

# Green Sukuk Issuance as an Investment Instrument for Sustainable Development

<sup>1</sup>Imam Arifiadi Ramadhan, <sup>2</sup>Wirdyaningsih

<sup>1</sup>Faculty of Law Universitas Indonesia Jakarta, Indonesia

<sup>2</sup>Faculty of Law Universitas Indonesia Jakarta, Indonesia

Email: [imam.arifiadiramadhan@gmail.com](mailto:imam.arifiadiramadhan@gmail.com), [wirdyaningsih@gmail.com](mailto:wirdyaningsih@gmail.com)

## ABSTRACT

Indonesia's ratification of Paris Agreement through Law No. 16/2016 in October 2016 shows the commitment of the Indonesian government to prevent adverse impacts of climate changes. Such commitment, however, requires a huge sum of funding. Indonesia, as the country with the biggest Muslim population, lead the world to fund the environmentally-friendly project with the issuance of the first sovereign green sukuk. Green sukuk is a unique product that must meet sharia-compliance and green compliance. Currently sharia-compliance of sukuk green refers to OJK regulation number 3/Pojk.04/2018, regarding issuance and sukuk requirements, while green compliance refers to OJK regulation number 60/Pojk.04/2017, concerning the issuance and debt securities requirements environmentally friendly (Green Bond). However, because of its uniqueness which must fulfil both types of compliance, it is necessary to examine whether a new regulation is needed, specifically to regulate this green sukuk. This study used a juridical-normative method to study the issuance of green sukuk in terms of law and concept. Therefore, the purposes of this research are to review the laws and schemes in the collaboration. The research concludes: first, the green criteria of the Indonesian green sukuk, and, second, the sharia criteria of the Indonesian green sukuk.

**Keywords:** *sukuk, green sukuk, Green Bond, sustainable development*

## 1. INTRODUCTION

In 2018, after two years of marginal increases, the Islamic financial services industry (IFSI) returned to strong (8.3%) growth, and its total worth slightly surpassed the USD 2 trillion mark. The main growth drivers were *ṣukūk* issuances by sovereigns and multilateral institutions. The volume of *ṣukūk* outstanding grew by 25.6%, and assets of Islamic funds grew by almost 19%. Islamic banking assets grew by only 4.3%, reducing the share of Islamic banking in the total value of the IFSI to 76%; while the share of the Islamic apital market (ICM; *ṣukūk* outstanding plus Islamic funds' assets) increased to nearly 23%. Takāful contributions increased by 4% and retained a 1.3% share of the total IFSI value (Islamic Financial Services Board, 2018).

Continuing a rapid development of Sukuk in the last couple of years, both the government and corporate Sukuk have continued a improvement in 2017. The government of Indonesia has consistently issued the government Sukuk (namely SBSN), and similar to the corporate one with more varieties of corporate Sukuk issued to the market. For the government, SBSN is an integral part of the fiscal policy to finance infrastructure development in Indonesia.

Since the approval of the Act Number 19 the Year 2008 on SBSN, the issuance of the first series of SBSN, namely Islamic Fixed Rate (IFR), worth IDR 15 trillion and the total issuance of SBSN has reached IDR764.51 billion circa 2008. After that initiation, varieties of Sukuk are available

in the market, among others are Retail Sukuk (SR), Indonesian Global Sukuk (SNI), Pilgrimage Sukuk (SDHI), Treasury Sukuk (SPN-S), Project-Based Sukuk (PBS) and the most recent one (issued in 2016) is Saving Sukuk (ST). Up to the end of 2017, the total accumulated SBSN was accounted for IDR192.5 trillion or 17% of the total government bonds (International Islamic Financial Market, 2018).

Compared to 2016, in which the total of SBSN was IDR 179.9 trillion, SBSN inflated 51.8% in 2017. These figures reflect that the Government of Indonesia has a strong commitment to regularly issue Sukuk Negara in both domestic and global market, to support the development of the global Islamic financial market and attract investors to invest in the fast-growing Islamic financial institutions in Indonesia. The issuance of Sukuk Negara on the international market consistently in the last decade, placed Indonesia as the largest country in sukuk issuance on the international market (Arifin, Tribunnews, 2018).

In March 2018, the Indonesian government issued Sukuk Negara in the global market (global sukuk), worth a total of USD 3 billion. This Sukuk Negara consists of global green sukuk worth USD 1,25 billion and regular global sukuk worth USD 1,75 billion. The market response to the issuance of green sukuk was positive. The Minister of Finance, Sri Mulyani, assessed that investor' interest in the green sukuk was set against the market's desire to add to their portfolio (Candra, Republika, 2018).

