules lay down the procedures for the issue of securities and their official registration.	Amendments are needed to set out comprehensive and detailed procedures for the issue and official registration of sukuk.
Reg. No. 1911 **25 February 2009**	Order on the Approval of the Provisions on the Registry of Securities Holders	Together with other legislation, the Provisions set out the procedures governing the registry of holders of stock, corporate bonds holders and infrastructure bonds.	Amendments are needed to make the Provisions applicable to sukuk as well.
Reg. No. 2079 **19 February 2010**	Order on the Approval of the Provisions on the Organization of the Protection of Confidential Information by Professional Participants in the Securities Market	The provisions set out procedures to ensure the protection of confidential information by the professional participants of securities market.	There is no need for amendments; the Provisions can be applied to sukuk as they stand.

Number and date of adoption	Title	Content	Summary of required changes
Reg. No. 2383 **31 July 2012**	Order on the Approval of the Rules for Providing and Publishing Information on the Securities Market	The Rules govern the procedures for providing and publishing information on the securities market.	There is no need for amendments.
Reg. No. 3199 **5 December 2019**	Order on the Establishment of a Special Procedure for the Circulation of Securities	According to the procedures set out in this Order, the circulation of securities other than government securities is only permitted once their placement has been completed in accordance with the relevant legislation.	There is no need for amendments.
DOCUMENTS OF THE AUTHORIZED GOVERNMENT AGENCIES **Other ministries and agencies**			
Reg. No. 1874 **2 December 2008**	Joint Resolution of the Centre for Coordination and Control of Securities Market Functioning under the State Property Committee of the Republic of Uzbekistan, the State Committee of the Republic of Uzbekistan on the Management of State Property, the Ministry of Finance of the Republic of Uzbekistan and the Board of the Central Bank of the Republic of Uzbekistan on the Approval of the Provisions on Professional Standards of Activity for Institutional Investors in the Securities Market	The Provisions set standards for the professional activities of institutional investors in the securities market. The institutional investors are investment funds, insurers and commercial banks.	There is no need for amendments.

Number and date of adoption	Title	Content	Summary of required changes
Reg. No. 1473 **27 April 2005**	Joint Resolution of the Ministry of Finance of the Republic of Uzbekistan and the State Committee of the Republic of Uzbekistan on the Management of State Property and Entrepreneurship Support on the Approval of the Provisions on Procedures for Cconducting the Activity of the Management of the Packages of State Stocks (Shares) in the Authorized Funds of Economic Societies	The Provisions set out the procedures governing the management of state stocks (shares) in the authorized funds of economic societies.	There is no need for amendments.
Reg. No. 1875 **2 December 2008**	Joint Resolution of the Centre for Coordination and Control of Securities Market Functioning under the State Property Committee of the Republic of Uzbekistan, the State Committee of the Republic of Uzbekistan on the State Property Management, the Ministry of Finance of the Republic of Uzbekistan and the Board of the Central of the Republic of Uzbekistan on the Approval of Provisions on Regulatory Requirements for the Quality and Minimum Level of Investments in Corporate Securities by Institutional Investors	The Provisions set out conditions governing the investments of institutional investments in corporate securities, including quality issues and minimum levels of investment.	There is no need for amendments.

Number and date of adoption	Title	Content	Summary of required changes
Reg. No. 1692 **June 22, 2007**	Joint Resolution of the Centre for Coordination and Control of Securities Market Functioning under the State Property Committee of the Republic of Uzbekistan and the Board of the Central of the Republic of Uzbekistan on the Approval of Provisions on the Procedure for the Circulation of Securities in Foreign currency on the Territory of the Republic of Uzbekistan, the Purchase by Residents of Securities in Foreign Currency and the Purchase by Non-Residents of Securities Issued by Residents	The Provisions regulate the circulation of securities denominated in foreign currency in Uzbekistan, the purchase by residents of securities in foreign currency, and the purchase by non-residents of securities issued by residents. They apply to the stocks, bonds and other securities publicly registered by the government agency authorized to regulate the securities market.	Some of the rules need to be amended. For instance, according to Paragraph 15, sales of securities purchased by a non-resident to residents must be conducted in the national currency of Uzbekistan. This rule may inconvenience non-resident investors when settling transactions involving the purchase and sale of sukuk.

Note: This list contains the most basic items of legislation that are directly applicable to the securities market, and is based on the legal and regulatory documents available to us. The list is not exhaustive and there may be other items of legislation that affect the securities market.

