



malaysian ICM



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RISK SHARING: A WAY FORWARD TO PUBLIC GOOD

Replication featured strongly in the early stages of modern Islamic finance and has enabled it to meet customer needs, achieve scale and prove its commercial viability. In essence, Islamic finance that we see today has been premised on a Shariah-compliant approach, where much of its product structures essentially replicate those of conventional finance. These structures have been based on debt-based contracts and leverage; and are further exposed to the weaknesses of the fractional reserve system.

Just as some leading economists have called for reforms to the present financial system, Islamic finance economists, academicians, scholars and practitioners too have articulated their concerns over the present state of Islamic finance. Greater justice and prevention of harm in human society is only possible if the financial system contributes positively towards this end. And this could be partly achieved by a risk-sharing system as opposed to a risk-transfer system. There is therefore a need to create a comprehensive case for a risk-sharing system.

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THE CONCEPT OF RISK SHARING AND PUBLIC GOOD IN ISLAMIC FINANCE¹

Much has been said and continues to be said about the foothold which Islamic finance has gained in the international financial landscape. A range of proof points support this contention and justify further projections of the growth trajectory of Islamic finance in the coming decades.

We have achieved double-digit growth rates for various components of Islamic finance including sukuk, Islamic fund management and banking, whether at the national, regional or international levels. Additionally there has been increasing acceptance of Islamic finance not only in the Muslim-majority countries but also in certain predominantly non-Muslim jurisdictions. We have also witnessed the growing size of funds seeking Shariah-compliant investments and the increasing participation of multi-national corporations, multi-lateral institutions and conventional institutions in sukuk issuances.

The benefits of Islamic finance are well-documented and well-known to all. Rather than to revisit or restate the pre-conditions for its further growth, the purpose of this article is to share views on two aspects of Islamic finance i.e. the concept of risk-sharing and of public good. These two aspects of Islamic finance are often over-looked or perhaps undervalued.

Islamic finance started as an industry within the conventional framework based on adapted structures that were Shariah-compliant with the hope that these would eventually evolve and become more closely aligned with the core principles of the Shariah. However, the Shariah-compliant industry continued to grow, with most of the available products being largely adaptations of their conventional equivalents. We must acknowledge though that this has been most effective from the marketing perspective and has facilitated understanding and acceptance of these products; indeed it has been instrumental in getting Islamic finance to where it is today.

However, the adaptation of conventional products to create Shariah-compliant ones, meant that there has been less

“More concerted efforts to facilitate the expansion of Islamic finance towards risk-sharing structures will provide Islamic finance with a distinctive value proposition...”

urgency to study and apply valuable Shariah concepts and principles. To some extent, this has diminished the value and spirit of the Shariah in Islamic finance and as a consequence, there continues to be disagreements, uncertainties and concerns with respect to the acceptability of certain Islamic finance products and services.

Furthermore, adaptation has resulted in direct comparisons being made between conventional and Islamic products in terms of risk-return profiles, cost structures and legal, tax as well as regulatory considerations. Often and not unexpectedly, such comparison would result in Islamic products being seen as less attractive.

Thus, for Islamic finance to flourish further and sustain its long-term growth, it must be able to offer a more distinctive value proposition that is universal and all-encompassing. In this regard, risk-sharing is one of the cornerstones of the Shariah. Risk-sharing contributes to fairness and collaboration, both of which are universal values. More concerted efforts to facilitate the expansion of Islamic finance towards risk-sharing structures will therefore provide Islamic finance with a distinctive value proposition which will not only broaden its customer base to include investors seeking risk-participatory instruments, but also offers innovative product structures to provide diversification benefits.

Retracing its origins, Islamic finance started with simple Shariah-compliant transactions being undertaken within the prevailing financial system in order to provide the ummah

¹ This article is extracted from the keynote address delivered by Tan Sri Zarinah Anwar, the then SC Chairman, at the 5th International Islamic Capital Market Forum, in Kuala Lumpur on 10 November 2011.

with a solution to *riba*. But as mentioned earlier, the hope that these would evolve into Shariah-based products and transactions has not materialised in any significant manner.