Green sukuk is a new instrument for the government to raise fund to run sustainable development projects. In fact, green sukuk issuance in March 2018, is the first to be done by Asian country (Alika, Katadata, 2018). This green sukuk issuance will focus on funding green infrastructure projects. Some of those projects are flood containment, city main drainage management, and beach management by the Ministry of Public Work and Housing, worth IDR 501 billion. Furthermore, there are train support infrastructure management project worth IDR 165 billion, renewable energy utilization project worth IDR 743 billion, and residential health and medium drainage management system project worth IDR 149 billion (Asmara, CNBC, 2018).

## 2. Research Method

Based on the problems examined by the author, namely regarding the regulation in the issuance of green sukuk, this study, according to its form, is juridical-normative research. Juridical-normative research is research focusing on examining the application of norms in positive law. The approach used in juridical-normative research is a legislative approach that deals with the research topics (Ibrahim, 2006). The legislation referred to is the legislation that applies to Indonesia and other regulations relating to the topic of green sukuk issuance.

## 3. Discussions

Green sukuk is a unique instrument that needs to comply with both sharia and green compliance. Under the current situation, sharia compliance from green sukuk refers to OJK Regulation No. 3/POJK.04/2018 regarding Sukuk Issuance and Requirement, while its green compliance refers to OJK Regulation No. 60/POJK.04/2017, regarding Green Bond Issuance and Requirement. However, because of the uniqueness of green sukuk that need to comply both types of standard, further discussion is necessary to address whether a new regulation is needed, to specifically regulates this green sukuk.

### 3.1. Green criteria of the Indonesian Green Sukuk

As mentioned in the introduction, green sukuk need to comply with green and sharia criteria. Green criteria of green sukuk are the same that used in green bonds, which developed first. Green bonds are simply bonds, but their "green" label distinguishes them from a regular bond, as it shows the commitment to specially use the raised funds to finance "green" projects, assets or business activities (ICMA 2015).

In 2014, the Green Bond Principles (GBP) was first launched in 2014 by a group of issuers, investors and international banks; they work with the International Capital Market Association to promote the principles. The principles were considered as a significant progress in the

establishment of standards and criteria to define a green bond since initially, guidance for green bonds' market practice seems to be difficult to find (Anugrahaeni, 2017).

The efforts that signify the commitment to fund environmental projects is what distinguishes green bonds from conventional bonds. The GBP serves as the most widely used guidelines to define green bonds, which covers the process of project selection to reporting. Despite the distinctive features, green bonds also have similarity with regular bonds. In the case of full-recourse green bonds, the responsibility goes to the issuers –not the revenues derived from the specific project as there is no legal "green" promise to fulfil the liability (Preclaw 2015).

Furthermore, Preclaw (2015) argued that this similarity is imposed to induce the market growth by providing the convenience of familiarity with the traditional practices of bonds for issuers in the middle of their efforts of signalling a commitment to sustainability. In spite of issued by companies specializing in environmental business lines, such as the wind and solar energy, their bonds are not automatically qualified as green bonds. The GBP defines five major broad categories of environmental projects, namely pollution prevention and control, alternative energy, green building, sustainable water, and energy efficiency.

The green principle of green bond in Indonesia is regulated in Financial Services Authority Regulation No. 60 /POJK.04/2017. One of the important thing regulated by this regulation is type of businesses that can be financed from the issuance of Green Bonded Debt Securities. It can be a business activity and / or other activities related to: a) Renewable energy; b) Energy efficiency; c) Pollution prevention and control; d) Management of natural resources and sustainable use of land; e) conservation of terrestrial and water biodiversity; f) environmentally-friendly transportation;

Prior to issuing green sukuk in 2018, Indonesian Government launched The Republic of Indonesia Green Bond and Green Sukuk Framework. The Framework contains Use of Proceeds, Process for Project Evaluation and Selection, Management of Proceeds, and Reporting. Regarding the Green Bond Principles, the proceeds of each Green Bond or Green Sukuk will be used exclusively to finance or re-finance expenditure directly related to "Eligible Green Projects". "Eligible Green Projects" refer to projects which promote the transition to a low-emission economy and resilient climate growth, including climate mitigation, adaptation, and biodiversity in accordance with the criteria and process set out in this Framework. Eligible Green Projects must fall into at least one of the following sectors: energy efficiency and renewable energy, green building, green tourism, disaster risk reduction, sustainable transport, waste to energy and waste management, sustainable management natural resources, and sustainable agriculture. For the avoidance of doubt, in any case, the Eligible Green Projects shall exclude the below: a) New fossil fuel based electric power generation capacity and expenditure related to the improvement in the efficiency of fossil fuel-based electric power generation. b)

Large scale hydropower plants (>30 MW capacity) c) Nuclear and nuclear-related assets.