APPENDIX 2: MINUTES OF MEETINGS WITH MAJOR STAKEHOLDERS

Thursday, 13 August

Meeting 1: UNDP Environment and Climate Change Cluster

- UNDP Uzbekistan's Environment Cluster and Climate Change units have been working to address environmental issues in Uzbekistan and advocating for the efficient use of energy. UNDP Uzbekistan plays an important role in the development of mitigation and adaptation projects. Under the mitigation programme, a "Green Mortgage Mechanisms" project has been implemented with the objective of encouraging the construction of energy-efficient and low-carbon housing in rural areas. The National Bank of Uzbekistan and Qishloq Qurilish Bank are involved in the project and issue green mortgages as an innovative banking product that meets environmental requirements and attracts clients from rural areas. UNDP Uzbekistan is also involved in electric vehicle projects.
- The Strategy for Transition to a Green Economy was developed and adopted in 2019 and as all sectors are inter-linked, the government of Uzbekistan has prioritized all sectors in the development of the green economy in the country. The energy, agriculture and transportation sectors have the most bankable projects.
- There are opportunities in the energy sector. The government is very keen to develop green energy as it is clear that the power supply is not sufficient and generation has to be increased.
- Projects in the energy sector include the construction of solar power plants, wind parks and small hydropower development projects. Masdar Clean Energy, a private company, has undertaken a 100 MW solar plant pilot project with financing from public resources and IFIs using the PPP model.
- All UNDP projects are grant-based. The grants comes from the Global Environment Facility (GEF) and Green Climate Fund (GCF).
- The size of the capital markets is very small. Excluding government bond sales, the market turnover for 2019 was only US$ 50-55 million. The banking sector is relatively large: total bank assets amount to 40 percent of the GDP. However, banks are limited in investing in the capital market. On the one hand you have banks that have a lot of assets that could be invested, while on the other hand you have a very small capital market.
- Islamic finance is seen as a promising avenue, given the large Muslim population and the demand from the public, as well as recent interest from the government. It is important to increase awareness and capacity for green financing and green sukuk, as these are new concepts at the governmental level.
- The Ministry of Finance, Ministry of Agriculture, Ministry of Water Resources, Ministry of Transportation, State Committee of the Republic of Uzbekistan on Ecology and Environmental Protection, Agency for the Development of Public-Private Partnership, Chamber of Commerce and Industry of the Republic of Uzbekistan, Ministry of Foreign Economic Relations, Investments and Trade, Ministry of Innovative Development, Central Bank, and commercial banks such as the National Bank of Uzbekistan, Qishloq Qurilish Bank and Ipoteka Bank could be interviewed.

Friday, 28 August

Meeting 2: Qishloq Qurilish Bank

- Since 2019, the Bank has been working with UNDP Uzbekistan to implement an energy-efficient housing project called the "Green Mortgage" project. For the time being, the project primarily focuses on rural areas.
- Qishloq Qurilish Bank does not focus solely on incorporating green solutions in new houses, but is also concerned with green solutions for existing homes. The Bank is constantly striving to maximize the effectiveness of the project.
- The green mortgages are not cheaper than conventional mortgages. The main difference is the equipment used. The equipment is energy efficient and its cost is subsidized or financed by UNDP. The cost of the equipment is not reflected in the mortgage price.
- So far, the only assistance the Bank has received has been from the UNDP. However, negotiations are under way with the EBRD regarding the financing of the Green Mortgage project.
- The UNDP is conducting an energy audit, but there are still no definitive results. The UNDP takes the data of a random building and measures its financial savings by analysing its utility bills and reductions in carbon emissions.
- With respect to demand for Green Mortgages, Bank officials believe that if the supply of mortgages increased, the demand would follow, as the mindset of the local people values the environmental impact and not only the financial benefit, and is thus well aligned with the project's overarching aim.
- In 2019, Green Mortgages accounted for ten percent of all mortgage loans extended in Uzbekistan. In 2020, the figure has increased to 11 percent.
- The majority of the rural households which take out Green Mortgages have an off-grid battery. However, very few houses rely solely on the current off-grid system: most of them have hybrid systems, and are connected to the central grid as well, since the power generated by solar panels alone is insufficient to meet the households' daily power needs.
- Currently, households are not legally permitted to sell surplus electricity, as the electricity market is dominated and regulated by the state. If allowed, this could represent a promising avenue for more sustainable energy production and consumption.

Meeting 3: Capital Markets Development Agency

- In the current phase of Uzbekistan's development, the demand for green projects is rather low. In order to change this, the existing legal and regulatory frameworks governing the Uzbekistani capital markets need to be fundamentally restructured.
- The green sukuk initiative could raise awareness about the possible benefits of Islamic finance in addressing both financial and environmental concerns. The CMDA is also looking for technical assistance from IsDB and UNDP on the amendment of the legislative framework relevant to the issue of green sukuk.
- With regards to the demand for Islamic financial services, it was suggested that the City of Tashkent, as well as other major, mainly Muslim-populated cities, have already shown interest in introducing green sukuk. The City of Tashkent also has a large number of ongoing energy efficiency projects.

