

SEIZING OPPORTUNITIES IN GREEN FINANCING AND ISLAMIC FINANCE

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ABSTRACT

Islamic Finance can play a major role in financing sustainable development and energy projects in core markets where it operates. The development of green Islamic finance in Asia and the Middle East, for example, would arguably create an opportunity for both governments and corporate their investment capital and provide a new asset class featuring a balanced risk-sharing element for issuers, and fixed-income returns for investors. Islamic financial structures will broaden equity capital and provide new risk return profiles for project funding and investors .With the emergence of the market for Sukuk, it seems that it is possible that renewable energy projects could be financed by Islamic financing, with the participation of both the Islamic banks and conventional banks. There is a need for broadening equity capital in energy and renewable energy investment through Islamic finance. Therefore, Islamic project financing will become an essential part of financing such projects in recent years.

Islamic Finance is no doubt a key contributor to economic growth in almost all the countries of the Middle East, and the industry, supported by international Multilateral Development Banks (MDBs), has for several decades helped in raising capital for numerous infrastructure projects around the world. This study presents an analysis of the main drivers and factors for building the business case of a new thinking to finance sustainable development in the energy and renewable energy sectors.

Keywords: *Renewable energy, Islamic finance and Sukuk*

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Introduction

Green finance is a broad term that can refer to financial investments flowing into sustainable development projects and initiatives, environmental products, and policies that encourage the development of a more sustainable economy.

Islamic banking or Islamic finance or Sharia-compliant finance is something that complies with Sharia (Islamic law) and Islamic financial model works on the basis of risk sharing. The customer and the bank share the risk of any investment on agreed terms, and divide any profits between them.

The global energy landscape will experience a major transformation in the coming decades; with renewable and natural gas the big winners in the race to meet energy demand growth until 2040, according to the latest edition of the World Energy Outlook, the International Energy Agency's (IEA) flagship publication. An increasing emphasis on energy efficiency has given rise to a new way of thinking in relation to alternative energy sources. Both regulatory regimes and financial institutions have taken steps to address opportunities and challenges to finance the renewable energy industries.

In many parts of the world, corporate and governments have made a commitment to renewable energy and set clear targets and strategies to support sustainability goals. Financing alternatives have been supported by Multilateral Development Banks (MDBs) and energy-specialized agencies and industry groups, and have helped make the sector more attractive to the private sector.

In Green Growth Strategy, that the sustainable energy of the future will require new thinking and new systems – essentially a transformation in the way we produce, deliver and consume energy. As such, a new way of thinking should comprise a new financing mechanism to fund energy projects

Rationale

- The rationales for diversification in the Bahrain energy sources are mainly due to, growing population, rising demand for energy and resource constraints. The government of Bahrain has set an official target for 5% of electricity generation from renewable energy by 2020, with more focus on capacity addition of solar power and the fundamental causes of a debt-based financial system, which led to the global financial crises.
- With the emergence of the market for Sukuk it seems that it is possible that renewable energy projects could be financed by Islamic financing. Therefore, Islamic project financing will become an essential part of financing these projects in recent years with immense potential and opportunity.

Objectives

- To explores the new opportunities to invest in the development of power generation capacity and renewable energy technologies.
- To study the need for innovative financing solutions through risk sharing as an alternative to traditional debt-based approach.

Research Methodology

The data used has been collected from various secondary sources like books, journal, newspaper, & internet. The accuracy of the study is limited to the accuracy of these sources.

The study examined energy regulatory frameworks of KSA and UAE with special focus in Kingdom of Bahrain and looked at the renewable energy initiatives and government support on these countries and assessed the size and patterns of investment projects based on discussions with energy practitioners, policy-makers, Islamic finance professionals and thought leaders have produced interesting consensus over the debate on whether Islamic

finance can play a major role in financing sustainable development and energy projects in core markets where it operates. And, if so, how can Islamic finance leaders capture opportunities in the renewable energy industry and take a lead as a responsible investment platform in the development and economic growth of societies.