The Republic of Indonesia Green Bond and Green Sukuk Framework then reviewed by CICERO (Center for International Climate and Environmental Research - Oslo), an independent, not-for-profit, research institute. CICERO Second Opinions are graded dark green, medium green or light green, reflecting the climate and environmental ambitions of the bonds and the robustness of the governance structure of the Green Bond and Green Sukuk Framework. The grading is based on a broad qualitative assessment of each project type, according to what extent it contributes to building a low-carbon and climate resilient society. The shading methodology also aims at providing transparency to investors when comparing Green Bond and Green Sukuk Frameworks exposure to climate risks. A dark green project is less exposed to climate risks than a lighter green investment. The Second Opinion will allocate a 'shade of green' to the Green Bond and Green Sukuk Framework of The Republic of Indonesia's:

- Dark green for projects and solutions that currently realizes the long-term vision of low carbon and resilient climate future. Typically, this will entail zero-emission solutions and governance structures that integrate environmental concerns into all activities.
- Medium green for projects and solutions that represent steps towards the long-term vision, but are not quite there yet.
- Light green for projects and solutions that are environmentally friendly but do not by themselves represent or is part of the long-term vision (e.g. energy efficiency in fossil-based processes).
- Brown for projects that are irrelevant or in opposition to the long-term vision of a low carbon and resilient climate future.

Based on the use of proceeds, the framework is in alignment with the ASEAN Green Bond Standards (November 2017), as well as following the Green Bond Principles. In addition, the Republic of Indonesia Financial Services Authority regulates the issuance and requirements of a green bond (December 2017). This framework is in line with the regulation, and it will be the issuer's responsibility to meet the transparency and other requirements of the regulation going forward.

Overall, The Republic of Indonesia Green Bond and Green Sukuk Framework are given a medium green assessment with very strong recommendations, which means the framework represent steps towards the long-term vision but are not quite there yet.

### **3.2. Sharia criteria of the Indonesian Green Sukuk**

National Sharia Board's (DSN) Fatwa No. 32/DSN-MUI/IX/2002 defines sukuk as long-term security based on sharia principles issued by issuers, to pay income to holders of Islamic bonds in the form of profit-sharing, margins and fees, and to repay bond funds when it is due. According to

Law No. 19/2008, Sukuk are securities issued based on sharia principles, as evidence of the investment in SBSN assets, both in rupiah and foreign currencies. The party that issues the state sukuk is a legal entity established based on the legislation to issue the sukuk. Its assets are state-owned goods that have economic value that is based on the State sukuk. Furthermore, Sukuk are regulated in Financial Services Authority's (OJK) Regulation No. 18/POJK.04/2015, which stated Sukuk are Sharia Securities in the form of certificates or proof of ownership of equal value and represent a unified or undivided share for the underlying assets.

National Sharia Board's Fatwa on Sukuk become the cornerstone for Islamic securities in Indonesia. That is because until 2002, the year the fatwa was issued, the bonds that have been issued so far, are still not following the provisions of sharia so that they can not accommodate the community's need for bonds that are in accordance with sharia. The Fatwa stated that the bonds that are justified according to sharia are bonds based on sharia principles. Sharia principles in question include the type of agreements, the type of business, income, and transfer of ownership. The agreements that can be used in the issuance of sharia bonds include: 1) *Mudharabah (Muqaradhah) / Qiradh*, 2) *Musharaka*, 3) *Murabaha*, 4) *Salam*, 5) *Istishna*, and 6) *Ijarah*. The type of business carried out by Issuers (*Mudharib*) must not conflict with sharia by taking into account the substance of the DSN-MUI Fatwa Number 20 / DSN-MUI / IV / 2001, concerning the Investment Implementation Guidelines for Sharia Mutual Funds. Investment income (revenue) is distributed by Issuers (*Mudharib*) to holders of *Mudharabah* Sharia Bonds (*Shahibul Mal*) must be free of non-halal elements. Furthermore, income is obtained by Sharia Bond holders in accordance with the contract used. The last one, transfer of ownership of sharia bonds follows the type of transaction used.

The types of business activities conflicting with Islamic Sharia according to DSN-MUI Fatwa Number 20 / DSN-MUI / IV / 2001, as mentioned earlier, include: a) Gambling and gaming businesses that are classified as gambling or prohibited trade; b) Business of conventional financial institutions (*ribawi*), including conventional banking and insurance; c) Businesses that produce, distribute, and trade food and haram drinks; d) Businesses that produce, distribute, and / or provide goods or services that are morally damaging and harmless.

