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Mobilising Islamic Banking for Climate Action



General Council for Islamic
Banks and Financial Institutions



المجلس العام للبنوك
والمؤسسات المالية الإسلامية



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Partners



This product is one of the outputs of the 'SDG-Climate Facility: Climate Action for Human Security' project. With financial support from the Swedish International Development Agency (Sida), the project is a multi-partner platform focusing on the impacts of climate change on human security in the Arab region, especially in the context of countries in crisis. It brings together the League of Arab States (LAS), Arab Water Council (AWC), United Nations Development Programme (UNDP), United Nations Environment Programme Finance Initiative (UNEP FI), World Food Programme (WFP), United Nations Office for Disaster Reduction (UNDRR), and United Nations Human Settlements Programme (UN-Habitat), to deliver climate-oriented solutions that address climate challenges and bring co-benefits across the SDGs. In doing so, it aims to scale up access to and delivery of climate finance, including through innovative partnerships with the private sector.



CIBAFI is an international organisation established in 2001 and headquartered in the Kingdom of Bahrain. CIBAFI is affiliated with the Organisation of Islamic Cooperation (OIC). CIBAFI represents the Islamic financial services industry globally, defending and promoting its role, consolidating co-operation among its members, and with other institutions with similar interests and objectives. With over 130 members from more than 30 jurisdictions, representing market players, international intergovernmental organisations, professional firms, and industry associations, CIBAFI is recognised as a key piece in the international architecture of Islamic finance. Its mission is to support the Islamic financial services industry growth by providing specific activities and initiatives that leverage current opportunities while preserving the value proposition of Islamic finance. CIBAFI is guided by its Strategic Objectives, which are, 1) Advocacy of Islamic Finance Values and Related Policies & Regulations; 2) Sustainability and Innovation Integration; 3) Industry Research and Analysis; and 4) Professional Development.



The Islamic Development Bank (IsDB) is a multilateral development bank (MDB) working to improve the social and economic development of its member countries and Muslim communities around the world to deliver impact at scale. IsDB supports its member countries to meet their climate and sustainable development goals and targets through economic and social infrastructure investments, institutional strengthening, capacity building, partnership, and leveraging its resource-mobilization capabilities with other private, national, bilateral and multilateral development partners. IsDB is the world's largest public Islamic finance institution and the largest south-south MDB.

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Acronyms and abbreviations

AAOIFI	The Accounting and Auditing Organization for Islamic Financial Institutions
ACG	Arab Coordination Group
ADB	Asian Development Bank
ASEAN	The Association of Southeast Asian Nations
BCBS	Basel Committee on Banking Supervision
BNM	Bank Negara Malaysia
BAB	The Bahrain Association of Banks
CBE	Central Bank of Egypt
COP	Conference of the Parties—generally referred to as the United Nations Climate Change Conference
CIBAFI	The General Council for Islamic Banks and Financial Institutions
DIB	Dubai Islamic Bank
EGP	Egyptian Pound
ESG	Environmental, Social, and Governance
FRA	The Egyptian Financial Regulatory Authority
GCC	Gulf Cooperation Council
GHG	Greenhouse Gas
GIBS	Global Islamic Bankers' Survey
ICMA	International Capital Market Association
IFI	Islamic Financial Institution
IFRS	International Financial Reporting Standards
IFSB	Islamic Financial Services Board
IMF	International Monetary Fund
IPCC	The Intergovernmental Panel on Climate Change
IsDB	Islamic Development Bank
ISSB	International Sustainability Standards Board
MDBs	Multilateral Development Banks
M&E	Monitoring and Evaluation
MENA	Middle East and North Africa
MOENV	Ministry of Environment, Jordan
MYR	Malaysian Ringgit
NGFS	Network for Greening the Financial System
PSIA	Profit Sharing Investment Account
PRB	Principles of Responsible Banking
QIB	Qatar Islamic Bank
SBTI	Science-Based Targets Initiative
SDGs	Sustainable Development Goals
SRI	Socially Responsible Investment

TCFD	Task Force on Climate-related Financial Disclosures
UNEP FI	The United Nations Environment Programme Finance Initiative
UNFCCC	The United Nations Framework Convention on Climate Change
USD	United States Dollars
VBI	Value-Based Intermediation



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Foreword

The Middle East and North Africa (MENA) region is highly vulnerable to the physical impacts of climate change. At just +2°C of global temperature rise, heat extremes will occur regularly across summer months, reaching new norms of more than 50°C in certain regions. Precipitation will reduce across the fertile Mediterranean coast, impacting agriculture and water supply, and increasing desertification and soil erosion. In the longer-term, sea level rise will expose major coastal cities to regular coastal flooding.

Islamic finance is a rapidly growing sector of the MENA finance industry and has its foundation in an ethical and responsible framework for investing. Whilst the potential for expanding Islamic finance institutions' frameworks to include climate and environmental issues is considerable, most institutions are only in the early stages of assessing how climate change may impact their businesses and how they might manage those impacts. Therefore, it is crucial for Islamic financial institutions to maintain a clear perspective, enabling them to effectively navigate the increasing risks while harnessing the myriad opportunities that climate-related finance offers.

This is why our three institutions—the UN Environment Program Finance Initiative (UNEP FI), the Islamic Development Bank (IsDB) and the General Council for Islamic Banks and Financial Institutions (CIBAFI)—have teamed up to provide this comprehensive guide on climate change for Islamic banks in MENA. This guide provides an overview of the current state of climate action in Islamic finance, a summary of the Islamic basis for action on climate change, and a clear pathway for Islamic banks to transition their business in response to a rapidly changing climate. This report is a specific complement to the work already being developed by each of the three institutions to support the finance sector in responding to climate change—from climate risk assessment to the measurement of Greenhouse Gas emissions and target-setting—with specific guidance for Islamic banks. Our three institutions aim to continue this collaboration over the coming years and to develop an Islamic finance sector that is both resilient and proactive in the face of a changing climate.

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Executive summary

Islamic banking has come to the forefront as a potential driver of climate finance in the Middle East and North Africa (MENA) region. This sector has demonstrated considerable resilience against global economic shocks, the rise of the COVID-19 pandemic, and impending global economic inflation.

Islamic finance has a strong position in the region, especially, though by no means exclusively, in the Gulf Cooperation Council (GCC) countries. In Islamic finance generally, there has been increasing interest in Environmental, Social and Governance (ESG), green and sustainable products, with particular interest in sustainability-related and green *sukuk*. The MENA region has also been prominent in this trend.

Such momentum creates opportunities for Islamic banks in the MENA region. On one hand, the transition to a low-carbon economy will create important investment opportunities across multiple sectors in the region. On the other hand, they, and the countries in which they operate, are exposed to risks from climate change which they need to evaluate and manage.

A growing number of countries in the region are taking climate action in the form of tailored policies and regulatory measures to support a market transition to less carbon-intensive and more resilient economies. Such transitions will involve, and have implications for, the financial sector. At the same time, international regulators and standard-setting bodies, including those focused specifically on Islamic finance, are increasingly embedding climate change considerations. For example, disclosure standards from the International Sustainability Standards Board (ISSB), may imminently be adopted by some countries in the region.

In addition to the commercial risks and opportunities arising from climate change, and the current and potential regulatory pressures, there are strong moral reasons for Islamic banks to bring climate issues into the mainstream of their business. Islamic finance is based on religious principles. The link between those principles and concern for sustainable development can be articulated in several ways. There are growing calls among sharia scholars, academics and international organizations in Islamic finance to capitalize on the common values that link sharia-based principles of Islamic finance, sustainable development, and climate action to provide an ethical conceptual framework that will further encourage Islamic banks to develop proactive climate action agendas.

An increasing number of Islamic banks in the MENA region are starting to integrate sustainability and ESG into their operational framework with varying degrees of scope and depth of integration. Climate change awareness and engagement differs from

one bank to another. Some Islamic banks are adopting global reporting and disclosure practices. They are also adopting internationally relevant frameworks and evaluative approaches, sometimes with modifications for Islamic finance. But some Islamic banks still seem to see climate concerns as relatively peripheral to their business or struggle to integrate it into their day-to-day business frameworks.

Incorporating climate considerations into bank operations increases Islamic banks' capacity to face climate-related financial risks and uncertainty. Concurrently, it can facilitate the transition to carbon-neutral and climate-resilient markets and economies, and realize new opportunities inherent in that process.

This report sets out an approach intended to provide preliminary guidance, and support to interested Islamic banks to help bring efforts related to climate change into the mainstream of their businesses. It does so across five main pillars:

1. Climate leadership
2. Strategic climate management
3. Climate-related operational integration
4. Performance measurement and accountability and
5. Collaboration and exchange on climate resilience.

Each of these five pillars incorporate key actions to improve the institutions' response to climate change as set out below:

Islamic banks				
Climate leadership	Strategic climate management	Collaboration & exchange of climate resilience	Climate performance & accountability	Climate-related operational integration
Appropriate oversight & decision making	Setting climate-related limits	Engagement & advocacy	Measure & track	Implement decarbonisation approaches
Embed climate into governance structures	Identify climate risk & opportunities	Share learning & knowledge	Disclose & report	Offer climate-aligned financial products & services
	Measure & integrate			
	Set climate targets & strategy			

The report also sets out guidance for regulatory and other public authorities, including trade associations, to support these efforts.



About this report

This report presents the current integration of climate-related practices in Islamic banking in the MENA region based on interviews, surveys, and an in-depth desk review, and goes on to indicate how Islamic banks can bring climate action into the mainstream of their businesses. The report is one of the main outcomes of a programme to “Promote Climate Finance within the Islamic Banking Sector in the MENA Region”, a collaboration between the United Nations Environment Programme Finance Initiative (UNEP FI), Islamic Development Bank (IsDB), Islamic Development Bank Institute (IsDBI) and the General Council for Islamic Banks and Financial Institutions (CIBAFI).

Audience

The report is aimed particularly at Islamic banks in the MENA region. Specifically, it targets the following:

- Islamic banks.
- Islamic windows of conventional banks.
- Shareholders, partners, and clients of Islamic banks and financial institutions.

Other audiences that can also benefit include:

- Islamic banks and Islamic windows in other regions.
- Other types of Islamic financial institution, for example takaful operators and Islamic fund managers
- Regulators and central banks that oversee Islamic finance markets.
- Other conventional banks that prioritize value-based sustainability practice.
- Anyone interested to explore further an emerging nexus between Islamic finance and climate resilience.

Because this report is intended primarily for those already active in Islamic finance, it assumes a knowledge of the basic principles underlying that activity. A brief introduction to the subject is, however, presented in [Annex 1](#).

Methodology and research considerations

This report has been developed through both a desk review and an assessment.

The desk review provides a review and investigation of an already existing body of knowledge that includes a plethora of reports, manuals, studies, secondary data and

conceptual frameworks to form a comprehensive understanding of the new emerging nexus of Islamic banking and climate action. The review builds on reports and research conducted by UNEP FI, IsDB, IsDBI, and CIBAFI, among others, to harmonize efforts and build on work already done.

The assessment aims to capture first-hand experience and data collected from interviews and focus groups, and participatory dialogue with sharia scholars, practitioners, bankers, and regulators from the region. The assessment has also been supported and guided by data extracted from the CIBAFI Global Islamic Bankers' Survey, which supplemented data gathered from interviews and workshops.

The Middle East and North Africa is a diverse, heterogeneous region. Each country has unique and specific socio-economic circumstances and different institutional and regulatory ecosystems. The rapid growth of Islamic banking and its economic prominence in the Gulf Cooperation Council (GCC) sub-region—including Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates—especially in terms of Environmental, Social and Governance (ESG) and climate-related practices, compares favourably with the position of Islamic banks operating in some non-GCC countries such as Egypt, Tunisia, and Morocco. This report aims to:

- Capture some of the unique socio-economic settings that can lead to a different set of barriers and even a different set of opportunities when it comes to climate action.
- Delve deeper into understanding the capacity of banks in these countries to understand climate risk and evaluate their ability to mainstream climate considerations into their operations.
- Identify success stories from GCC countries and countries outside the region such as Malaysia.

1. Status of Islamic Finance and Banking in MENA

Islamic finance globally has a long pattern of expansion, growing faster than its conventional counterpart over recent years, and showing resilience in the face of global economic disruptions such as inflationary shocks, COVID-19, etc. In 2021, it grew by 11.3% to reach a total estimated value of USD 3.06 trillion (IFSB, 2022). Islamic banking is the dominant sector by assets (68.7% in 2021), but its growth (6.5% in 2021) has in recent years been slower than that of the Islamic capital market.

Within Islamic banking, the largest jurisdiction globally in terms of assets is Saudi Arabia, followed by Iran (Islamic Republic of), Malaysia, the United Arab Emirates, Qatar, Kuwait and Bahrain. In terms of share of the domestic market, Iran (Islamic Republic of) and Sudan claim entirely Islamic banking systems. They are followed by Saudi Arabia, Brunei Darussalam, Kuwait, Malaysia and Qatar, with a further eight jurisdictions having Islamic market shares of over 15%.

