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Sustainable Finance in the GCC

Sustainable Finance in the GCC[1]

Executive Summary

Sustainable finance and investing are becoming mainstream in the world of finance. Concerns about global warming and adverse weather events have intensified discussions around the need for sustainable development. Financing for Sustainable Development Report 2024 published by United Nations (UN) has estimated that financing and investment gaps to meet the sustainable development goals are between USD 2.5 trillion to 4 trillion annually, highlighting the exigency of scaling up sustainable finance.

Strengthened by investor interest, issuance of sustainable financing instruments has quadrupled over 2018-2023, amounting to USD 1.3 trillion in 2023. Globally, total assets of sustainable funds (open-end funds and ETFs) are at USD 2.98 trillion. While there are many existing products under the sustainable finance umbrella such as green loans, sustainability linked bonds etc. financial institutions also continue to launch new sustainable finance-oriented products. With companies and countries setting up sustainability goals and financial commitments, sustainable finance is firmly set on the growth path. Additionally, emerging trends such as adoption of technology, interest from Sovereign Wealth Funds, acceptance in Islamic financing also favour sustainable finance's growth.

Green, social, sustainable, and sustainable-linked bonds market in the MENA region was at USD 24 billion in 2023, growing at 155% y/y in terms of value. Saudi Arabia and UAE had been the key issuers, making up about 77% of the total. GCC governments and regulators have started the adoption of sustainable finance with varying degrees of progress. In Kuwait, some measures such as such as issuance of guidelines on sustainable financing, issuance of ESG reporting guide have been undertaken by both banking and capital markets regulators. Adoption of sustainable finance by financial institutions and companies is gathering pace, with players across sectors such as banking, logistics and retail adopting sustainable finance.

Given the segment's relative infancy, sustainable finance is facing challenges such as greenwashing, lack of clarity on financial benefits and talent gap. Measures such as implementation of anti-greenwashing rules, standardizing reporting, lowering of complexity of sustainable finance rules, addressing skill gap could provide much needed boost to the growth of sustainable finance.

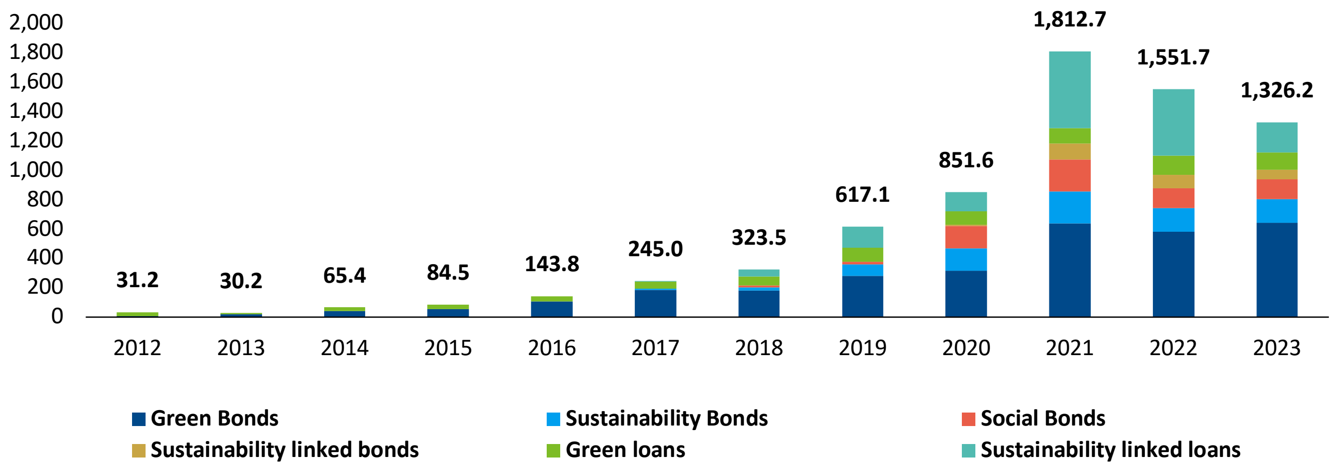
[1] **This report was prepared by:** Aparna K.S., Senior Consultant and Srinithi Ramakrishnan, Analyst, at Marmore MENA Intelligence, the research arm of Kuwait Financial Centre "Markaz".

Explaining Sustainable Finance

Sustainable finance and ESG have become common terms in the world of finance and investing. From green bonds funding renewable energy projects to impact investments targeting specific positive outcomes, sustainable finance is reshaping the financial landscape. Sustainable development emerged as a point of focus for governments and corporates following frequent incidences of climate change related events such as scorching temperatures, intense drought, sandstorms, hurricanes and the depletion of non-renewable resources. Sustainable development projects require financing to materialize. Hence, ensuring the flow of money into green projects is essential to facilitate the transition to a sustainable future. Financing for Sustainable Development Report 2024 published by United Nations (UN) estimates SDG financing and investment gaps at between USD 2.5 trillion- 4 trillion annually.

