



H.E. Abdullah Salim Abdullah al Salmi
Executive President
Capital Markets Authority
Sultanate of Oman
Sent by email to oeep@cma.gov.om

RE: Public Consultation on Draft Sukuk and Bonds Regulation

Your Excellency:

We wish to congratulate the Capital Markets Authority on issuing draft regulations for bonds & sukuk that includes a section on Financing Responsible & Sustainable Investment and thank you for the opportunity to comment. Overall, we think the intention behind the regulation is well designed. There are a few areas that we recommend improvements could be made to, which align with recent developments in responsible finance, as well as sukuk regulation, with the unique structural elements that are not present in conventional bonds.

In addition, before our detailed comments on the green, blue, social, sustainability and awqaf issuance (“labeled bonds & sukuk”) regulations, we would recommend that the CMA consider supplementing this labeled bonds & sukuk regulation, either within this version or through supplemental follow-up regulation of transition-related and sustainability-linked bonds & sukuk.

Oman is making transformative investments in green hydrogen capacity today that will lead to large renewable energy and green hydrogen supply in the coming two decades, in line with Oman Vision 2040.¹ However, in the meantime, there will be significant investment needed, for example, to upgrade existing infrastructure to ensure it can be used for green hydrogen without needing to build new energy infrastructure systems from the ground-up.

Much of this investment may not fit cleanly within the defined areas of ‘green’ investment, but it will nonetheless be relevant for the transition. There should be specific standards that provide equivalent guardrails against greenwashing for transition bonds & sukuk. Similarly, for companies issuing financing for general corporate purposes, which is not covered in the current regulation, sustainability-linked bonds and sukuk will be needed.

Similar to transition bonds and sukuk, sustainability-linked instruments will need regulations to prevent greenwashing and preserve the integrity of Oman’s responsible & sustainable capital markets. One such challenge facing sustainability-linked instruments that the CMA should be aware of when creating supplemental regulation is that under current common practice, investors have little incentive to ensure

¹ Paddison, Laura. “Oman plans to build world’s largest green hydrogen plant,” *The Guardian*, 27 May 2021.
<https://www.theguardian.com/world/2021/may/27/oman-plans-to-build-worlds-largest-green-hydrogen-plant>

that sustainability targets are linked to use of proceeds, or are being met, and in fact benefit financially when targets are not met (with step-up coupon resulting).

These issues with sustainability-linked bonds and sukuk could be solved relatively simply by requiring that issuers commit to paying a penalty for non-performance towards nonprofits mitigating the impact, which addresses desired impact while mitigating investor incentive problems. It would be useful for such a change to be pioneered by a regulator from an Islamic market, because it would demonstrate how well-developed practices used in Islamic finance can contribute to responsible finance more broadly.

Such a change proposed here would address incentive issues in sustainability-linked bonds & sukuk by removing the financial incentive for investors to subscribe to bonds & sukuk that are unlikely to meet their sustainability targets. It would borrow on well-established practices in Islamic banking that allows late payments to be charged to provide an incentive for timely payment, while not allowing banks to recognize the fees as income. This was established as a practice in Islamic finance whereby late fees are collected but donated to eliminate moral hazard. This will also reduce the incentives for banks to encourage customers to take out more financing than they can service which may carry adverse social impact.

Below we provide our further comments on the proposed regulation:

Article (81):

The guidelines for responsible and sustainable bonds or Sukuk limit use of proceeds to projects outlined in Chapter IX (Financing Responsible and Sustainable Investments). It does not currently provide qualification for any negative impacts of these projects or the issuer/obligor such as in the European Commission's taxonomy, which has environmental screening criteria relating to 'Do No Significant Harm' (DNSH) as well as social safeguards.² A similar criteria would improve the integrity of the market by excluding issuers with a green project, but which also have unmitigated environmental or social impacts.