Islamic finance has continued largely on a path of replication of conventional finance, a model that has not only met the needs of consumers but has also proven to be viable, allowing for the adaptation of the existing regulatory, legal and accounting frameworks, while at the same time ensuring that the contracts used in the transactions comply with the Shariah.

But although the form of contracts for conventional and Shariah-compliant financial transactions differ, the problems and challenges are not dissimilar. Continued reliance on debt-based structures perpetuates the element of inequitable risk sharing by virtue of the risks in debt-based transactions being largely transferred to the clients or investors.

The sub-prime crisis serves to remind us of the fragility of a debt-based system – whereby the securitisation of the bundled sub-prime mortgages by the lenders effectively transferred the entire risks on the mortgages to the investors. Compounding the issue was the fact that these products, which generally lacked clarity and transparency, were being offered to investors who might not have fully appreciated the risks of the structure. As we have seen, risk transfer together with high leverage weakens the link between the financial and real sector and can undermine the entire financial system.

Risk-sharing integrates risk management with value creation. The Islamic concepts of *musharakah* and *mudharabah*, for example, target value creation and are good ways of managing risk. In a healthy venture, the fear of loss serves to counter-balance hope for gain.

When a system allows for the shifting of risk (at a cost), the fear factor becomes inoperative insofar as the seller of risk is concerned.²

Risk sharing also encourages entrepreneurship. When project promoters are able to share the business risks of their new ventures equitably with willing investors, more entrepreneurs will emerge, thus contributing to real economic growth and real wealth creation.

While risk sharing fosters strong commitments, it must have deterrent features that can effectively address any violation of the applicable principles or arrangements. Only in this way we can have a system that is competitive and allows for profit-maximisation. Risk-sharing structures by their very nature will foster greater self and market discipline, thus allowing the regulators to focus on their core business of investor protection, ensuring fair and orderly markets and minimising systemic risks. The risk-sharing concept, therefore, leads to the attainment of public good and promotes ethical and responsible corporate conduct.

It must be recognised that modern finance has contributed immensely towards global economic and social development, towards the betterment of humanity. New ethical dimensions have been introduced into the financial services industry, such as corporate social responsibility programmes, socially responsible investing, green-financing, application of the Equator Principles³ which ensures the commitment of conventional institutions to the pursuit of public good.

In March 2011, the Securities Commission Malaysia (SC) and the Oxford Centre for Islamic Studies (OCIS) jointly hosted the 2nd SC-OCIS Roundtable on the theme “Islamic Finance and the Public Good”. Attended by leading Shariah scholars, advisors, academicians and practitioners, the roundtable generated highly insightful, critical and constructive deliberations on the subject matter. In his Keynote Address at the 2nd SC-OCIS Roundtable, HRH Raja Dr Nazrin Shah reminded the participants, “We should not be satisfied with just achieving something that is *halal*, but instead should strive for something that is also good or wholesome. If we are to adopt a similar approach in our endeavour to bring Islamic finance to greater heights, we therefore must not overlook the need to incorporate the element of *tayyib* into

² Current Financial Crisis and Islamic Economics. <http://www.siddiqi.com>

³ The Equator Principles (EPs) are a credit risk management framework for determining, assessing and managing environmental and social risk in project finance transactions.

products and practices. This need is especially relevant when the Islamic finance industry remains largely in an adaptive, as opposed to innovative, mode. The process of adapting a product or practice from conventional to Shariah-compliant may at times focus on eliminating the *haram* while neglecting to incorporate the *tayyib*.⁴

Clearly the ultimate objective of Islamic finance must be to fulfil the objectives of the Shariah, the *maqasid Shariah*.⁴ The kind of measured approach that the Shariah takes to the prohibition of *riba*, leverage, speculative risk-taking and *gharar*⁵ is meant to realise the ideals of social justice and to prevent exploitation. Thus the motivation for partaking in Islamic finance should therefore also include considerations beyond just the rationale that funds are from permissible sources, transactions are asset-backed, forms are Shariah-compliant and greater transparency are apparent in the structures. Islamic finance needs to work for the good of society and towards achieving the aspirations of Islamic economics by fulfilling all the conditions of *maqasid Shariah*.

