Islamic Sustainable Finance and Investment Survey 2022 results

From August to October 2022, ISFI surveyed over 100 Islamic finance industry practitioners to understand how their respective organizations are adopting Islamic sustainable finance and investment. MARLENA KAREEM analyzes the results.

KEY INSIGHTS

77% of surveyed practitioners see greenwashing as an issue in the Islamic ESG space

49% of surveyed practitioners attribute a desire to make a positive impact as the main factor driving ESG adoption for their institution

6% of respondents attributed pressure from industry peers and the main reason for ESG adoption in its financial institution

60% of surveyed practitioners attribute a lack of robust ESG data as the main challenge their institution faces in ESG adoption

54% of surveyed practitioners think Islamic institutions should consider a company's stance on LGBTQ+ [lesbian, gay, bisexual, transgender, queer and others] issues when making investment decisions

Why are institutions adopting ESG practices?

The industry is seeing a shift toward sustainability. What are the deciding factors Islamic financial institutions consider when adapting ESG practices? Based on our findings, a number of factors come into play, ranging from market demand, financial returns and the regulatory landscape to keeping on par with competitors' best practice and generating positive environmental and sustainability-related outcomes.

"I think it is economic proposition at the end of the day. The commercial banks are concerned with their bottom line," said one respondent.

Additionally, the potential of ESG adoption to provide insights on a financial institution's risks has also been highlighted.

"Adopting ESG gives good insight into the risks a bank faces. In addition, minimizing regulatory and legal interventions, reducing costs, meeting client needs and requests about environmentally-friendly products and positive reputation are deciding factors," noted one market practitioner.

"We chose to use ESG, because it improves the control of company processes and practices, establishing high management standards for the business and assisting in compliance with local and global regulations," said another industry player.

Thirty percent of survey respondents attribute a desire to make a positive impact as the main factor driving ESG adoption for their institution, beating the second reason for adoption, a desire to meet client needs and request which was at 19%, by a landslide. Only 6% of respondents attributed pressure from industry peers as the main reason for ESG adaptation in their financial institution.

Greenwashing concerns holding Islamic financial institutions back?

While there are many factors driving ESG practices for Islamic financial institutions, institutions face several challenges in embracing ESG. Greenwashing is a significant concern for Islamic financial institutions with 77% of surveyed practitioners seeing greenwashing as an issue in the Islamic ESG space.

This finding raises concerns as to whether Islamic financial institutions are approaching ESG practices superficially to 'cash in' on the current sustainability trend. Moreover, the concerns over greenwashing within the space also suggest that greenwashing claims are a possibility, in which case Islamic financial institutions would be exposed to reputational risk.

While the concerns over greenwashing are significant, it is by no means the only challenge faced by Islamic financial institutions. Sixty percent of practitioners reported the lack of robust ESG data as one of the top two challenges their institution face in ESG adoption. Approximately 35% singled out additional costs, a lack of suitable products and the complex and confusing regulatory landscape as their top challenges.

Chart 1: What are the two main driving factors driving your institution to adopt and offer ESG products?

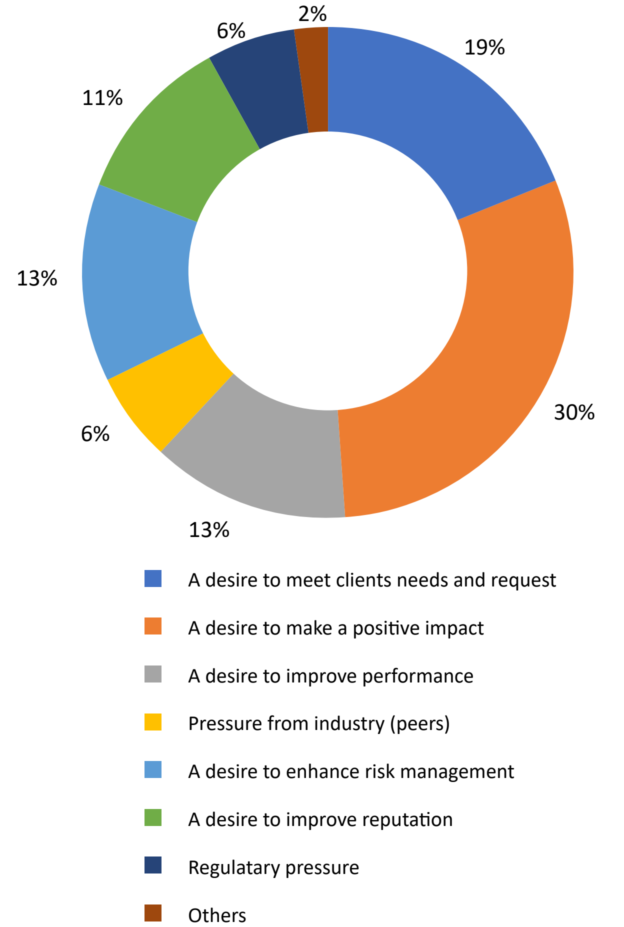
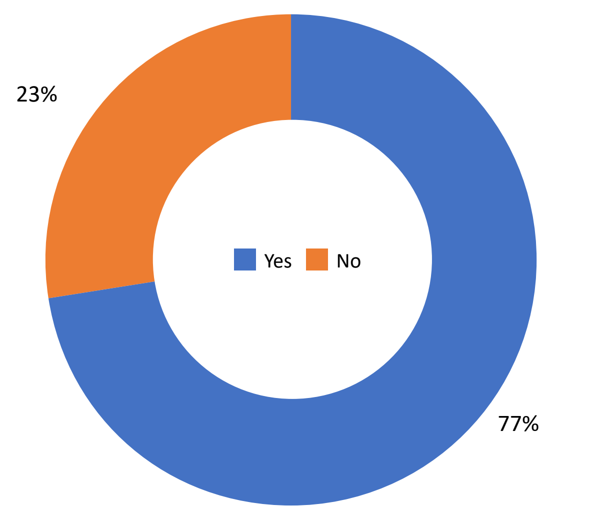