Article (84):

It is unclear how the list of objectives in this Article relate to the definitions contained in Articles (85) and (86) which provide a rough taxonomy, but it is not definitive. The lists outlined in the regulation are qualified by the phrasing that qualifying projects "include but are not limited to" the items referenced. It would be desirable to avoid potential for greenwashing to clearly state that an issuer must have an objective defined in Article (84) and meet one of the qualifications outlined in Article (85) or (86).

Article (85):

It appears the reference in the text to "Article (82)(5)" should be revised to read "targeted population under Article (84)(e)".

² European Commission Delegated Regulation C(2021)2800 on supplementing Regulation (EU) 2020/852 of the European Parliament and of the Council by establishing the technical screening criteria. [https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=PI_COM:C\(2021\)2800](https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=PI_COM:C(2021)2800).

Article (86):

There is significant ambiguity in the definition of “Blue projects” under subheading (B) which encompasses projects related to “(i) Seas and oceans” which would, as written, allow for funding unsustainable activities as long as they pertain to seas and oceans. It would be easiest to fix this gap by clarifying that in order to qualify under (86)(B)(i), the issuer would also have to align with one of the definitions outlined within (A) (Green) or (C) (Social). We would recommend that Articles (85) and (86) also be qualified with reference to a policy along the same lines as DNSH or social safeguard requirement that we commented on under Article (81).

We would recommend that the regulation clearly states that Article (86)(E) relates only to Responsible and Sustainable Sukuk and not Bonds.

Article (87):

We recommend that the items included in this Article be supplemented for Sukuk with an analysis of the underlying asset uses if the issuance is a Sukuk. Green bond standards typically cover only the funds raised by the issuer in the offering and their uses, and not any other assets. However, it is common for many Sukuk to incorporate a tangible or intangible asset that is not related to the ultimate use of proceeds. In the absence of this specific requirement, an unsustainable asset could be used to raise through a responsible or sustainable Sukuk, which would harm market credibility in a similar way that green bond issuance by companies in the extractive industries has.³

Article (92):

We would recommend that for Sukuk, the requirements for filing be expanded to include underlying assets or assets used to facilitate issuance to address the comment we posed in relation to Article (87).

Article (93):

We would recommend that impact metrics have an “apply or explain” standard where either an issuer applies an existing impact measurement framework (e.g., the Global Impact Investment Network’s IRIS+ System, or the Impact Measurement Project’s framework), or if it uses an alternative method, an explanation from the issuer about why an existing established framework could not be used.

Article (94):

It is unclear if the reference to confidential information should refer to Article (91) as stated or Article (92) which covers required disclosure. If it is the latter, we support the requirement that the external auditor be required to provide consent for generic information to be disclosed to the public. We would

³ Hale, Thomas. “The green bond that wasn’t,” *Financial Times*, 24 January 2018.
<https://www.ft.com/content/0898253d-97c3-3b51-8e43-706217a93e48>

further recommend that the regulation require that the issuer fully disclose the information that would otherwise be covered by Article (92) and detailed reasons why it cannot be publicly disclosed, so that the external auditor's decision is made with full information.

Article (96):

We support the proposed Article that would require an independent, internationally recognized external auditor, but would also recommend that there be an alternative process to qualify independent domestic external auditors even if they are not "internationally recognized". Alternatively, the regulation should provide further clear definition of what "internationally recognized" means, such that a domestic external auditor could be qualified. For example, if it could qualify by successfully being accredited through an internationally recognized accreditation program. This change would promote domestic capacity development in Oman for responsible and sustainable finance, which will be vital to expanding the range of Omani issuers who could access the market.

Thank you for the opportunity to comment on the proposed Regulation for Issuance of Bonds and Sukuk and we would be happy to provide further detail or clarification as needed for our comments.

Sincerely,

A handwritten signature in black ink, appearing to read "Blake Goud". The signature is fluid and cursive, with the first letters of the first and last names being capitalized and prominent.

Blake Goud
CEO

Responsible Finance & Investment (RFI) Foundation