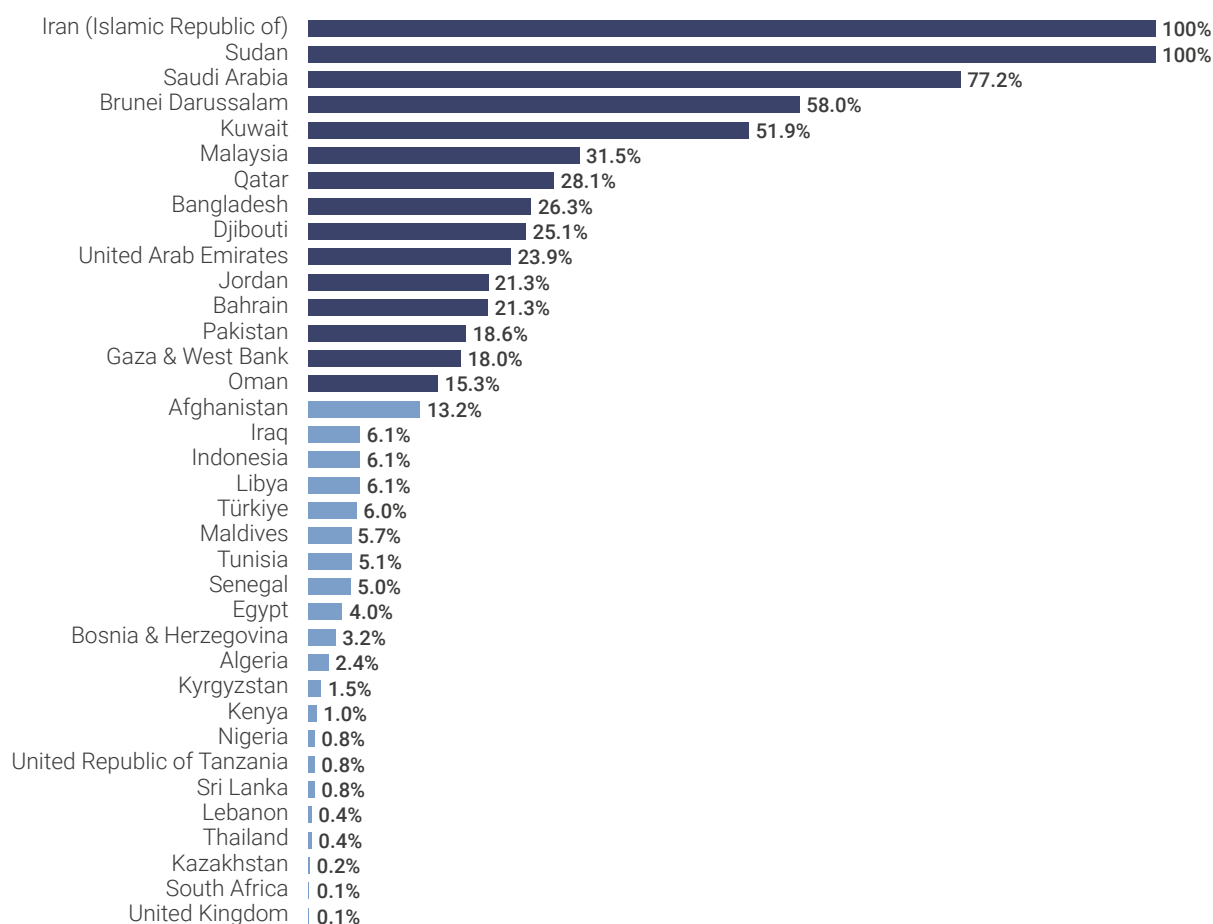


Figure 1: Islamic banking share of total banking assets by jurisdiction (2021): from IFSB (2022)

Turning specifically to the MENA region, the countries of the GCC in total accounted for 57.6% of Islamic banking assets. Besides Iran (Islamic Republic of), a number of non-GCC countries in the region have a significant Islamic banking presence, notably Jordan, Egypt and Iraq.

Sukuk issuance was less concentrated in the region, partly because of large sovereign issuances by Indonesia. Excluding issuances by multilateral organizations, the largest domiciles for *sukuk* originators were Saudi Arabia, Malaysia, Indonesia, Kuwait, Türkiye and the United Arab Emirates.

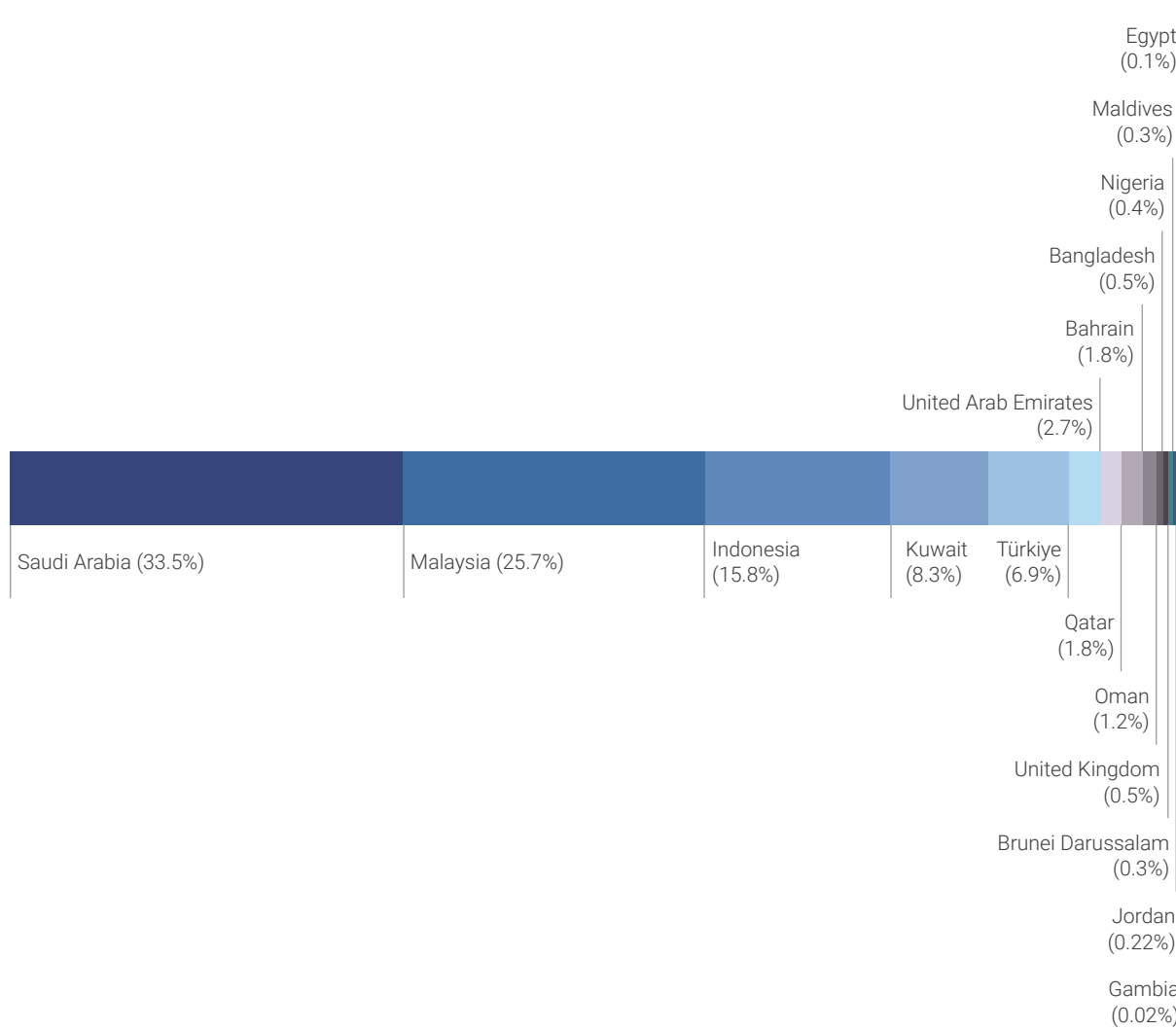


Figure 2: Total *sukuk* issuances by domicile of originator, excluding multilaterals (2021): from IFSB (2022)

Corporate issuances were led by Malaysia, followed by Saudi Arabia, Türkiye, the United Arab Emirates, Kuwait and Bahrain. However, any single year figures can be skewed by a few large issuances. GCC banks in particular have made very large issuances, often for regulatory capital purposes. Nevertheless, the GCC has a very large continuous presence in the *sukuk* market, with lower activity from other MENA jurisdictions, including Iran (Islamic Republic of) and Egypt.

2. A snapshot of ESG and climate-related Islamic finance

In recent years, the growing role of Islamic banking in the global economy has been accompanied by a growing interest in ESG investing. This has been most conspicuous in the Islamic capital market, where there have been a number of *sukuk* issuances to finance green, ESG or sustainable projects.

This trend is driven in part by increasing awareness of the need to address climate change, and a growing awareness of ethical synergies between the values of Islam, responsible banking, and responsible investing. But it is also driven by the fact that ESG investing can offer attractive returns and business opportunities in different countries. As Islamic finance continues to grow in volume and influence, *sukuk* are likely to be increasingly used to finance green projects around the world.

At a global level, IsDB has launched an ambitious policy agenda to promote this type of financial instrument. In 2020, IsDB issued their first USD 1.5 billion sustainable *sukuk*, followed by another USD 2.5 billion issuance in 2021 (IsDB, 2021). IsDB was also the first multilateral development bank to issue a green euro-denominated *sukuk* in 2019. In 2021, Malaysia issued a sovereign *sukuk* of USD 1.3 billion, including a USD 800 million sustainability tranche, with proceeds used to finance social and green projects aligned to the UN Sustainable Development Goals (SDGs) (IFSB, 2022).

Indonesia issued a USD 750 million green *sukuk* tranche as part of a USD 3 billion issuance in the first half of 2021 and Dubai Islamic Bank (DIB) was among the *sukuk* buyers (IFSB, 2022). In 2022 Saudi National Bank and Riyadh Bank issued sustainability-linked *sukuk* worth USD 750 million each (IFSB, 2022). DIB has announced its second sustainability *sukuk* offering. The USD 1 billion Senior Issue has a 5.5-year tenor and was issued in February 2023. This offering follows DIB's inaugural sustainability *sukuk*, a landmark USD 750 million five-year Senior Issue that was issued only three months earlier, in November 2022 (DIB, 2023).

There have also been green or sustainable issuances by non-financial corporate entities. As an example from the MENA region, the United Arab Emirates-based retail group Majid Al-Futtaim has now issued three green *sukuk*—the most recent, in 2023, being for USD 500 million. Sustainability-related *sukuk* issuances in 2021 totalled USD 5.3 billion. Figure 2 below highlights the evolution of ESG *sukuk* issuances between 2017 and 2021.

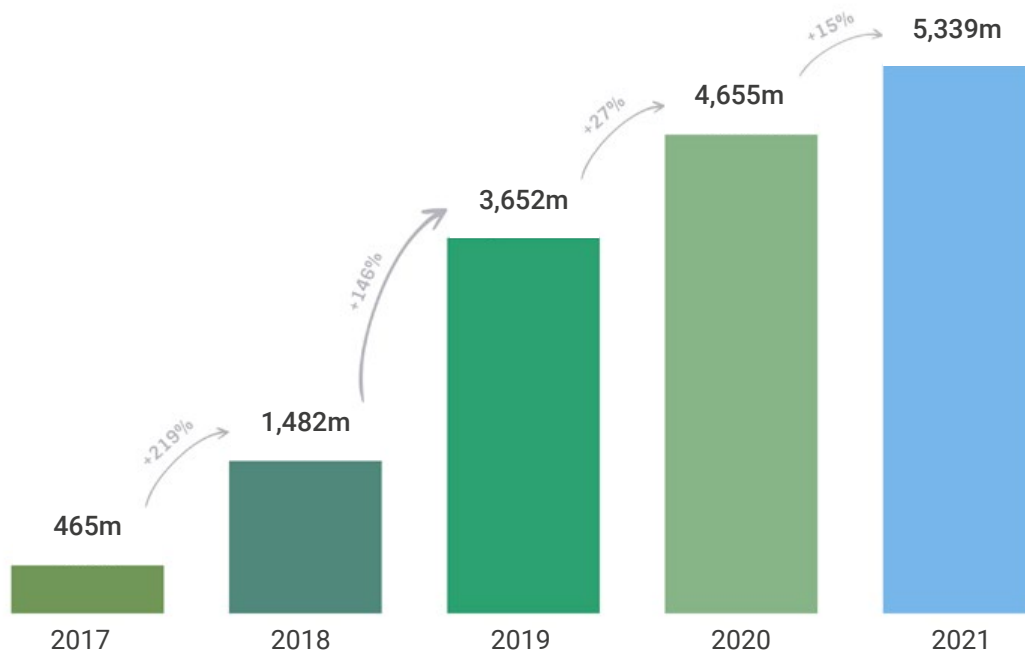


Figure 3: ESG Sukuk Issuance Trajectory 2017–2021 (Refinitiv, 2022)

The increase in ESG and green *sukuk* issuances has been accelerated by the announcement of net-zero commitments and economic transition plans largely in GCC countries. Saudi Arabia’s net-zero commitment, to be achieved by 2060, has been a catalyst for the creation of two Saudi-led investment initiatives, the Saudi Green Initiative and the Middle East Green Initiative, with a significant investment appetite for green and climate-aligned projects in Saudi Arabia and in the wider Middle East region.

In addition to these Saudi investment initiatives, Arab Coordination Group (ACG) members pledged USD 24 billion at COP27 in Egypt to support climate resilience by 2030. ACG is a strategic alliance of regional development funds that coordinates development money. The initiative’s main objective is to help developing and small island nations tackle climate change and global warming. The IsDB contributed USD 13 billion to this pledge to target green project financing in its member countries (OPEC Fund, 2022).

Box 1: “Feeling the Heat” of Climate-related Physical and Economic Impacts in MENA

The International Monetary Fund (IMF) issued a recent report on climate-related economic impacts on the Middle East and Central Asia (Duenwald et al, 2022). The report highlights the significant material risks to banks, including Islamic Banks. The main findings pertaining to the Middle East include:

- High level of climate-related impacts. These translate into economic, physical, human, and social costs, along with increased vulnerability of investments, projects, assets, and infrastructure in the region.

- Direct negative impacts on economic growth, food security, agriculture, manufacturing, transportation, services, rural and urban livelihoods, job security, and poverty.
- Heightened water scarcity and stress, especially in the GCC countries and Egypt. A significant number of countries in MENA are among the top water-stressed countries in the world, suffering from desertification, high levels of soil salinization, and agricultural land degradation.
- Temperatures have increased by about 1.5°C on average over the past three decades. Extreme warm spells have been witnessed in Iraq, Kuwait, and Iran (Islamic Republic of).
- Greater variations in annual rainfall (Jordan, Kuwait, and Oman) or declining annual rainfall (Lebanon).
- High frequency and severity of climate-related disasters such as flooding in Egypt, Iraq, Morocco, and Tunisia. Rising sea levels impacting economically significant coastal areas such as in Egypt and the United Arab Emirates.