Literature Review

Adelekan, S.; Wamuziri, S.; Binsardi, B 2014, Evaluation of Islamic financing products for housing and infrastructure development. The instruments proposed by Islamic finance could represent valuable tools for financing the renewable energy sector. Among the main Islamic financial instruments, there are Murabaha, Mudaraba, Ijara, and Sukuk. Murabaha is a contract of sale in which the lender buys an asset at the specific request of the debtor and then sells it for an amount equal to the purchase cost plus a mark-up and a deferred price over time. Mudaraba is a partnership contract between a party that provides risk capital and another party that manages the agreed and approved project.

Marszałek, Daszyńska-Żygadło, 2016, Green investments are burdened with significant financial risk connected with the uncertainty of the expected results and difficulties in raising the capital. In this regard, green bonds are often offered in a secured (repayment is guaranteed by the issuer) or guaranteed form (redemption is guaranteed by another entity, not the issuer, usually via securitisation). Other ways to minimise the risk embedded in the construction of a green bond is by issuing a hybrid bond (an instrument combining the features of equity and a loan, offering the issuers high flexibility of financing conditions) and a revenue bond (the repayment is from the whole or a part of the profit from the investment financed through the issue).

Armeanu, D.; Vintila, G.; Gherghina, S. 2017, The widespread development of Renewable Energy Sources (RESs) is mainly driven by the goals of preventing climate change and reducing greenhouse gas (GHG) emissions, in addition to the reduction of energy dependency that characterizes most European countries

Overview of the Energy Industry in Bahrain

- Oil and gas sector has been used as primary energy source.
- Bahrain largely relies on gas for power generation.
- The rationale for diversification in energy sources is due to growing population and rising demand.
- Future domestic energy demand is a challenge.
- The energy sector still represents the biggest contributor to the Kingdom's GDP.
- The country is looking to renewable energy to increase the production of electricity and reduce pollution.
- Bahrain encourages investment and cooperation in renewable energy as part of its developmental plans.
- The government of Bahrain has set an official target for 5% of electricity generation from renewable energy by 2020.

Bahrain economic indicators 	GDP	• GDP – US\$32.22 billion (World Bank, 2015) • GDP growth – 2.9% (World Bank, 2015) • Oil GDP (share of total nominal GDP) 24.0% (IMF, 2014)
	Population	• Total population – 1.38 million (World bank, 2015)
	Major industries	• Petroleum processing and refining, aluminum smelting, Islamic and offshore banking, insurance, ship repairing and tourism (IMF)
	Energy investment & financing institutions	• First Energy Bank • APICORP

Source: Thomson Reuters

The regulatory and industry framework, Key initiatives

- The energy industry in Bahrain is overseen by two governmental authorities, the Electricity and Water Authority (EWA) and the National Oil and Gas Authority (NOGA).
- The unit is responsible for establishing strategies and policies and legislations, and stimulating initiatives and investment projects that promote energy efficiency and widening the share of the production of energy from renewable sources.

Challenges and opportunities in renewable energy investment

- Bahrain will require a dedicated institution to lead the development of renewable energy projects.
- In term of financial incentives, there is no dedicated governmental body for renewable energy fund within the country.

Finance and investment

- Bahrain encourages investment and cooperation in renewable energy especially solar energy as part of its developmental plans and programs.
- The energy sector still represents the biggest contributor to the Kingdom's GDP.

Potential for Islamic Finance

- The fundamental causes of a debt-based financial system, which led to the global financial crises, have yet to be addressed and resolved.
- Islamic financial structures increase equity capital and provide new risk return profiles for project funding and investors.

