

GUIDANCE NOTE ON ISSUANCE OF GREEN, SOCIAL AND SUSTAINABILITY SUKUK IN LABUAN INTERNATIONAL BUSINESS AND FINANCIAL CENTRE

1.0 Introduction

- 1.1 The Guidance Note on Issuance of Green, Social and Sustainability Sukuk in Labuan International Business and Financial Centre (IBFC) is issued to enhance market awareness and provide market guidance on the green, social and sustainability (GSS) sukuk that can be offered out of Labuan IBFC.
- 1.2 Green sukuk are sukuk issued to invest in projects that generate climate-related or environmental benefits while social sukuk are sukuk issued to fund new or existing projects with positive social outcomes. Sustainability sukuk are sukuk issued to finance or re-finance a combination of both green and social projects.
- 1.3 This guidance note is to be read together with the Explanatory Note on Issuance and Subscription of Sukuk in Labuan IBFC.

2.0 Background

- 2.1 Sustainable finance is growing in prominence in international financial markets. Sustainable finance refers to any form of financial service integrating environmental, social and governance criteria into the business or investment decisions for the lasting benefit of both clients and society at large.
- 2.2 Sustainable finance is no longer seen as a fringe activity, but a profitable and desirable sector, which drives financial markets, serves society and enhances the status of financial centres that demonstrate expertise.
- 2.3 Financial products such as green labelled bonds, sukuk and loans have become globally recognised as an effective means of directing investment capital towards climate change mitigation as well as climate change resilience and adaptation projects. Green sukuk, social-impact sukuk and sustainability sukuk have also emerged as viable financial instruments that can support infrastructure financing demands in emerging markets and developing economies to promote sustainable and climate-resilient growth.

- 2.4 In this regard, Labuan IBFC offers a suitable environment for GSS sukuk issuance particularly for the Asia-Pacific region as it has a comprehensive infrastructure that supports and accords certainty as well as integrity for Shariah-based structures.
- 2.5 The appeal of GSS sukuk is its potential to attract a more diverse investor universe as it is available to conventional and Islamic investors as well as GSS investors. For the Islamic investors, there are significant commonalities in the principles and values underlying both sustainable finance and Islamic finance. Sustainable finance is very much aligned to Islamic finance in terms of advocating positive values such as social responsibility, shared prosperity and sustainable growth. As for GSS investors, GSS sukuk would provide a new avenue to meet their investments goals for sustainable finance.

3.0 Labuan IBFC's Facilitative Regime for Sukuk Issuance

- 3.1 Labuan IBFC has in place a conducive ecosystem for sukuk issuance and investments. Labuan IBFC's facilitative regime for sukuk issuance and investments is reflected by its market features as follows:

3.1.1 Well-developed Islamic Finance Infrastructure

- (i) The Centre has an integrated and internationally recognised legal, regulatory and Shariah framework that confer certainty and uphold the integrity of Islamic financial transactions.
- (ii) The broad and liquid Islamic capital market offers a wide range of Islamic financial instruments as well as diversified and skilled financial service providers.
- (iii) There is a significant pool of talent in structuring new innovative Islamic financial instruments.
- (iv) A wide investor base is available from Islamic and conventional financial institutions, pension funds and fund management companies.
- (v) Issuers have an opportunity for listing on any of the international exchanges including the Labuan International Financial Exchange (LFX).

3.1.2 Supportive Islamic Finance Ecosystem

- (i) The Centre has no foreign exchange restrictions.
- (ii) There is mutual recognition of Shariah opinions issued in other jurisdictions.
- (iii) The Centre allows flexibility in applying the preferred governing law in the offering documents.

3.1.3 Strategic Jurisdiction

- (i) Labuan IBFC provides a gateway to Asia Pacific markets and its promising growth prospects and economic opportunities, making it strategically positioned for attracting investors for sukuk issuance.
- (ii) Issuers can benefit from competitive pricing, which may be better as compared to conventional bond pricing due to the high demand of sukuk in the region.