- The Agency points out that about 30-40 percent of SMEs are reluctant to seek conventional finance for religious reasons, further highlighting the positive prospects for Islamic finance in the country.
- The Agency suggests that investors are typically more sensitive to price than to any other aspect of a financial instrument, such as the social, environmental or religious aspects. Consequently, any financial instrument must incorporate/reflect the price element.
- The local capital market is small, underdeveloped and immature, and a more robust capital market is needed in order to achieve the SDGs. For this reason, the CMDA stated that the issuance of green sukuk should be in domestic currency, as this would energize and stimulate the local capital market. Moreover, given that the proceeds from the sukuk would be in local currency, it would be reasonable for the sukuk themselves to be in local currency as well. Another argument in favour of local currency sukuk relates to local currency savings. Remittances make up abour 15 percent of Uzbekistan's GDP, compared to a global average of about 4 percent, so the diaspora could represent an important investor base.
- The speed with which a green sukuk could be implemented depends on the commitment of the government of Uzbekistan and other agencies. If the project is widely promoted, and attracts investors' attention, other IFIs and organizations, such as the EBRD and/or IsDB could come aboard and help finance it.
- Ultimately, the CMDA offers their full support, and will lend their best efforts to helping the UNDP to jointly put the project into practice.

Meeting 4: Ipoteka Bank

- The bank is not currently involved in the Green Mortgage project, but a process of negotiation with the UNDP is under way, and the Bank itself is currently going through an internal transformation process.
- There are several ongoing projects in energy efficiency, but they can hardly be described as commercial, given that they are initiated by the state, and the Ministry of Finance provides lines of financing.
- In 2014, the Bank received US$ 10 million from the IsDB although this was for financing commercial projects, rather than green ones.
- At the moment, there are no tax incentives or privileges to encourage banks to invest in green projects. At times, banks do receive funding from the Ministry of Finance at interest rates lower than the market interest rates. In return, banks are expected to provide finance at lower interest rates to borrowers too. This is, however, primarily intended to benefit the borrowers, not the banks.
- The Bank has ongoing projects in areas like agriculture, services, transportation, textiles and housing, and it believes that housing projects could be eligible for green sukuk.

Meeting 5: Ipak Yuli Bank

- Last year, the Bank signed an agreement worth US$ 5 million with the EBRD to finance green projects. So far, 13 projects have been initiated, some of which deal with the production of special medical equipment. The first tranche of US$ 2.4 million has already been utilized, and the second tranche is due to be released in September this year. The loan agreement entailed two main clauses: the projects have to be in the area of green energy, and they have to be related to energy efficiency.

- In 2014, the Bank received US$ 0.5 million from the International Development Association (IDA) to support renewable energy sources in agriculture (irrigation, equipment). Seven projects have been initiated so far. The projects typically took two years to implement, after which a protocol on results monitoring was signed. Unlike the EBRD loan agreement, the IDA financing was in the form of a grant.
- The Bank has faced some challenges while implementing green projects. Most clients are not fully aware of the importance of green technology. The low prices of non-renewable energy sources in Uzbekistan make them more attractive to users. The market for renewable energy in the country is undeveloped, as there are very few local manufacturers and energy technology is mainly imported. However, the inefficiency of the sources of energy that are currently preferred has resulted in a shortage of energy, highlighting the need to develop and invest in green sources.
- The Bank is not very engaged in the capital markets. It does not issue bonds, and its lines of financing typically come from IFIs or large foreign banks. Until a few months ago, bonds had to be secured with collateral, which made banks reluctant to issue them. However, the regulation in question was recently amended, and the volume of bonds issued is expected to increase.
- A few days prior to the meeting, a small number of Dutch and German impact investors bought shares in Ipak Yuli. This was not done through a public offering; rather, the potential investors were approached directly.
- With the appropriate regulatory framework in place, the bank would be willing to issue a green sukuk. The project would be interesting for the Bank, as it is locally-based and would secure long term financing. At the moment, the Bank lacks long term domestic financing, which is why it has to borrow from large foreign banks or IFIs. The Bank does not have enough long-term deposits in local currency, as people prefer to save in foreign currency out of fear of inflation. This situation could be improved by issuing green sukuk in Uzbek som.
- The Bank does not participate in the Green Mortgage project, but is working with the ICD to set up an Islamic finance window. The Bank claims that demand for Islamic financial instruments in Uzbekistan is high, as in any other Muslim country. The ICD is providing both financial and technical assistance. Several other banks are also working to open Islamic finance windows. All of them are waiting for the Central Bank's approval to begin trading.
- Islamic windows could be set up without major changes in legislation. Only a few changes are needed, and these can be made by the Central Bank alone. However, the further growth of Islamic finance would require more thorough changes. The experience of neighboring countries in Central Asia suggests that separate laws on Islamic finance and banking must be in place, and that this process typically takes from 5 to 10 years. The countries in the region are already in the process of adopting such laws, and have even established separate Islamic finance organizations.

