The Sustainable Development Goals (SDGs) Funding Gap in Islamic Finance - A Reflection

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The Impetus

The Islamic Development Bank (IDB) has estimated that the financing gap of member states of the Organization of Islamic Cooperation (OIC) to achieve United Nations Sustainable Development Goals (SDGs) is about USD1 trillion per year, of which USD700 billion is earmarked for infrastructure. Even though 40% of world poor live in OIC countries earning the equivalent of USD1.25 a day or less, as of 2017, the world's 14 development banks including those of Asia and Africa have offered no more than USD175 billion to address the gap. Dr. Banda Hajjar, the IDB President, aptly described the available amount "represents only a drop in the sea compared to the size of this gap" (Moqana 2019).[1] To meet the expectation of the SDG, the amount estimated is in the range of USD5-7 billion each year. The difficult task of achieving SDG calls for meaningful collaboration and mobilization of all key stakeholders – individual governments, multilateral agencies as well as private funding sectors (UNDP, IICPSD and IDB 2017). This will be met through high-level discussions, studies and researches, dialogues centred on the existing available infrastructure and capabilities, highlighting challenges that hinder progress and crafting realistic means and ways to address this critical gap.

UNDP-IDB Global Islamic Finance and Impact Investing Platform

In 2016, the United Nations Development Programme (UNDP) and IDB established the Global Islamic Finance and Impact Investing Platform (GIFIIP) to position Islamic finance impact investing as one of the leading enablers of SDG implementation around the world through private sector engagement. With this platform, UNDP and IDB aim to create a collaborative working space among stakeholders to address the funding deficit and nurture an Islamic finance impact investing business ecosystem. To facilitate the process of achieving this goal, a year later, IDB's Islamic Research and Training Institute (IRTI) together with UNDP's Istanbul International Center for Private Sector in Development (IICPSD) issued a report that aims to create awareness of the compatibility of Islamic finance and impact investing and the role of Islamic finance and impact investing in advancing SDG (UNDP, IICPSD and IDB, 2017).[2]

While such concerted initiative is welcomed, it is an undisputed fact that conventional vehicles have often become a major partner or driving force in integrating Islamic finance into the mainstream. Another good example that Islamic finance can learn is from the European Commission, in particular, its approach and process in embracing and addressing SDG deficit through governance and regulatory framework.

The European Commission

The European Union (EU) strongly supports the implemention of the SDG and the Paris Climate Agreement. To achieve the EU's 2030 targets agreed in Paris which includes a 40% cut in greenhouse gas emissions, they face an estimated EUR180 billion investment gap per year. Though the EU provides European Fund for Strategic Investments to attract the required investments, the scale of investment goes beyond the capacity of public sector. The financial sector could play the key partner role by:

- re-orienting investments towards more sustainable technologies and businesses;
- financing growth in a sustainable manner over the long-term; and
- contribute to the creation of a low-carbon, climate-resilient and circular economy.

In May 2018, the Commission adopted a package of measures implementing several key actions announced in its action plan on sustainable finance.

The package includes:

- A proposal for a regulation on the establishment of a framework to facilitate sustainable investment. This regulation establishes the conditions and the framework to gradually create a unified classification system ('taxonomy') on what can be considered an environmentally sustainable economic activity. This is a first and essential step in the efforts to channel investments into sustainable activities.

- A proposal for a regulation on disclosures relating to sustainable investments and sustainability risks and amending Directive (EU) 2016/2341. This regulation will introduce disclosure obligations on how institutional investors and asset managers integrate environmental, social and governance (ESG) factors in their risk processes. Requirements to incorporate ESG factors in investment decision-making processes, as part of their duties towards investors and beneficiaries, will be further specified through delegated acts.

- A proposal for a regulation amending the benchmark regulation. The proposed amendment will create a new category of benchmarks comprising low-carbon and positive carbon impact benchmarks, which will provide investors with better information on the carbon footprint of their investments.

In addition, from May to June 2018, the Commission has been seeking feedback on amendments to delegated acts under the main directives for the European investment industry, Markets in Financial Instruments Directive (MiFID II) and the Insurance Distribution Directive to include ESG considerations into the advice that investment firms and insurance distributors offer to individual clients. The Commission intends to clarify how asset managers, insurance companies, and investment or insurance advisors should integrate sustainability risks and, where relevant, other sustainability factors in the areas of organizational requirements, operating conditions, risk management and target market assessment.[3] On 18 April 2019, the European Parliament endorsed the legislation setting the building blocks of a capital markets union, including the regulation on disclosures relating to sustainable investments and sustainability risks.[4]

Lesson Learnt

The key lesson that Islamic finance could learn from the European Commission's experience above is transparency. According to Ali Khokha (2019),[5] a senior manager at PWC Luxembourg, investment trends in Europe and globally have shown that more and more investors who were interested in investing in innovative and real-economy-linked products have shifted their preferences from classical Islamic finance/faith-based products to more tailor-made types of sustainable investments such as ESG, Sustainable and Responsible Investment (SRI) and green products. The reason is due to the following three key issues that permeate Islamic finance and have led to the change in investors' appetite:

- The quality of governance;

- Transparency on investment management and risk management processes; and

- The reporting requirement surroundings the products.

If these issues bear the cause for the change of investors' direction, it is perhaps timely for Islamic finance to ponder and consider the mainstream critical development. Sustainable financing and transparency framework and strategic implementation processes match the current appetite and requirements of ethical investors - the panacea for SDG funding deficit that completes the jigsaw puzzle which have for years plagued Islamic finance.

1 Moqana, Lahssen. 2019. Hajjar: Funding Gap for SDGs in Islamic Countries Near $1 Trillion Per Year. Available at: https://aawsat.com/english/home/article/1617771/hajjar-funding-gap-sdgs-islamic-countries-nears-1-trillion-year?utm_source=Eloqua&utm_medium=email&utm_campaign=00009NG_NewsletterIslamicFinanceWeekly_Other&utm_content=Newsletter_IslamicFinanceWeekly_10March2019

2 United Nation Development Program, Istanbul International Center for Private Sector in Development and Islamic Development Bank. (2017). I for Impact: Blending Islamic Finance and Impact Investing for the Global Goals.

3 It will do it either by amending existing delegated acts under the UCITS Directive 2009/65/EC, the AIFM Directive 2011/61/EU, the MiFID II Directive 2014/65/EU, the Solvency II Directive 2009/138/EC and the IDD Directive 2016/97, or by adopting new delegated acts under the same Directives.

4 European Union. 2019. Sustainable Finance. Available at: https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance_en#commission-action-plan-on-sustainable-finance

5 Ali Khokha. 2019. Sustainable risk: Should Islamic finance learn from the ESG, SRI and green products. Available at: https://www.islamicfinancenews.com/sustainability-risk-should-islamic-finance-learn-from-the-esg-sri-and-green-products.html