4.0 Labuan IBFC's Regulatory Requirements for Sukuk Issuance

4.1 Labuan IBFC's regulatory requirements for sukuk issuance are delineated below:

4.1.1 Legal Provision

The issuance of sukuk in Labuan IBFC is subject to the provisions of Part III of the Labuan Islamic Financial Services and Securities Act 2010 (LIFSSA).

4.1.2 Eligible Issuers

Any person¹, through the establishment of a Labuan company or registration of a foreign Labuan company under the Labuan Companies Act 1990, may make an offer or invitation to subscribe for sukuk in or from Labuan IBFC.

4.1.3 Approval Requirements

- (i) Any person who makes an offer for subscription or purchase or issues an invitation to subscribe for or purchase sukuk (subsequently referred to as offer for subscription of sukuk) in or from Labuan IBFC, must obtain prior written approval from Labuan FSA under Section 13(1) of the LIFSSA,

¹ "Person" includes a corporation, partnership, a body of persons, corporate or unincorporated and a corporation sole.

unless the offers or invitations of sukuk are excluded from the approval requirements of Labuan FSA as specified under Section 13(5) of the LIFSSA.

- (ii) The offers or invitations of sukuk which are excluded from the requirement for prior written approval of Labuan FSA² includes an offer or invitation of sukuk where the first time investment of each of the initial sukuk holders is:
 - (a) not less than two hundred and fifty thousand ringgit (or the equivalent in any other currency); or
 - (b) less than two hundred and fifty thousand ringgit (or the equivalent in any other currency) with the invitation to whom the offer is communicated does not exceed fifty person;

and the investors are in possession of sufficient information to be able to make a reasonable evaluation of the offer or invitation.

- (iii) A resident of Malaysia who makes an offer for subscription of sukuk in or from Labuan IBFC, is subject to the requirements of the Capital Markets and Services Act 2007 together with its relevant amendments and the Foreign Exchange Administration Rules issued by Bank Negara Malaysia³.
- (iv) A non-resident who makes an offer for subscription of sukuk in or from Labuan IBFC is required to register the disclosure document with the Securities Commission Malaysia as specified in the Capital Markets and Services (Amendment of Schedule 5, 6, 7, and 8) Order 2015.

4.1.4 Eligible Investors

- (i) Any person may subscribe to the sukuk issued in or from Labuan IBFC.
- (ii) Residents of Malaysia may subscribe to the sukuk issued in or from Labuan IBFC, subject to the requirements under the Foreign Exchange Administration Rules issued by Bank Negara Malaysia⁴.

² For the issuance of sukuk that falls under Section 13(5) of LIFSSA, Labuan trust companies as the resident secretary of the Labuan company shall notify Labuan FSA not later than 30 calendar days after the issuance of the sukuk in Labuan IBFC.

³ Please refer to Notice 2 – Borrowing and Guarantee under Bank Negara Malaysia’s Foreign Exchange Administration Rules.

⁴ Please refer to Notice 3 – Investment in Foreign Currency Asset under Bank Negara Malaysia’s Foreign Exchange Administration Rules.

5.0 GSS Sukuk Issuance in Labuan IBFC

- 5.1 The issuance of GSS sukuk in Labuan IBFC can be aligned with any recognised international standards for green, social or sustainability framework such as the:
- (i) International Capital Market Association (ICMA)'s Green Bond Principles, Social Bond Principles and Sustainability Bond Guidelines,
 - (ii) Climate Bonds Initiative (CBI) Climate Bonds eligibility taxonomy and Climate Bonds Standard,
 - (iii) ASEAN Capital Markets Forum (ACMF) ASEAN Green, Social and Sustainability Bond Standards,
 - (iv) People's Bank of China Green Bond Endorsed Project Catalogue, and
 - (v) other aligned frameworks.
- 5.2 In addition, the GSS sukuk shall be approved and endorsed by a Shariah adviser to ensure compliance with Shariah principles.

6.0 Case Studies of GSS Sukuk Issues

- 6.1 Case studies of selected GSS sukuk issues are highlighted in the Appendix of the Guidance Note as reference.