Meeting 6: Ministry of Energy

- The Ministry is currently working on a new Electricity Law. The second draft has already been prepared. The law would lay the foundations for the transformation of the state-regulated industry into a free market one, in which the prices of utilities are determined by the market and the industry is self-regulated.

- There is a deficit in the supply of power, which has led to agreements beign signed with private power producers. In the near future, the Ministry is hoping for a wholesale market in which private actors could sell electricity freely.
- In October 2019, the tender for the first independent power producer (a French company) was finalized. The company is to build a power station in the desert with a capacity of 100 MW. The tender was supported by the IFC. In addition, several Turkish companies, such as Aksa Energy and Cengiz, are to relocate turbines to Uzbekistan to set up hydropower plants. Cengiz is also expected to provide an additional 240 MW of capacity under a Power Purchase Agreement (PPA).
- In June, through the world's largest [wind power] PPA in one location, Masdar agreed to provide a capacity of 500 MW. There are ongoing negotiations for several wind power plants. At the moment, there are four tenders for the use of renewable energy sources, which are financed by either the IFC or the EBRD.
- Th signing of PPAs is intended to secure short term financing from IFIs, as they provide cheap funding. In the future, more sustainable, long-term means of financing could come from local green sukuk issues.
- Other potential issuers, in addition to high voltage producers, are the distributors of energy and the owners of the grid. Currently, these are both state owned and have not been separated. The separation of these two entities/functions is expected to begin next year.
- In the future, if the market is indeed self-regulated, it will be possible for retailers to buy energy from wholesalers and sell to individuals. Some of these retailers could enter niche markets and offer only green energy. This could represent a window of opportunity for green sukuk.
- With regards to access to electricity, there are no statistics for off-grid use in rural areas, but the off-grid market segment is not very large. There are some new power plants, and the energy deficit has been reduced slightly. However, the deficit is still very large, and sometimes the power supply to certain areas or sectors has to be cut off to prevent a nationwide blackout. It would be very useful if surplus power [generated off-grid] could be sold back. This would alleviate the power shortage. A scheme is being considered under which households and small companies wold be able to sell back energy using Smart Meters, which measure the consumption of electricity and calculate the surplus. This would require changes in current regulations. Negotiations on the topic are already under way.
- Overall, the share of renewables in total energy consumption and production is very low.

Meeting 7: Ministry of Investments and Foreign Trade

- The Ministry is the focal point for attracting foreign investment and for cooperation with the IFIs – in contrast to most other countries, where the focal point for cooperation with the IFIs is the Ministry of Finance.
- The Ministry has been cooperating with the IsDB since 2003 and more than a dozen projects have been implemented. In 2018, the IsDB and the President decided to create a partnership to open up Islamic windows in the country. The idea is to introduce sukuk first, followed by the introduction of green sukuk.
- The bond markets are expanding, and both government and commercial bonds are traded. The foreign debt has been growing slightly. In order to slow or halt the growth of

the foreign debt, the bond issues should be in local currency. This raises the question of whether international investors and/or IFIs have an appetite for local currency issues. The signs are that demand exists. The Asian Development Bank has agreed to buy offshore bonds worth UZS 25 million. Although the agreement was signed earlier this year, its execution has been delayed due to disruptions caused by the COVID-19 pandemic. There are also ongoing negotiations with the World Bank to buy bonds denominated in Uzbek som. The World Bank is currently assisting with water irrigation related projects, and there are ongoing initiatives to expand the use of solar panels for power generation.

- The Ministry suggests that Uzbekistan is deploying various incentives in order to try to create a good climate for attracting foreign investors. However, more attention needs to be paid to other sectors, apart from the few sectors favoured by foreign investors, which typically include minerals, oil, chemicals, gas and textiles. In other words, more emphasis should be placed on the green sectors of the economy in order to launch green sukuk and thereby attract larger numbers and different groups of investors.
- Over the past few years, green projects have been financed through the PPP mechanism. The incentives and initiative have come from the government, and the finance and expertise from the private companies that win the tenders.
- The government has launched the 2020-2022 investment programme. These programmes have been prepared for several years now. They have two main components: the first part consists of projects already planned, the funding for which has already been secured from the IFIs in most cases, and the second part is dedicated to prospective projects, for which investors have yet to be found.
- The Ministry suggests that there are currently several challenges that foreign investors might face. In this context, the court system needs to be improved, and the question of guarantees needs to be addressed as well. The government is working on addressing both of these matters.
- Government agencies are opposed to the issue of foreign currency debt. Although the level of foreign currency debt is still under control, caution is needed, especially because foreign borrowing is running higher than usual due to the COVID-19 pandemic.
- Overall, the Ministry views green sukuk as an important financial tool going forward.

