Informal summary of the roundtable on "The Role of Islamic Finance in Sustainable Development Financing and the Opportunities in Creating New Partnerships in the Implementation of the Post-2015 Development Agenda, hosted by the Islamic Development Bank in collaboration with UN-DESA

(Islamic Development Bank HQ, Jeddah, Kingdom of Saudi Arabia, 2 June 2014)

Overview

The roundtable discussion explored the current and potential role of Islamic finance in the promotion of sustainable development. In that context, the roundtable brought together a wide range of specialists in Islamic Finance and development economics from the Islamic Development Bank Group (IDB), the Co-Chairs of the Intergovernmental Committee of Experts on Sustainable Development Financing (ICESDF), representatives from the UN system (UN-DESA, UN-ESCWA) and other stakeholders. The objective of the meeting was to provide input to the report of the ICESD, which will propose options for an effective sustainable development financing strategy to facilitate the mobilization of resources and their effective use in achieving sustainable development objectives.

Mr.Ahmet Tiktik, Acting-Vice President (Cooperation & Capacity Development), IDB, delivered the welcoming addres. The meeting was chaired by Mr. Jamel Eddine Zarrouk, Chief Economist, IDB. Presentations were made by Mr. Alex Trepelkov, Director, Financing for Development Office, United Nations Department of Economic and Social Affairs, on the intergovernmental processes in preparation of the post-2015 United Nations development agenda; Mr. Mansur Muhtar and Ambassador Pertti Majanen, Co-Chairs of the United Nations Intergovernmental Committee of Experts on Sustainable Development Financing (ICESDF) on the work of the ICESDF; Dr. Salman Syed Ali, Senior Research Economist (IRTI) on the role of Islamic finance in sustainable development; Br. Adil Al Sharif, Executive Director and Br. Maher Idrissi, Senior Specialist (WWF) on forms for solidarity-based financing for sustainable development (Wakf & Zakāt) and Br. Lotfi Zairi, Head Regulations and Monitoring Division (ICIEC) on Takaful and Br. Hedi Mejai, Director, Investment Department on Sukuk (Islamic Bonds). Salient features of the presentations and ensuing discussions are summarized below.

I. The preparatory processes of the Post-2015 Development agenda

The preparation of the post-2015 development agenda has been a global and inclusive process. There are currently four major processes at the UN to discuss the post-2015 development agenda and its means of implementation. These processes include: (1) Preparations for the 2015 Summit; (2) The Open Working Group on Sustainable Development Goals; (3) The Intergovernmental Committee of Experts on Sustainable Development Financing; and (4) The preparation of the third international conference on financing for development. UN Members States have emphasized their determination to craft a strong post-2015 development agenda. They further agreed that the final phase of the intergovernmental work will culminate in a summit at the level of Heads of State and Government to be held in September 2015 for the adoption of the post-2015 development agenda. Member States also agreed that the post-2015 development agenda will contain, as an integral part, a set of action-oriented, global and universally applicable sustainable development goals (SDGs), while taking into account different national realities, capacities and levels of development and respecting national policies and priorities. They will integrate economic, social and environmental aspects and recognize their inter-linkages in achieving sustainable development in all its dimensions. The Open Working

Group on SDGs was established in January 2013, with the task of submitting a proposal for SDGs to the UN General Assembly by next September. Moreover, the Intergovernmental Committee of Experts on Sustainable Development Financing is currently drafting its report, which will propose options on an effective sustainable development financing strategy to facilitate the mobilization of resources and their effective use in achieving sustainable development objectives. It was noted that the implementation of the post-2015 development agenda must rely on a strong and comprehensive framework for sustainable development financing. To this end, the UN General Assembly decided to convene a third international conference on financing for development. There is a convergence of views that the 2002 Monterrey Consensus and the 2008 Doha Declaration on Financing for Development provide a solid conceptual basis for the substantive preparation of the Conference and negotiations on its outcome. To support the intergovernmental negotiations on the post-2015 development agenda, the Secretary-General will synthesize the full range of inputs, including the reports of both the Open Working Group on SDGs and the Intergovernmental Committee of Experts on SDF, and present a synthesis report to the General Assembly before the end of this year. In that context, the continued engagement and support from the IDB is important in the common quest to move towards a holistic and forward-looking financing framework to underpin a comprehensive post-2015 sustainable development agenda.