Labuan Financial Services Authority 27 March 2020

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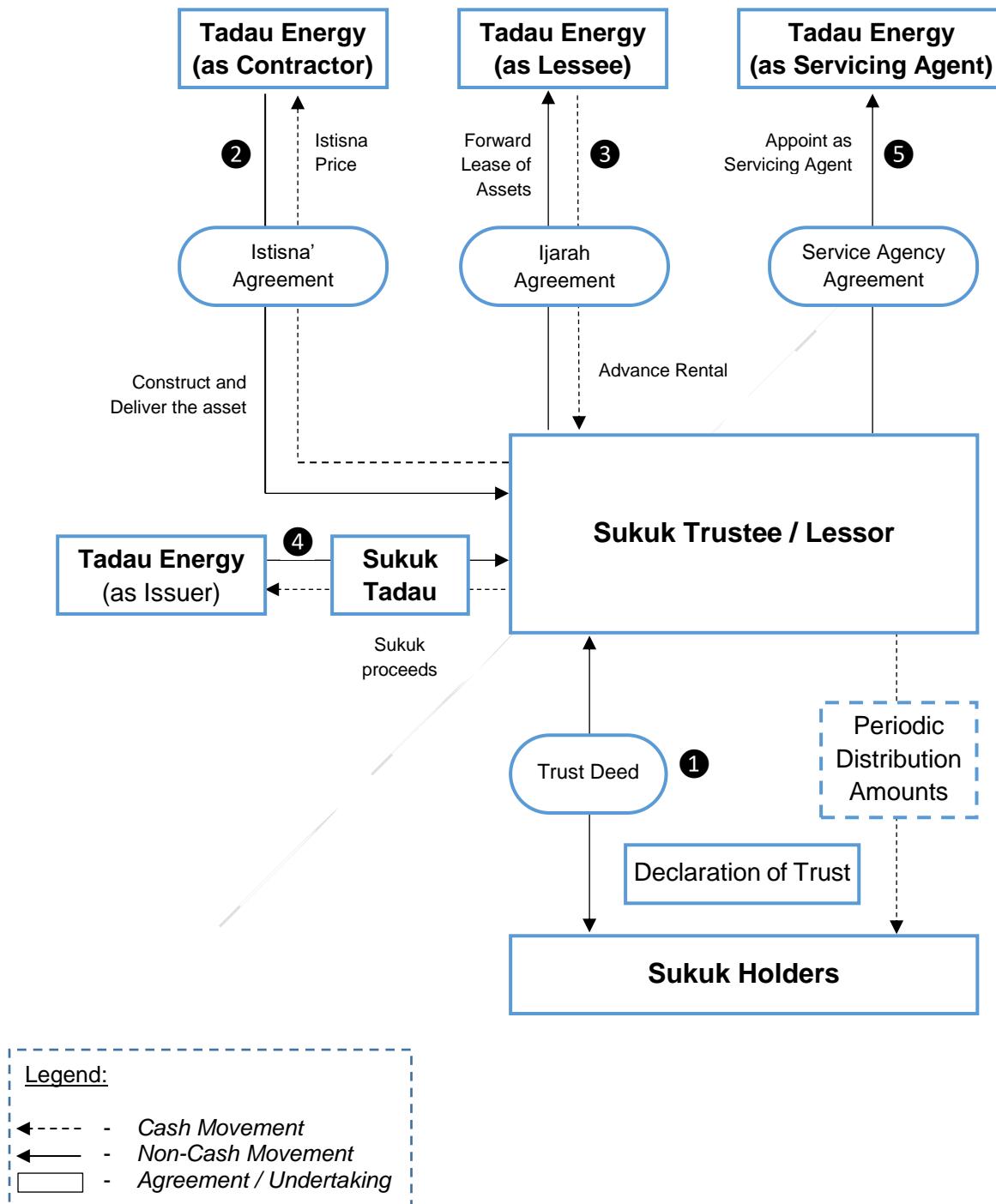
Case Study 1: Green Sukuk - Tadau Energy Sdn Bhd issued MYR250 million sukuk to finance the construction of 50 MW solar photovoltaic (PV) plants in Sabah, Malaysia.