Wednesday, 02 September

Meeting 8: Ministry of Finance

- The Ministry of Finance (MoF) conducts feasibility analyses of potential new financial instruments, and has conducted an analysis of the prerequisites for launching sukuk in Uzbekistan. The analysis showed that issuers need to have good ratings and be able to comply with Sharia capital standards. The government has started working on the implementation of Islamic finance
- Regulatory procedures allowing the government to issue sukuk are believed to be lacking, making government issuance of sukuk an unpopular option. At the moment, there are no proper, separate regulations that deal with Islamic financial activities. The private sector and private banks might therefore be more interesting fronts for green sukuk issuance. The private sector has a great potential to issue green sukuk, given that state-owned enterprise are transitioning to the IFRS, but private ones have the freedom to choose their accounting systems.

- Local capital markets in general are not well populated due to the lack of investors. However, private Uzbek companies are willing to participate in foreign capital markets, such as London, where they issue eurobonds denominated in foreign currency. Meanwhile, people are sceptical about depositing savings in local banks, both for religious reasons and because of their distrust in the local currency
- Some of the sectors in which green sukuk could be useful are the energy sector, textiles, agriculture, solar energy and electronics.
- Since the issue of sukuk by the government is not the preferred option, municipal issues could be an alternative. However, municipal assets and liabilities are directly linked to government assets and liabilities, so municipal debt adds to the national debt. For this reason, what is needed is a clear guideline explaining the steps that private sector firms need to follow in order to enter the capital markets.

Meeting 9: Islamic Business and Finance LLC

- The LLC wishes to raise awareness of Islamic finance. There is a huge demand for Islamic finance in Uzbekistan, due to the majority Muslim population. The LLC has conducted a survey on the demand for Islamic finance. Most of the respondents replied that they would prefer more Islamic financial services
- With regards to savings that remain untapped due to people's reluctance to save in conventional banks, the LLC suggests that according to a study by the ADB, about 30 percent of the population does not use conventional banking services. This can be quantified at between US$ 1 billion and US$ 3 billion. In order to address this issue, people need to be informed about the benefits and value added of Islamic finance.
- The LLC has established a Telegram group and a website on Islamic finance. There are currently over 7,000 active members. The existence of this network can help to raise the level of financial literacy in the country with respect to Islamic finance.
- A presidential decree was drafted in 2017, but it has still not been approved. At the moment, there is no legal document on Islamic finance in place. The Central Bank is also reluctant about the introduction of Islamic finance on the basis that the capacity of the country to engage in Islamic finance is inadequate.
- The most critical government bodies for introducing green sukuk, according to the LLC, are the Ministry of Investments, the Ministry of Finance and the CMDA. The most suitable sector is agriculture, especially horticulture and the provision of alternative sources of energy for horticulturalists.
- The LLC is a member of a working group aimed at raising awareness about Islamic finance in Uzbekistan. The working group is informal and meets once a month to discuss the prospects and challenges for Islamic finance in the country.
- The LLC is willing to support the research by facilitating contacts with Uzbek lawyers and other experts who are well informed both about the existing regulations and about Islamic finance.

Meeting 10: Association of Leasing Companies

- The Association delivered a presentation about its own activities and the Uzbek leasing market, including an analysis covering 30 leasing companies and 107 commercial banks.

The volume of new lease deals has been increasing over the past five years and the total leasing portfolio has expanded. The most active sector in the leasing market is agriculture (30 percent) followed by construction (20 percent). Taiba and UzbekLeasing were mentioned as the two most prominent Uzbek leasing companies working with the ICD. Leasing services are provided mainly to SMEs.