- The development of green Islamic finance creates an opportunity to diversify investment capital and provide a balanced risk-sharing element for issuers and investors.
- A significant share of Sukuk issuance has been structured to reduce risks through guarantees and credit enhancement measures.
- During 2009, First Energy Bank Successfully completed approximately 9% stake acquisition in the Al Dur independent Water and Power Project (IWPP).
- First Energy Bank B.S.C.(c) (“FEB” or the “Bank”) is an Islamic investment bank licensed by the Central Bank of Bahrain (CBB) and headquartered in Manama, Kingdom of Bahrain.

The emerging popularity of Sukuk

Current market conditions may well present a unique opportunity. There is undoubtedly a need for innovative financing solutions that feature a new and revised business model to replace the traditional debt-based financing approach that arguably led to the global financial crisis of 2008. With these kinds of challenges in mind, multinational energy corporate are arguably now seeking alternative sources of capital. Clearly, the diversification of funding renewable energy projects will add more benefits to economic growth, sustainable development and greener economies. A number of countries in the Middle East is currently considering green bond and green Sukuk.

Shariah-compliant Investment structures

A significant share of Sukuk issuance has been structured to reduce risks through guarantees and credit enhancement measures developed by Multilateral Development Banks (MDBs), such as the highly-rated Islamic Development Bank (IDB) and its

affiliated organizations. This has taken place primarily to attract private sector participation in the economic growth of the Organization of Islamic Cooperation (OIC). Other structures include Wakala investment, Ijarah lease, Mudarabah and Musharakah. The use of these instruments depends largely on the type of assets and services required in a particular project.

Policy development and regulation				
	Renewable energy strategies/initiatives	Regulation and government guidance level	Factors that impact the growth of renewable energy	Regulatory initiatives that support the use of Islamic Finance structures
MENA - GCC				
Saudi Arabia	- Plans to build 16 nuclear power plants by 2032 - Aims to achieve 3.45 GW of renewables installed by 2020	Has a Ministry of Energy, Electricity, Congregation Regulatory Authority and K.A.CARE	Budgetary, strategic direction and renewable policies	- By default, all financing arrangements are made under Islamic principles - Commercial banks willing to give loans in presence of enabling policies
UAE	- Clean Energy Strategy 2050 - REmap 2030	- Plans to include more policy planning in its renewable energy strategy - Dubai Supreme Council of Energy (DSCE) has several responsibilities to improve renewable energy consumption	Costs of oil and gas, costs of renewable energy, size of the country's export revenue and its role in the energy industry	- Aims to amplify the role of Sukuk in renewable energy developments through green Sukuk - DSCE and World Bank agree to develop a green investment strategy incorporating Sukuk
Bahrain	- Sustainable Energy Unit in conjunction with United Nations Development Program - Bahrain Energy Vision aims for 5% of its installed capacity to be generated from renewables by 2020	EWA and NOGA oversee the energy industry. There is no designated authority to promote renewable energy	- Will require a dedicated institution or industry body to lead renewable energy projects - Unknown technology-specific targets	The Central Bank of Bahrain (CBB) and in particular the Bahrain Bourse have in place sound regulations for issuing green Sukuk and other Sharia'-compliant investment structures.

Source: Thomson Reuters

Findings and recommendations

- Linkages between sustainable and renewable energy sources being funded by Islamic finance ensure a sustainable eco-system and financial eco-system.

- Investors and practitioners largely see Sukuk as a socially responsible investment asset class as it offers a different risk-and-return profile for investors and issuers alike.
- With the emergence of the Green Sukuk the renewable energy projects could be financed by Islamic financing.

Conclusion

- The investors are keen to diversify their debt financing methods and evidently searching for cost effective financing as per Sharia principles.
- A number of countries in the Middle East are currently considering green Sukuk issuance at sovereign level.
- A recent increase in the usage of Sukuk as a capital market tool to finance infrastructure projects.
- Islamic financing solutions for sustainability have largely focused on Sukuk issuance. Green Sukuk is a good model to finance sustainable infrastructure as well as help bridge the gap between conventional and Islamic financial worlds.

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