Box 2: Sustainable Finance Framework Developed by IsDB

The IsDB's Sustainable Finance Framework was first developed in 2019 in accordance with the Green Bond Principles (2018), Social Bond Principles (2018), and Sustainability Bond Guidelines (2018). The framework, which is used to issue green or sustainability *sukuk*, is based on these pillars: 1) Use of proceeds; 2) Process for project evaluation and selection; 3) Management of proceeds; and 4) Reporting.

Accordingly, IsDB issued two types of *sukuk*, namely green *sukuk* (where proceeds are allocated to green projects) and sustainability *sukuk* (where proceeds are allocated to green and social project categories). The framework can be used to finance climate-related projects. It also proposes a spectrum of priority projects that can be financed by green *sukuk* including:

- Renewable energy and energy efficiency
- Clean transportation
- Pollution prevention and control
- Environmentally sustainable management of natural living resources and land use
- Sustainable water and wastewater management

The Framework also provides a project exclusion list that complies with sharia in addition to prohibiting projects that are harmful to the environment or increase emissions.

Meanwhile, IsDB has issued a climate change policy, alongside its sustainable finance framework, to emphasise the need to address climate change beyond its integration as a component of ESG or sustainable finance (IsDB, 2019). Rather, climate change should be prioritised with special attention paid to financing climate mitigation and adaptation. The Bank's Climate Action Plan was issued in 2019, building on a previous policy developed in 2017, which has consequently developed an action plan. It also sets out modalities for achieving IsDB's climate finance target of 35% by 2025 (IsDB, 2020) and Paris alignment of sovereign operations by the end of 2023.

The examples given above—and these are only a few of many—illustrate that there is active commitment both globally and in the MENA region to address the issues of climate change. Their number is likely to increase when COP28 is held in the region, in Dubai in November 2023. At the same time there is active investor interest in sustainable investments. Together, these factors create commercial opportunities for Islamic banks.

3. Risks and regulation

Climate-related financial risks

Climate change poses direct risks to banks. These include physical risks, both to the bank's own operations and to its business, for example if homes which it has financed through mortgages are at increased risk of destruction as a result of adverse weather events. They also include transition risks, for example if changing patterns of economic behaviour associated with the transition to net zero lead to declining demand for certain products, reducing a firm's ability to repay the financing. These are risks which banks need to manage.

There has been substantial work from international standard-setters in this area, notably the Basel Committee on Banking Supervision (BCBS), which has published *Principles for the effective management and supervision of climate-related risks* (BCBS, 2022), which are likely to influence regulatory authorities' approach to climate-related risks. The Islamic Financial Services Board (IFSB) is developing a Guidance Note relating specifically to Islamic banking, based largely on the BCBS Principles. It has already incorporated this into its Islamic banking disclosure standard (IFSB-22) based on those recommended by the Task Force on Climate-related Financial Disclosures (TCFD) (see below).

Regulatory policies, and frameworks

Broader regulatory activity at the international level has addressed not only the risks to banks but the impact of banks—and particularly banks' financings—on climate change. In general, initiatives in this area have been focused on disclosure. The TCFD, a private-sector body set up under the auspices of the Financial Stability Board, recommended a set of disclosures, broadly speaking about governance and process, which have been widely adopted (TCFD, 2022). Other private-sector initiatives, for example the Greenhouse Gas (GHG) Protocol, provide important frameworks for assessing and disclosing impacts, in the case of the GHG Protocol, around emissions.

After a period in which a range of initiatives—public, private and mixed—were leading to some confusion in the market, international support coalesced around the formation of the International Sustainability Standards Board (ISSB) under the auspices of the International Financial Reporting Standards (IFRS) Foundation. The ISSB has now issued two reporting standards, the second of which (S2) focuses specifically on climate. ISSB S2 requires both process disclosures based largely on the recommendations of the TCFD and impact disclosures, including those from financings, based largely on the GHG Protocol. This new standard will of course be available for voluntary reporting, but it (or indeed other disclosure standards) may be imposed on banks by their regulators.

Individual jurisdictions, including some in the MENA region, have also launched their own initiatives. While some of these have imposed mandatory requirements on banks, others have aimed at encouraging voluntary compliance with national policies or commitments.

In Jordan, the government has made sustainability a key pillar of its 2022 Economic Modernisation Vision. It is preparing a sustainable finance strategy for the financial sector in the country and in 2021, a green bond and *sukuk* issuance guide was developed and published (MOENV, 2021).

In Morocco, the government adopted the 2030 National Sustainable Development Strategy in 2017, and in 2019 launched the 2030 National Climate Plan which aims to strengthen resilience to climate risks, to accelerate the transition to a low-carbon economy and to promote redirection of finance towards these goals (World Bank, 2022). In 2016, the central bank coordinated the preparation of a Roadmap for aligning the financial sector with sustainable development.

Egypt has made progress in several areas:

- In 2018, the Egyptian Financial Regulatory Authority (FRA) amended the Capital Market Law to introduce provisions on green bonds and *sukuk*. The FRA amended the law again in 2022 to introduce sustainability, ESG, social, and gender bonds. In 2019, a green bond guide was developed.
- The FRA issued its first regulation on ESG and TCFD-aligned disclosures in 2021, targeting large non-banking financial companies—both conventional and Islamic—for insurance, capital markets, leasing, mortgages, and microfinance.
- Concurrently, the Central Bank of Egypt (CBE) issued guiding principles on sustainable finance at the end of 2021, targeting both conventional and Islamic banks. The following year, the CBE (2022) sent a circular asking banks to start measuring and tracking their carbon footprint, asking specifically for Scope 1 and Scope 2 emissions.

Box 3: The Central Bank of Egypt's Guiding Principles on Sustainable Finance

The Central Bank of Egypt has developed Guiding Principles to catalyse the mainstreaming of sustainability practices (CBE, 2021). These principles target all banks: both Islamic and conventional. In addition to covering the need for capacity building, efficient resource management and partnerships, the Guiding Principles cover:

1. **“Enhancing sustainable finance”** to integrate ESG considerations in financing activities, as well as developing abilities to manage and integrate environmental and social risk in risk management frameworks. Banks should also develop green and climate friendly products such as green loans, green investments, green bonds and *sukuk*.
2. **“Managing climate change risks”** by identifying and classifying climate-related risks and working toward mitigating them, in addition to promoting the finance of projects reducing climate change impacts.
3. **“Reporting”** on activities related to internal sustainability practices and others related to sustainable finance by creating and developing integrated information systems and reporting procedures.

The government of the United Arab Emirates has established a Sustainable Finance Working Group, including representatives of all the relevant authorities, including those of the two Financial Free Zones. The Government and Working Group have produced a series of publications including the United Arab Emirates sustainable finance framework 2021-2031, issued by the Ministry of Climate Change and Environment, which draws particular attention to green *sukuk*.

Box 4: Core elements of the 2021-2032 United Arab Emirates' Sustainable Finance Framework

The core elements of the Framework include:

- Mainstreaming sustainability in financial decision making and risk management through the development of environmental stress testing tools to aid the financial sector at large and the establishment of regulatory guidelines for the management and assessment of environmental and climate risk among other actions.
- Creating and enabling a national green taxonomy and exploring incentives to promote green finance such as tax deductions, guarantees, etc.
- Encouraging the issuance of sovereign green bonds and *sukuk*, supported by the development of climate-related and green project pipelines.
- Encouraging the alignment of governance, reporting, and disclosures to international frameworks and standards such as the TCFD.

Broadly similar examples could be cited from other countries in the region.

There are also initiatives from non-governmental bodies either in the region or with a specific mandate in Islamic finance.

In 2018, the Sustainable Development Committee of the Bahrain Association of Banks published a set of recommendations on sustainable finance, including a group of recommendations on how banks could internalise sustainability in their operations (BAB, 2018).

The Islamic Corporation for the Development of the Private Sector, part of the IsDB group, headquartered in Saudi Arabia, is developing ESG standards for private and public sector *sukuk* issuances (ADB, 2022).

CIBAFI has initiated a project aimed at developing a carbon footprint measurement methodology specific to Islamic financial institutions. With regard to raising awareness about climate change, CIBAFI has also released briefings covering topics related to climate change, climate-related risks, and climate change stress testing and how these topics are impacting the Islamic finance industry.

Box 5: CIBAFI's GHG Measurement and Reporting Tool for Islamic Finance Institutions

CIBAFI, with the support of IsDB, is leading an initiative aiming at establishing a comprehensive methodology to develop a global GHG measurement and reporting tool that considers the characteristics of Islamic financial institutions' (IFIs) portfolios and the environments in which these institutions operate. The initiative is currently a work in progress, and it is aligned with CIBAFI's strategic objectives to address and support international sustainability goals, such as the Paris Agreement, and to reinforce IFIs' role in addressing global challenges, such as reducing the risk and impact of climate change. The GHG measurement and reporting tool will help IFIs to:

- Identify to what extent their investment financing portfolios are responsible for GHG emissions as per the Scope 3 methodology
- Establish a clear and structured action plan to address and manage climate risks and opportunities in line with the Paris Agreement and international standards
- Reinforce their role in supporting climate action.

4. Islamic principles, Maqasid Al-Sharia and Climate Action

The previous sections have explored the commercial risks and opportunities which Islamic banks face as a result of climate change, and the regulatory requirements and pressures which may bear on them. But there is a third set of imperatives for Islamic banks in particular. These are the moral imperatives stemming from the foundational values of Islamic finance.

The development of Islamic finance has been guided largely by Islamic contract law, which tends to class actions or transactions as permissible or impermissible. In recent years, however, there has been an increased focus on *Maqasid al-Sharia*, the purposes of sharia, which refers to the underlying goals and objectives of Islamic law. These have been articulated in different ways by different scholars, as has their relationship to the formal legal reasoning of the schools of Islamic law. The *Maqasid al-Sharia* have nevertheless come into greater prominence in recent years as a source of positive ethical guidance for Islamic finance. One articulation of the *Maqasid al-Sharia* is set out below.

Maqasid Sharia				
<p>Maqasid Sharia (also known as the "purpose of Sharia") refers to the underlying goals and objectives of Islamic law (Sharia). These goals are believed to be universal and are intended to promote the well-being and prosperity of individuals and society.</p> <p>They are often used as a framework for interpreting and applying Islamic law and are as important source of guidance in Islamic finance.</p>				
Major pillars				
Protection of Religion (<i>din</i>)	Protection of life (<i>nafs</i>)	Protection of intellect (<i>aqi</i>)	Protection of progeny (<i>nasl</i>)	Protection of wealth (<i>mal</i>)
Refers to the protection of the principles, and values of Islam.	Refers to the protection of human life and the promotion of physical and mental well-being.	Refers to the promotion of Intellectual and cognitive growth and development, as well as the protection of individual freedom and autonomy.	Refers to the promotion of the family unit and the protection of the rights of children and future generations.	Refers to the promotion of economic justice and the protection of individual and communal wealth.

Figure 4: Maqasid al-Sharia

Understanding the Ethical Bridge

Interviewed scholars have pointed to the conceptual direct link between *Maqasid al-Sharia* and climate action. Islamic financial institutions are increasingly linking nature and ecology to the fulfilment of *Maqasid al-Sharia*. Consensus has not yet been reached between scholars on how to provide a model of *Maqasid al-Sharia* that has direct mention of environmental stewardship, nor on the strength of the linkages that can be established. However, there appears to be a growing consensus that *Maqasid al-Sharia* does offer a fruitful way of thinking about environmental responsibility.

For example, a number of Islamic scholars have published a book setting out how *Maqasid al-Sharia* concepts can be linked to the SDGs (Hassan, M. Kabir et al, 2021). They argue that climate change results in physical climate impacts in the form of floods, droughts, extreme weather changes, and rising sea levels. These impacts can have economic repercussions that are harmful to the public good, public wellbeing, and the economy. This is a core consideration for the intentions and objectives of sharia which revolves around the fulfilment of justice to the greater good for all (Hassan, M. Kabir et al, 2021). Thus, a link can be established between global sustainability goals that deal with climate and the environment and a number of the *Maqasid al-Sharia* elements:

Table 1: Relationship between global Sustainable Development Goals and principles of Maqasid al-Sharia

Maqasid Sharia Pillars	Climate Change impact on the Observance of Maqasid Sharia Pillars.	Expected Negative Impact on Islamic Finance and the Economy	SDGs that Address Climate Challenges
Protection of Life (<i>Nafs</i>)	<ul style="list-style-type: none"> ▪ Direct impact on human life through extreme weather events such as floods, hurricanes, and droughts, which can lead to loss of life and displacement of people. ▪ Changes in weather patterns can also impact food and water supplies, leading to malnutrition, water scarcity, and increased risk of disease outbreaks, further threatening human life. ▪ In addition to the direct impact, climate change can also have an indirect impact on human life through economic and social disruption, which can lead to poverty, unemployment, and social unrest. 	<ul style="list-style-type: none"> ▪ Negative impact on investments in sectors such as tourism and agriculture, as well as on insurance companies and financial institutions that are exposed to climate risks. ▪ Increased costs for health care and disaster response can also strain government budgets, leading to reduced investment in other areas. ▪ Negative impact on the valuation of assets and investments, as well as on the profitability of business that are dependent on natural resources or have high exposure to climate risks. ▪ Financial institutions may also face increased credit risk and liquidity risk, leading to higher costs and reduced lending. 	<p>SDG 6: Clean Water and Sanitation</p> <p>SDG 7: Affordable and Clean Energy</p> <p>SDG8: Responsible Production and Consumption</p> <p>SDG13: Climate Action</p> <p>SDG14: Life Below Water</p> <p>SDG15: Life on Land</p>
Protection of Material Wealth (<i>Mal</i>)	<ul style="list-style-type: none"> ▪ Risk to property and financial assets due to natural disasters caused by climate change, such as floods and storms, can lead to property damage and loss of income for individuals and businesses. ▪ Climate change can also lead to economic instability and volatility, which can impact financial markets and investments, leading to financial losses for individuals and businesses. ▪ Furthermore, changes in weather patterns and the availability of natural resources can also impact economic activity, particularly in industries such as agriculture, forestry, and fishing. 	<ul style="list-style-type: none"> ▪ Negative impact on long-term economic growth and development, as well as on the ability of future generations to meet their basic needs and maintain a high standard of living. ▪ Increased costs for disaster response and environmental remediation can also strain government budgets, leading to reduced investment in other areas. ▪ Additionally, the loss of cultural and spiritual values can lead to social unrest and decreased social cohesion. 	