- A number of proposed areas for cooperation were presented. These included: providing training programmes about green sukuk; increasing lines of murabaha financing; participating in the shareholder capital of Uzbek Leasing International (ULI), and consultancy and participation in sukuk issues.
- With regards to lines of financing from the ICD, companies apply for funding with murabaha-based projects, and the funds are transferred to those which are selected after a process of screening and evaluation. Each project receiving murabaha finance has to be cleared by the ICD.
- The leasing companies in Uzbekistan are not particularly active in the bond markets: only one or two companies are involved. As much as 90 percent of the capital market belongs to the banks. The problem does not stem from the companies themselves but from the general lack of capital market activity. Limited liability companies do not face restrictions in issuing corporate bonds. Until recently, only commercial banks were allowed to issue corporate bonds. However, the CMDA recently drafted and subsequently adopted legislation allowing LLCs to issue corporate bonds to raise funds and attract investments too.
- The majority of the corporate bonds issued are denominated in local currency, as the legislative framework does not allow for issuance in foreign currencies. The rationale behind this is to promote the use of the local currency. Last year, however, one company issued eurobonds and so pioneered the issue of a commercial bond denominated in foreign currency.
- The majority of corporate bond buyers/investors in Uzbekistan are insurance companies. In addition, there are a number of companies which have free cash and are unable to deposit all of it in banks due to specific legal limitations. These companies also engage in bond markets in order to invest their free cash.
- Agriculture is a very important sector for green finance. Uzbekistan produces 15-16 million tons of fruit and vegetables annually, and new green investment projects are needed to provide energy for agricultural production. There is also great potential for solar energy for residential purposes, as the number of days of sunshine each year is high. Since Uzbekistan has been experiencing water supply issues, especially in agricultural production, projects financing better water management would be very useful. Energy-saving equipment or zero- or low-carbon construction equipment would be worth looking at as well. Finally, Uzbekistan is developing its electric car and green transportation facilities.

Friday, 04 September

Meeting 11: Republican Stock Exchange (UZRSE)

- The UZRSE is working on the development of the local capital markets. It is also working towards developing a sukuk market in the country. According to the UZRSE, the introduction of sukuk remains heavily dependent on legal amendments to be made by the CMDA.
- With regards to the UZRSE's involvement in green initiatives, some of the companies listed on the exchange have projects related to green growth related projects. The UZRSE also plans to introduce financial instruments for green growth that differ from the traditional stock and bonds currently traded.

- The total market capitalization is US$ 5 billion. However, companies partly or wholly owned by the government account for 50 percent of this figure. The privatization of government companies is envisaged in the near future. The UZRSE also wishes to diversify the instruments traded and thereby increase the size of the capital market. Until recently, only joint stock companies could issue bonds. However, since the President's approval, LLCs have become eligible to issue bonds as well.
- Until 2019, companies were not legally allowed to trade in corporate bonds. However, since 2019, they have been encouraged to issue bonds. Currently, there are four main corporate bond issuers – three banks and one leasing company.
- The UZRSE believes that there is huge potential and demand for Islamic bonds in Uzbekistan. The officials also stated that it would be easier to make amendments to regulations concerning the private sector. In other words, the UZRSE views the private sector as the preferred potential issuer of green sukuk, rather than a sovereign issue.

Meeting 12: State Committee for Ecology

- The State Committee for Ecology works closely with international organizations, such as the Green Climate Fund, to implement various eco-friendly projects. Since 2017, in addition to its primary mandate for environmental protection, the Committee has been responsible for a solid waste management project in Tashkent using the PPP mechanism. It works closely with municipalities and regional governments. It is also working with the French Development Agency to expand the solid waste management project in Samarkand.
- The solid waste management project could be scaled up and expanded to Samarkand through the issue of a green sukuk.
- Typically, the projects of the State Committee are financed through credit lines from the IFIs. The solid waste management project is being financed through a loan from the French Development Agency.
- The overall aim of the solid waste management project is to extract biogas from waste. The project has been under way since 2018. Currently, the equipment is being procured for the extraction of the gas. It is hoped that the project will be completed by 2021 or 2022.
- The private and public stakeholders that could be approached for a discussion of this project include the Agency for Private-Public Partnerships under the Ministry of Finance, and the Chamber of Commerce and Industry.
- The financing gap could be tackled through a blended finance approach consisting of grants from the IFIs coupled with funds raised by issuing green sukuk to foreign and local investors.
- The SCE plans to prepare a grant funding proposal for up to US$ 20 million, which could then be used to attract financing from IFIs, as most of the IFIs would prefer to see their investments have a multiplier effect.

Monday, 07 September

Meeting 13: Ministry of Water Resources

- Due to climatic conditions, the drainage system in the country needs to be improved and the level of salt in the soil controlled. The Water Resource Usage division within the Ministry has been involved in the construction of 28,400 kilometres of irrigation infrastructure and several pumping stations. Pump stations are of great importance in Uzbekistan, as they are used to carry water uphill, given the country's rocky landscape. This process is heavily energy-dependent.