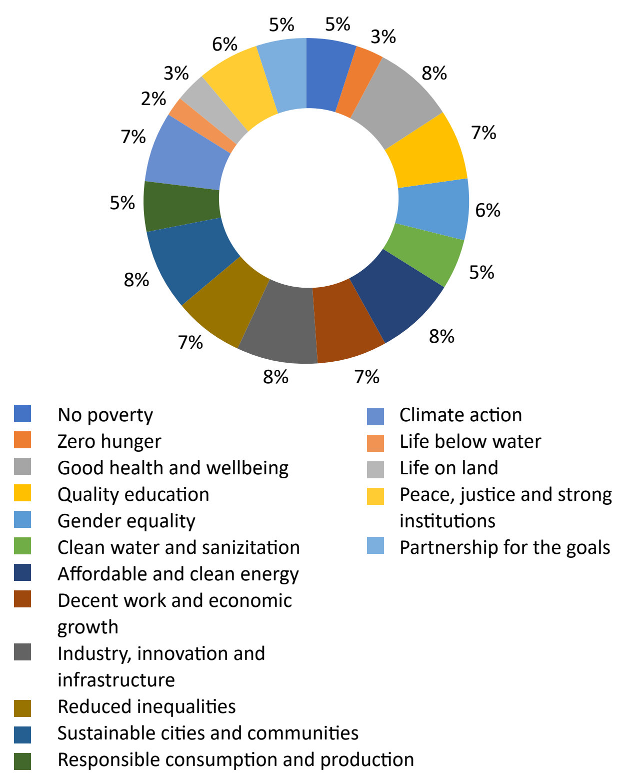
Chart 2: Do you see greenwashing as an issue in the Islamic ESG space?



Zero hunger not a priority

According to our survey results, the SDGs are relatively equally represented by respondents with SDG 14 of life underwater being the least prioritized. Interestingly, SDG 2 of zero hunger was given the second-lowest priority. This result is surprising considering how, according to the Standing Committee for Economic and Commercial Cooperation of the Organization of the Islamic Cooperation, 48.75% of least developed countries are member countries of the OIC. Moreover, 21% of the population of the OIC lives on under US$1.9 per day.

Chart 3: Which SDGs does your institution prioritize?



'Name and shame'?

With regards to concerns over integrity and greenwashing within the Islamic ESG space, we asked industry practitioners how financial institutions should be held responsible in ESG mismanagement and non-compliance.

Several survey respondents proposed naming and shaming as a response to ESG mismanagement. While this may act as a deterrent to prevent institutions from ESG mismanagement, it does not provide actionable insights on how mismanagement can be avoided. Other approaches including fining were also proposed by industry player respondents.

"Constant review and measurement. It should be proactive not retroactive. Investors are at liberty to review relationships with such institutions," one respondent commented. Several respondents, alternatively, proposed proactive measures to mitigate ESG mismanagement including a robust regulatory landscape, incentives for ESG compliant practices, as well as transparent disclosure practices from financial institutions.

Further, defining terms and having good ESG literacy have also been highlighted as key factors to prevent ESG non-compliance.

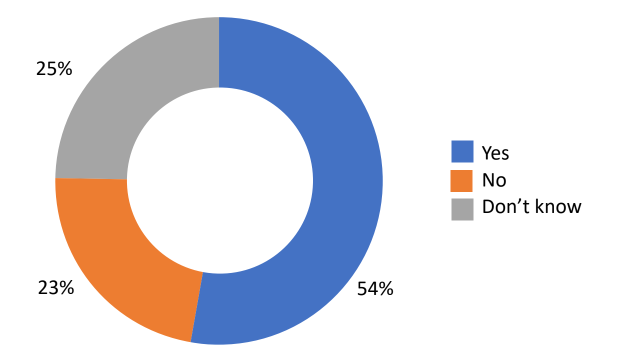
"The first thing is the awareness and understanding of ESG itself within financial institutions. [It] should be encouraged to all and not just a specific department ... When everyone is on the same page, the risk in mismanagement and non-compliance of ESG will be reduced," opined one practitioner.

Do we consider LGBTQ+ issues?

While we as an industry often highlight the synergies between the SDGs and Islamic sustainability, there are some gray areas as well as areas where the two diverge. SDG 5 of gender equality is clear on its stance of gender inclusivity and LGBTQ+ matters. From an Islamic perspective, however, this is a tricky area.

We asked industry practitioners if Islamic institutions should consider a company's stance on LGBTQ+ issues when making investment decisions and we got very

Chart 4: Should Islamic institutions consider a company's stance on LGBTQ+ issues when making investment decisions?



interesting responses. Over half (54%) said that it should be a consideration. Based on this view, a company's stock should be excluded from a Shariah compliant fund based on its LGBTQ+ policy.

With 25% answering that they do not know if LGBTQ+ issues should be a consideration, this suggest that the industry may need clear guidelines and directives on where Islamic sustainability stands in relation to its conventional counterpart.

Moreover, with 21% of respondents answering that LGBTQ+ issues should not be a consideration, does this mean that, in addition to differing Shariah compliance screening methodologies, this factor further adds to the disparity of 'investible' assets from institution to institution?