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Integrating Sustainability into Islamic Products

The need of the hour

London, 19th. January 2010

Fares Mourad, Head of Islamic Finance

Agenda

- Scope and Current situation
- Sustainability and Islamic Finance
- Business case
- Possibilities and requirements

Current situation

- Hardly, a day passes without listening or reading some news about **Global Warming** on television channels and newspapers
- Hardly, a day passes without listening or reading some news about **Global Water Shortage** on television channels and newspapers
- Hardly, a day passes without listening or reading some news about **Food Shortage** on television channels and newspapers
- Hardly, a day passes without listening or reading some news about the **limits of our resources** on television channels and newspapers
- Hardly, a day passes without listening or reading some news about the **Financial crises we have been facing since 2008** on television channels and newspapers



Every day and second we are faced with our
Environment and the constrains it faces



What does our Environment comprise of?

- Nature we live in
 - Social environment we interact with
 - The economy we live in
 - Etc.
-
- Everything around us



Sustainability Philosophy – Investment Rationale

Sustainability means.... safeguarding the **FUTURE** of one's own life environment and that of current and oncoming generations

Sustainability as a key rating and investment criterion offers lower investment risks with above average return potential



How does Islam address our relation to the environment

■ AL-Rahman 55

الشَّمْسُ وَالْقَمَرُ بِحُسْبَانٍ (٥) وَالنَّجْمُ وَالشَّجَرُ يَسْجُدَانِ (٦) وَالسَّمَاءَ رَفَعَهَا
وَوَضَعَ الْمِيزَانَ (٧) أَلَّا تَطْغَوْا فِي الْمِيزَانِ (٨) وَأَقِيمُوا الْوَزْنَ بِالْقِسْطِ وَلَا
تُخْسِرُوا الْمِيزَانَ (٩)

The sun and the moon are made punctual. (5) The stars and the trees adore. (6) And the sky He hath uplifted; and He hath set the measure, (7) That ye exceed not the measure, (8) But observe the measure strictly, nor fall short thereof. (9)

- All actions of the Prophet PbuH have been focused on the environment and how to preserve current resources (e.g. scarcity of water)



Positive financial performance impact of SRI

- „Theory“

- **Avoid „latent risks“:**

Reputation risks, legal restrictions (e.g. bans of hazardous substances), liability risks (e.g. product safety), labour conflicts, etc.

- **Use „latent opportunities“:**

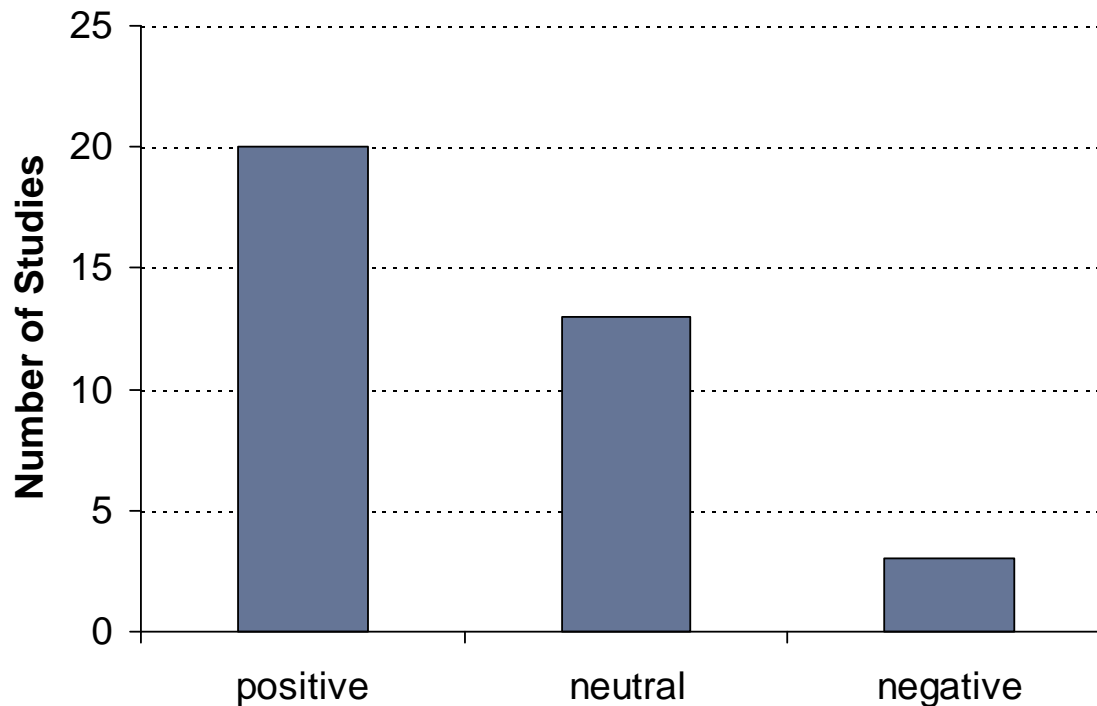
Efficiency gains through waste reduction; productivity gains through motivated employees; increase innovative power; creation of „sympathetic“ brands; improved access to capital