Maqasid Sharia Pillars	Climate Change impact on the Observance of Maqasid Sharia Pillars.	Expected Negative Impact on Islamic Finance and the Economy	SDGs that Address Climate Challenges
Protection of Progeny (<i>Nasl</i>)	<ul style="list-style-type: none"> ■ Changes in climate can impact natural resources such as water, soil, and forests, leading to degradation and depletion of these resources over time. This can have long-term impacts on economic growth and development, as well as on the ability of future generations to meet their basic needs and maintain a high standard of living and also impact human reproductive health. ■ Changes in weather patterns can also impact food and water supplies, leading to malnutrition, water scarcity, and increased risk of disease outbreaks, further exacerbating the impact on future generations and human reproductive health in general. ■ Furthermore, climate change can also impact cultural and spiritual values that are tied to the natural world, particularly for indigenous and traditional communities that rely on natural resources for their livelihoods and identity. 		

However, this is not the only way to think about the issue, and other Muslim thinkers have arrived at broadly similar conclusions by different routes. One such example is through the utilization of the fourth Islamic Legal Maxim: "Injury must be removed (*al-darar yuzal*)". Global warming and climate change results in direct harm to afflicted areas and their populations. Humans should endeavour to correct their actions that are aggravating climate change and leading to harm in societies. "The Islamic Declaration on Global Climate Change" was announced in 2015 and is based on this premise. Box 6 below elaborates on this Declaration.

Box 6: The Islamic Declaration on Global Climate Change

The Islamic Declaration on Global Climate Change (IFEES, 2015) was announced in 2015 during the International Islamic Climate Change Symposium in Türkiye. This declaration was developed jointly by a group of Muslim scholars, academics, faith leaders, and environmentalists. It acknowledges the moral and ethical responsibility of individuals, economies, countries, and businesses to fight climate change. It does not explicitly reference *Maqasid al-Sharia* and thus can be seen as arriving at a similar conclusion by a different theological route.

The Islamic Declaration on Climate Action calls on nations, especially oil-producing states, to lead the way in phasing out their greenhouse gas emissions as early as possible. It also calls on these nations to provide generous financial and technical support to the less well-off so that they can phase out their emissions as well.

The declaration urges all Islamic countries to commit to 100% renewable energy and adopt zero emissions strategies as soon as possible. It also calls on Islamic nations to invest in decentralized renewable energy, which is seen as the best way to reduce poverty and achieve sustainable development.

Of particular relevance to the financial sector are the Declaration's calls to corporations, finance institutions, and the business sector to:

- "Shoulder the consequences of their profit-making activities, and take a visibly more active role in reducing their carbon footprint and other forms of impact upon the natural environment;
- "In order to mitigate the environmental impact of their activities, commit themselves to 100 % renewable energy and/or a zero emissions strategy as early as possible and shift investments into renewable energy;
- "Change from the current business model, which is based on an unsustainable escalating economy, and adopt a circular economy that is wholly sustainable;
- "Pay more heed to social and ecological responsibilities, particularly to the extent that they extract and utilize scarce resources;
- "Assist in the divestment from the fossil fuel driven economy and the scaling up of renewable energy and other ecological alternatives."

Potential efforts to align Sharia, ESG, and Climate Governance

Building on these moral imperatives, a number of initiatives have been taken to explore how they can be embedded in the governance of Islamic financial institutions. At national level, Malaysia has created a value-based intermediation framework that includes aligning sharia governance with sustainable development. This framework signalled clarity to banks, facilitated the work of sharia boards within the operation of the banking models, while giving the moral and ethical background to align sharia to sustainable development and ESG considerations. It is also the basis on which the country is encouraging more banks and financial institutions to integrate climate considerations.

Box 7: Aligning Sharia with a value-based Intermediation Framework in Malaysia

Value-based Intermediation (VBI) is an initiative introduced by Bank Negara Malaysia (BNM), the central bank of Malaysia, that aims to promote value-based banking activities. BNM first issued the framework and its principles in 2017, followed by implementing guidance for banks, as well as a scorecard to evaluate impact and assess its efficacy. The underlying principles of VBI are:

- Integrating sharia governance to go beyond the traditional sharia compliance approach, and also acting to ensure that the outcome of Islamic banking activities is based on *Maqasid al-Sharia* in its result and impact on the community, economy, environment, and society.
- The maximization of benefits and prevention or minimization of harm in all activities, operations, and outcomes.
- Fairness, transparency, and strong governance.
- Constructive and inclusive collaboration with stakeholders.
- As declared by its creators, the framework has commonalities with ethical finance, and ESG concepts. But it is based on *Maqasid al-Sharia*, which inspires its values, and the goals of Islamic finance.

The VBI guide provides a comprehensive mainstreaming process and steps to integrate the above-mentioned principles within the governance, management, and operation of banking activities. Outcome and suggested key performance indicators evaluate the impact of banking activities on the economy, profitability, community, and the environment as the principal elements through which *Maqasid al-Sharia* can be observed. A VBI evaluation scorecard was also developed to help banks and institutions evaluate their progress. It is worth noting that the implementation of VBI has led to the issuance of a climate-specific taxonomy and the creation of a working group.

Similarly, CIBAFI published a sustainability guide in 2022. The guide aims to introduce an internal integration of sustainability practices. The guide proposes a sharia-based governance approach that integrates sustainability and ESG relevant practices. It builds on an expanded interpretation of *Maqasid al-Sharia* objectives and proposes an Islamic-aligned definition for sustainable development.

New proposed approach to understanding Maqasid Sharia			
Proposed & redefined objectives			
In vigorating the value of human life	In vigorating the human self	In vigorating the society	In vigorating the physical environment
<ul style="list-style-type: none"> ▪ Faith ▪ Human rights 	<ul style="list-style-type: none"> ▪ Self ▪ Intellect 	<ul style="list-style-type: none"> ▪ Prosperity ▪ Social entity 	<ul style="list-style-type: none"> ▪ Wealth ▪ Environment
(CIBAFI, 2022)			

Figure 5: New proposed approach to understanding Maqasid al-Sharia (CIBAFI, 2022)

Proposed Islamic definition of sustainable development

Recognising the complementary nature of all the stakeholders to reach unity (Tawhid) within the balance (Mizan), which requires the recognition and provision of an opportunity space for the given (fitra) development path for each stakeholder to reach their perfection, where the growth of each stakeholder has to be in harmony with other stakeholders' leading to inter- and intra-generational justice (adalah) through the actualisation of equilibrium-based (ihsani) governance"

CIBAFI, 2022 p.13

Figure 6: An Islamic definition of sustainable development (CIBAFI, 2022)

This definition is based on human intergenerational wellbeing, which cannot be achieved unless humans protect and address the wellbeing of their physical environment and planet. Although climate change is not explicitly mentioned, it is aligned to this new interpretation through the fourth objective of “invigorating the physical environment” under the element of ecology. Within this context, a set of relevant activities to climate action and resilience can be proposed and aligned.

More recently, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) has issued an exposure draft of a new governance standard on the “*Shari’ah Decision-Making (SDM) Process*” (AAOIFI, 2022). Part of this explores explicitly how *Maqasid al-Sharia* considerations can be integrated within that process in an Islamic financial institution. In this context, one question is the role of the sharia board. The Exposure Draft proposes that the primary role of the sharia board should continue to be to give advice on the permissibility of particular options, but that where more than one option is permissible, the sharia board can give advice on which should be seen as preferable.

5. Climate-related Islamic banking practices and activities

In response to these imperatives, commercial, regulatory and moral, what actions are Islamic banks taking? An increasing number of Islamic banks in the MENA region are starting to integrate sustainability and ESG into their operational framework with varying degrees of scope and depth of integration. Climate change awareness and engagement differs from one bank to another. Some Islamic banks, like their conventional counterparts, are adopting global reporting and disclosure practices. They are also adopting internationally relevant frameworks and evaluative approaches, sometimes with modifications to reflect the specificities of Islamic finance. On the other hand, some Islamic banks still seem to see climate concerns as relatively peripheral to their business or struggle to integrate it into their day-to-day business frameworks.

CIBAFI annual survey trends and highlights

One strand of evidence comes from CIBAFI's annual Global Islamic Bankers' Survey (GIBS) over the period 2015-2022. The way and the extent to which the survey has covered issues of sustainability or specifically climate change has varied from year to year, and some care needs to be taken in interpreting the results, especially at regional level, given relatively small sample sizes and uneven national coverage.

As early as 2015, when asked what core Islamic banking values they sought to promote, respondent Islamic banks gave relatively high scores to both sustainable, responsible (ESG) financing or investments, and to environmentally friendly practices, with particularly high scores coming from North Africa. However, more detailed insights came from the 2016 GIBS, which dedicated a special section to sustainability. Some of the relevant highlights from the MENA region included:

- Participating banks had a limited exposure to, and understanding of, green and renewable energy sectors.
- Participating banks assigned moderate importance to employee capacity building initiatives to promote responsible business practices in general including those that are relevant to:
 - Integrating social environmental practices into employee performance and compensation.
 - Developing employee competencies for managing the environmental impact of the bank.
 - Training programmes on responsible business practices.

- Banks assigned only low to moderate importance to green business practices including green buildings, energy demand management, environment-related financial risk assessments, and lowering of travel emissions.
- Banks considered the absence of a business case a significant constraint to the adoption of ESG practices. They saw little or no demand for sustainability-linked products and practices and, in their jurisdictions, few social and environmental regulations.

There has clearly been significant change in the external environment since 2016, and subsequent surveys have shown a gradual increase in concern for climate change. For example, climate change risk has been rising through the list of risks about which banks are concerned, though it remains in the bottom quartile of this list. These responses suggest that Islamic banks do not see climate issues as posing substantial risks to their operations, though this is of course different from whether they perceive a moral responsibility themselves to take action on climate issues. Several questions pertaining to this have been asked in different sections of the survey and, in some instances, the responses to open-ended questions have been more illuminating than the closed-ended responses. Overall, they suggest an incomplete understanding of key issues, a strong commitment to action on the part of some banks, often at the urging of their regulators, but a lower commitment elsewhere. For many banks, climate action, like other areas of sustainability, appears to lie outside the business mainstream. It is often perceived as something to be addressed as part of social responsibility programmes or through charitable donations, rather than as part of core business strategy.

Nevertheless, perceptions have shifted in recent years, assisted by an overall improved understanding of the role that green and climate finance plays within markets, especially capital markets, and awareness of climate-related projects as business opportunities. Stakeholders show some awareness of the need to mainstream the management of climate-related risks and emerging market opportunities, such as the need to change credit appraisals, assess project and investment performance, and reduce energy use. But there was no evidence of systemic or coherent adopted approaches to do so, such as identifying and accounting for climate related financial risks, 'science-based' transition plans, or tracking of emissions of financed projects and investments.

This broadly accords with some observations from interviews with Islamic banks. Interviewed banks acknowledged the importance of preparing for future risks, including climate change impacts, but lack the knowledge and skills necessary to assess and prioritise climate risk and to independently scan markets for climate-related opportu-

nities. These banks asserted that their desire to adhere to international frameworks for carbon reduction and responsible investments would lead them to recognise a connection between sharia compliance and these frameworks, since the ethical basis is similar. However, banks have had difficulty identifying tools that would help them develop their climate strategies, such as spatial information tools and relevant climate and asset data, as well as climate taxonomies. Some of these problems are likely to be common to conventional banks in the same jurisdictions. In the GCC (as in Malaysia), the adoption of different climate-related practices has been fuelled by government regulations, policies, and a business interest to expand into new business niches and green investment opportunities especially, in the GCC case, clean energy.

In this context, however, it should be remembered that most—though not all—Islamic banks are relatively small. They often lack the capabilities of major international banks and tend to be responsive to regulatory pressures and requirements rather than proactive. However, there are some larger Islamic banks which have adopted more active strategies.

Select case study and interview observations on climate mainstreaming practices

This section presents observations on how three of the larger Islamic banks, two from the MENA region and one, as a comparison, from Malaysia, have brought climate concerns into the mainstream of their businesses. It is based on primary evidence from the banks themselves.

Dubai Islamic Bank's sustainable finance practices

Dubai Islamic Bank (DIB) has a major advisory business in the *sukuk* market and, since 2018, has been increasingly active in the issuance of ESG *sukuk*, having supported nearly USD 6 billion of green Islamic capital market transactions.

DIB is the first Islamic bank in the United Arab Emirates to publish a Sustainable Finance Framework to facilitate the financing of green and social initiatives and projects in 2022.

In 2021, the bank released its initial annual sustainability report and ESG framework report. The ESG framework comprises five pillars: ethics and integrity, positive community impact, a thriving work environment, environmental stewardship, and sustainable finance and investment.

Within the context of its Sustainable Finance and ESG frameworks, climate relevant practices include:

- Financing environmentally beneficial projects, such as renewable energy, energy efficiency, clean transportation, green buildings, pollution prevention and control, and sustainable water and wastewater management.
- Adopting a list of green projects which it may finance with the proceeds from green *sukuk* issuances. Selection criteria include emissions reduction.
- Providing financing at reduced rates for hybrid and electric vehicles.

- Implementing a plan to increase energy efficiency, recycle, construct green buildings, and reduce fuel consumption as part of its environmental stewardship initiative. In addition, it monitors Scope 1 and 2 carbon emissions.
- Implementing Scope 3 accounting. To achieve this, the bank is measuring the carbon emissions of its portfolio companies (scopes 1 and 2) and will develop a screening criterion to identify carbon-intensive industries in which it invests or operates.
- Developing a framework for ESG risk exposure and tolerance, as well as an ESG scorecard for evaluation.