- All the expenses of the Ministry are covered by the state budget.
- The water infrastructure was built 50-60 years ago. It therefore requires constant maintenance, which consumes a lot of electric energy. For this reason, the Ministry is aiming to attract investors to finance new and innovative pump stations. Replacing the old energy-intensive pump stations would have a positive impact on energy efficiency in Uzbekistan. The Ministry believes that its initiative for replacing all pump stations with more energy-efficient ones could be eligible for green sukuk financing.
- The Ministry has released a Concept Note outlining its overall plans. The annual energy consumption of the Ministry is worth US$ 8 million, and accounts for 10 percent of all the electricity used in the country. Moreover, 70 percent of the entire budget that the Ministry receives from the Government is spent on electricity. These figures highlight the need to adopt more energy-efficient solutions as soon as possible.
- With respect to the financing of water management projects, maintenance and simple operations are typically financed by the national government, whereas big projects are usually financed through lines of finance from the IFIs. So far, the Ministry has received funding worth a total of about US$ 1 billion from the World Bank, IsDB and ADB to finance six projects. Most of the funding is in the form of loans, although the Ministry has also received several grants to finance training and the procurement of IT equipment.
- The private sector has not been involved in financing water management projects to date. However, the Ministry is currently working with the private sector to establish PPPs, following the President's new Concept Note.
- The lack of private sector involvement in the financing of water management projects was due to legal constraints. In the past, legislation did not envisage the financing of water management projects by the private sector. However, since the President's Concept Note, the idea of PPPs has been developing.
- Finally, the Ministry believes that the projects which it is and will be working on are eligible for green sukuk financing, as they can be labelled "green", comply with Sharia principles of Islamic finance and are capable of generating economic returns.

Meeting 14: Ministry of Housing

- The Ministry is working on a number of green projects, and has so far secured lines of financing from the IsDB in the form of istisna. In addition to funding from the IsDB, Ministry projects are also financed by the ADB. Last year, the Ministry worked with the ADB on a project worth US$ 800 million to improve water supplies in certain regions. It is hoping to expand these projects to more regions in the near future.
- The Ministry has several planned projects that need financing. It therefore regards green sukuk as an interesting potential source of highly needed funds. The Ministry's projects are usually financed by the IFIs. This financing takes the form of loans, although the Ministry occasionally receives grants for feasibility studies and tenders.
- The private sector has not traditionally been involved in financing housing projects. This year, however, the Ministry has launched efforts to attract private sector funding through PPP mechanisms. For now, the Ministry has opened a tender for a PPP to finance a sewage system, and the private sector candidates should be shortlisted by late September.

- Uzbekisan does not yet have any green buildings in the Western sense. An initiative is under way to replace the old heating systems with new ones that are more energy-efficient and sustainable. This initiative could potentially be eligible for financing via green sukuk. The size of the project is yet to be determined.

Tuesday, 08 September

Meeting 15: PPP Development Agency

- The Agency has a pipeline of projects worth US$ 10 billion. It is interested in the idea of introducing green sukuk in Uzbekistan, but believes that there is still a lot of work to be done to make a green sukuk issue possible. Private-public partnerships in Uzbekistan are typically large in scale, with values of hundreds of millions if not billions of dollars. The Agency also collaborates with the IFIs, from inception all the way through to the bidding processes. It has numerous ongoing projects in the area of energy efficiency with a total value estimated at around US$ 2 billion. Although the Agency is interested in green sukuk, it is concerned about the demand and cost-effectiveness, as Sharia-compliant instruments are typically more expensive than traditional ones.
- The IFIs could be instrumental in promoting green sukuk, especially if a blended finance approach is adopted. Although they are more expensive than traditional instruments, Sharia-compliant instruments might also cater to people who do not take part in traditional banking due to their religious beliefs. Islamic finance, and green sukuk in particular, also have the potential to attract impact investors, regardless of religious beliefs.
- The Committee suggests that the projects they are now working on with the ADB, IsDB and ICD would be eligible for green sukuk, as they are intended to eliminate the power shortage by using renewable energy with up to 500 MW of capacity. All of these projects were initiated by the state.
- The primary investors are almost always foreign, as domestic investors lack operational and technical experience. As projects involving renewable energy are relatively new, there is still not enough domestic expertise. On the contrary, smaller-scale projects, such as solid waste management facilities, are financed by local investors.
- There are some PPP projects at the municipal level, but these are typically small in scale.
- Given that almost all IFIs nowadays require an environmental impact assessment, all projects must be sustainable in nature.

Meeting 16: Ministry of Innovation

- The Istanbul International Center for Private Sector in Development (IICPSD) is seeking to attract both domestic and foreign investors to support environmentally-friendly projects in Uzbekistan.
- With regards to potentially eligible projects, there was a conference on ecology last year, supported by UNDP, at which 24 projects were presented. These projects are now to be presented in a single publication. Once this is published, it will be distributed to all the international organizations present in the country, including the UNDP country office. There are also some curently small projects which could grow larger over time.
- All these 24 projects are concerned with remedying the ecological disaster of the Aral Sea (5.6 million hectares of sea turned into a desert). The projects are social in nature, and are not-for-profit.