It is not until 2008 though that Indonesia adopted the fatwa into national law through the Law No. 19/2008. DSN's Fatwa just contains the principle of Sukuk, and it is regulated further by the Law No. 19/2008. The agreements that can be used in the issuance of sharia bonds reduced to just include: 1) *Mudharabah*, 2) *Musharaka*, 3) *Istishna*, and 4) *Ijarah*, with the possibility of another type of agreement in accordance of sharia principles. Unfortunately, there is no elaboration on the type of business carried out by the issuers and investment income distributed by the issuers, that the fatwa stated must not conflict with sharia principles.

Financial Services Authority Regulation No. 18/POJK.04/2015 mostly regulates the technical issues on issuing sukuk. Still, in this regulation, there is no criteria on the type of business and investment income.

#### 4. CONCLUSION

The regulation concerning green criteria of green sukuk are deemed good, as reflected on the medium green rating given by CICERO. The framework, which is made in accordance to Financial Services Authority Regulation No. 60 /POJK.04/2017, means that the regulation is following the Green Bond Principle. It is the most widely used guidelines to define green bonds, which covers the process of project selection to reporting.

The regulation concerning sharia criteria, however, do not detail the use of proceeds. The types of business activities that conflict with sharia are just regulated in the DSN Fatwa, which is weaker than the law passed by legislation body (DPR) or Regulation from Financial Services Authority.

Given the complexity of green sukuk as a product that needs to comply both types of standard, a new regulation is needed, that specifically regulates this green sukuk consisting both types of the standard on one regulation. The new regulation can add sharia criteria on the Use of Proceeds, Process for Project Evaluation and Selection, Management of Proceeds, and Reporting that is already in place.

#### REFERENCES

- [1] Aassouli, Dalal, et. al. *Green Sukuk, Energy Poverty, and Climate Change: A Roadmap for Sub-Saharan Africa*. Washington D.C.: World Bank, 2018.
- [2] Accounting and Auditing Organization for Islamic Financial Institutions. *Shari'ah Standards*. Manama: AAOIFI, 2015.
- [3] CICERO. *Second Opinion on The Republic of Indonesia's Green Bond and Green Sukuk Framework*. Oslo: CICERO, 2018
- [4] Dewan Syariah Nasional Majelis Ulama Indonesia. *Himpunan Fatwa Dewan Syariah Nasional*. Jakarta: Bank Indonesia, 2003.
- [5] International Islamic Financial Market. *IIFM Annual Sukuk Report 2018*. Manama: International Islamic Financial Market, 2018.
- [6] Islamic Financial Services Board. *Islamic Financial Services Industry Stability Report 2018*. Kuala Lumpur: Islamic Financial Services Board, 2018.
- [7] Kementrian Keuangan. *The Republic of Indonesia Green Bond and Green Sukuk Framework*. Jakarta: Direktorat Jenderal Pengelolaan Pembiayaan dan Risiko (DJPPR), 2015.
- [8] Mamudji, Sri et. al., *Metode Penelitian dan Penulisan Hukum*, cet. 1. Jakarta: Badan Penerbit Fakultas Hukum Universitas Indonesia, 2005.
- [9] Obaidullah, Mohammed. *Managing Climate Change: The Role of Islamic Finance*. Jeddah: Islamic Research and Training Institute, 2017.
- [10] Prabowo, Anto. *Siaran Pers: Ojk Terbitkan Tiga Peraturan Obligasi Daerah, Green Bonds, Dan E-Registration Serta Kebijakan Lainnya*, SP-112/DHMS/OJK/IV/2017. Jakarta: OJK, 2017.
- [11] Preclaw, R. (2015). *The Cost of Being Green Investors Pay a Green Premium*. , (September).
- [12] Campisi, Domenico, Simone Gitto, dan Donato Morea. "Shari'ah-compliant finance: a possible novel paradigm for green economy investments in Italy." *Sustainability*, Vol. 10, Issue 11, 2018.
- [13] Moghul, Umar dan Samir H.K. Safar-Aly. "Green Sukuk: The Introduction of Islam's Enviromental Ethics to Contemporary Islamic Finance." *The Georgetown International Enviromental Law Review*, Vol. 27, No. 1, 2014.
- [14] Morea, Donato dan Luigi Antonio Poggi. "An innovative model for the sustainability of investments in the wind energy sector: The use of green sukuk in an italian case study." *International Journal of Energy Economics and Policy*, Vol 7, Issue 2, 2017.
- [15] Oktaviani, Yuri, et. al. "Financial solutions for biodiversity in contributing to the economic development in indonesia." *E3S web of conferences*, 2018.