Sustainable finance is an overarching term referring to the investment process accounting for and promoting ESG factors. Environmental considerations might include climate change mitigation and adaptation, preservation of biodiversity to mention a few. Social considerations could refer to issues of inequality, inclusiveness, labour relations, or human rights issues. The governance of public and private institutions including management structures, employee relations and executive remuneration are few governance considerations in the decision-making process.

Global issuance of sustainability finance products (USD billion)



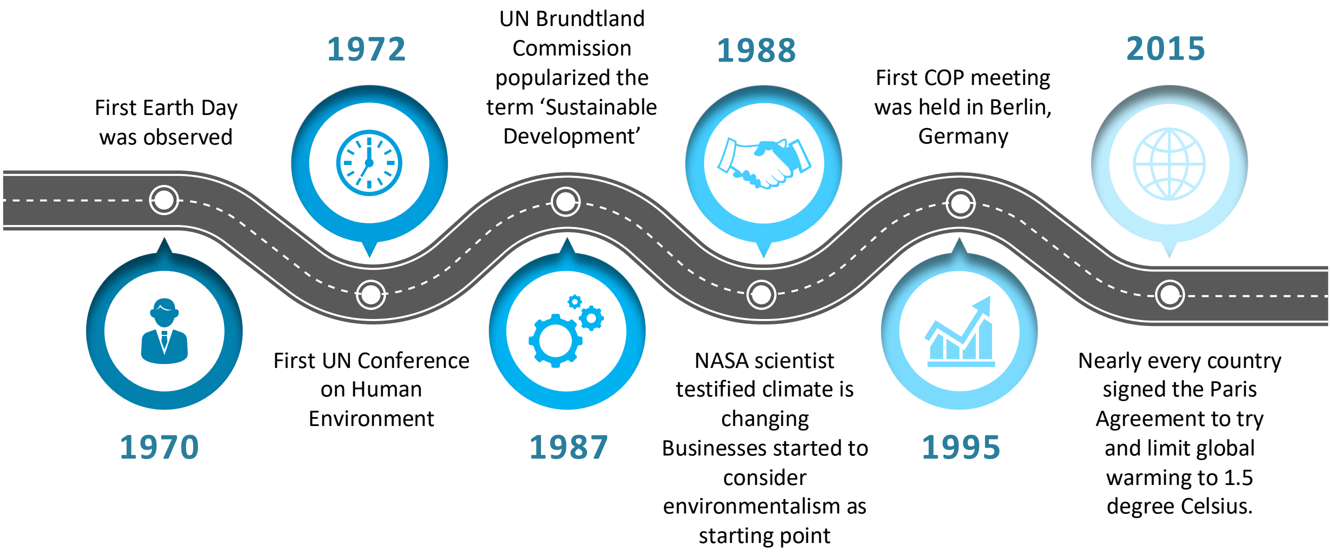
Source: The Banker, Bloomberg

Issuance of sustainable financing instruments have quadrupled over 2018-2023 owing to a surge in investor interest. The aggregate value of issuance peaked in 2021 at USD 1.8 trillion driven by intensified sustainability targets of corporates, a COVID 19-induced surge in social debt, and heightened investor enthusiasm in ESG market. The decline in volume of issuances in 2022 and 2023 could be attributed to high inflation, increasing interest rates and investor concerns on greenwashing. Despite a mild moderation of sustainability finance product issuances since 2021, the overall positive trend in the sustainable finance market points to stable investor confidence and the resilience of sustainable investment strategies. In January 2024, Morgan Stanley surveyed around 2,800 investors with over USD 100,000 in investable assets across the U.S., UK, France, Germany, Switzerland and Japan. Roughly 54% of the respondents expected to increase the percentage of their portfolios allocated to sustainable investments within the next 12 months and a large majority of investors believed that strong ESG practices can lead to better long-term returns.

Sustainable finance product issuances in 2024 are expected to be on par the levels witnessed in 2023, with demand for higher-quality issuances and the need for increased sustainability data disclosure requirements. Green bond issuances are expected to continue their upswing in 2024 supported by relatively more advanced green bond frameworks detailing guidelines for eligible project selection, use of proceeds allocation, and impact reporting. Investor skepticism over credibility of sustainability-linked bonds might weigh down on their issuance in 2024.

How it all began?

Industrial revolution is still considered one of the key milestones that propelled the global economy to where it currently stands. While it fueled economic progress, it also accelerated environmental degradation as industries emitted carbon dioxide and other greenhouse gases resulting in frequent extreme weather events such as drought, flood, rise in sea levels and global temperature, which eventually led to calls on environmental conservation.