Qatar Islamic Bank's Sustainability Policy

Qatar Islamic Bank (QIB) set out its Sustainability Policy in 2022, noting explicitly the convergence between the elements of sustainability and the principles of Islamic banking. Commitments relevant to climate included:

- Offering sharia compliant sustainable finance products and services to QIB customers;
- Supporting the bank's clients' transition to a low carbon economy;
- Reducing the bank's own carbon emissions as well as its energy and resource consumption.

Greenhouse gas emissions are one of several ESG-related factors that play a part in determining financing decisions. The bank estimated its portfolio of renewable energy projects in 2021 as USD 460 million and its portfolio of green buildings finance as USD 1.1 billion. It has also reviewed all its financings over a certain size to determine their suitability for financing through a green *sukuk*.

At retail level, QIB has announced a car financing scheme including incentives to buy electric cars.

In governance terms, QIB has established a Sustainability Committee headed by the Group Chief Executive, while the Board's Audit and Risk Committee is tasked with integrating ESG risks within the Board's risk appetite and risk management frameworks.

CIMB Islamic Bank Berhad Malaysia Climate Practices

CIMB Islamic Bank Berhad and its conventional counterpart CIMB Bank Berhad are part of the CIMB Group that covers Malaysia and the Association of Southeast Asian Nations (ASEAN) region. CIMB Group and its two affiliate banks operate through a sustainability roadmap integrated into the Forward23+ Strategic Plan launched in the second half of 2020. The main pillars of the roadmap (2021) are dictated by ESG considerations and the Malaysia value-based intermediation framework. The sustainability roadmap and pillars have been locally adapted to the SDGs through a materiality assessment, which identified climate action as a key SDG.

Table 3: CIMB Group & CIMB Islamic Climate Mainstreaming Efforts

Climate governance and strategy
<p>The bank adheres to the overall group level climate ambition:</p> <ul style="list-style-type: none">■ CIMB Group is a founding signatory of the Principles for Responsible Banking (PRB)■ As a member of the Net-Zero Banking Alliance, CIMB is committed to achieving net-zero Scope 1 and 2 emissions by 2030 and net-zero emissions overall by 2050—including Scope 3 financed emissions.■ The group has achieved a 24% reduction in carbon emissions (Scope 1 & 2) from a 2019 baseline, while the group aims for a 25% reduction in 2024 as part of its commitments for 2030.■ It has also pledged to implement a “zero deforestation” policy by mid-2022.■ First banking group in ASEAN to commit to phasing out coal by 2040.■ The Group intends to allocate MYR 30 billion in sustainable financing by 2024, in accordance with the green, social, and sustainable impact products and services framework of the banks. <p>In terms of governance, CIMB Group has established a board subcommittee, the ‘Sustainability and Governance’ Committee, to strengthen board oversight of the two banks and the establishment of a group sustainability division.</p> <p>The board’s risk subcommittee coordinates with the Sustainability and Governance committee regarding climate risk oversight.</p>
Climate risk management and operational integration
<ul style="list-style-type: none">■ In 2020, the group integrated climate physical and transition risk into the risk directory of the group.■ Regarding climate risk integration, the group adhered to a risk framework aligned with TCFD. Using the Paris Agreement Capital Transition Assessment for banks, the Group conducted its first pilot transition risk scenario analysis in 2021.■ The Group analysed Scope 3-financed emissions across non-balance sheet financing patterns, including wholesale, commercial, and consumer segments.■ The Partnership for Carbon Accounting Financials methodology was used to estimate the financed emissions of a subset of clients.■ Nine carbon-intensive industries, including agriculture, aluminium, cement, coal, commercial and residential real estate, iron and steel, oil and gas, power generation, and transportation, were chosen for analysis.■ Developed the Green, Social, Sustainable Impact Products and Services Framework, including financing for climate risk mitigation and adaptation.■ Piloted the Bank Negara Malaysia Climate Change and Principle based Taxonomy on selected financing facilities within the construction sector.■ Incorporated climate risk considerations as part of client and transaction-level Sustainability Due Diligence.

Climate related finance and products offered by the bank

For wholesale, retail and consumer:

- Eco-saving (paperless) Islamic accounts.
- Preferential rates for green buildings for customers purchasing houses.
- Preferential rates for new hybrid cars.
- Access for clients to invest in a sharia and ESG principles-based fund.

For businesses:

- The structuring and pricing of the Government of Indonesia's USD 3 billion global *sukuk* offering with a green *sukuk* tranche, and the Government of Malaysia's USD 1.3 billion *wakala sukuk*, which included a USD 800 million sustainability tranche.
- Mobilizing MYR 25.9 billion of sustainable finance under the Green, Social, Sustainable Impact Products and Services Framework in 2021 and increased Assets Under Management in ESG funds.

Climate performance and disclosures

- Committed to fully align to TCFD recommendations by 2023 report. Currently some TCFD-related disclosures are integrated in sustainability reporting.

6. Introducing a mainstreaming approach

Incorporating climate considerations into bank operations, as some Islamic banks have already done, increases Islamic banks' capacity to face climate-related financial risks and uncertainty. Concurrently, this can facilitate the transition to carbon-neutral and climate-resilient markets and economies. The proposed approach is intended to provide preliminary guidance, and support to interested Islamic banks in their progressive mainstreaming efforts related to climate change.

The guidance that follows is organised around five pillars or entry points, each comprising a set of implementation-facilitating steps. This guidance aims to:

- Introduce the process of incorporating climate change considerations to Islamic banks and financial institutions.
- Encourage alignment and harmonisation with national, regional, and international frameworks, principles, and practices.
- Establish a foundation for Islamic banks to become climate leaders, pursuing climate-related market opportunities and providing climate finance credit and services.



Figure 7: The five pillars

It is important to note the following regarding the proposed approach and pillars:

- These pillars cut across a bank's multifaceted operations. **Each pillar can be considered an entry point** for starting the mainstreaming process independently.
- The **proposed pillars can be implemented independently**, in different orders or through periodic phases depending on the resources and needs of the individuals responsible for designing and implementing them.
- **This proposed approach is intended to be preliminary and is by no means the only way to mainstream climate change**, nor are the suggested interventions under each pillar the only or the most comprehensive blueprint for the banks that are consider-

ing a mainstreaming process. In particular, a framework was set out by UNEP FI in a 2023 report for assessing progress on decarbonisation. That four-pillar structure in fact maps well at high level to the first four pillars of UNEP FI's 2023 report, though it naturally does not cover the specificities of Islamic banks, notably sharia governance.

- The pillars form a system; however, **a bank can always start working on establishing the most relevant pillars and the others will be tackled as the bank makes progress.** For example, a bank could always work on partnerships and collaboration for better understanding of climate change matters, before adopting a top-down approach.
- **The nature and depth of suggested climate actions and interventions under each of the five pillars (see Figure 8) will vary** depending on the bank's volume of transactions, diversity of asset portfolio, risk appetite, level of climate exposure, scope of operations, diversity of services offered, and institutional readiness. It also depends on the bank's capacity to mobilise resources, its willingness to commit, and its desire to capitalise on the economic and commercial opportunities presented by climate adaptation and mitigation efforts.
- Further, **the proposed actions in this note are not exhaustive or final.** Assessing the international landscape of climate-related standards, norms, guidance, and approaches is to be encouraged to modify, enhance, or supplement the proposed strategy.

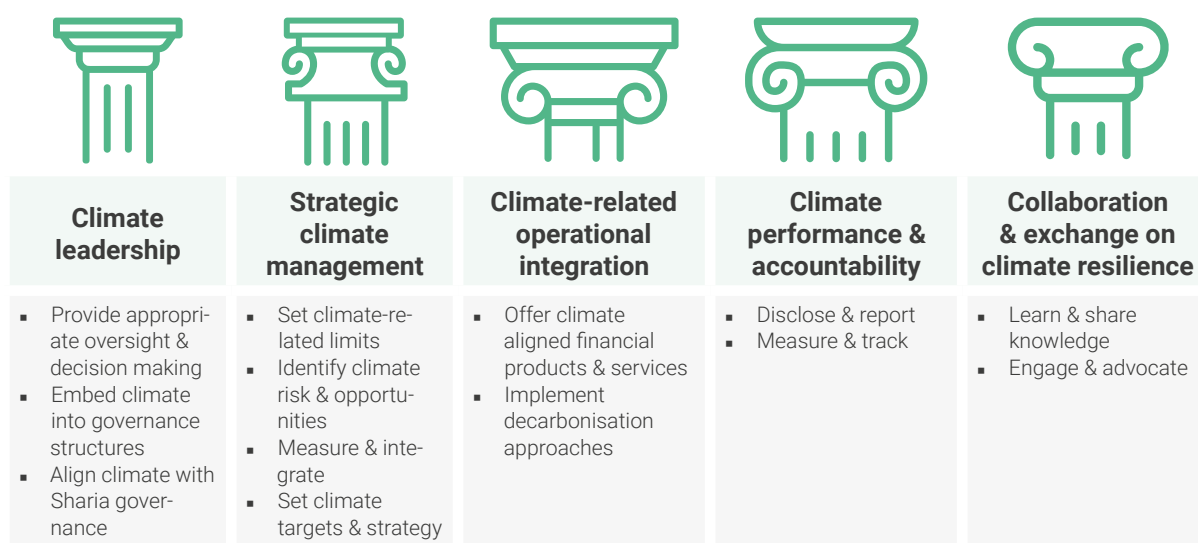


Figure 8: Proposed five pillars and respective climate interventions

Foundations for successful implementation

The effectiveness of the process of mainstreaming depends on the following factors:

- **Sharia alignment:** All proposed mainstreaming activities are intended to be implemented in accordance with the sharia principles of Islamic finance, thereby promoting the need to achieve shared value between economic growth, the environment, and society.
- **Complementarity and benchmarking:** Suggested pillars intend to promote the use of various existing international tools, guidance and measurement approaches, impact and performance matrices, and disclosures.
- **Assessing readiness:** A baseline assessment should be carried out to determine institutional, knowledge, capacity, and action on climate-related practices, as well as an assessment of potential entry points for introducing or expanding climate action.
- **Voluntary action:** The implementation of these suggested pillars is voluntary and should serve as an introduction to developing a climate strategy and be complemented by other guidance reports and frameworks.

Pillar one: Climate leadership responsibilities for boards and senior management

Boards and senior management need to have a leadership role in setting climate-related strategy planning, oversight, accountability, and setting related risk appetite to ensure the sound and effective operations of their bank. Here are suggested interventions that can take place under pillar one:

Boards of Islamic banks are increasingly challenged by the disruptive nature of climate change, which can have a negative impact on the profitability, sustainability, and growth of their organisations and cuts across the financial risks that banks currently assess. This carries with it a variety of credit, market, liquidity, underwriting, operational, but also litigation and reputational risks. To this end, they are expected to acknowledge and address climate change as a risk to investors, regulators, and other stakeholders, as well as partners and clients. In addition, they need to anticipate new business opportunities resulting from the transition to a net-zero economy. Board Members are expected to:

Provide appropriate oversight and decision-making	Embed climate into governance structures	Align climate with Sharia Governance
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<p>Provide appropriate oversight and decision-making</p>	<ul style="list-style-type: none"> ▪ Have knowledge and good understanding about climate change risks and opportunities business and financial implications on the overall bank's growth strategy, operation, and market positioning. ▪ Build the climate knowledge of its members through the receipt of adequate and up to date capacity building and director specific trainings to facilitate the boards responsibility of climate oversight and governance. ▪ Assume long-term climate oversight and responsibility including the approval of the bank's climate targets, strategy, the banks issuance of sustainable finance framework and relevant climate and green finance instruments. ▪ Review and assess identified and measured relevant climate related risk exposures and opportunities. ▪ If perceived climate related financial risk is significant, approve and endorse the integration of climate risk within the banks' risk appetite statement and financial risk framework. ▪ Consider enlisting the support of relevant climate experts to initiate a climate mainstreaming process within the bank. ▪ Periodically review and track progress and performance of climate targets, strategy, and related interventions. ▪ Review and approve annual climate-related disclosure and reporting.
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<p>Embed climate into governance structures</p>	<ul style="list-style-type: none"> ▪ Embed climate within board level governance structures such as committees, subcommittees and among relevant workstreams. An example would be risk, audit, sharia and/or ESG committees. ▪ Ensure that the responsibilities of, and relationships between, committees with climate-related responsibilities are clear. ▪ Clearly define and explicitly assign roles and responsibilities associated with identifying and managing climate-related financial risks throughout the bank’s organisational structure and ensure relevant functions and business units have adequate resources and expertise to effectively fulfil responsibilities regarding climate-related financial risk management. Where dedicated climate units are set up, their responsibilities and interaction with existing governance structures should be clearly defined. ▪ Ensure that all functions, departments, and teams involved in the implementation of the climate strategy possess the necessary managerial technical skills, training, and knowledge. ▪ Ensure the provision of appropriate capacity building and training to members of climate-relevant committees or boards.
<p>Align climate with Sharia Governance</p>	<p>While the sharia board has an advisory role, banks should consider the following:</p> <ul style="list-style-type: none"> ▪ Seek a sharia board level recognition of the connection between climate action and sharia values to demonstrate commitment to climate action and show leadership in the industry. This will help to reinforce the bank’s dedication to climate resilience and signal to the sector that it takes its climate-related responsibilities seriously. ▪ Provide climate-related training and information to sharia board or committee members to improve their understanding of climate change and the associated risks for banks. ▪ Consider adding climate considerations as an optional provision within the sharia committee’s scope of work. In particular, where more than one course of action is permissible in sharia terms, the board may be asked to advise on which best serves the objectives of sharia. ▪ Ensure periodic coordination and alignment between the sharia board and newly established governance structures within the bank that are relevant to climate action. ▪ Align potential climate-related Islamic financial products and financing with sharia board/committee recommendations as needed.