Structure Description

1) At Inception and During Construction of the Assets

1. The Sukuk Trustee shall declare a trust over the Trust Assets for the benefit of the Sukuk holders. The Trust Assets comprise the rights, interest and benefit in, to and under the Istisna' agreements, the completed Assets, the Ijarah Agreements, the Service Agency Agreement and the Purchase Undertaking.
2. The Sukuk Trustee (acting on behalf of the Sukuk holders), shall first enter into an Istisna' Agreement with the Issuer (in its capacity as "Contractor") in respect of each of Asset 1 and Asset 2 (solar PV plants). The Contractor will build, construct and deliver the assets for the Sukuk holders for the respective Istisna' price.
3. The Sukuk Trustee will subsequently enter into an Ijarah Agreement with the Issuer in respect of each asset. The Sukuk Trustee (as "Lessor") agrees to lease and the Issuer (as "Lessee") agrees to take on the lease of the relevant Asset (under the concept of Ijarah Mawsufah Fi Zimmah i.e. Forward Lease).
4. The Issuer issues the sukuk, where the sukuk shall represent the Sukuk holders' interest, rights and entitlements under and to the Trust Assets, including the proportionate undivided ownership of the assets upon completion and delivery. The sukuk proceeds shall be utilised to pay the Issuer (in its capacity as Contractor) the Istisna' price under the Istisna' Agreements.
5. Pursuant to a Service Agency Agreement, the Sukuk Trustee shall appoint the Issuer as "Servicing Agent" throughout the Lease Period under each Ijarah Agreement. The Servicing Agent shall perform all repairs, replacements, acts and maintenance works and pay ownership expenses in respect of each asset during the respective Lease Periods.

Diagram I: At Inception and During Construction of Assets



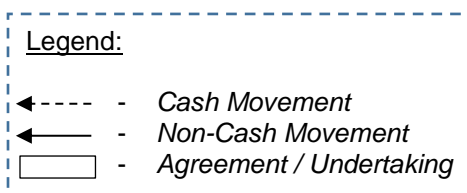
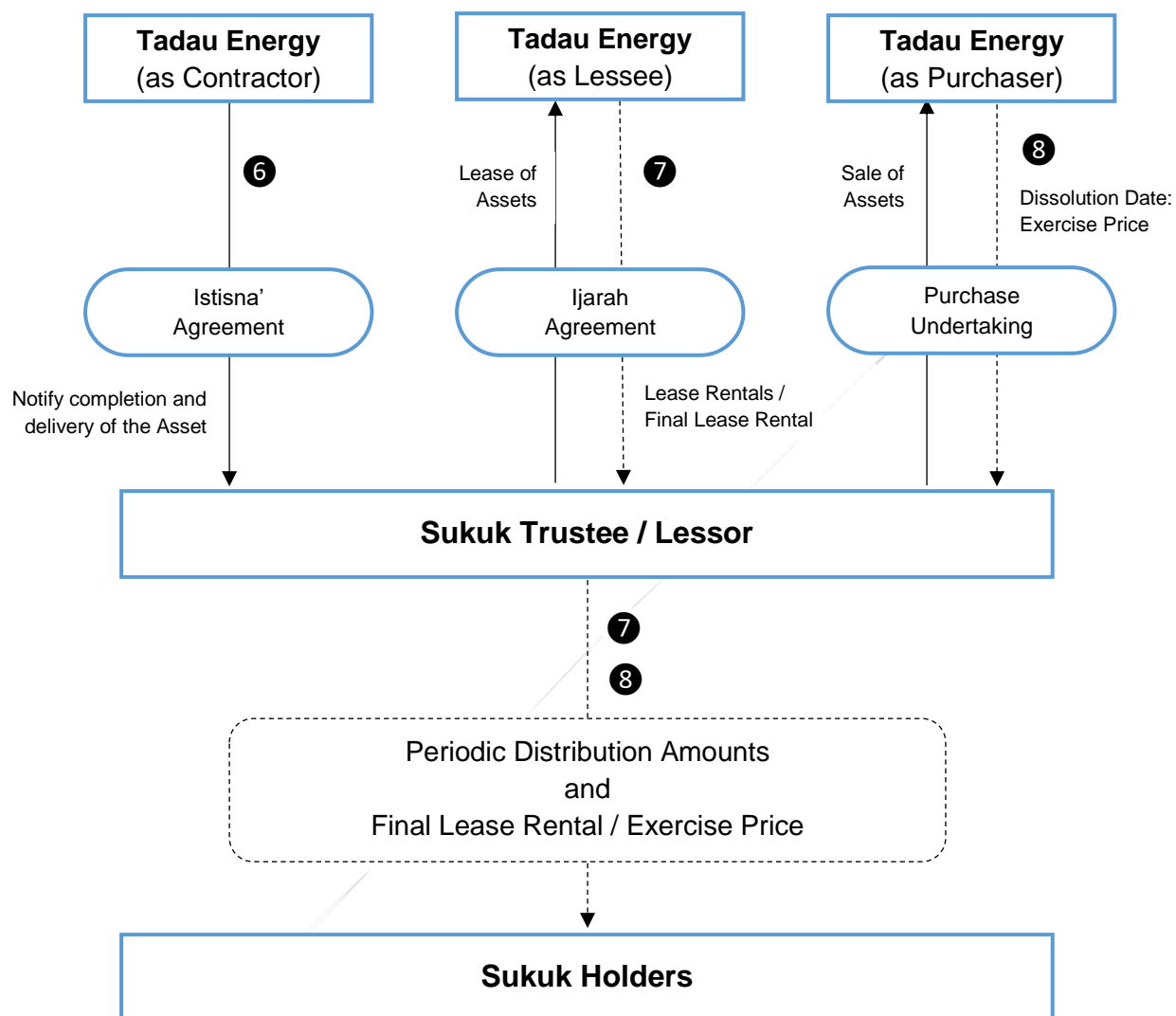
II) Post completion of the Assets and at Maturity