The virtues of Islamic finance need to be unlocked further. Public good, ethics, shared values, governance, real and tangible contributions to the economy hold the key to innovation and growth. The pursuit of profits guided by a higher social purpose will create not just economic returns but also comply with universal values shared by all of mankind. Indeed it is possible to derive profits from doing good. Putting this in place will strengthen the universality and acceptability of Islamic finance, enabling it to offer a distinctive value proposition.

Today, there is increasing interest displayed by both institutional and retail investors who wish to invest according to their closely-held beliefs and values. Ethical investment is no longer a specialist discipline that is of interest to only a small group of investors. More and more investors view it as the basis for a forward looking investment strategy that incorporates a focus on value preservation. Similarly Shariah stipulates that capital should be allocated to those who create value for the investors in their business affairs and promote environmental protection, social good and corporate governance excellence as part of their value proposition.

Malaysia is well-poised to take Islamic finance to the next level given our success as an established Islamic financial centre where the government, regulators and industry all work hand-in-hand to support Islamic finance initiatives.

Under *Capital Market Masterplan 2 (CMP2)*, the widening of the international base of the Islamic capital market has been identified as a key growth driver. In this respect, successful implementation of initiatives and strategies to facilitate and expand the Shariah-based approach, with its underlying qualities of promoting ethical and equitable economic and social developments that have universal appeal, will be crucial in supporting the sustainable growth of the Islamic capital market.

It is hope that the leading global industry practitioners, scholars and experts be able to conduct further assessment on the realisation of risk-sharing structures and transactions towards achieving public good in Islamic finance.

⁴ Objective of Shariah.

⁵ An Islamic finance term describing a risky or hazardous sale, where details concerning the sale item are unknown or uncertain. *Gharar* is generally prohibited under Islam, which explicitly forbids trades that are considered to have excessive risk due to uncertainty.

ISLAMIC ECONOMICS AND THE PUBLIC GOOD – THE ETHICAL AND SOCIAL DIMENSION¹

There is a book written by Thomas Sowell² titled '*A Conflict of Visions*' that discusses the history of scholarship and even of practical politics as being a conflict of visions. Beneath finance there are the foundations, and these foundations are the worldview that underlies our finance. According to Sowell, we will do almost anything to achieve our visions except think about them or discuss and elaborate on them. In Islamic economics and Islamic finance, we have not done the same things sufficiently too. We have not given enough attention to those foundations: the visions.

There is no denying that where numbers are concerned, the growth of Islamic banking and finance has been impressive. The term *maqasid Shariah* has been used many times when we speak of present-day Islamic banking and finance being compliant to the legal dimension of Shariah. But, in this article Islamic finance, it is referred to as being compliant to the legal dimension of Shariah rather than to equate everything that we do in Islamic finance to be in compliant with the Shariah as a whole. Maybe this is something that we could discuss a bit more on.

On creating Islamic finance instruments to compete with conventional finance, there is no denying that Malaysia has given tremendous support towards the development of Islamic finance. There is an overall recognition that we need to talk about the multi-dimensional nature of promoting Islamic banking and finance. By this, it means that the political will is there and the legal framework and educational has been given much attention too. Dr Abbas Mirakhor referred to Islamic finance as a rootless tree. The analogy of what we are now doing is 'pruning the branches'. We have not given enough attention to the roots and trunk, the trunk being what Dato Dr Hamid

Abu Sulaiman³ referred to as the core knowledge that you need to have – an integrated body of knowledge that combines our heritage with modern knowledge. We already have the branches which hopefully would bear us the fruit, but we also need the trunk and the roots, to which we have not given the attention that they deserve.