Pillar two: Strategic climate management

The board and senior management have complementary roles in climate mainstreaming, with the board providing oversight and guidance, and senior management responsible for implementation. Effective collaboration between the two is essential to ensure the success of the organization's efforts to address climate change. Senior management is expected to ensure that the following are adopted and implemented by risk management functions within the bank and integrated across business functions:

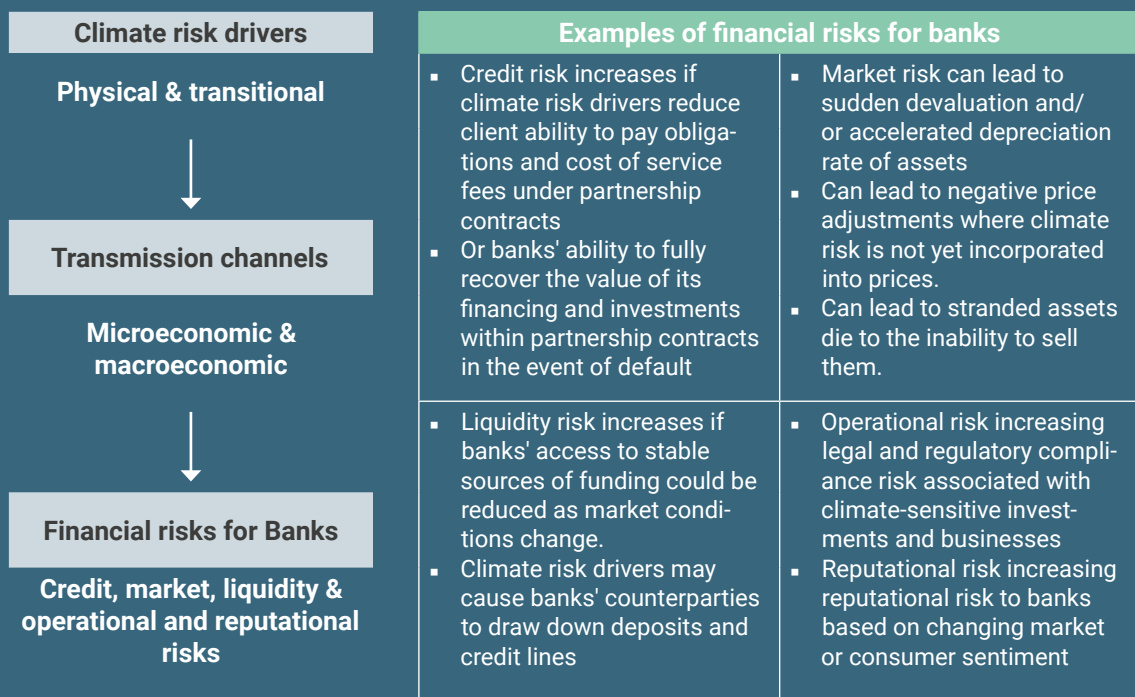
Identify climate risks and opportunities	Measure and integrate	Set climate targets and strategy	Set climate-related limits
Identify climate risks and opportunities	<ul style="list-style-type: none"> ▪ Adopt a baseline understanding and categorization of climate drivers that cause financial risks. This could be the TCFD framework or other framework that is being developed or endorsed by regulators of markets that the bank operates in. ▪ Compile a list of the identified possible risks and opportunity drivers. ▪ Identify transmission channels that convert climate risk and opportunity drivers into climate-related economic and financial risks and opportunities that can be measured and quantified. ▪ Categorise and prioritise identified climate-related financial risks according to their materiality and impact on the bank's risk exposure. Consider how physical and transitional climate-related risks translate into standard risk categories: credit risk, market risk, liquidity risk, operational risk, etc. ▪ The extent of the bank's material exposure resulting from these identified priority risks and opportunities should be measured and, if possible, translated into a financial risk. ▪ Depending on the methodologies used and the availability of the required set of skills and resources, the analysis can be qualitative or quantitative. The use of a quantitative approach is recommended by the TCFD yields to be able to incorporate into the financial institution's standard financial risk assessments. However, a qualitative assessment will also provide useful information around risk magnitude where data is missing, of poor quality, or difficult to obtain. 		
Measure and integrate	<ul style="list-style-type: none"> ▪ Ideally, a quantitative approach as adopted and practised by all international frameworks and practices should integrate climate scenario analysis, incorporating relevant data to customise these scenarios and the use of multiple scenarios to account for the impact of different time horizons and variations of inputs. Measurement approaches and scenario analysis also differ when measuring transitional and physical risk. ▪ Increasing reliance on climate scenario analysis has led to the creation of a range of climate models and climate scenarios offered by different providers, including different calculation approaches. One source of scenarios particularly relevant to the financial sector is the Network for Greening the Financial System (NGFS). ▪ Alongside risk assessment, carbon emissions should be measured, both in terms of carbon intensity and absolute emissions. ▪ Climate-related financial risk should be integrated into the overall financial risk framework of the bank and reassessed and updated periodically. 		

	<ul style="list-style-type: none"> ▪ It should also be reflected and incorporated in the overall strategy of the bank, in strategic planning, and in budgeting. ▪ Depending on the bank's transition risk exposure, the bank may decide to manage those risks by developing a decarbonisation strategy, see next section. Climate-related physical risks would require an adaptation strategy covering the bank's operations and engaging with clients that are potentially more highly exposed to climate impacts.
<p>Set climate targets and strategy</p>	<ul style="list-style-type: none"> ▪ Based on understanding the bank's risk exposure related to climate impact performance, the bank's relevant management are encouraged to set climate targets and anchor these using climate transition strategies. ▪ It is also advised to align used methods and approaches to determine the climate targets to internationally practiced and tested approaches such as UNEP FI Guidance on Climate Target Setting for Banks, Science-based Targets Initiative SBTi or its first science-based global standard for corporate net-zero targets and the measurement approaches of Scope 3 guided by The Principles for Carbon Accounting Financials. ▪ Set intermediate reduction targets with specific short- to medium-term time intervals to act as progress indicators towards achieving the long-term target. ▪ Determine the value of these targets based on measured material climate risks, the current carbon measures of absolute emissions and intensity, and the bank's operational and resource ability to adopt a decarbonization pathway and approach. ▪ Setting targets could be in the form of a percentage reduction in the overall absolute emissions of the bank or a value of absolute emissions covering all three scopes. Targets should be time-bound, including a base year and target year, and specify their scope (sectors, geography). ▪ Develop a climate strategy that includes the process undertaken by the bank to identify, prioritise and monetise climate risk and opportunities, over short-, medium-, and long-term. ▪ Examples of what can be included in the strategy: <ul style="list-style-type: none"> ▪ Relevant set climate targets and goals, plans of interventions to achieve these set targets, existing climate governance structures and explanation of the transition plan to lead to these targets. ▪ The bank's climate risk appetite and the type, magnitude, and time horizon of climate-related material exposures. ▪ The bank's climate risk and opportunity framework, and the results of the climate-related financial risk assessments including material financial climate risk exposures. ▪ Potential impact of the risks and the prioritised opportunities associated with these exposures.
<p>Set climate-related limits</p>	<ul style="list-style-type: none"> ▪ Islamic banks may begin to incorporate climate considerations into their policies, particularly by imposing restrictions or bans on certain sectors such as coal mining or certain types of deforestation as an immediate form of climate risk mitigation. Such decisions will normally be taken by the Board, but on the advice of senior management. ▪ Islamic banks already adhere to sharia principles that necessitate the maintenance of an exclusionary list. To further strengthen their commitment to climate action, banks should consider creating a climate-related exclusionary list, which would help to ensure that their investments and financing do not contribute to activities that further exacerbate climate change.

Box 8: Transmission Channels as Proposed by the BCBS

In *Climate-related risk drivers and their transmission channels*, the Basel Committee on Banking Supervision (BCBS, 2021) presents a conceptual framework on how climate-related risk drivers can be translated into financial risks for banks through microeconomic and macroeconomic channels. In addition to defining the transmission channels, there are sources of variation that will differentiate climate-related financial risk severity and impact for different banks and financial institutions. Transmission channels could be:

- The microeconomic channel linked to the operation of the bank and to the financial services it offers, the cost of financing, the issuance of asset-backed financial instruments, client eligibility and reliability, and the value and return on assets and investments.









- The macroeconomic channel associated with economic and market patterns and trends influenced by the transition to a low-carbon economy (for example, economic growth, inflation rate, fiscal and monetary policies, labour, and unemployment rates, and so on).

Box 9: Principles of Responsible Banking and related climate target setting

On 22 September 2019, the Principles for Responsible Banking (PRB) was launched at the United Nations Headquarters in New York City, during the UN General Assembly.

The principles encourage alignment to the SDGs agenda and the Climate Paris Agreement. They cover a range of themes such as working responsibly with stakeholders and customers, impact and target setting, governance and transparency and accountability. They target all types of banks including Islamic banking. The framework consists of 6 Principles designed to bring purpose, vision and ambition to sustainable finance and are meant to address the strategic, transactional and portfolio levels within banks (UNEP FI, 2019).

 <p>Principle 1: Alignment</p> <p>We will align our business strategy to individuals' needs and society's goals, as expressed in the SDGs, the Paris Agreement and relevant national and regional frameworks.</p>	 <p>Principle 2: Impact & Target Setting</p> <p>We will continuously increase our positive impacts while reducing the negative impacts on, and managing the risks to, people and environment resulting from our activities, products and services. To this end, we will set and publish targets where we can have the most significant impacts.</p>	 <p>Principle 3: Clients & Customers</p> <p>We will work responsibly with our clients and our customers to encourage sustainable practices and enable economic activities that create shared prosperity for current and future generations.</p>
 <p>Principle 4: Stakeholders</p> <p>We will proactively and responsibly consult, engage and partner with relevant stakeholders to achieve society's goals.</p>	 <p>Principle 5: Governance & Culture</p> <p>We will implement our commitment to these Principle through effective governance and a culture of responsible banking.</p>	 <p>Principle 6: Transparency & Accountability</p> <p>We will periodically review our individual and collective implementation of these Principles and be transparent about and accountable for our positive and negative impacts and our contribution to society's goals.</p>

To facilitate adherence to these principles, UNEP FI issued specific guidance on climate target setting (UNEP FI, 2021), which can also be adopted by Islamic Banks without conflicting with basic sharia rules (figure 11).

01	Banks shall set and publicly disclose long-term and intermediate targets to support meeting the temperature goals of the Paris Agreement.
02	Banks shall establish an emissions baseline and annually measure and report the emissions profile of their lending portfolios and investment activities.
03	Banks shall use widely accepted science-based decarbonisation scenarios to set both long-term and intermediate targets that are aligned with the temperature goals of the Paris Agreement.
04	Banks shall regularly review targets to ensure consistency with current climate science

Figure 11: UNEP FI Climate Target Setting (2021)

Pillar three: Climate related operational integration

The third pillar focuses on the implementation process of the bank's climate strategy including set targets and interventions across banking operations, including function- or department-specific policies and strategies. Banks should:

Implement decarbonisation approaches

Offer climate aligned financial products and services

Implement decarbonisation approaches

- Determine the scope and level of granularity needed to develop decarbonization approaches to implement developed carbon strategy. This can include the selection of specific functions, financial products, or market sectors. It can also include ongoing projects, active contracts with clients or prospective clients, or future pipelines of projects.
- Examples of decarbonization approaches could be:
 - Gradual disinvestment from carbon-intensive sectors and industries.
 - Creating an exclusionary list for carbon-intensive sectors.
 - Allocating finance for green and climate projects.
 - Utilizing green and sustainable *sukuk* or other instruments.
 - Setting a baseline percentage to own, manage, or invest in climate opportunities.
 - Providing preferential pricing for services related to climate opportunities.
- Align climate activities with existing ESG or sustainability frameworks or related tools that are already embedded and in use.
- Launch efforts to measure carbon emissions required by Scope 3 of the GHG accounting protocol for enhanced due diligence on carbon impact measurement and tracking efforts.
- Develop a sustainable finance framework to guide the issuance and utilisation of green and climate-friendly instruments.
- Ensure that ESG criteria used for assessments are also climate-aligned, if relevant.
- Consider possible institutional level activities targeting internal operations to reduce Scope 1 and 2 emissions.

Offer climate aligned financial products and services

- Review existing financial products offered by the bank to identify among them any relevant or potential products that can be attuned to become climate aligned.
- Ensure teams responsible for product and service design are provided with appropriate training to equip them with the necessary skills to propose and design green products.
- Conduct market research studies to scout for climate-relevant opportunities that can benefit the retail, commercial, and corporate sectors of the bank.
- Conduct customer behaviour research to understand the green and climate-focused behaviours and interests of clients to inform the selection of prospective green and climate-aligned financial products.
- Capitalise on identified opportunities and select promising sectors for green investments by developing a climate-specific business development plan.
- Develop green and climate related financial products such as green home financing, green deposit accounts, etc.
- Consider issuing green *sukuk*, green funds, and other forms of green financial instruments to finance appropriate parts of the bank's activity.
- Where the bank has an advisory function, encourage clients to consider accessing international climate and green finance opportunities through the issuance of green instruments.

Pillar four: Climate performance and accountability

This pillar is focused on establishing monitoring and evaluation (M&E) and impact assessment frameworks, and exhibiting accountability through disclosure and reporting. The implementation of this pillar requires the inclusion of benchmarks, metrics and indicators that measure the bank's performance on climate management and progress towards climate targets. Banks should aim to:

Measure & track

Disclose & report

Similar to the previous pillar, there is no one universal approach to performance and impact evaluation, but a range of approaches and methodologies that can be utilised and adapted according to available expertise, resources, and scope of implementation.

Measure & track	
	<ul style="list-style-type: none"> ■ Develop an M&E framework to answer the following important questions: <ul style="list-style-type: none"> ■ What results—outcomes and impact—have been achieved? ■ What worked well and did not work well, and why? ■ What lessons can be identified from implementation? ■ What is the periodic interval for M&E assessments? ■ Define the objectives that need to be delivered by the M&E framework. Possible objectives include: <ul style="list-style-type: none"> ■ Assessing climate performance and impact. ■ Trace the path and amount of climate-aligned finance. ■ Review and monitor identified and evaluated climate-related financial risks. ■ Progress towards climate-related targets.
	<ul style="list-style-type: none"> ■ Adopt internationally recognised climate-related definitions & concepts to simplify M&E activation, international reporting, and knowledge sharing. ■ Choose climate impact assessment tools. Quantitative and qualitative tools and metrics have been developed internationally for this. TCFD metrics and indicators, carbon tracking principles, ESG metrics, and carbon indicators can track climate performance. ■ Report results to the board of directors to track progress through internal reporting channels as per put in place climate related governance structures or through the creation and usage a board-level climate dashboard.