6. Upon completion of construction and delivery of the relevant asset, the Contractor shall notify the Sukuk Trustee of the completion and delivery of the asset pursuant to the Istisna' Agreement.
7. During the lease period, the Lessee will pay the lease rentals to the Lessor pursuant to the Ijarah Agreements. The lease rentals for each tranche shall be equivalent to the Periodic Distribution Amount which is to be channelled to the Sukuk holders on the Periodic Distribution Dates. The final lease rental shall include the following:
 - (i) last periodic distribution amount;
 - (ii) nominal value of the relevant maturing tranche; and
 - (iii) the ownership expenses.

Conditional upon the full payment of the lease rental, upon the maturity date of the final outstanding tranche of the sukuk, the relevant asset shall be granted/transferred without cost to the Lessee by way of conditional hibah in accordance with the Ijarah Agreement.

8. The Issuer (as Purchaser) will grant a "Purchase Undertaking" to the Sukuk Trustee, whereby the Purchaser irrevocably undertakes to purchase the proportionate undivided ownership in the relevant asset from the Sukuk Trustee acting for the Sukuk holders, upon the declaration of any Dissolution Event at the relevant Exercise Price via a Sale Agreement. The proceeds shall be utilised for the redemption of the sukuk held by the Sukuk holders which shall then be cancelled.

Diagram II: Post completion of the Assets and at Maturity



Source: Tadau Energy Sdn Bhd Information Memorandum

Case Study 2: Social Impact Sukuk - Khazanah Nasional Berhad issued MYR100 million sukuk to fund schools under the Yayasan AMIR Trust School Program.

Structure Description

The Ihsan Sukuk is based on Sukuk Al Wakalah Bil Istithmar. The certificates represent projects or activities that are managed on the basis of investment agency by appointing an agent to manage the operation on behalf of the certificate holders.