We have established many academic institutions, but in many of these institutions we have overlooked the foundation, neglected to discuss the vision, spent a lot of time on downstream activities and not given enough upstream focus. There is more interest in creating physical institutions but less emphasis on the development of thought and philosophy.

In 1989, Vali Nasr⁴ wrote about the development of Islamic economics, banking and finance. According to him, there has been too much focus on institutions but not enough attention given to the development of thought. The situation is probably still valid today, this lack of focus on the development of thought which refers to the foundations and visions. There is a misunderstanding and confusion on what economics was and what it has become. There is also a misunderstanding on the scope and subject matter of Islamic economics. We cannot have Islamic finance without Islamic economics, just as we cannot discuss on Islamic economics without focusing on the foundations. And then there is the integration of ethics into economics.

The global events of today compel us to relook at economics. The 1998–1999 crisis gave a big boost to the economics discipline, forcing people to reassess the foundation. What is happening today gives us the opportunity to bring back ethics into economics. Islamic finance and Islamic economics has to have the elements

¹ This article is extracted from a presentation by Professor Mohamed Aslam Haneef from Department of Economics and Islamic Economics and Policy Research Unit, International Islamic University Malaysia, at the 5th International Islamic Capital Market Forum, in Kuala Lumpur on 10 November 2011.

² An American economist, social theorist, political philosopher and author.

³ Former Rector of the International Islamic University Malaysia.

⁴ A leading expert on Middle East and Islamic world and Professor of International Politics at the Fletcher School of Law and Diplomacy of Tufts University.

of ethics in them. This is something we need to elaborate on. But what visions shall we subscribe to? There is a conflict of two visions here. One, which probably represents the alternative vision that we may want to promote, subscribes that an individual is also responsible for the well-being of others. Many of us would have a problem with this statement. We would argue that a company's duty is limited to its shareholders and an individual's to his own self-interest.

The other vision holds that the productive selfishness of the individual produces riches for the community as a whole. This is the 'invisible hand', a doctrine proffered by Adam Smith, which states that the pursuit of self-interest promotes the public good.

Amartya Sen⁵ talked about the two sources of modern economics ethics and engineering. He dwelled on how, over the years, ethics has been marginalised while the mathematical component has dominated in prominence, so much so that economics has been termed as the 'queen' of the social sciences and it has been physics that has been emulated to the highest level; but at the cost of ethics. Today we have this situation where it is generally agreed upon that ethics does not really come into the mainstream neo-classical economics textbook. If we want to reclaim this ethical source we have to determine what needs to be done and who is responsible to carry it out. It would have to be a joint-effort that involves academicians, industry players as well as regulators. We have passed the stage where academics used to criticize Islamic banking and finance, nevertheless Islamic banking and finance practitioners would just ignore them. We have now come to the stage where there is an all-round recognition that it has got to be a joint effort.

Even though economics seems to be an ethical-free science, the consensus among many prominent scholars over the years, including one of the founding fathers of modern economics, John Stuart Mills, is that there is no such thing as economics being a value-free science. According to Mills the assumptions that we make in economics are not necessarily true nor are they universal. If the founding fathers of economics presented what we call economics today as being founded upon this

“Today we have this situation where it is generally agreed upon that ethics does not really come into the mainstream neo-classical economics textbook. If we want to reclaim this ethical source we have to determine what needs to be done and who is responsible to carry it out.”

vision of the self-interest maximiser who is only interested in his own wellbeing, then it may not be universal nor may it even be true. Sen has elaborated on this quite well in his work although many others have also talked about it. Schumpeter talked about this in 1954 and so have Robert Heilbroner,⁶ who was basically saying that there is an ideological base of modern economics, it is the capitalist vision and it represents what he termed as the 'capitalist regime'. The word 'regime' inevitably carries a negative connotation. Perhaps Heilbroner meant it to be as such. It can be just dominating as the socialist regime.

