Innovative Islamic Social Finance

Muhammad Didi Hardiana
Team Leader – Innovative Financing Lab
UNDP Indonesia
On the ground in about 170 countries and territories, UNDP works to eradicate poverty while protecting the planet. We help countries develop strong policies, skills, partnerships, and institutions so they can sustain their progress.
SDGs Financing: Problem or trillion $ opportunity?

Global

• SDGs requires additional investment of $5-7 tn per year up to 2030 (ICESDF).
• Developing countries needs $3.3-4.5 tn per year (UNCTAD).
• Financing shortfall of about $2.5 tn (World Investment Report 2014 – Investing in the SDGs).

Government alone cannot be responsible for domestic financing, leaving opportunity for increased and more effective philanthropic giving and social finance.

Domestic public and private investment accounts for more than half of all financing for development.

Country Level

Indonesia Context
Global Financing Trends

USD billions, constant 2016 prices

- Domestic public
- Domestic private
- International public
- International private
Asia-Pacific Financing Trends

Financing mix in Asia-Pacific as a whole

- Domestic public: 48.7%
- Domestic private: 43.6%
- International public: 7.3%
- International private: 0.4%

Financing mix in Asia-Pacific LDCs

- Domestic public: 32.2%
- Domestic private: 18.3%
- International public: 9.3%
- International private: 40.3%
Indonesia Financing Trends

- **International public**: 6%
- **International private**: 14%
- **Domestic public**: 32%
- **Domestic private**: 48%

Domestic private investment accounts for almost half of all financing (2015)

**RPJMN 2019-2024 source of fund, IDR trillion**

| Source: Indonesia’s Development Assessment (DFA) supported by UNDP |

<table>
<thead>
<tr>
<th>Total spending for Infrastructure, Education, Health</th>
<th>APBN¹</th>
<th>Private</th>
<th>Remaining Gap</th>
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<tbody>
<tr>
<td>14,500</td>
<td>6,750</td>
<td>6,290</td>
<td>1,460</td>
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Unlock the untapped potential of non-government sources.

The need for a coordinated approach in creating a conducive ecosystem for SDGs funding.

The need for a shared platform for dialogue with non-state actors (business, civil society, development partners and others).

The need for innovative financing schemes.

The need to link private investment to SDGs.

Source: UNDP. Financing the SDGs in ASEAN, and Linking resources with sustainable development results in Indonesia: an Integrated National Financing Framework.
SDGs Country Platform
The innovative financing lab focuses on how to attract, channel and direct private and Islamic finance for development - including from philanthropy, private investors and religious organizations.

It also places emphasis on how such alternative finance is contributing towards the SDGs: helping to measure and finance the SDGs and the impact of such investments.
**ISLAMIC FINANCE**

- blended finance
- green & blue finance

**GREEN SUKUK**

**ISLAMIC FINANCE**

- zakat for SDGs
- CSR
- SDG INDONESIA ONE

**GREEN BOND**

- blue finance framework

**ISLAMIC FINANCE**

- waqf blockchain
- SDG financing hub
- youth entrepreneurship initiative
- impact accelerator
- impact investment
- sdg impact fund
- social impact bond
- ideathononesia
- youth co:lab
- national dialogue

**GREEN Bond**

- climate budget tagging
- climate change fiscal framework

**PUBLIC CLIMATE FINANCE**

- crowdfunding

**SDG FINANCING HUB**

- youth entrepreneurship initiative
- youth co:lab
- national dialogue
Why Islamic Finance?

Assets expected to exceed $3 trillion by 2020.

Annual Islamic finance industry expansion 10-12%.

Embodies socially responsible & sustainable development.

Engaging with religious organisations crucial for peace, development, promoting tolerance.
According to Charity Aid Foundation, Indonesia is one among two countries with the highest proportion of people donating money (2016-2018) and being the only developing country out of the seven most generous countries in the world (2018).
**Commonalities between SDGs and Maqasid Sharia**

*Maqasid Sharia* (MS) is very systematic and it attempts to address human welfare and wellbeing in a comprehensive way in a systemic manner.

17 SDGs are important for the world community and for the Muslims as well because:

- They are good in themselves.
- Not in direct conflict with Islamic percepts.
- Have been agreed by world community in general.
Complementarity of Islamic Finance

Initial lift → Help people move beyond survival to security & growth

Revolving fund for the micro-entreprises; investment in waqf land → Promote inclusive, sustainable economic growth

Zakat → Islamic Microfinance

Cash & land Waqf → Sukuk
UNDP partners with Baznas to leverage zakat funds (US$350k) for micro-hydro energy in rural Sumatra in a blended finance mechanism in 2018. The collaboration is continued with local economic development programme.
22% of global population is Muslim and Islamic finance reached an estimated value of around US$2 trillion in 2015, with assets of US$3 trillion expected by 2020.

The worldwide value of zakat is potentially US$200 billion to US$1 trillion annually.

Poor and/or needy (fakir/miskin) received 89.60% of total allocated funds.

ZIS average annual rate (2002-2016), GDP growth 5.42%.