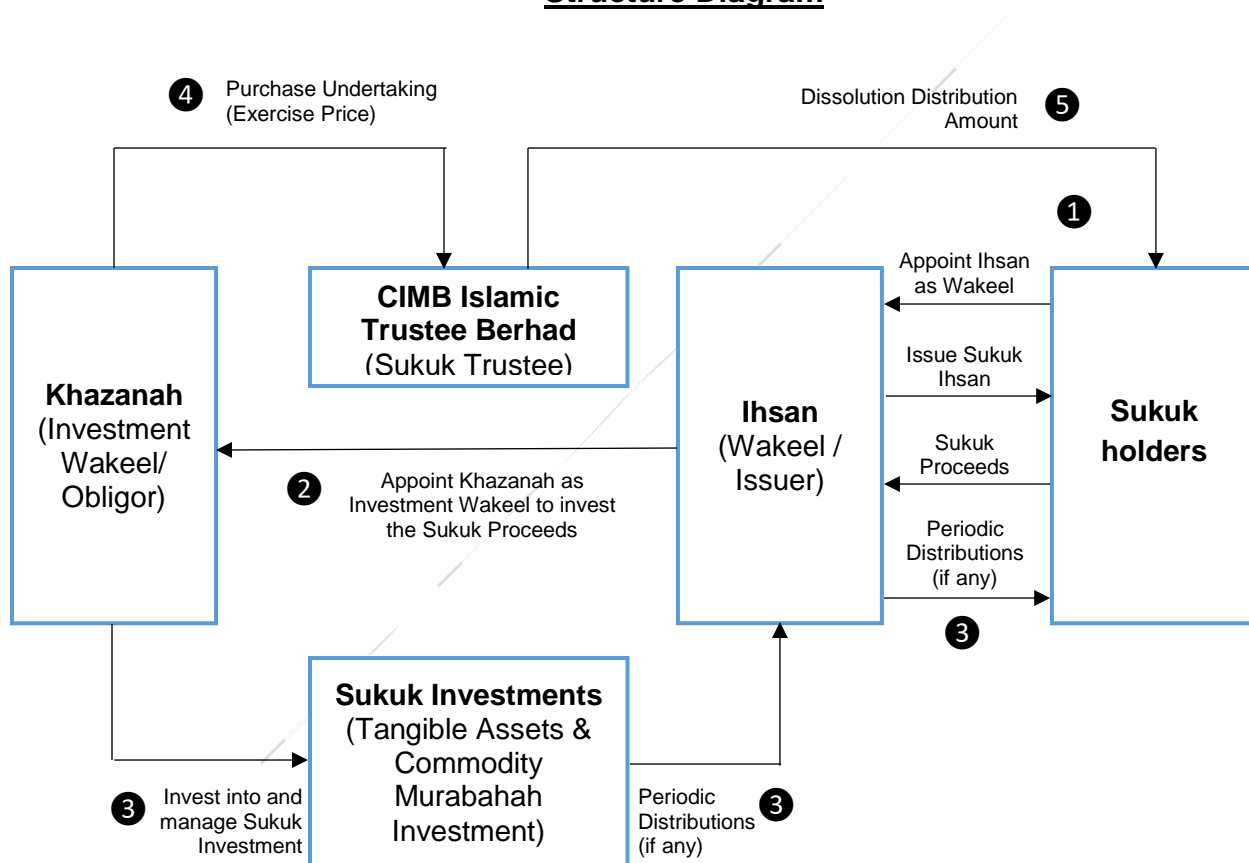
1. Ihsan Sukuk Berhad as the Issuer and Wakeel, declares a trust over the Sukuk Proceeds and over the Sukuk Investments.
2. Pursuant to a Wakalah agreement between the Sukuk Trustee and Ihsan, the Trustee, CIMB Islamic Trustee Berhad⁵, will appoint Ihsan to act as its agent (Wakeel) to invest the Sukuk Proceeds in Sukuk Investments. Ihsan, in turn will appoint Khazanah as the sub-wakeel or agent on its behalf (Investment Wakeel) to invest the Sukuk Proceeds.
3. Khazanah in the capacity of Investment Wakeel will invest the Sukuk Proceeds into an investment portfolio comprising of (i) Shariah-compliant tangible assets, and (ii) Shariah-compliant commodities purchased and sold under the principle of Murabahah.
4. Khazanah (in the capacity of the Obligor) will grant a Purchase Undertaking to the Sukuk Trustee whereby on a Scheduled Dissolution Date or the Dissolution Declaration Date, whichever is the earlier, Khazanah will purchase the Tangible Assets at the Exercise Price.
5. Upon exercise of the Purchase Undertaking and then full payment of all amounts due and payable under the Sukuk Ihsan, the relevant trust in respect of the Trust Assets will be dissolved and the relevant Sukuk Ihsan held by the Sukuk holders will be cancelled.
6. In case of a Dissolution Event, the Sukuk Trustee is entitled to enforce its rights under the Transaction Documents, requiring Khazanah to purchase the Tangible Assets and pay the Exercise Price under the Purchase Undertaking and pay the outstanding

⁵ This is not a special purpose vehicle created for the purpose of this Sukuk, it is an existing subsidiary of CIMB Group.

amounts of the Deferred Sale Price under the commodity Murabahah. The Sukuk Trustee will use the proceeds thereof to redeem the Sukuk Ihsan at the Dissolution Distribution Amount.

