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Islamic finance and ESG investing

Khalid Al Kayed, CEO of Bank Nizwa, Oman's first dedicated Islamic bank, reflects on the natural alignment between Sharia law and sustainable investing.

The global sustainable finance market is predicted to reach $153trn by 2025.

With record inflows last year, there has never been more focus on environmental, social and governance (ESG) investing, not just from investors and the financial sector, but also the world's governments.

The United Nations (UN) Sustainable Development Goals (SDGs), adopted by all member states in 2015, aim to end poverty, protect the planet and ensure that all people enjoy peace and prosperity by 2030, solidifying sustainable finance as a crucial strategy for the future.

It is clear then that those financial organisations with demonstrable ESG capability will have the edge over less sustainable competitors.

This trend plays neatly to the Islamic finance sector, whose adherence to Sharia investment principles aligns closely to those of sustainable investing, which in turn could accelerate the realisation of the UN SDGs.

The objective of Sharia law—known as Maqasid al-Shariah—is to promote the welfare of humankind and prevent harm by preserving religion, life, intellect, family lineage and wealth. The goal of sustainable investing, meanwhile, is to manage ESG risks to promote long-term financial performance.

Khalid Al Kayed, CEO of Bank Nizwa, says: "There are more similarities than differences between Sharia and sustainable investment, as well as sustainable finance. Islamic financial institutions can build on these parallels to create a strong, effective ESG presence."

Environmental

Under Sharia law, all natural and depletable resources are blessings from Allah. They are entrusted to humankind but must be preserved and protected.

To meet this principle, Islamic finance institutions are using a range of Sharia-compliant investments to support environmental initiatives. Green sukuk (Islamic bonds), for example, is one of many instruments that finance multiple projects including renewable energy and waste management, as well as projects in the power sector, which is in the midst of transitioning to become a sustainable industry with a low carbon footprint.

Mr Al Kayed says: "As Oman moves towards a low-carbon economy, we are motivated by the role we play in building a more sustainable future. We are demonstrating this in the communities we serve by supporting clean economic growth."

Social

It is not permissible under Sharia law to charge interest on a loan, and credit cannot be used to fund exploitative and socially or morally harmful activities. It is no surprise then that in addition to financing large-scale infrastructure, Islamic financial organisations provide microfinance designed to drive prosperity for those on low incomes, often in developing countries.

Sharia law also dictates that money be redirected from the rich to the poor and insists on almsgiving (zakat) apart from other wealth distribution instruments such as voluntary donation (sadaqah) and endowment (waqaf).

Mr Al Kayed says: "Sharia principles are aligned to the UN SDG of eliminating poverty, among other SDGs. Islamic finance is central to eradicating hardcore poverty and dispersing wealth more justly by utilising and encouraging the use of wealth distribution instruments as mentioned above."

Governance

All financial institutions are subject to rigorous regulatory oversight, but those operating under Sharia law must meet two levels of governance, namely corporate governance and Sharia governance, which is particular to Islamic banking. In addition to the standard internal and external audits, Islamic banks will also have a Sharia audit function.

According to Mr Al Kayed, where banks fail to comply with Sharia principles, any profit made on those transactions will be deducted from the income of the bank and diverted to charitable causes. The same shall be disclosed in its Annual Income Statement for transparency purposes.