Dr Mirakhor's two books titled '*New Issues in Islamic Finance and Economics*' and '*Islam and Development*', contain a detailed discussion of what is discussed. We need to re-familiarise ourselves with the Islamic worldview – the Islamic vision, because we have forgotten it due to internal and external reasons. The elements of Islamic worldview concerning man, the universe, the goal in life and their connection to economic life – all these need to be revived. You cannot leave out the 'bigger picture' that is based on the vision if we want to develop meaningful Islamic banking and finance.

In 1978, Professor Syed Naquib al-Attas wrote of '*The Loss of Adab, The Corruption of Knowledge and The Moral Dislocation of the Muslim World*'. According to Professor al-Attas, the fundamental concepts in Islamic worldview have lost their true significance due to the

⁵ An Indian economist who was awarded the 1998 Nobel Prize in Economic Sciences for his contribution to welfare economics and social choice theory.

⁶ An American economist and historian of economic thought.

‘narrowing of meaning’ and hence, limited understanding of Muslims. It seems that the Muslim world is obsessed with law, but we cannot be focusing only on the law if we want to develop this social science called economics – it has to go beyond the *halal* and *tayyib*. We have to go back to the true meaning of these terms so that it then can be used in our theoretical construct. But if we do not get the correct understanding of these terms, then we are going to face problems when we try to build-up Islamic economics and Islamic finance. I would even argue that Islamic finance today has grown without economics. It is just a totally marginalised Islamic economics. This is not the fault of the finance people but the finance of the economics because they have not spent enough time developing those theoretical construct. But if we look at conventional finance as it is today, we find that it has a solid foundation in conventional economics. We do not have the equivalent of that in Islamic finance.

Today we have an Islamic economics that replicates conventional economics. So how do we rectify this situation? We have two alternatives – either we mould existing institutions to conform to the Shariah or try to mould the Shariah to conform to existing framework. We have accepted the framework, and together with the framework come all the assumptions concerning value and vision. Unless we can get the vision correct and use it in our construct, we are not really going to be able to do justice to Islamic economics or Islamic finance. We need further discussion as to whether it will be able to serve the public good. This issue was raised in the 1980s by some scholars who questioned some of the discussions on Islamic economics and Islamic banking at that time. This indicates how long this issue has been outstanding. These scholars inquired whether we are on the right track, whether Islamic economics and Islamic finance is contributing to the *ummah*. Umar Chapra raised the same query in 2000. We will be on the right track only if we contribute to solving the problems of humanity,

“ We have two alternatives – either we mould existing institutions to conform to the Shariah or try to mould the Shariah to conform to existing framework. ”

more specifically, that of the Muslim world. In 2004, Asad Zaman postulated that Islamic economics is not on the right track because it is replicating modern neo-classical economics. According to Asad, modern economics is the economics for the rich as it only focuses on how resources are allocated. He contended that Islamic economics and Islamic finance have not been able to solve the problem of poverty in the Muslim world.

Looking at the direction we have taken in the last ten years, we have moved back on the right track. This might be because we have realised that even in modern economics the construct is getting heavier as time goes by and it is going to evolve. The thing about capitalism is that it has the wonderful ability to evolve and incorporate elements that at one time were criticized. The Islamic finance ‘tree’ requires the main branches, and the main branches require the ‘trunk’. This is an epistemological and methodological process which requires creative synthesis between our heritage and modern economics and finance. I would go beyond economics and finance; it would also have to go through what Schumpeter called ‘knowledge that is the sociology of economics’, and of course we would need psychology as well. The ‘tree’ must be rooted – It should cover wider issues on system, goals including worldview and vision.