- The Key Performance Indicators (KPIs) for the First Sukuk Ihsan will be evaluated prior to the maturity date of the First Sukuk Ihsan by an independent auditor to be appointed from time to time. The independent auditor will provide a KPI Evaluation Report to the Sukuk Trustee and depending upon whether or not the KPIs are met, the nominal value of the Dissolution Distribution Amount payable to the Sukuk holders will be kept at par or reduced accordingly.

Structure Diagram



Source: IIFM Sukuk Report 5th Edition

Case Study 3: Sustainability Sukuk – Edra Solar issued MYR245 million sukuk (through Commodity Murabahah structure) to re-finance the development of the Kuala Ketil Solar Farm as well as Fruit Farming surrounding the solar farm.

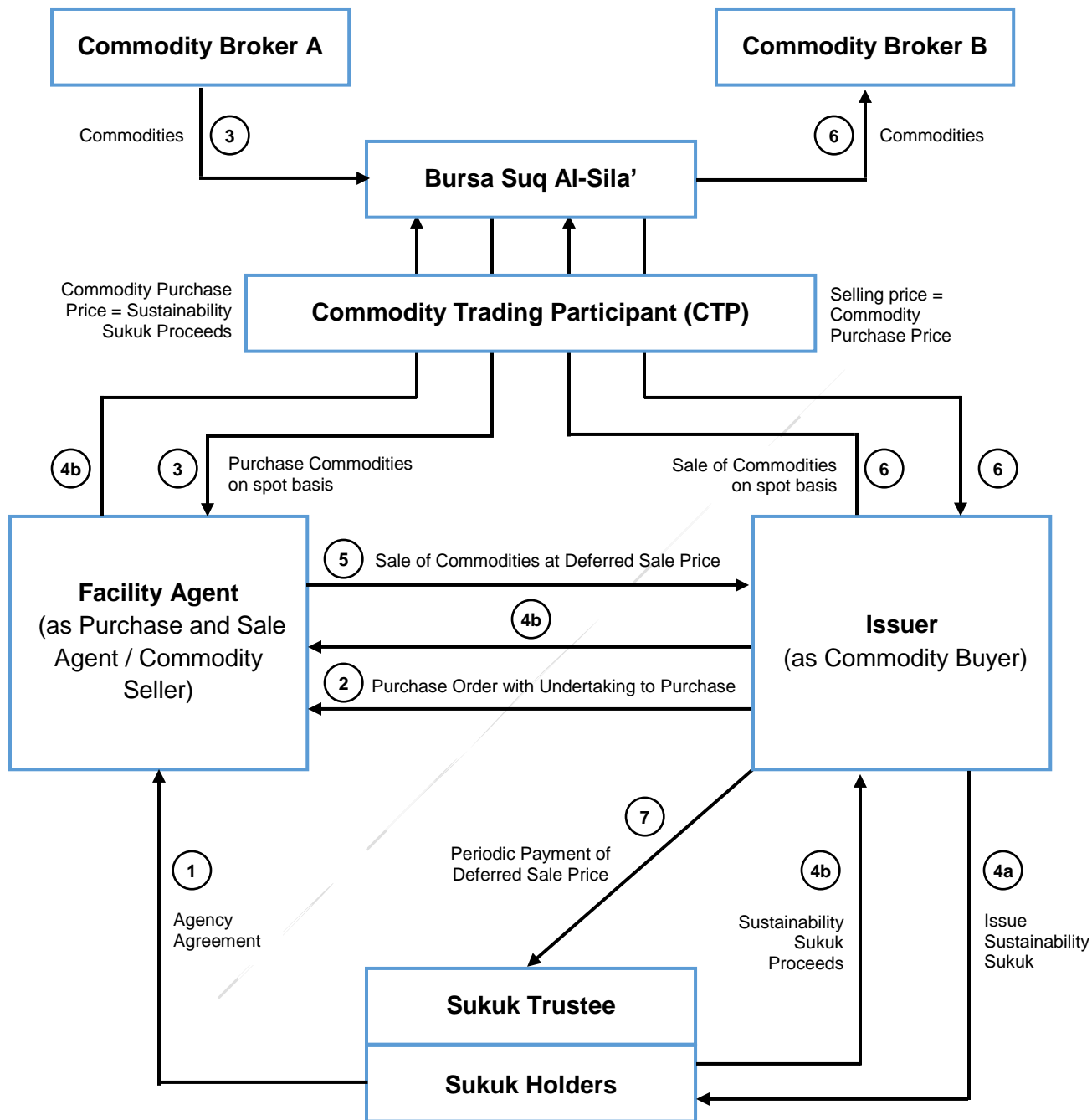
Structure Description

1. The Sukuk Trustee, on behalf of the Sukuk holders, and the Facility Agent shall enter into an agreement (“Agency Agreement”), pursuant to which the Facility Agent is appointed as the Wakeel (agent) of the Sukuk holders (in such capacity, the “Purchase and Sale Agent”) for the purchase and sale of Shariah-compliant commodities which shall include, but are not limited to, crude palm oil and such other acceptable commodities which are provided through the commodity trading platform, Bursa Suq Al-Sila’ and/or such other independent commodity platform as approved by the Shariah Adviser (“Commodities”).
2. Pursuant to the commodity murabahah master agreement (“Commodity Murabahah Master Agreement”) to be entered into between the Issuer (in such capacity, the “Commodity Buyer”), the Purchase and Sale Agent and the Commodity Seller (as defined below), the Issuer (as “Commodity Buyer”) shall issue to the Purchase and Sale Agent a purchase order (“Purchase Order”) with an undertaking to purchase the Commodities (“Identified Asset”) from the Sukuk holders via Purchase and Sale Agent (as “Commodity Seller”) at the Deferred Sale Price (as defined below).