- The Ministry of Innovation was set up recently, about one year ago, and has a mandate to reduce the negative impact on the Aral sea. It is communicating and working with the IsDB to this end.
- Additionally, there are some start-up projects and science-based projects in need of funding, and the initiators could find green sukuk an important source of financing. However, their projects would need to be environmentally sustainable and green to be eligible for financing via green sukuk.

Friday, 11 September

Meeting 17: Solid Waste Management Project

- The project is primarily located in the city of Tashkent, and is operated as a state-owned enterprise. Currently, the SOE is mainly concerned with waste segregation.
- There are two main ongoing projects, supported by the UNDP country office and Coca Cola. One of the projects involves the purchase of coloured waste containers. The other is concerned with street cleaning. Both projects have been financed through grants, and both have been very successful. However, there is still a need to raise more awareness among the population. These are for-profit projects designed to generate income. Financing is needed in order to expand beyond Tashkent, as the first stages were merely a pilot. Records show that waste segregation was more successful prior to the COVID-19 pandemic.
- The SOE believes that green sukuk would be useful for attracting investors to finance the technologies needed to expand the waste segregation project. They are also working on implementing PPP models as a means of financing the project.

Wednesday, 7 October

Meeting 18: Ministry of Agriculture

- The Ministry is currently undergoing a massive internal transformation. In addition, the Ministry is taking the lead in transforming the overall agricultural sector in the country.
- The Strategy for the Development of Agriculture for 2020-2030 calls for the role of the state in the agribusiness economy to be limited and promotes greater participation of private sector investors in the sector.
- Currently, the Ministry has three financing methods: sovereign loans, technical assistance and grants, and the IFIs.
- The sector can be described as a highly stable one investment-wise, and the projects undertaken in agriculture provide stable and secure long-term revenue and returns, given that food safety is one of the top priorities for the Uzbek government.
- The Ministry is also pushing for a land reform. In this case, land would become an asset that could be sold, bought, and leased on the market. That would provide easy access to financing, as currently all land for agricultural purposes is owned by the Uzbek government.
- There are some projects that generate a financial return and could qualify for green financing. For example, there are projects focused on improving the irrigation system, that aimed both at enhancing the efficiency of water use and at making the soil more

fertile. One project is supported by an Austrian company through a soft loan, and this is a revenue generating project.

- Overall, the Ministry agrees that green sukuk can be used for financing infrastructure projects in the agricultural sector, and suggests that a long-term partnership with the Ministry for structuring green bankable agricultural projects would be highly beneficial for them.

Written Response : The Central Bank of Uzbekistan

- The Central Bank of Uzbekistan (CBU) has conducted a self-assessment of its compliance with Basel Core Standards and developed an Action Plan for developing its regulatory framework in line with Basel standards in 2020-2022. As per the Action Plan, and with the assistance of the World Bank, a new regulation on corporate governance in banks was developed by the Central Bank and registered by the Ministry of Justice on June 30, 2020 (#3254). The regulation determines the responsibilities and functions of the supervisory board, committees and management, defines their relationships with internal control functions and provides guidance on ensuring the principles of accountability, fairness, transparency and responsibility within banks.
- In Accordance with the Law on the Central Bank of Uzbekistan, the CBU focuses on ensuring the stability of prices, the banking system and payment systems. It is currently putting great emphasis on developing its institutional capacity and ensuring the regulatory framework is in compliance with international standards, including those of the Basel Committee.
- The Strategy to Reform the Banking Sector of the Republic of Uzbekistan for the period of 2020-2025 determines four priority directions – namely:
  - Increasing the efficiency of the banking system;
  - Improving the stability of the banks;
  - Improving financial inclusion;
  - Reducing the share of the state in the banking system.
- Once progress has been made in these priority areas, the CBU may focus on other spheres and engage in environmental factors and the green financing ecosystem. Meanwhile, the CBU participates in the initiatives of the Alliance for Financial Inclusion, which includes a green finance working group.
- The regulatory bodies are increaisngly interested in the implementation of Islamic finance mechanisms. However, the integration of Islamic finance principles into the Uzbek system necessitates a comprehensive revision of the legal framework regulating banking and finance, taxation, insurance, accounting, capital markets, civil law, judicial affairs and other spheres. To this end, a working group has been established under the Ministry of Foreign Trade and Investments. This group is due to prepare a report and make recommendations based on an in-depth analysis of the economic and legal aspects of the adoption of Islamic finance, its merits and the potential difficulties or barriers that may arise.
- On an individual basis, commercial banks are nevertheless attracting Islamic credit lines and extending loans on Islamic principles.