II. Overview of the activities of the United Nations Intergovernmental Committee of Experts on Sustainable Development Financing

In its deliberations in New York, the ICESDF has come to a number of preliminary conclusions. First and foremost, there is a convergence of views that while estimates of financing needs for sustainable development are necessarily imprecise, needs are extremely large. However, even if all countries meet their Official Development Assistance (ODA) commitments, it is clear that ODA alone will not be sufficient. Nonetheless, total financing needs still represent a relatively small portion of global savings. The challenge is how to promote a financial system with the right institutions and governance that incentivize a redirection of some of this investment toward sustainable development. Therefore, both private and public financing from domestic and international sources are necessary, and both need to be effectively exploited. Generally, public and private resources serve development goals better if they are seen as complements rather than substitutes, as each type of financing has unique objectives. Public sector policies need to focus on incentivizing private sector investment. In addition, public financing at the national and international levels will remain necessary in critical areas of international cooperation that the private sector will still be unlikely to finance. Moreover, South-South cooperation, ODA and innovative sources of finance are crucial sources of finance. However, they are complementary to each other as well and should not be seen as substitutes. It is important to work towards a unified post-2015 development agenda with poverty as an overarching focus that is rooted in a single practical, implementable and action-oriented financing framework.

Regional outreach events have complemented the regular sessions of the Committee. In addition to the IDB meeting, outreach events for the ICESDF have been hosted by ECLAC (Santiago, Chile, 15-16 January), the Foreign Ministry of Finland (Helsinki (3-4 April 2014) and ECA (2-3 May 2014, Addis Ababa, Ethiopia). In addition to the Jeddah meeting, a further meeting would be held by ESCAP on 10-12 June 2014, in collaboration with the Ministry of Finance, Indonesia, for the Asia and Pacific Region. Some of the key messages that emanated from the regional meetings were the need to reduce inequality and address fragilities of the international financial system; (Latin America and the Caribbean) and the importance to increase domestic resource mobilization and tackle illicit financial flows (Africa). The Helsinki event highlighted the potential of new partnerships between the private and public sector.

III. Islamic Finance for Sustainable Development-An Overview

Islamic finance is based on the principles of Islamic law (also known Shariah) and guided by Islamic economics. The two basic principles behind Islamic finance are the sharing of profit and loss and, significantly, the prohibition of the collection and payment of interest, which is not permitted under Islamic law. The ethical, multichannel and diversity dimensions of Islamic Finance as well as its link to the real economy were highlighted during the presentation and discussions. In terms of the diversity of application, the use of Islamic Finance extends to a range of economic subsectors (international trade, housing, education and health, food and water security, infrastructure and energy, agriculture and rural communities). While each sector has its own peculiarities, Islamic Finance has suitable ways to address them. There is a diversity of modes through which Islamic Finance is provided, including murabaha (a sale, where the seller expressly mentions the cost he has incurred on the commodities for sale and sells it to another person by adding some profit or mark-up, which is known to the buyer); Istisna (a contract of exchange with deferred delivery, applied to specified made-to-order items); Mudharba (a partnership whereby one party provides capital (rab al- maal) and the other party provides labor (mudharib); and Musharkah (a partnership, where two or more financiers provide finance for a project and all partners are entitled to a share in the profits resulting from the project in a ratio, which is mutually agreed upon. However, the losses, if any, are to be shared exactly in the proportion of capital proportion.) Moreover, tradable securities (sukuk, shares, waqf certificates, etc.) originate from these mechanisms. It was highlighted that Islamic finance was provided through a multitude of channels, including through public, private and voluntary sectors for a wide range of goods and services (food and water security, housing, energy and infrastructure, education and health, trade) to further economic development.