3. The Purchase and Sale Agent, via a commodity trading participant (“CTP”), shall purchase on spot basis the Commodities from a commodity supplier(s) at Bursa Suq Al-Sila’ and/or such other independent commodity platform (“Commodity Broker A”) pursuant to an agreement entered into between the Purchase and Sale Agent and the CTP (“CTP Purchase Agreement”) at the commodity purchase price equivalent to such proceeds of the Sustainability Sukuk (“Commodity Purchase Price”).
4. (a) The Issuer shall issue the Sustainability Sukuk to the Sukuk holders.

(b) The Sustainability Sukuk proceeds shall be used to pay the Commodity Purchase Price. The Sustainability Sukuk shall evidence the Sukuk holders’ ownership of the Commodities and subsequently once the Commodities are sold to the Commodity Buyer, the Sukuk holders’ entitlement to receive the Deferred Sale Price.

5. The Commodity Seller on behalf of the Sukuk holders shall sell the Commodities to the Commodity Buyer at a deferred sale price equivalent to the Commodity Purchase Price plus the profit margin (“Deferred Sale Price”) payable on a deferred basis upon the terms of a sale and purchase agreement (“Commodity Sale and Purchase Agreement”) to be entered into between the Commodity Seller and the Commodity Buyer.
6. The Commodity Buyer, via a CTP, shall sell the Commodities at Bursa Suq Al-Sila’ and/or such other independent commodity platform to other than Commodity Broker A (“Commodity Broker B”) pursuant to an agreement entered into between the Commodity Buyer and the CTP (the “CTP Sale Agreement”) on spot basis for a selling price equivalent to the Commodity Purchase Price.
7. The Commodity Buyer shall make periodic payments on the relevant periodic payment dates forming part of the Deferred Sale Price to the Sukuk holders during the tenure of the Sustainability Sukuk and final payment on the maturity date of the Sustainability Sukuk.

Structure Diagram



Source: Edra Solar Sdn Bhd Information Memorandum