Source: Akepa - The Sustainable Agency

The green bond issuances started in 2007, with inaugural issuance from the European Investment Bank to finance its climate-related projects. The Global Financial Crisis of 2008 marked a period that led to the introduction of concepts like the triple bottom line, which urged businesses to balance profit with social and environmental impact. Since 2015, there has been an increase inattention on sustainability with abundance of information. In October 2018, Standard Chartered and the World Bank issued the world's first sovereign blue bond for the Republic of Seychelles to help protect marine areas. The number of times sustainability was mentioned in annual reports, quarterly reports, earnings transcripts, and investor presentations has witnessed consistent growth and reached record levels in 2020. In 2022, European Union issued green bond worth 12 billion euros (USD 14 billion), marking the largest issuance of sustainable debt. The Global Climate Financing Framework was signed by global leaders at the COP28 in 2023 to ensure that the goal to mobilize USD 100 billion to tackle climate change in developing countries is met. In 2023, the Italian government recorded the largest green bond sale, which totaled to 10 billion euros. In January 2024, the African Development Bank issued a USD 750 million worth sustainable hybrid capital note to boost their sustainability lending capacity.

Significance of sustainable finance

The negative financial and environmental implications of rising carbon footprint have mobilized finance towards a transition to a low-carbon and sustainable economy. Sustainable finance plays a pivotal role in transforming the economy from one that exploits natural resources and society to one that has a restorative positive influence. Sustainable finance diverts capital towards a sustainable future through investing in projects that reduce sustainability risks.

Some Key Sustainability Oriented Projects

Masdar City project in Abu Dhabi

The under-construction city is powered by renewable energy, and deploys rainwater harvesting and solar-powered street lights.

Use 70% less energy than a traditional city.

The Øresund Bridge between Sweden and Denmark

A 16-mile long bridge that connects Sweden and Denmark, powered by wind turbines.

It deploys sustainable technologies, such as energy-efficient lighting and recycled materials.

Bullitt Center in Seattle

Energy efficient and uses rainwater harvesting and solar panels.

LEED Platinum certified commercial building.

Source: Various

The growing trend of companies and governments investing in sustainable projects is expected to generate revenue in addition to creating a positive impact on the environment. The sustainable projects focus on minimizing the ecological footprint by promoting sustainable resource management, waste reduction, and the use of renewable energy sources. According to a report by EY in 2022, implementing the strong pipeline of renewable energy projects is expected inject more than USD 1.9 trillion into the global economy over a three-year period, equivalent to 85% of the GDP lost in 2020. Hence, these projects have become crucial in pursuing economic growth in a manner that minimizes negative environmental impacts.

Sustainable financing is paramount in speeding the progress towards carbon neutral goals of several countries. According to the National Public Utilities Council, a U.S-based research organization, 137 countries have committed to carbon neutrality, confirmed by pledges to the Carbon Neutrality Coalition and policy statements by governments. Over 90% of the 137 countries have set a target of 2050 for reaching carbon neutrality due to membership in the Carbon Neutrality Coalition, which asks member states to target 2050 for their goal but leaves commitment up to them.

Carbon Neutral Goals of select countries

Source: Visual Capitalist

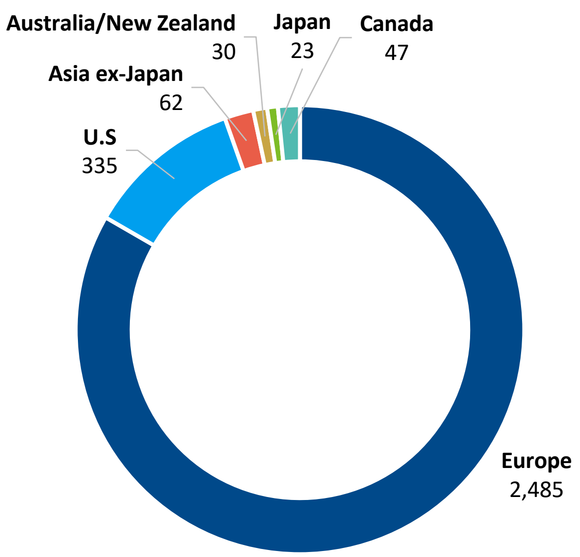
Sustainable Investment Commitments from Global Players

USD 2.5 trillion	• Planned investments to be channeled towards sustainable development by JP Morgan over 2021-2030
EUR 1 trillion	• Planned investments to be mobilised under European Union's Green Deal by 2030
USD 750 billion	• Sustainable finance to be deployed by Goldman Sachs by 2030

Source: Goldman Sachs, JP Morgan, EU

Globally, total assets of sustainable funds (open-end funds and ETFs) are at USD 2.98 trillion.

Global Sustainable Fund Assets (USD bn, as of June 2024)



Source: Morning Star

Types of Sustainable Finance Products

Sustainable Finance has evolved over time and currently consists of many products under its umbrella:

Green Bond/Sukuk	•Funds raised through these bonds are used to finance projects that have positive environmental impact. •**Example**: Saudi Arabia's Public Investment Fund had issue two green bonds totaling to USD 8.5 billion. Of this, PIF has invested USD 1.3bn in eligible green projects in renewable energy, energy efficiency etc.
Social Impact Bond/Sukuk	•Proceeds are used to finance social projects that achieve positive social outcomes or address a social issue. •**Example**: The National Bank of Ras Al Khaimah issued the first public social bond in GCC for USD 600 million in July 2024, the proceeds of which would be used to support MSMEs and to improve healthcare in the society.
Sustainability Bond/Sukuk	• Proceeds are used to finance or re-finance a combination of green and social projects or activities. •**Example**: Dubai Islamic Bank has issued sustainability sukuks for USD 750mn and USD 1,000 mn. The proceeds have been used for renewable energy, clean transportation, employment generation, affordable housing etc.
Sustainability Linked Bond/Sukuk	•These bonds are linked to the issuer's achievement of agreed sustainability goals. Lack of progress by the issuer towards the selected KPI for the goal could result in higher coupon payments.
Green Loan	•Borrowers use funds to exclusively fund green projects. •**Example**: NEOM Green Hydrogen Company availed USD 6.1 bn green loan for construction of production facility from a consortium of 23 banks and financial institutions.
Sustainability Linked Loan	•These loans are linked to the sustainability performance of the borrower. For example, if the borrower meets certain ESG targets tailored for that company, the interest payable on the loan will reduce.. •**Example**: Emirates NBD raised USD 1.75 billion sustainability linked loan which was linked to sustainability metrics such as gender diversity in top management roles and water conservation.

Source: The Banker, ArabNews and Other Sources

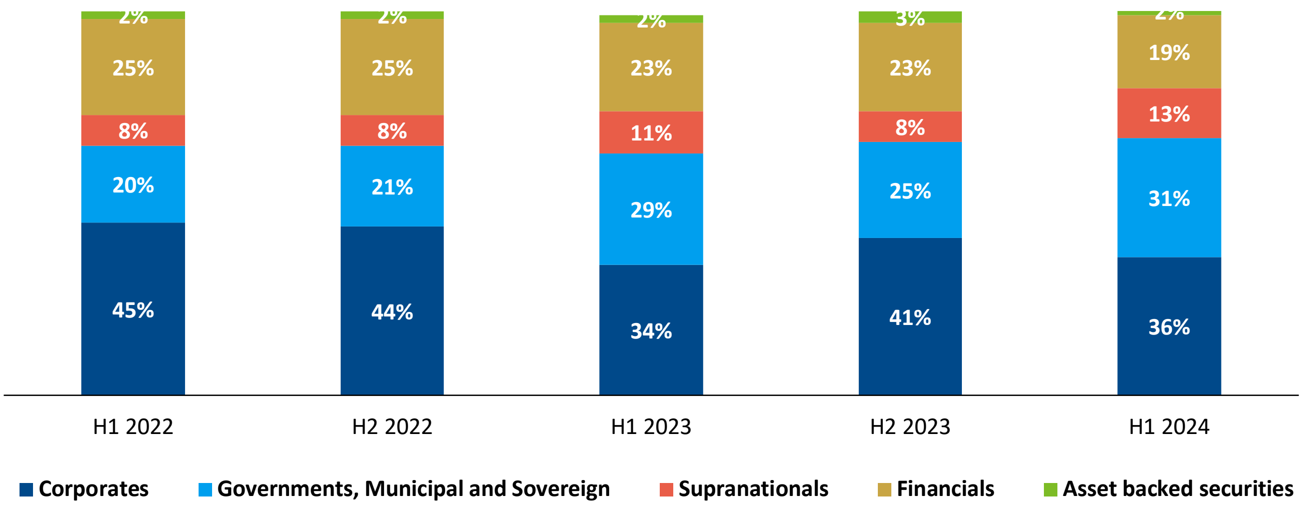
Financial institutions also continue to launch new products under the sustainable finance umbrella. For example, Dubai Islamic Bank's offers sustainable home finance through which borrowers can invest in green homes, avail ancillary finance for solar panels and sustainable construction materials.

Emerging trends and Growing Momentum of Sustainable finance

- **Focus on transition bonds:** Value of transition bonds issued increased almost eightfold in H1 2024 compared to H2 2023.[2] Transition bonds enable companies to finance decarburization activities that are not conventionally green but can markedly reduce emissions in hard-to-subside sectors. Notably, Japan leads the market for transition bonds, with USD 13.9 billion of the USD 15.5 billion issued volume in H1 2024, largely enabled by Japan's Climate Transition Bond Framework. The surge in transition bonds could indicate a higher level of openness for the corporates to evaluate transition activities and embrace product innovation.

- **Public sector to lead the sustainability finance issuances:** Government agencies, municipal, sovereigns, and supranational entities have been the growth engine for global sustainable finance issuance. Their share in the total market grew from 29% in H1 2023 to 44% in H1 2024. This action from governments to manage sustainability risks and climate change initiatives underpin the stability in the market share of governments in the sustainability finance issuances. The issuance momentum is expected to continue supported by the energy transition and Net Zero goals of countries.