Disclose & report

- Select a disclosure and reporting framework in alignment with country-level regulations and climate policies. A common baseline is the TCFD reporting and disclosure framework, though there may be jurisdictional reporting requirements depending on the location of a bank's business.
- As a baseline for disclosure and reporting, consider focusing on:
 - Annual M&E outputs including progress on climate strategy, targets, carbon emissions, climate governance activities, climate-related risk drivers, categories, levels of exposure, and related financial risks.
 - Metrics and methodologies for emissions and risk measurement.
 - Assumptions and parameters used for scenario analysis, if relevant.
 - Transparency on data sources, data quality, scenarios, and assessment methodologies, including limitations and assumptions.
- Ensure that the disclosure framework and reporting process are integrated into the bank's overall M&E framework.
- Similarly, ensure alignment with existing relevant ESG and/or sustainability disclosure or reporting obligations that the bank already adheres to.
- Put in place the necessary procedures and informational and communication channels to facilitate data collection.
- Consider, if it is not already a legal requirement, enlisting the service of third-party assurance for an additional level of verifiability.

Pillar five: Collaboration and exchange

The last pillar deals with the importance of developing partnerships, engagement plans, and joining international platforms to promote knowledge sharing, learning from new experiences, building on existing efforts, and leading by example. Implementing this pillar can happen through:

Engage & advocate

Learn & share knowledge

To support partnerships and policy, banks should:

Engage & advocate

- Identify and map potential and material stakeholders that the bank needs to engage with to facilitate the implementation of its climate strategy. These include:
 - Public sector policymakers and regulators
 - Sharia scholars and experts when relevant
 - Individual and corporate clients, particularly those identified in climate-related risk and opportunity assessments
 - Shareholders and investors
 - Civil Society
 - Market & industry peers
- Consider the creation of a stakeholder engagement action plan specifically tailored to identified priority stakeholders, especially clients that can facilitate and add value to the banks' climate management and targets.
- Activate the stakeholder engagement action plan by:
 - Organising dialogue with regulators for enhanced climate regulatory clarity.
 - Advocating with decision makers on climate related regulations and coherent climate transition policies.
 - Discussing and learning about the climate policy of countries that the bank operates in, including Nationally Determined Contributions (NDCs) and National Adaptation Plans (NAPs).
 - Increasing industry awareness on the existing synergies between sharia and climate resilience.
 - Educating market peers and stakeholders on the bank's climate action efforts and offer climate-related financial products and services.
 - Educating and providing capacity building and technical advisory support for clients on climate resilience and how their institutions can mainstream climate-related considerations within their respective operational frameworks. This may be directly related to the significance of tracking financed emissions.
- Engaging with clients and customers to promote and highlight climate-related market opportunities and how they can use the bank's financial services for climate-related projects.
- Also, engaging with clients and customers on how to identify, assess and manage climate risks as this will have an impact on the bank's own risk profile.

Learn & share knowledge

- Identify and compile a list of potential partner institutions that the bank can benefit from through learning, knowledge sharing, and best practices.
- Join or organise events, or attend events sponsored by Islamic finance support institutions and platforms, such as CIBAFI, AAIOFI, IFSB, and IsDB.
- Join membership-based networks and alliances such as the Net Zero Banking Alliance and UNEP FI Principles for Responsible Banking, among others, that will help the bank adhere to common principles and standards guiding the industry on a global level.
- Attend international conferences, webinars, and roundtables to tap into the latest developments on knowledge, methodologies, and approaches being used for standards, disclosures, reporting evaluations, scenario analysis, and measuring emissions.

7. Removing barriers: recommendations for public authorities

The previous section dealt with the actions that Islamic banks can take to bring climate action into the mainstream of their business. In doing so, however, they will face a number of barriers. Some of these will be internal and for the banks themselves to address. Others will be external and require action by others, mainly regulators and other public authorities. These barriers will also affect the banks' conventional counterparts. In this context, it is important to recall that many Islamic banks are relatively small, with often lower capabilities than internationally active banks. For example, while a large bank might be capable of developing its own scenarios for climate-related stress testing, a smaller bank (whether conventional or Islamic) is likely to be reliant on scenarios developed by others, mainly its own regulators. A large bank may also be able to access data from a range of clients to estimate the carbon emissions impact of an investment in a particular sector, while a smaller bank may have to rely on secondary data from external sources. This section therefore sets out some actions that public authorities can take to create a supportive policy and regulatory environment that encourages the mainstreaming of climate change in financial institutions' strategies and activities.

Of note, while the roles of trade associations may vary across jurisdictions, in some they play an important part in guiding the local industry and may even have a quasi-regulatory role. Where appropriate, these recommendations for public authorities may also apply to trade associations.

Public authorities can:

- **Develop a clear climate policy framework** outlining expectations and requirements to mainstream climate change, manage climate risks, engage in climate mitigation and report on progress.
- **Provide guidance for banks to facilitate alignment to these policies** including the adopting or developing of a green project taxonomy.
- **Require disclosure and reporting** on climate-related risks and strategies for managing these risks.
- **Require climate-related stress testing for banks** at an individual level and at the level of the financial system as a whole and provide banks with locally relevant scenarios to be used as the basis for stress-testing.
- **Develop climate change-aligned investment priorities** and climate-sensitive sectors that can be used by Islamic banks without infringing their sharia compliance.

- **Develop and implement carbon or climate action tracking frameworks** to assess and evaluate the impact of climate or green finance.
- **Develop or adopt local taxonomies and databases** to be used by banks and others in reporting GHG emissions.
- **Provide financial incentives** such as tax breaks or subsidies for Islamic banks to invest in sustainable projects.
- **Provide training for banks** on country level climate policies and strategies to guide their respective setting of climate ambitions.
- **Encourage Islamic banks to align to climate related international frameworks** including carbon measurement, international Islamic finance sector standards, financial risk assessment frameworks, and climate scenario analysis.
- **Include financial institutions, including Islamic banks, in consultation processes when drafting climate policies** to expose their decision makers to the risks and opportunities involved.
- **Facilitate knowledge sharing and collaboration** among Islamic banks and with other stakeholders, including government agencies, non-governmental organizations, and the private sector.

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Annex 1: A brief introduction to Islamic Finance

A brief history

Islamic banking emerged from a rising demand for financial transactions for daily operations consistent with Islamic economic and financial principles. Existing conventional financial banks and institutions did not meet the demands of specific religious Muslim communities in newly independent, growing economies in MENA and Asia. These communities wanted alternative financial institutions that were more in line with their Islamic values and beliefs. Table 4 below depicts key milestones that have contributed to the emergence, and growth of the sector (Hussain et al, 2015):

Table 4: Growth of Islamic finance since 1950s

Time Period	Significance	Milestones
1950s–1960s	First attempts at developing Islamic finance and banking models providing a learning experience and refining an emerging Islamic banking model.	<ul style="list-style-type: none"> 1950s: creation of an Islamic no-interest credit union in rural Pakistan. 1962: Lembaga Tabung Haji, the Malaysian hajj pilgrims’ fund, established to collect Hajj deposits from pilgrims. 1963: the first known Islamic Bank “Mit Ghamr” established in Egypt to conduct trading and economic exchange (<i>Muamalat</i>) aligned to Islamic sharia.
1970s	Triggered by the oil boom in the 1970s, several leading Islamic banks in the Gulf region were established. The growth of the sector was based on increasing market demand and expanding financial transactions	<ul style="list-style-type: none"> 1975: establishment of the Islamic Development Bank in Saudi Arabia and the Dubai Islamic Bank. 1977: Faisal Islamic Bank (Sudan & then Egypt) and Kuwait Finance House established. 1978: Europe’s first Islamic bank established in Luxembourg.
1990s & beyond	Creation of global and regional Islamic finance organizations to provide technical advisory, research, guidelines, and standards and to support the overall interest of the Islamic Finance Industry.	<ul style="list-style-type: none"> 1991: the Accounting and Auditing Organization for Islamic Financial Institutions established in Bahrain. 2001: The General Council for Islamic Banks and Financial Institutions launched by the IsDB and several leading Islamic financial institutions. 2002: the Islamic Financial Services Board established in Malaysia.

Underlying Principles of Islamic Banking

Islamic finance can be defined as the provision of financial services and transactions that conform to Islamic law (sharia) and its underlying principles relating to trade, financial transactions, and business exchange. Sharia has been interpreted over the years by a number of schools of Islamic jurisprudence. On matters relating to finance, while there are large areas of consensus, there are also some differences between, and sometimes within, schools.

The principles of sharia include a number of prohibitions. Some of these relate to specific products or activities (for example, alcohol or pornography). Other important prohibitions include interest (*riba*), gambling or speculation (*mairsir*) and fundamental uncertainty (*gharar*).

Modern Islamic finance has in general been developed around contractual forms known from at least the early Islamic period and around which substantial jurisprudence has been established. These are often referred to by their Arabic names. However, in modern practice these contracts are often surrounded by other arrangements which may materially affect the economic substance of the transaction as a whole.

Table 5: Taxonomy of Islamic banks (adapted from Islamic Bankers Resources Center, 2017)

Islamic banks	Windows	Subsidiaries
<ul style="list-style-type: none"> ▪ Standalone banking institutions. ▪ Independent management and operations. ▪ Owned distribution channels such as branches 	<ul style="list-style-type: none"> ▪ Embedded within a conventional bank ▪ Shared management and operations ▪ Shared distribution channels such as branches 	<ul style="list-style-type: none"> ▪ Owned by a banking group with conventional operations ▪ Operates independently but can share certain managerial, strategic & operational practices & frameworks ▪ Owns distribution channels such as branches and/or utilizes the branches of the conventional bank.

Within Islamic finance, Islamic banking is the largest subsector. An Islamic bank deals with customers and clients through financial transactions, financial products, investments, and trading that comply with the principles of Islamic sharia (Hassan, M. Kabir, et al, 2021). The main types of Islamic banks are:

Islamic banks can, in practice, provide equivalent services to most of those provided by conventional banks, such as current accounts, savings accounts, mortgages, vehicle financing, working capital for businesses, trade finance, and so on. These will generally be based on different principles from those offered by conventional banks, and the favoured structures differ between jurisdictions. However, they are often economically very similar. In particular, although there is a strong theoretical preference for risk-sharing transaction forms, their use in practice is more limited.

One particular characteristic of Islamic banks is the Profit-Sharing Investment Account

(PSIA), in which clients share in the returns from the bank's financings. Although in practice many such accounts are structured so that they can pay a market rate of return not dissimilar to a conventional savings account, it is possible to conceive of a "green" PSIA which is supported only by the bank's "green" financings (though there may be technical and regulatory issues to be addressed).

In some areas, particularly transactions on capital markets, sharia restrictions have greater impact on Islamic banks. In particular, the large majority of sharia scholars do not permit short selling or the trading of debt other than at par, and there are few derivatives or hedging instruments which are considered sharia-compliant.

In addition to Islamic banking, other sectors of Islamic finance include Islamic insurance, commonly based on a principle of mutual support (*takaful*), and the Islamic capital market. This market includes sharia-compliant equities, Islamic collective investment schemes and, importantly in the present context, *sukuk*.

The word "*sukuk*" is an Arabic plural meaning something like "certificates". *Sukuk* are, in practice, the nearest Islamic equivalent to conventional bonds (which are impermissible because they pay interest). Although *sukuk* can in principle have a wide range of risk/return profiles, most are in practice structured to be economically very similar to bonds. *Sukuk* issuances in 2021 were USD 185.4 billion (IFSB 2022). 44% of the issuances were by sovereigns and 14% by multilateral organisations, the large majority of the remainder being from the financial sector.

Banks may play a number of roles in the *sukuk* market. They may be originators, to meet their own capital needs. They may be investors (especially in sovereign *sukuk* for liquidity management purposes). They may also be advisers or managers of issuances (as a conventional bank might be for a bond issuance).

Islamic banks are subject to the supervision of central banks and regulators in the normal way, but are also expected to have some form of sharia governance. This may or may not be a regulatory requirement, depending on the jurisdiction, and arrangements vary. However, as part of their sharia governance, Islamic banks often establish sharia boards or committees that play an important role in verifying the bank's authentic sharia-based practices.

Table 6: Role of a sharia committee (Adapted from AAIOFI Standards on Central Sharia Boards, 2022)

Role of a Sharia committee/board	
Suggest and approve policies and frameworks of Sharia governance and design audit and review processes to ensure the continuous compliance of the bank	Review and approve the terms and conditions of financial & products, and services, as well as the underlying assets and transactions
Ensure Sharia-related regulatory compliance of the bank related to the government and align to standards and practices.	Can issue fatwas (Islamic legal advisory rulings) on specific issues for conflict resolution related to the bank's operations or financial products and services

Sometimes there will also be a sharia board or committee at national level to ensure consistency of interpretation across the industry.

Sharia scholars are qualified to a high level in both sharia and finance and would normally have undergone further professional development before they would be regarded as credible sharia board members of a substantial Islamic bank.

There are three principal standard-setters for Islamic finance.

- The International Islamic Financial Market, based in Bahrain, aims to produce industry standard structures and documentation for various forms of transaction. It has often collaborated with the International Swaps and Derivatives Association.
- The Accounting and Auditing Organization for Islamic Financial Institutions, also based in Bahrain, was set up to develop accounting and auditing standards but, in practice, its greatest influence has been through its sharia standards. These are the leading standards on sharia matters, though they are not universally accepted; for example, scholars in Malaysia tend to take a more liberal view on the permissibility of various transaction types.
- The Islamic Financial Services Board, based in Malaysia, was set up to develop prudential standards for Islamic finance (though the word “prudential” has been stretched over the years). It bases its standards, where appropriate, on those of the corresponding conventional standard-setters. In banking this means mainly the BCBS.