IV. Solidarity-based Financing for Sustainable Development – (Wakf and Zakāt)

Wakf and Zakāt are traditional Islamic models for solidiary-based financing for sustainable development. A waqf is a religious endowment in Islamic law, typically a plot of land or even cash for Muslim religious or charitable purposes. The IDB with its Vision 1440 H (2020), "A Vision for Human Dignity", aims to promote Wakf and Zakāt to help develop these institutions further as key instruments for promoting poverty alleviation and reducing income gaps, as well as fighting disease, promoting health and spurring sustainable development. Waqf exists in public, family or private or mixed form. Real estate-based Waqf generates proceeds through the rental of properties, which then fund social development needs. Cash and commodity based Waqf provides direct lending to the needy in sectors like health, education, agriculture and the environment. The IDB group will explore new Waqfs for Development (W4D) tools, which include approaches where the Waqf principle would target the "bottom of the pyramid" (i.e. through investing Waqf assets into socially responsible projects and doing business with the poor), or where Waqf would represent a new asset class in which social impact, economic empowerment are sought beyond monetary return. Moreover, careful due diligence, and intelligent PPPPs (Public /Private /Philanthropic /Partnership) could mitigate risks and help achieve development objectives. New Waqf initiatives, (like Waqaf Singapore, Awqaf Capital Common funds, Waqf Structure partnership and Alfalah Consulting) were in the pipeline to further harness the potential of Waqf for sustainable development.

Zakāt is the practice of charitable giving by Muslims based on accumulated wealth, and is obligatory for all who are able to do so. It is considered to be a personal responsibility for Muslims to ease economic hardship for other Muslims and eliminate inequality for followers of Islam. Zakāt has great potential to mobilize additional untapped resources for poverty alleviation. However, its impact on poverty eradication would depend on the size of Zakāt collections and the kind of disbursements. While it is estimated that Zakāt generates about USD 10 billion annually, experts suggest that it could reach USD 200 billion per year.

V. Takaful

Takaful is an insurance concept observing the rules of Islamic banking. The insurance is a cooperative system of reimbursement in case of loss, which is paid to people and companies concerned about hazards and compensated out of a fund to which they agree to donate small regular contributions managed on their behalf by a Takaful Operator. The Takaful industry exists both for Zakāt microfinance and Awqaf[1] Funds. Takaful is based on the principles of shared responsibility, solidarity, and cooperation. The system is serving human development through supporting four Maqasid (foundational goals of Islam), specifically the preservation of life, prosperity, intellect and wealth,

Moreover, in contrast to the modern-day conventional insurance, where the vendor invests the proceeds of its product for the profit of its shareholders, who are not necessarily policyholders, “Takaful” is founded on the principle of separation between the funds and operations of shareholders, thus passing the ownership of the Takaful (Insurance) fund and operations to the policyholders. The policyholders share in the investment pool's profits as well as its losses. However, a positive return on policies is not legally guaranteed, as any fixed profit guarantee would be akin to receiving interest and offend the prohibition against interest rates. There are important cross-sectoral synergies between the Takaful industry and the Islamic banking sector and the Islamic capital market, since Takaful could provide guarantees for many other forms of financial services, especially through Sukuk (see next section) risk mitigation

Takaful’s has seen steady growth over the last 5 years. The industry is forecasted to reach 17 billion USD in 2015. Takaful contributes to the solidarity pillar of Islamic finance, through risk sharing, preserving a connection to the real economy and screening investments through a moral filter (social responsibility and sustainability). The mechanism has been applied in different contexts in the form different products, such as MicroTakaful (the provision of Takaful products to the underserved and low-income populations), investment-linked Takaful (a family Takaful plan that combines investment and Takaful coverage) and Takaful for pension funds (e.g., .the Takaful Umbrella Fund, which is a retirement benefits fund that pools together retirement benefits for small, medium or large organizations and institutions with a purpose of coming up with a practical, cost effective, shariah compliant and professionally managed retirement benefits scheme for the members). The Takaful industry provided a useful alternative to conventional insurance products. More specifically, Takaful could help promote financial inclusion and financial stability through providing Islamic finance for the poor and connecting finance with the real economy by sharing responsibility for investments between the Takaful operator and the policyholders.