Remaining challenges:

Zakat as a **positive measure** to redistribute wealth to **prevent poverty**.

Overcoming preference towards **short-term interpersonal support**.

**Expanding access** to the unbanked, enhancing **effectiveness** of zakat institutions.
In 2017, Indonesia’s Zakat Body, BAZNAS, extends first contribution to support the SDGs through zakat funds for micro-hydro energy in rural villages in Sumatra and leverages a UNDP/GEF funded project and CSR funds from Bank Jambi, a state-owned provincial bank.

The partnership between UNDP Indonesia and BAZNAS, the national zakat agency, is groundbreaking because it is the first time that zakat organization has committed to supporting the SDGs anywhere in the world.

Four micro-hydro power plants, which the project built directly benefit for a total of 803 households (about 4,500 people) from four villages giving them access to electricity and to likewise bolster rural livelihoods and increases the economic activities of the communities.
Islamic Microfinance: A special opportunity

Microfinance can change lifestyles by offering loans to a group of people who rely on social collateral.

Microfinance generally charges high interest rates, even higher than banks (not accessible for all).

Islamic microfinance, with interest-free contracts with sources of funds from donation can include zakat, infaq, sadaqa, waqf and hibah. Source of deposit includes wadiah, qard hasan and mudarabah, while sources of equity includes musharakah.

Success Story of Islamic Microfinance
In Palestine, UNDP is facilitating the mobilization of funds for small and medium-sized enterprise.

UNDP Success Story of Microfinance
UNDP Nepal established Micro-Enterprise Development Programme (MEDP), creating more than 119,085 new microenterprises and contributing to the creation of 187,358 jobs in rural areas since 1998.

73% Of the entrepreneur created had moved out of poverty.
UNDP Indonesia is engaging with Indonesian Waqf Board to develop *waqf* digital platform through blockchain technology with support from AID:Tech.
Waqf Spending Horizon

Old Paradigm: waqf is only in the form of land to be built cemetery, mosque, school.

Long-term

Income generation

More flexible

Waqf land in Indonesia comprising 4,300 sq.km in 435,768 locations with a value of $27 billion.

Indonesian population 263 million\(^1\)

Muslim 87% or 230 million\(^2\)

Middle class 74 million\(^3\)

Indonesia Wakaf Summit 2017:
Potential: $12 billion
Collected in 2017: $27 million
Target in 2018: $60 million

\(^2\)Badan Pusat Statistik. Penduduk Menurut Wilayah dan Agama yang Dianut. Sensus Penduduk 2010
\(^3\)Boston Consulting Group - Asia’s Next Big Opportunity: Indonesia’s Rising Middle-Class and Affluent Consumers 2013.
UNDP has been supporting the Ministry of Finance’s performance-based budgeting through climate budget tagging that culminated in the issuance of first sovereign Green Sukuk in 2018.
In 2018 & 2019, RoI has issued Green Sukuk of $2 Billion (~IDR 30 trillion)

- The world’s first sovereign green sukuk
- First country to issue green bond/sukuk twice consecutively

Green bonds market developed quite rapidly in recent years. Globally there is, up to now, USD1.45 tn climate aligned bonds with USD389 bn alone in green bond. (CBI, 2018)

**SOVEREIGN GREEN BOND CLUB: POLAND, FRANCE, FIJI, INDONESIA, NIGERIA, BELGIUM**

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**What is Sukuk?**
- Sukuk is bonds that comply to Islamic law/securities based on Islamic principles.

**How is Sukuk different than Bond?**
- Sukuk represents proportionate ownership of an asset, while bonds indicate a debt obligation. In other words, sukuk is backed with tangible assets not debt.
- The assets that back sukuk are compliant with Sharia.
- The returns of bonds in the form of interest payments, while returns on Sukuk is periodical payments - rent/profit.

**How is it being regulated in Indonesia?**
- Regulation from the National Islamic Council (DSN MUI) No 01/DSN-MUI/III/2012.

**What is Green Bond/Sukuk?**
- Innovative financial instruments where the proceeds are invested exclusively to finance or refinance green projects that generate climate or other environmental benefits, including mitigation, adaptation and biodiversity.
Green Framework

4 MAIN PILLARS

Pillar I: Use of Proceeds

Pillar II: Project Evaluation and Selection

Pillar III: Management of Proceeds

Pillar IV: Reporting

9 ELIGIBLE SECTORS

DARK GREEN
Renewable Energy
Resilience to Climate Change for Disaster Risk Areas

LIGHT TO MEDIUM GREEN
Sustainable Management of Natural Resources
Energy Efficiency

MEDIUM TO DARK GREEN
Waste to Energy & Waste Management
Sustainable Agriculture
Sustainable Transportation
Green Tourism

LIGHT GREEN
Green Building

INDONESIA GREEN BOND/SUKUK FRAMEWORK

MEDIUM GREEN REVIEW BY CICERO
one of the world’s leading green bond reviewer

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Indonesia’s Green Sukuk (Cont’d)

Use of Proceeds for RoI Green Sukuk 2018 cover five main green eligible sectors.