Contribution of issuance to global sustainability finance market by entity type



Source: Bloomberg New Energy Finance, ING Research

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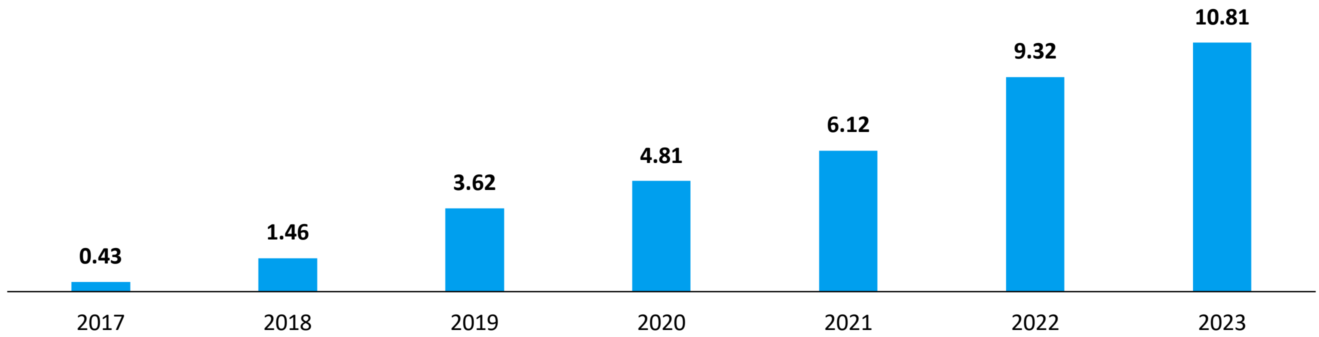
[2] ING Research

- **Islamic Finance on the rise:** Sustainable sukuk issuances in 2023 was at USD 10.8 billion, making up 6.4% of the global sukuk issuances during the year. Green sukuk accounted for roughly 63% of sustainable sukuk issuance in 2023, supported by the Islamic countries' energy and climate transition agendas. The predominance of green financing is consistent with the conventional bond market, with green bonds accounting for more than 60% of ESG-labelled issuances in 2023, according to Credit Agricole. UAE accounted for 40% of sustainable issuances during the year, while Saudi Arabia represented 20% of the issuances, according to S&P data. Issuances in the UAE surged owing to COP28 coupled with an exemption of sukuk registration fees introduced by UAE regulators last year. Companies (49%) and banks (36%) have remained the predominant issuers of sustainable sukuk.[3] The trend of sustainable sukuk issuances by banks is expected to continue as they intend to diversify their investor base. The issuance of digital sukuk is expected to gain traction in the field of sustainable sukuk. Digital sukuk involves digitizing the process of sukuk issuance, with standardized documentation and ease of access for investors.

Sustainable Sukuk Issuances (USD billion)