VI. Sukuk (Islamic Bonds) and Funds

Sukuk commonly refers to the Islamic equivalent of bonds. However, as opposed to conventional bonds, which merely confer ownership of a debt, Sukuk grants the investor a share of an asset, along with the commensurate cash flows and risk. As such, Sukuk securities adhere to Islamic laws sometimes referred to as Shari’ah principles, which prohibit the charging or payment of interest. The

[1] Awqaf is the plural form of waqf.

emergence of Sukuk has been one of the most significant developments in Islamic capital markets in recent years. Put simply, Sukuk instruments act as a bridge. They link their issuers, primarily sovereigns and corporations in the Middle East and Southeast Asia, with a wide pool of investors, many of whom are seeking to diversify their holdings beyond traditional asset classes. In this way, funds raised through Sukuk can be allocated in an efficient and transparent way to infrastructure initiatives and other suitable projects in the 56 member countries of the IDB, as well as communities in over 100 non-member countries. It was noted that Sukuk issuance has proven its resilience during recent periods of turbulence in global capital markets. Sukuk issuance increased from USD 14.9 billion in 2008 to USD 23.3 billion in 2009, with Asia showing particular strength. Even so, the Sukuk market is still a niche one, albeit with huge potential for growth. Indeed, the Sukuk growth rate is currently 10-15 per cent in global financial markets. Sukuk could also make an important contribution to address the resource gap for multilateral development banks stemming from their expanding mandates. For example, the African Development Bank mobilized USD112 million in 2013 in funds from 7 donor agencies. Sukuks have also been implemented in Europe. For example, the first Sukuk programme in Europe was launched in 2004, through the German federal state of Saxony-Anhalt and in 2005, the UK issued the region's first corporate Sukuk. Sukuks in infrastructure were by far the largest. Between 2001 and 2013, a total of USD 84.3 bn worth of infrastructure Sukuks have been issued by more than 10 different countries. The IDB had demonstrated its commitment to the Sukuk market by regularly tapping into the public markets for the past six years (2004-2014), with about USD 7 billions of issuance. There has been increased demand for IDB Sukuks from institutions outside the region as around 49 per cent come from Asian and European countries. Although most issuances are USD denominated, IDB utilized private placement for Sukuks in other currencies such as GBP, EUR and MYR. The IDB has approved investments in infrastructure with an equivalent size of USD 3.29 billion through various infrastructure funds, which were set up in partnership with MDBs. Investments in power, water, transport Infrastructure and industries amounts for more than 50 per cent of total investments in Infrastructure. Moreover, while more than 50 per cent is invested in the Middle East, IDB's investment span across many regions in Africa, and in Asia. Some challenges exist in promoting the use of Sukuks. For example, some markets do not have the regulatory framework to address Islamic finance and frequently deals do not adhere to Shariah compliant deals. However, Sukuks are now a widely accepted financial instrument. By being asset backed, Sukuk, like Islamic finance in general, remains closely linked to the real economy and could represent an important tool to realize real social and economic progress within a post 2015 development agenda.

VII. Conclusion

Several key messages emerged during the discussions:

(I) Islamic finance products are suited to promote sustainable development in its economic, social and environmental dimensions and should be an important element of a holistic financing framework for the post-2015 development agenda.

(II) Islamic finance products have helped further social development. Solidarity-based Islamic finance, especially Zakāt and Waqf, can play an important role in promoting additional sources for finance at the local levels.

(III) Islamic finance promotes financial inclusion. Given the significant and growing share of the Muslim population in the world, Islamic finance will continue to play an important role by providing customized financial services for this segment of the global population.

(IV) Islamic finance can contribute to aligning incentive structures between policyholders, investors and fund managers to the benefit of social and economic development. For example, the Islamic insurance concept “Takaful” is founded on the principle of separation between the funds and operations of shareholders, thus passing the ownership of the fund and operations to the policyholders, who share profits as well as losses.

(V) Islamic finance contributes to financial stability and has demonstrated its resilience during the global economic and financial crisis. Especially, its fundamental principle of sharing risk and building longer-term relationships between individuals and financial institutions facilitates a sound connection between the financial sector and the real economy. In light of the negative role financialization has played in the run up to the world financial and economic crisis, Islamic finance could therefore make a significant contribution to a more stable, inclusive and development-oriented international financial system, based on common interests and shared responsibilities.

(VI) The full potential of Islamic finance products has not yet been explored, sometimes for questionable political reasons. Islamic finance products should be considered by non-Muslim providers and users, where they are competitive and offer positive externalities in promoting sustainable development. For example, Sukuks (often called Islamic bonds), could potentially generate large amount of money for infrastructure investment and simultaneously promote greater links between the financial sector and the real economy. In that context, new partnerships between Islamic finance and other financial service providers should be explored.