SRI & Performance: Results of a Recent Survey by Mercer

Review of 36 studies on SRI and performance^{a)}: Majority shows evidence of a positive relationship

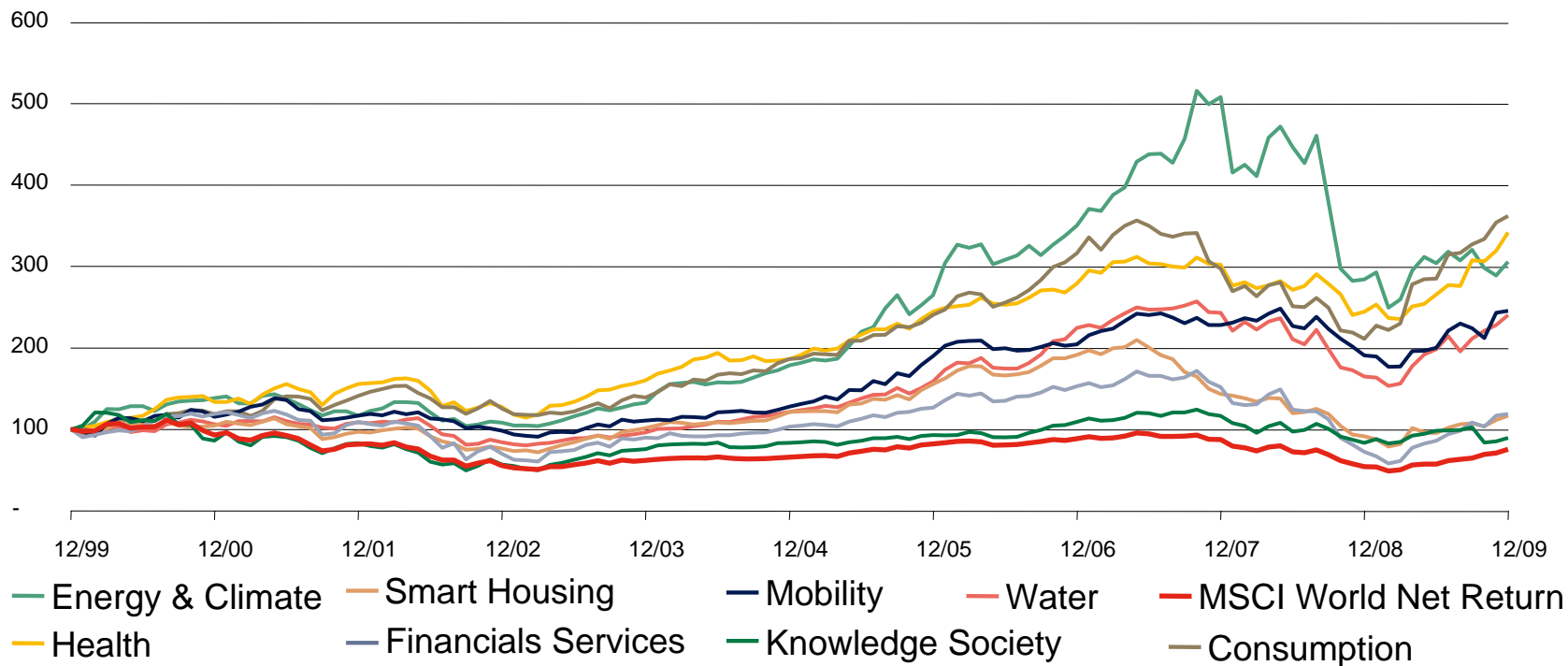


a) Combined result of Mercer-Studies "Demystifying Responsible Investment Performance", October 2007 and "Shedding Light on Responsible Investment", November 2009



Performance: Our Sustainability Themes Tend to Outperform the Overall Equity Markets