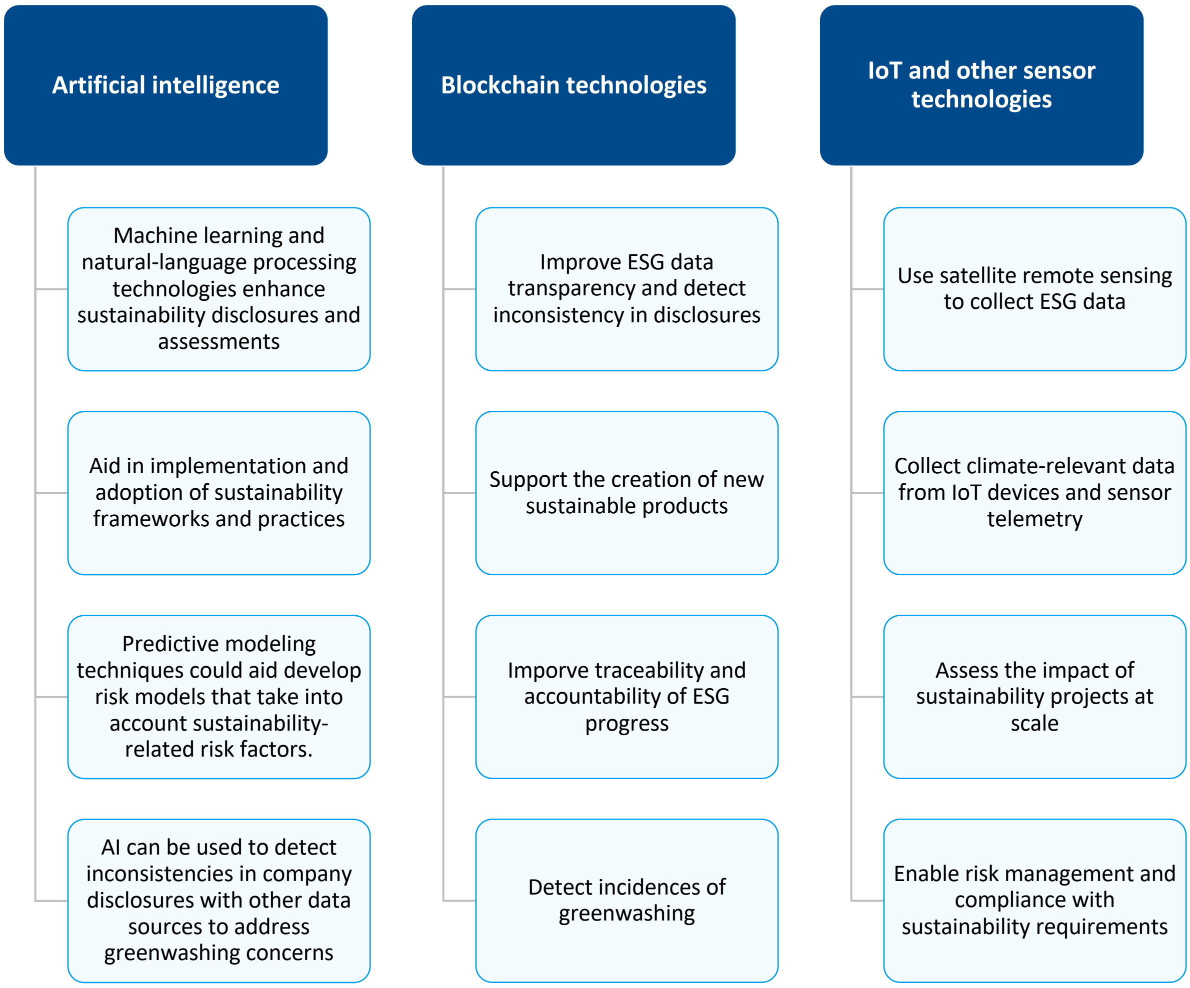
Source: S&P

- **Rising prevalence of green jobs:** Job roles related to ESG are gaining prominence across the globe. According to LinkedIn's Global Green Skills Report 2023, the share of green talent in the workforce rose by a median of 12.3% between 2022 and 2023. Meanwhile, the share of job postings requiring at least one green skill grew by a median of 22.4%. For instance, the U.S. added 142,000 clean energy jobs in 2023, with employment in the clean energy sector growing more than twice as fast as the rest of the energy industry and the economy overall. Roughly 56% of the jobs added in the energy sector involved clean energy.[4] In the GCC region, employees have displayed a heightened awareness of the importance of green skills compared to their global counterparts owing to the green initiatives of the economies. According to survey conducted by LinkedIn published in July 2024, roughly 61% of Gen Z professionals considered rejecting a job opportunity if they do not believe in the employer's green policies. Approximately, 72% of Gen Z professionals in the UAE expressed their concern about the impact of climate change.[5]

[3] The Banker
[4] CBS News
[5] Zawya

- **ESG investments by SWFs:** According to the Global Sovereign Wealth Funds (SWF) 2024 report, SWF's investment in green assets across the world reached USD 26.1 billion in 2023 in support of companies related to the energy transition, including renewable energy, battery storage and electric vehicles. Gulf SWFs accounted for almost half of that figure with emphasis on energy transition agenda and recycling revenues into green impact investments. For instance, the Saudi Public Investment Fund (PIF) has invested directly in the manufacture of electric vehicles (EV) and the entire automotive value chain. PIF began its involvement in Lucid in 2018 by investing USD 1.0 billion and has continued to pump capital into the EV maker since its IPO in 2021. Saudi Arabia aims that Lucid begins producing EVs in Saudi Arabia from 2025. Saudi Arabia's Public Investment Fund (PIF) has issued six green bonds totaling to USD 8.5 billion - USD 3.0 billion in October 2022 and USD 5.5 billion in February 2023. Abu Dhabi Investment Authority (ADIA) holds a minority stake in GreenKo, an operator of clean energy projects in India with a focus on wind, hydro and solar assets. Kuwait Investment Authority is working on making its portfolio completely ESG compliant.

- **Technology enables sustainability:** Despite minimal direct relevance to sustainable finance, advanced analytics and artificial intelligence (AI) have emerged as key tools for assessing environmental impact, optimizing resource utilization for corporates and enhance sustainability disclosures. For instance, BIS's Hong Kong center utilizes AI and big data technologies to enhance tracking of scope 3 emissions.



How is GCC embracing sustainable finance?

Green, social, sustainable, and sustainable-linked bonds market in the MENA was at USD 24 billion in 2023.[6] While this makes up about 3% of global market, the regional market is picking up speed, having grown at 155% y/y in terms of value in 2023. Saudi Arabia and UAE had been the key issuers, making up about 77% of the total. Green sukuk issued in the MENA region had been at USD 6.5 billion in 2023, making up about half of global green sukuk issuance during the year.[7] Sustainable loans market in MENA region had been at USD 54 billion as of November 2023, with 40% and 25% of it coming from Saudi Arabia and UAE respectively.[8]

Adoption by Governments/Regulators

GCC governments and regulators have started the adoption of sustainable finance with varying degrees of progress. Of the GCC countries, UAE has made considerable progress, standing out in terms of issuance Regulatory Framework for Green and Sustainability-Linked Bonds and Sukuk by the Securities and Commodities Authority and issuance of sustainable finance regulatory framework by its financial centers – Abu Dhabi Global Market and Dubai International Financial Centre. The country also has ESG indices - S&P/Hawkamah UAE ESG Index and FTSE ADX ESG Screened index.