- Sustainable Transport: 55.2%
- Renewable Energy: 8.0%
- Energy Efficiency: 8.1%
- Resilience to Climate Change: 22.2%
- Waste to Energy & Waste Management: 6.5%

23 PROJECTS across Indonesia

- 121 UNITS of solar, mini-hydro and micro-hydro power plant was developed
- 727 KM double-track railways is built in Java’s North Coast Line
- 3.4 MILLIONS of households received the benefit of the improvement in solid waste management

Distribution of Investors by Geography

- Indonesia: 10%
- Europe: 15%
- US: 18%
- Asia: 25%
- Islamic: 32%
Journey of Indonesia’s Green Sukuk

PRE ISSUANCE

Climate Budget Tagging Mechanism
• Selection of eligible green projects through a budget tagging system developed by MoF and UNDP

Green Bond/Sukuk Framework
• Assisted by Ministry of Planning, MOEF, Line Ministries, UNDP and HSBC
• Studied through a series of FGDs with experts/ investment banks/ issuers of green bonds

ISSUANCE

Roadshow
• Targeting new types of investors (green investors)
• Visiting green investors in Europe

1st Sovereign Green Sukuk Issuance
• March 2018
• Total issuance of USD 1.25 billion
• 29% green investors

2nd Sovereign Green Sukuk Issuance
• February 2019
• Total issuance of USD 750 million
• 29% green investors

1st Annual Green Sukuk Impact Report
• February 2019
• The preparation was assisted by Ministry of Planning, MOEF, Technical Line Ministries, UNDP, and the World Bank

Audit Process
• Audited by KPMG

2nd Party Review
• Labelled medium green from CICERO
Key Highlights on GS Impact Report

The development of Impact report is supported by UNDP and the World Bank Group. The final report is audited by KPMG.

Published in February 2019, less than a year from the issuance date (March 2018).

Allocation of Proceeds from Green Sukuk also promote national target to the SDGs.

Impact Report has been audited by KPMG which shows the alignment of whole Green Sukuk process to the ROI’s Green Framework.
How to link Islamic Social Finance to Commercial Side?
SDG-aligned private investment is growing, but remains a small part of the total.

- **Energy**
  - Private investment in energy mobilised by PPPs
  - Total energy investment: $701 bn
  - Energy investment: $49 bn

- **Fund investment**
  - Impact investment: $31 bn
  - Growth in pension fund assets + venture capital: $906 bn

- **Bonds**
  - Green bonds outstanding, Asia-Pacific: $338 bn
  - Corporate bonds outstanding, ASEAN+3: $5.4 tn
Private sector is ready to do more.

“There is no shortage of capital in the world economy. The real issue is that the global financial system is not channeling financial flows effectively towards investments for Sustainable Development.”
- Achim Steiner
Impact Investing

“Investments made into companies, organizations, and funds with the intention to generate social and environmental impact alongside a financial return.” - GIIN
Impact as Objective

Responsible Investments / Sustainable Investments

Value alignment
Shareholder value

Impact investments
Impact objective
Stakeholder value

• Comprehensive Impact Measurement and Management framework
• **Impact metrics** set in line with a major global benchmark targets - SDGs
• Focus on **understanding and enhancing impact** across several areas and **multiple stakeholders of various ecosystems**
• **Lean impact measurement and management system** to navigate a startups towards a sustainable business model
Impact Investment – Stages of Business Development
Impact Investing in Indonesia

• A high potential market.
• USD 148.8 Million across 58 deals from private investors (2018).
• Increasingly favourable policy landscape.
  • Investment law (25/2007).
  • Micro Small and Medium Enterprise Law (20/2008).
• Islamic Finance e.g. Zakat is 4% of GDP.

But….

• 70% MSMEs face financial barriers to revenue growth.
• Need mechanism for pooling and fund management for philanthropic giving.
Islamic Finance & Impact Investing: Common principles

Islamic Finance and Impact Investing share common principles:

- **Doing good and avoiding harm.**
- **No trade-off between financial gains & value creation.**
- **Attaining business goals in a way to benefit the society as a whole.**
- **Integrating disadvantaged & the poor that don’t use formal financial services.**

**The Impact Investment Value Chain**

Source: UNDP illustration based on Bridges Ventures and AVCA, 2014.
UNDP Strategy for Impact Investing in Indonesia

Incubator for very early stage start-ups. Youth Co:Lab, co-lead by UNDP and Citi Foundation, is an incubator for youth who have interest in social innovation, entrepreneurship, and start ups.

In partnership with local partners, Ministry of Youth and Ministry of Tourism and Creative Economy.

Youth Entrepreneurship Initiative

Impact Accelerator program is designed to provide social entrepreneurs with access to knowledge, networks, and resources they need to grow their businesses and their impact.

The first batch is currently rolling in partnership with 500 Startups.

UNDP Impact Accelerator

A blended finance fund to invest in companies that have the intention to generate a measurable and beneficial social or environmental impact.

SDG Impact Fund

Pipeline development

Scale-up capital

SDG Impact Framework – Islamic Impact Framework
Muhammad Didi Hardiana

+62 8111 5888 12

muhammad.hardiana@undp.org