Indexed Performance
31/12/1999 – 31/12/2009 in EUR



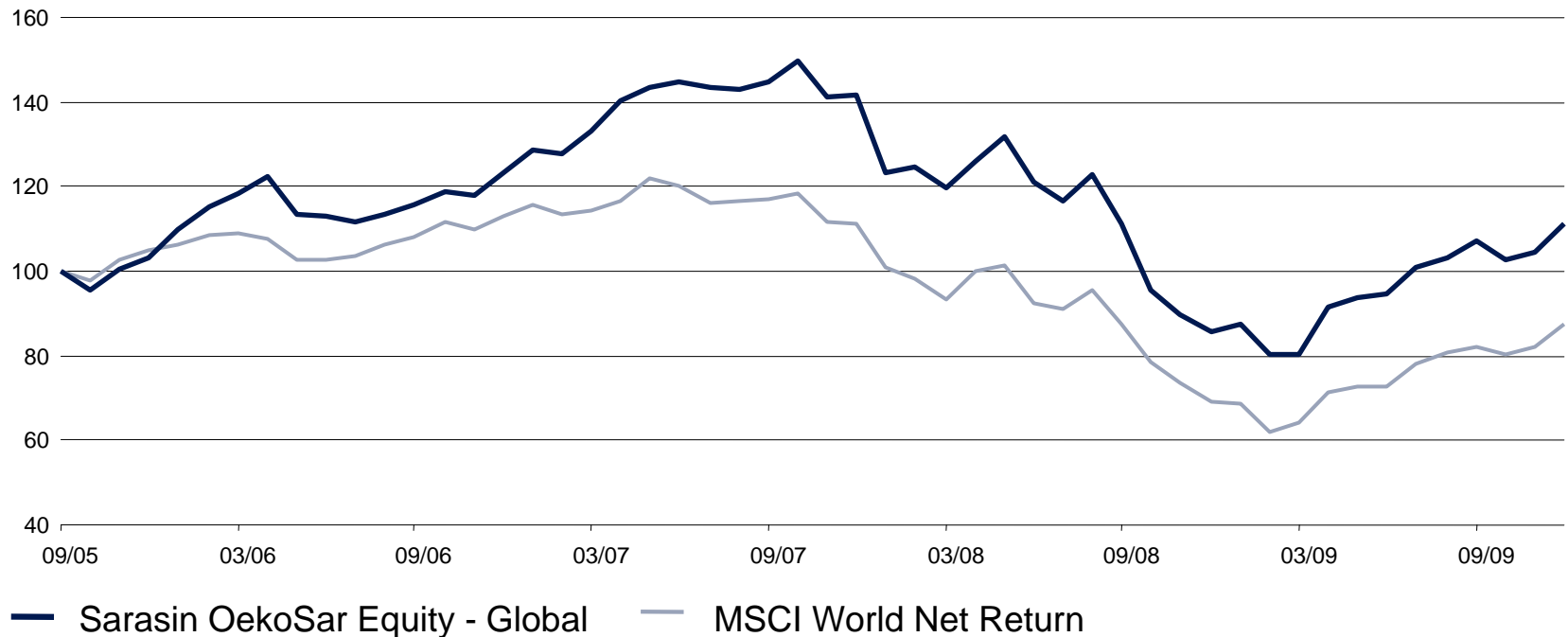
The performance of the individual themes is based on a backtesting consisting of the average monthly returns of the companies in our investment universe (as per September 2009) and does not include any trading costs or additional charges.

Source: Bloomberg, own calculations.