In Kuwait, some measures have been undertaken by both banking and capital markets. Central Bank of Kuwait has issued guidelines on sustainable financing and has also reportedly instructed banks to earmark a portion of their loan portfolios for green financing.[9] Boursa Kuwait is a signatory of Sustainable Stock Exchange initiative and has taken measures such as issuance of ESG Reporting guide, hosting of workshop on IFRS sustainability disclosure etc.

Table: Sustainable Finance in GCC (Government/Regulator)

	Saudi Arabia	UAE	Kuwait	Qatar	Oman	Bahrain
Sustainable/Green Finance Framework/Strategy	Yes	Yes	Yes	Yes	Yes	Yes
Sovereign Bond Issuance	Yes	Yes	-	Yes	In Progress	-
Central Bank Guidelines/Regulation on Sustainable Finance	-	Yes	Yes	Yes	Yes	Yes
Capital Market Regulatory Framework/ Guidelines Sustainable Finance	-	Yes	Yes	-	Yes	-
Financial Centre Regulations/Framework	-	Yes	-	Yes	-	-
ESG Index	-	Yes	-	Yes	-	-
Member of Sustainable Stock Exchange Initiative	Yes	Yes	Yes	Yes	Yes	Yes

Source: PwC, Various

[6] Bloomberg/Arabian Business
[7] Bloomberg/Arabian Business
[8] Environmental Finance
[9] Arab Times

Adoption by financial institutions and companies

In GCC, adoption of sustainable finance by financial institutions and companies is picking up. This is particularly so for UAE, aided by the country's hosting of the COP28 UN Climate Change Conference. In the conference's backdrop, UAE's financial sector has pledged to mobilize AED 1 trillion in sustainable finance by 2030. Other financial institutions that have adopted sustainable finance include National Bank of Kuwait, Warba Bank (Kuwait), Saudi National Bank (Saudi Arabia) etc. Examples of adopters among companies include government related entities such as DP World, BAPCO Energies and private companies like Majid Al Futtaim.

Table: Sustainable Finance in GCC (Financial Institutions/Companies)

	Saudi Arabia	UAE	Kuwait	Qatar	Oman	Bahrain
Banks having sustainable finance framework	Yes	Yes	Yes	Yes	Yes	Yes
Banks Issuing Sustainable Bonds	Yes	Yes	Yes	-	-	-
Banks providing Sustainable Loans	Yes	Yes	Yes	Yes	Yes	Yes
Investment Funds focused on sustainable finance	Yes	Yes	-	-	-	-
Energy companies availing sustainable financing/issuing sustainable bonds	-	Yes	-	-	-	Yes
Some other sectors which have availed sustainable finance	Power	Utilities, Logistics, Retail, Telecom	-	-	Shipping	Steel

Source: Various

Table: Some Key Sustainable Finance Deals in GCC

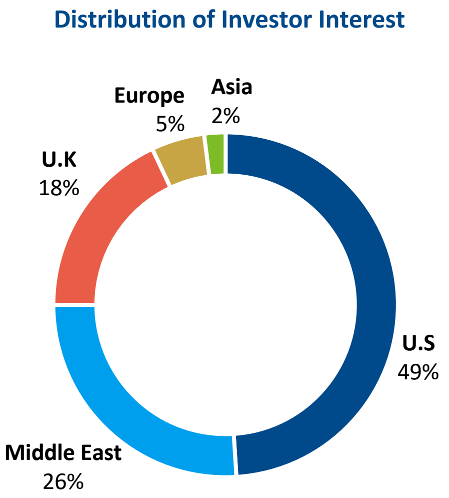
Organization	Country	Type of Financing	Amount (USD billion)
NEOM Green Hydrogen Company	KSA	Revolving credit facility from local banks for construction of Green Hydrogen plant	2.7
Government of Qatar	Qatar	Green bonds	2.5
Public Investment Fund	KSA	Green bonds	2.2
BAPCO Energies	Bahrain	Sustainability-linked Term facility	2.2
Emirate of Sharjah	UAE	Sustainable Bonds	0.5
National Bank of Kuwait	Kuwait	Green bonds	0.5

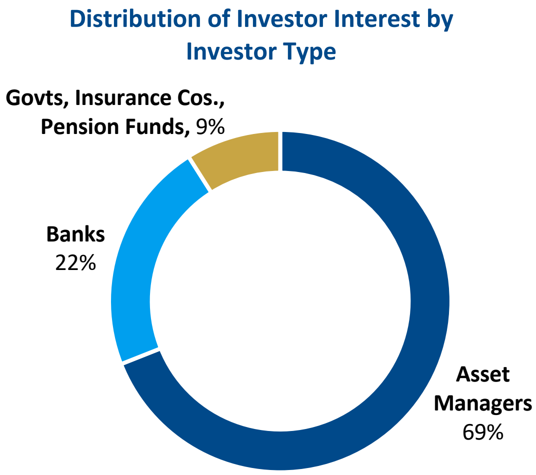
Source: Various

Case Study: Sustainable Finance Issuances in GCC

Case 1: First Green Bond Issuance in Kuwait

National Bank of Kuwait raised USD 500 million in green bonds in June 2024, making it the first such issuance for the bank and for Kuwait.[10] The notes have 6-year maturity and first call date after 5-years. The total order book for the new issuance amounted to USD 1.5 billion, equaling to a subscription rate of more than 3 times.





