

15 June 2023

## Sustainable And Responsible Investment Linked Sukuk

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The Securities Commission Malaysia (SC) introduced the Sustainable and Responsible Investment (SRI) Linked Sukuk (SRI-Linked Sukuk) Framework under Chapter 9 of Part 3 of the Guidelines on Unlisted Capital Market Products under the Lodge and Launch Framework and Chapter 23 of the Guidelines on Issuance of Corporate Bonds and Sukuk to Retail Investors. The SRI-Linked Sukuk Framework is an extension of the initiatives under the SRI Roadmap that was introduced by the SC in 2019 to broaden SRI products offerings.

The objective for the introduction of the new SRI-Linked Sukuk Framework by the SC was to facilitate fundraising by companies in addressing sustainability concerns such as climate change or social agenda, with features that relate to the issuer's sustainability performance commitments.

With the accelerated shift towards developing a climate-resilient future, high-emitting industries are at a high risk of being phased out. The SRI-Linked Sukuk will enable companies in these as well as other industries to transition into a low-carbon or net zero economy.

The SC further announced the expansion of the SRI Sukuk and Bond Grant Scheme (Grant) to SRI-Linked Sukuk issued under the SRI-Linked Sukuk Framework.

This alert summarises the key features of SRI-Linked Sukuk under the SRI-Linked Sukuk Framework and the Grant.

### What Is SRI-Linked Sukuk?

A SRI-Linked Sukuk is a sukuk where the financial and/or structural characteristics vary depending on whether the issuer achieves its predefined sustainability objectives within a predefined timeline.

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For instance, the SRI-Linked Sukuk may be structured such that the profit rate of the SRI-Linked Sukuk payable to sukuk holders would be raised if the issuer fails to meet the sustainability targets or vice versa.

## Key Components Of SRI-Linked Sukuk Framework

The five key components of SRI-Linked Sukuk Framework are as follows:

(1) Characteristics:

The financial and/or structural characteristics of the SRI-Linked Sukuk vary depending on whether the issuer achieves the KPIs and SPTs (both as defined below).

(2) Selection of Key Performance Indicators (KPIs):

An issuer must select KPIs that among others:

- (a) Are significant to the issuer's sustainability and business strategy.
- (b) Address relevant environmental, social or governance (ESG) challenges in the issuer's industry.
- (c) Are within the issuer's control.

(3) Calibration of Sustainable Performance Targets (SPTs):

An issuer must set out the SPTs, which are measurable targets of improvement over a predefined timeline, for each KPIs.

(4) External review:

An issuer must appoint (i) an independent external reviewer prior to issuance of SRI-Linked Sukuk to assess and provide a report on the issuer's compliance with the SRI-Linked Framework; and (ii)

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an independent verifier to provide a verification report annually on the issuer's performance level against each SPT for each KPI.

(5) Reporting:

An issuer has the obligation to report at least annually via publication of the following information on the designated website:

- (a) An up-to-date information on the performance of the selected KPIs, including baselines, where relevant.
- (b) Relevant information to enable the sukuk holders to assess and monitor the progress or relevancy of the selected KPIs and SPTs including any changes to the issuer's sustainability, business and ESG strategy that may impact the KPIs and SPTs.

## Process Of Issuance Of SRI-Linked Sukuk

Below is an illustration of the process for each issuance of SRI-Linked Sukuk:

(A) The following information are determined:

- (i) Profit Rate: 5% per annum
- (ii) KPI: Reduction in carbon dioxide emission from the issuer's operation
- (iii) SPT: In relation to the KPI, reduction of carbon dioxide emission by 50 million tonne by 30 September 2025
- (iv) Variation of Profit Rate: If issuer achieves the KPI and SPT by 30 September 2025, the profit rate will be reduced by 25 basis point (b.p) / if issuer fails to achieve the KPI and SPT by 30 September 2025, the profit rate will be raised by 25 b.p.

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- (B) The issuer issues the SRI-Linked Sukuk in accordance with the pre-determined terms.
- (C) On or after 30 September 2025, an external verifier assesses and confirms that the KPI and SPT have been achieved by the issuer.
- (D) The profit payment is reduced to 4.75% as incentive for achieving the objective.

### **Difference Between SRI Sukuk And SRI-Linked Sukuk**

A unique feature of the SRI-Linked Sukuk is the link to the KPIs and SPTs which would result in a variation of the financial and/or structural characteristics of the sukuk (i.e. step-up or step-down of profit rates) whereas SRI Sukuk does not have the same feature.

Further, unlike SRI Sukuk, there is no restriction on the use of the SRI-Linked Sukuk proceeds. Proceeds raised from a SRI-Linked Sukuk may be utilised for general purposes, whereas the proceeds from a SRI Sukuk must only be used for funding of eligible SRI projects.

### **Grant**

The expansion of the Grant to SRI-Linked Sukuk by the SC was to facilitate companies raising sukuk to meet their sustainable finance needs.

The Grant is extended to issuers to fund the external review cost relating to SRI Sukuk issuances under the SRI Sukuk framework and the SRI-Linked Sukuk Framework by SC and to bonds issued under the ASEAN Green Bond Standards, ASEAN Social Bond Standards and ASEAN Sustainability Bonds Standards.

### **Claim**

The eligible SRI-Linked Sukuk issuers are now able to apply to offset up to 90% of the external review costs incurred, subject to a maximum of RM300,000 per issuance.

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## Eligibility For Issuances That Qualify For The Grant

The effective period of sukuk and bond issuance that qualify for the Grant are as follows:

- (1) SRI Sukuk issued from 25 August 2020 onwards.
- (2) Bonds issued under the ASEAN Standards from 29 October 2020 onwards.
- (3) SRI-Linked Sukuk issued from 8 August 2022 onwards.

## How To Apply For The Grant?

The issuer is required to submit its application to Capital Markets Malaysia (CMM). The Grant will be paid on a reimbursement basis within 60 days upon complete submission to CMM.

## How Many Times Can The Issuer Claim For The Grant?

The issuer can claim for the Grant based on a one-time issue or issuance under a programme. Should there be more than one issuance requiring a separate external review, the issuer is able to claim on the review cost incurred for each issuance.

## Conclusion

Given that the SRI-Linked Sukuk under the SRI-Linked Sukuk Framework is structured based on the issuer's sustainability performance, the issuance of SRI-Linked Sukuk under the SRI-Linked Framework may be a new way forward in Malaysia to challenge and provide an opportunity for companies to demonstrate that serious proactive steps will be taken to achieve their sustainability objectives.