Sustainable Thematic Style: Track record using the example of OekoSar Equity

Indexed gross-performance

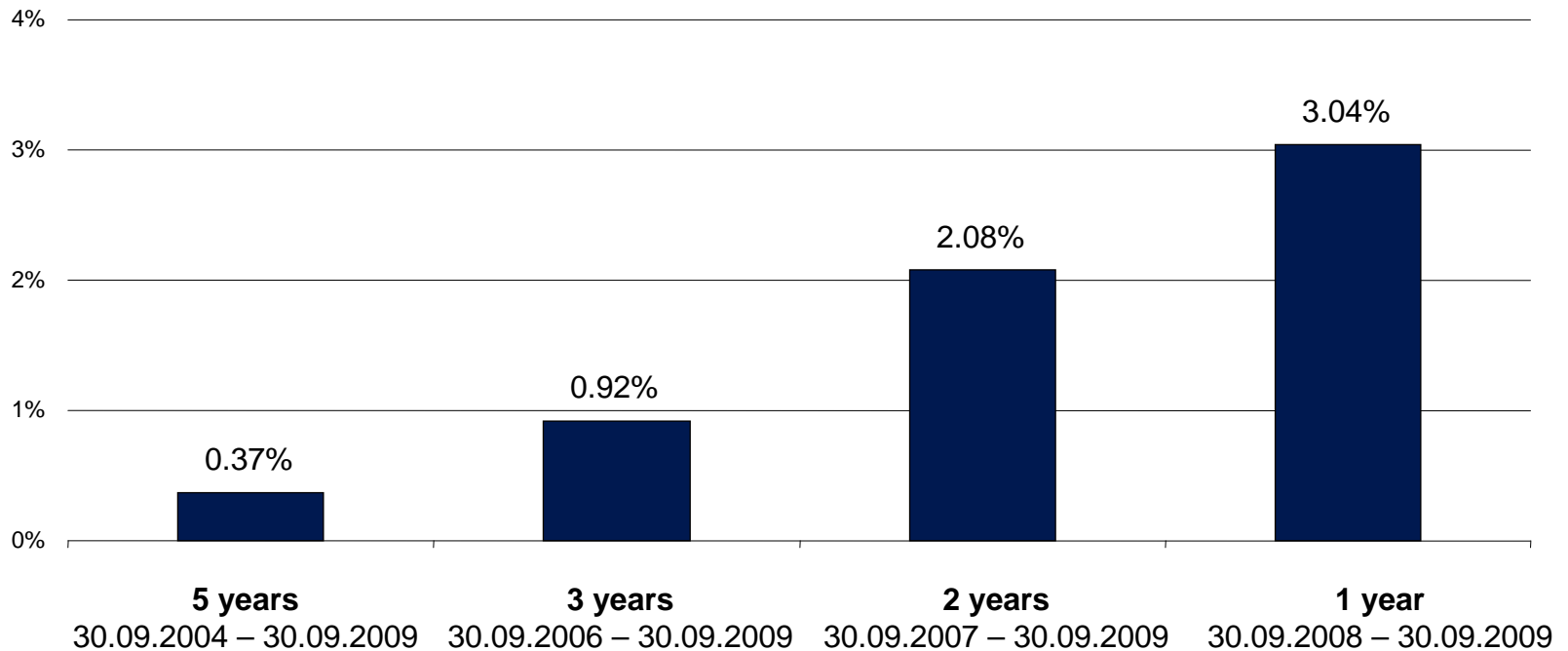
30/09/2005 – 31/12/2009 in EUR (since inception of the fund)



Source: Bloomberg. Net asset value at the starting date = 100. Performance does not include the effect of any initial charge. Individual costs such as fees, commissions and other payments are not reflected; if taken into account, these would have a negative impact on the development of value. This fund falls into risk class 4 (risk classes: 1: low; 2: moderate; 3: medium; 4: above-average; 5: high)

Annual outperformance of a sustainable bond portfolio over various investment periods

Relative performance Sarasin Sustainable Bond Portfolio vs. Lipper Bond EUR
% p.a. in EUR



Source: Lipper. Performance does not include the effect of any initial charge. Individual costs such as fees, commissions and other payments are not reflected; if taken into account, these would have a negative impact on the development of value. Historical changes in value are not a reliable indicator of future values.

Possible solutions to be considered in Islamic Finance

- Investments in Carbon Credits
- Investments in Renewable Energy
- Investments in Agriculture
- Investments in Timber
- Investments in Micro Finance
- Investments in.....



What are Carbon Credits and how does it function

- The carbon credit system was ratified in conjunction with the Kyoto Protocol. Its goal is to stop the increase of carbon dioxide emissions.
- It is A permit that allows the holder to emit one ton of carbon dioxide. Credits are awarded to countries or groups that have reduced their green house gases below their emission quota. Carbon credits can be traded in the international market at their current market price.
- For example, if an environmentalist group plants enough trees to reduce emissions by one ton, the group will be awarded a credit. If a steel producer has an emissions quota of 10 tons, but is expecting to produce 11 tons, it could purchase this carbon credit from the environmental group. The carbon credit system looks to reduce emissions by having countries honour their emission quotas and offer incentives for being below them.



What difficulties is Islamic Finance facing with Carbon Credits?

- Find a Standard and common understanding as how to apply

- Are Carbon Credits
 - a right to pollute and harm the environment?
 - Is it a fee for waste disposal associated with other activities?
 - Is it an allowance?



Conclusion

- Environment and Sustainability are stemming from the spirit of Islam
- Islam has a leading role and the Islamic Finance Industry has the responsibility and duty to fulfil this role
- In some cases the Islamic Finance Industry needs to define standards to assume the entrusted role to it by its faith.
- there are profits to be earned, otherwise investment banks would not invest so heavily. At the same time, it concerns the greater good. A perfect match for a responsible Islamic Banking!





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Thank you for
your attention