Source: NBK

The notes were issued at a discount and had a final coupon of 5.50%, fixed with semi-annual coupon payments until their first call date, followed by a floating rate of SOFR + 116 bps which would be paid on a quarterly basis. The bonds will be listed on the Irish Stock Exchange and the net proceeds from the bonds would be allocated to finance eligible green assets.

Case 2: Financing World's Largest Hydrogen Plant[11]

NEOM Green Hydrogen Company is building the world's largest green hydrogen plant to produce green ammonia at scale in 2026 in Saudi Arabia. Of the total investment value of USD 8.4 billion, USD 6.1 billion is being funded as non-recourse financing, making it one of the largest-ever project financings put in place under the green loan framework. It is also the first green hydrogen project to raise billions in project financing.[12] The project is being financed by a consortium of 23 banks and financial institutions, comprising of global and local banks, export credit cover from Euler Hermes, and commitments from the Saudi Industrial Development Fund and National Development Fund on behalf of the National Infrastructure Fund.

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[10] NBK
[11] NEOM
[12] PIF

Challenges in Sustainable Finance

While uptake of sustainable finance is gaining traction, there are some challenges to broader uptake:

1. **Greenwashing**

   Greenwashing refers to portrayal of a company or a product to be more ESG compliant than what it actually is. For example, an automobile manufacturer could advertise of low emissions but could have actually used underhand means to pass the emissions test. Greenwashing is a key challenge to the growth of sustainable finance as its occurrence leads to erosion of trust and would impact other sectors and broader sustainable finance market. Lack of standardized and mandatory reporting requirements is the primary reason for greenwashing incidents.

2. **Measurement and Reporting**

   Absence of unified ESG reporting frameworks result in differences and uncertainty in ESG reporting for companies. Additionally, determining material ESG factors and the subjective nature of some factors like community engagement or employee satisfaction also make measurement difficult, in turn impacting assessment of progress and financing against such progress.

3. **Unclear financial benefits**

   According to a BCG survey, portfolio managers and analysts had expressed concerns of whether pursuit of sustainability conflicts with a company's financial performance or provides clear economic benefits. This makes it important for companies to explicitly highlight the connection between their sustainability initiatives and value creation.

4. **Talent Gap**

   As adoption of sustainable finance grows, skills related to areas such as carbon accounting and energy auditing would be in demand. According to BCG, skills gap in the green economy is estimated at 7 million by 2030. The gap is also felt by companies in the Middle East with 41% of respondents to a PwC ESG survey highlighting lack of internal skills/expertise as a key barrier to furthering progress in ESG.

Recommendations

Some measures that could aid in the growth of sustainable finance are:

1. **Standardized Reporting**
   Standardizing reporting across different jurisdictions would ease compliance, enable comparison, ensure completeness in disclosures and reduce grey areas. Additionally, making reporting mandatory, lowering of complexity of sustainable finance rules could aid in better compliance. Regulators across the world could collaborate to create a commonly acceptable ESG framework.

2. **Handling Greenwashing**
   Regulations to address greenwashing concerns are coming up. Examples include U.K Anti-Greenwashing Rule and EU's Taxonomy Regulation and the Sustainable Finance Disclosure Regulation. In addition to improving regulations and reporting, investors like asset managers, pension funds, SWFs etc. could also play a role by engaging with companies to understand their commitment to sustainability. ESG rating is another important tool to combat greenwashing. Periodic monitoring by regulators could help in keeping a check on greenwashing.

3. **Skill Building**
   Addressing the talent gap in sustainable finance requires upskilling of financial professionals and introducing new skill sets from different disciplines to meet the cross-functional needs of sustainability. A system level example of skill building in sustainable finance is that of Ireland's Sustainable Finance Skillnet, a national network to develop skills to advance ESG best practice across financial services sector. Regulators could play an important role in promoting these programs that support capacity building.

Conclusion

To achieve their sustainability related goals such as targets on net-zero, renewables capacity etc, GCC countries would need considerable financing. Additionally, decarbonization strategies of companies in sectors such as oil, gas and chemicals would also require funding. It is estimated that green investments could add USD 2 trillion to the region's GDP by 2030.[13] According to PwC, companies in Middle East are also becoming more open to green loans, green bonds and sukuk to finance their sustainability initiatives, diversifying from relying mainly on self-financing such initiatives. Given the region's financing needs to meet its sustainability goals, improving investor awareness, increased regulatory and private sector effort to improve sustainable finance offerings and enforcing standardized and mandatory reporting requirements and impact assessments would ensure growth of sustainable finance in the region.

[13] Strategy&

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