Annex 2: Glossary of terms

This report uses the following definitions for recurring concepts throughout this publication. The endorsed definitions are those coined and/or widely used by international institutions to ensure that this body of work is inclusive, accurate, and aligned.

Sharia	Sharia refers to commandments, prohibitions, guidance, and principles under Islam based on Quran and the traditions and teachings of the Prophet Muhammad. It provides guidance in terms of belief, moral conduct, and practical rulings or laws acting as a system of life (IFSB, 2018).
Maqasid al-Sharia	The fundamental principles of sharia, which aim to promote and protect the interests of all human beings and avert all harm that impairs their interests (IFSB, 2018).
Islamic banks	Where banks operate and comply with Islamic law and sharia in all their facets of operations.
Sukuk	Certificates that represent a proportional undivided ownership right in tangible assets, or a pool of tangible assets and other types of assets. These assets could be in a specific project or specific investment activity that is sharia-compliant (IFSB, 2018).
Green sukuk	A form of Islamic <i>sukuk</i> where the use of proceeds is exclusively used to finance or refinance green and sharia-compliant projects at the same time (World Bank, 2020).
ESG or sustainability-linked sukuk	A form of Islamic <i>sukuk</i> where the use of proceeds is exclusively used to finance or refinance projects with positive social and environmental impacts.
Islamic windows	That part of a conventional financial institution (which may be a branch or a dedicated unit of that institution) that provides both fund management (investment accounts) and financing and investment that are sharia-compliant, with separate funds (IFSB, 2018).
Climate change	A change of climate which is attributed directly or indirectly to human activity that alters the composition of the global atmosphere and which is in addition to natural climate variability observed over comparable time periods (UNFCCC, 2015).

Climate finance	Local, national, or transnational financing—drawn from public, private, and alternative sources of financing— that seeks to support climate resilience through mitigation and adaptation actions that will address climate change (IPCCC, 2022)
Climate resilience	The ability and capacity of social, economic, and ecosystems to cope with a hazardous event or trend or disturbance due to the impact of climate change (IPCCC, 2022).
Climate mainstreaming	Climate mainstreaming is the systematic integration of climate considerations throughout a financial institution’s strategies and operations (I4CE, 2016).
Climate-related risk	The potential negative impacts of climate change on an organization. Physical risks from climate change to properties, assets, projects, land etc. Climate-related risks are also associated with the transition to a lower-carbon global economy, the most common of which relate to policy and legal actions, technology changes, market responses, and reputational considerations (TCFD, 2021).
Climate opportunities	Identified opportunities and positive impacts that can contribute to economic and business growth of an organization while also contributing to the overall climate resilience of the economy. Opportunities can range from resource efficiency and cost savings, the adoption and utilization of low-emission energy sources, the development of new products, markets, and services. Climate-related opportunities vary depending on the positioning, resources of an organization, and where it operates (TCFD, 2021).
Nationally determined contribution (NDCs)	A term used under the United Nations Framework Convention on Climate Change (UNFCCC) whereby a country that has joined the Paris Agreement outlines its plans for reducing its emissions (UNFCCC, 2015).
Climate scenario	A plausible description of how the future may develop based on a coherent and internally consistent set of assumptions about key driving forces (e.g., rate of technological change, prices) and relationships (TCFD, 2017).
Greenhouse gas (GHG) emissions scope levels	<ul style="list-style-type: none"> ▪ Scope 1 refers to all direct GHG emissions. ▪ Scope 2 refers to indirect GHG emissions from consumption of purchased electricity, heat, or steam. ▪ Scope 3 refers to other indirect emissions not covered in Scope 2 that occur in the value chain of the reporting company, including both upstream and downstream emissions (WRI & WBCSD, 2004).

Paris Agreement

The Paris Agreement is under the United Nations Framework Convention on Climate Change (UNFCCC) and was adopted in 2015, entered into force on 4 November 2016, and as of May 2018 had 195 Signatories and was ratified by 177 Parties. Article 2.1 of the Agreement has three main aims:

Holding the increase in the global average temperature to well below 2°C above pre-industrial levels and pursuing efforts to limit the temperature increase to 1.5°C above pre-industrial levels, recognizing that this would significantly reduce the risks and impacts of climate change;

Increasing the ability to adapt to the adverse impacts of climate change and foster climate resilience and low greenhouse gas emissions development, in a manner that does not threaten food production; and

Making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development.

Task Force on Climate-Related Financial Disclosures (TCFD)

Body created by the Financial Stability Board (an international organisation that monitors and makes recommendations about the global financial system) to develop consistent climate-related financial risk disclosures for use by companies, banks, and investors in providing information to stakeholders (TCFD, 2017).

Annex 3: Useful links across the five pillars

Pillar one: Climate leadership responsibilities for boards and senior management

For detailed guidance on climate board level governance please refer to:

- [World Economic Forum \(WEF\): Climate Governance on Corporate Boards Guiding principles \(2019\)](#)
- [TCFD: Climate Governance: Recommended disclosures \(2017\)](#)
- [UNEP FI & GARP: Climate Dashboards: Steering the Ship: Creating Board-Level Climate Dashboards for Banks \(2022\)](#)
- [BCBS: Principles for the effective management and supervision of climate-related financial risks \(2022\)](#)

Pillar two: Strategic climate management

For more details on climate risk frameworks, climate scenario analysis and measurement methodologies please refer to:

TCFD Climate Risk Framework

- [TCFD: Recommendations of the Task Force on Climate-related Financial Disclosures \(2016\)](#)
- [TCFD: Implementing the Recommendations of the Task Force on Climate-related Financial Disclosures \(2021\)](#)
- [TCFD: Guidance on Risk Management Integration and Disclosure \(2020\)](#)
- [TCFD: The Use of Scenario Analysis in Disclosure of Climate-Related Risks and Opportunities \(2016\)](#)

Basel Committee on Banking Supervision on risk drivers, transmission channels and measurement approaches

- [BCBS: Climate-related financial risks—measurement methodologies \(2021\)](#)
- [BCBS: Climate-related risk drivers and their transmission channels \(2021\)](#)
- [BCBS: Frequently asked questions on climate-related financial risks \(2022\)](#)
- [BCBS: Principles for the effective management and supervision of climate-related financial risks \(2022\)](#)

UNEP FI and Partners related tools and guidance

- [UNEP FI: Navigating a new climate: assessing credit risk and opportunity in a changing climate \(2018\)](#)
- [UNEP FI, Oliver Wyman & Mercer: Extending our horizons: assessing credit risk and opportunity in a changing climate \(2018\)](#)
- [UNEP FI: From Disclosure to Action: Applying TCFD principles throughout financial institutions \(2020\)](#)
- [UNEP FI: Beyond the Horizon: New Tools and Frameworks for Transition Risk Assessments from UNEP FI's TCFD Banking Programme \(2020\)](#)
- [UNEP FI: The 2023 Climate Risk Landscape: Mapping Climate-related Financial Risk Assessment Methodologies \(2023\)](#)
- [UNEP FI, EY & IIF: TCFD Play Book \(2020\)](#)

Glasgow Financial Alliance for Net Zero (GFANZ)

- [GFANZ: Measuring Portfolio Alignment \(2022\)](#)

GHG Protocol & The Partnership for Carbon Accounting Financials (PCAF)

- [WRI & WBCSD: Global GHG Accounting and Reporting Standard for the Financial Industry \(2023\)](#)
- [PCAF: Home page](#)
- [PCAF: Financed Emissions: The Global GHG Accounting & Reporting Standard Part A \(2022\)](#)
- [PCAF: Insurance-associated Emissions: The Global GHG Accounting and Reporting Standard Part C \(2022\)](#)

CIBAFI

- [CIBAFI: Greenhouse Gas \(GHG\) Accounting Tool for Islamic Financial Institutions \(IFIs\) \(2022\)—planned for late 2023](#)
- [CIBAFI: Climate Risk Stress Testing and its Implications for Islamic Banks \(2022\)](#)
- [CIBAFI: Climate Change and its Implications for the Financial Industry \(2020\)](#)

General Council for Islamic Banks and Financial Institutions (CIBAFI)

- [Sustainability Guide for Islamic Financial Institutions \(2022\)](#)

Other

- [Oliver Wyman & IACPM: Climate change: Managing a new financial risk \(2019\)](#)
- [Institute for Climate Economics \(I4CE\): Getting started on physical climate risk analysis in finance—available approaches and the way forward \(2018\)](#)
- [NGFS: Climate Scenarios for central banks and supervisors \(2022\)](#)

Pillar three: Climate related operational integration

For detailed guidance on carbon measurement, climate target setting, and strategy please refer to:

UNEP FI & the Net-Zero Banking Alliance (NZBA)

- [UNEP FI: Guidelines for Climate Target Setting for Banks \(2021\)](#)
- [UNEP FI: Guidelines for Climate Target Setting: Supporting notes \(2022\)](#)

Science-Based Targets Initiative (SBTi):

- [SBTi: SBTi Financial Sector and TCFD Reporting Guidance \(2023\)](#)
- [SBTi: Financial Sector Science-Based Targets Guidance \(2022\)](#)
- [SBTi: Science-based target setting tool \(version 2\)](#)
- [SBTi: Foundations for Science-Based Net-Zero Target Setting in the Financial Sector \(2022\)](#)

Pillar four: Climate performance and accountability

For more detailed guidance on decarbonisation and transition planning, and transition finance, please refer to:

Taskforce on Climate-related Financial Disclosures

- [TCFD: Guidance on Metrics, Targets and Transition Plans \(2021\)](#)

UNEP FI

- [UNEP FI: NZBA Transition Finance Guide \(2022\)](#)
- [UNEP FI: The Road Towards Banking Decarbonisation: The Case of MENA \(2023\)](#)

Glasgow Financial Alliance for Net Zero (GFANZ):

- [GFANZ: Towards a Global Baseline for Net-zero Transition Planning \(2022\)](#)
- [GFANZ: Financial Institutions Net-zero Transition Plans: Fundamentals, Recommendations, and Guidance \(2022\)](#)
- [GFANZ: Financial Institutions Net-zero Transition Plans: Supplemental Information \(2022\)](#)
- [GFANZ: Guidance on Use of Sectoral Pathways for Financial Institutions \(2022\)](#)

Climate Safe Lending Network:

- [CSLN: The Good Transition Plan: Climate Action Strategy Development Guidance for Banks & Lending Institutions \(2021\)](#)

Transition Plan Taskforce:

- [TPT: The Transition Plan Taskforce Disclosure Framework \(Consultation\) \(2022\) full guide due to be released late 2023](#)

Pillar five: Collaboration and exchange

For additional guidance on reporting and impact performance. Please refer to:

International Sustainability Standards Board (ISSB)—IFRS Foundation

- [ISSB: IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information \(2023\)](#)
- [ISSB: IFRS S2 Climate-related Disclosure \(2023\)](#)

Task Force on Climate-related Financial Disclosures (TCFD)

- [TCFD: Recommendations of the Task Force on Climate-related Financial Disclosures \(2017\)](#)
- [TCFD: Implementing the Recommendations of the Task Force on Climate-related Financial Disclosures \(2021\)](#)
- [TCFD: Guidance on Metrics, Targets, and Transition Plans \(2021\)](#)

Global Reporting Initiative (GRI)

- [GRI: Homepage \(accessed August 2023\)](#)

CDP

- [CDP: Guidance for companies \(webpage\) \(Accessed August 2023\)](#)

International Standards Organisation (ISO)

- [ISO 14097: 2021: Greenhouse gas management and related activities – Framework including principles and requirements for assessing and reporting investments and financing activities related to climate change](#)
- [ISO 32210: 2022: Sustainable Finance: Guidance on the application of sustainability principles for organizations in the financial sector](#)

International Capital Market Association (ICMA)

- [ICMA: The Principles, Guidelines and Handbooks on:](#)
 - [Green Bond Principles](#)
 - [Social Bond Principles](#)
 - [Sustainability Bond Guidelines](#)
 - [Sustainability-Linked Bond Principles](#)
 - [Climate Transition Finance Handbook](#)
 - [Mapping to the Sustainable Development Goals](#)
 - [Guidance on other Sustainable Financial Instruments](#)

Climate Bond Initiative

- [CBI: Climate Bonds Standard v4.0 \(2023\)](#)
- [CBI: Climate Bonds Taxonomy \(2023\)](#)

EU

- [European Commission: EU Taxonomy for Sustainable Activities \(accessed: August 2022\)](#)

IsDB

- [IsDB: Sustainable Finance Framework \(2019\)](#)

For additional guidance on client engagement and links to relevant stakeholders please refer to:

UNEP FI

- [UNEP FI: Leadership Strategies for Client Engagement: Advancing climate-related assessments \(2022\)](#)

The following are relevant webpages of stakeholders to engage on climate-related (Islamic) banking:

- [General Council for Islamic Banks & Financial Institutions \(CIBAFI\)](#)
- [Islamic Development Bank \(IsDB\)](#)
- [Islamic Financial Services Board \(IFSB\)](#)
- [Accounting and Auditing Organization for Islamic Financial Institutions \(AAOIFI\)](#)
- [Principles for Responsible Investments \(PRI\)](#)
- [United Nations Environment Programme Finance Initiative \(UNEP FI\)](#)
- [Net Zero Banking Alliance \(NZBA\)](#)
- [Equator Principles Association](#)
- [Mainstreaming Climate Action in Financial Institutions Initiative](#)
- [Global Alliance for Banking on Values \(GABV\)](#)
- [Glasgow Financial Alliance for Net Zero](#)
- [UN Global Compact](#)
- [Climate Governance Initiative—World Economic Forum \(WEF\)](#)

UN 
**environment
programme**

**finance
initiative**

UNEP Finance Initiative brings together a large network of banks, insurers and investors that collectively catalyses action across the financial system to deliver more sustainable global economies. For more than 30 years the initiative has been connecting the UN with financial institutions from around the world to shape the sustainable finance agenda. We've established the world's foremost sustainability frameworks that help the finance industry address global environmental, social and governance (ESG) challenges.

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