The higher objectives of the Shariah include establishing justice and promoting public good. As so far this has not been the concern of Islamic finance or the focus of Islamic economists. If the Shariah is viewed as it should be, then the ethical dimensions would be included in the framework. It can only be included if we have a clearer picture of what the vision is. We have two options – and this is specifically with reference to the Islamic banking industry – you either rectify the true meanings, which involves trying to convince everyone that the Shariah and *fiqh* as being wider (which is not an easy thing to do); or you could revert to the ‘Islamic Banking Advisory Board’ rather than the ‘Shariah Advisory Board’, where you could go beyond the legalities and include discussion on ethical dimension, public good etc, by getting people from different backgrounds that could enrich the development of Islamic banking. There has to be the link between economics and finance. According to John Maynard Keynes’ analogy ‘Money to the economy is like oil to the engine’. Keynes was referring to the fact that the financial system has to serve the real economy, just as the lubricant has to serve the purpose of the engine. But the bottom line is, what really counts is getting the people in the car to where they want to go. And this depends

on the vision. Islamic banking and finance has got to be connected to an Islamic economics foundation, which in turn has got to be connected to even deeper foundations than economics. The goals of Islamic economics depend on the visions. Everybody wants development, but what does development really mean? This will depend on your vision. How we go about to achieve that development will also depend on your vision.

There are certain things that we cannot do and certain things that we should not do. The first is probably a legal issue while the second is an ethical issue. Unless you get that clear, you probably will not be able to achieve the goal according to your vision. As far as Islamic economics and Islamic finance is concerned, the ultimate goal of having all the things that we want to have like, growth and development, socio-economic justice etc, has to be connected to the bigger goal of achieving ultimate success in this world and the hereafter. If that vision is not there, then maybe you are not going to be able to achieve the goals. Therefore what we do must be bound by the Shariah. Have we taken the goals of Islamic economics into consideration when we decide on the goals of Islamic finance? Is the growth and development of Islamic economics part and parcel of the decision making process in Islamic finance? Do we think of others when we decide in Islamic finance? Are all these part of the deal or are we basically looking only at our own organisational self-interest when we make decisions in Islamic finance?

For the capital market, what are its goals and how are they connected to the bigger picture? We have to differentiate between ethical investment and Islamic investment. This is where we can learn from the tremendous achievements of modern finance, but whatever we learn here must be evaluated from an Islamic position so that it corresponds with our vision. Deciding on what to accept, what needs to be modified, what ought to be rejected outright and determining how to go about doing them will be a major challenge for the industry players. We really need to go back to these areas of history of economics, understanding the connection of economics to finance and how it seems to be separated.

When Adam Smith wrote *'Wealth of Nation'*, he used the term self-interest, which was seen as a virtue during his time. Even today, self-interest is seen as a virtue and the same holds true in Islamic scholarship. But over the years till today, self-interest has been equated with selfishness. Is it really a vice? This is something that needs to be discussed further.

“ This is where we can learn from the tremendous achievements of modern finance, but whatever we learn here must be evaluated from an Islamic position so that it corresponds with our vision. ”

Then there is a criticism of the mainstream economics that has come from the West itself. Actually we can use this criticism to develop Islamic economics by coming come up with the ethical alternative that is based on Islamic economics. We need a different agent – instead of the rational ‘economic man’. The problem here will be, if we create an “Islamic man” as the new agent as some had proposed, is that agent real? Does he really exist? Maybe we should be asking whether he can exist instead. We have the Quran, the hadith, and resources that tell us how to create this even if the person is not there already. Milton Friedman said it very well when he said the economists created the economic man. By telling people ‘this is you’ and by teaching it in the curriculum at our institutions; we created the economic man. There are numerous exercises that have been conducted wherein they have given money to students from different faculties and found that the economics and business students were the most selfish students around. Why? Because that was what they were told they were.

Ethics is needed to be human. This is a very important point and whatever economics or finance we are going to have; ethics has to be part of it. It is part of Islamic economics and Islamic finance but we have not been able to incorporate it because we are still unclear on what our vision should be. Getting back to Adam Smith, just imagine if you were to add a few words to his famous quotation. Instead of saying ‘It’s not from the benevolence of the baker or the butcher that we receive our dinner, but from his self-interest’, Kenneth Lux proposed we add the words ‘only’ and ‘too’ so that it now reads: ‘It’s not only from the benevolence of the baker or the butcher that we receive our dinner, but from his self-interest too’. It now gives us a totally different view of how we should view individual agents in the economy.

JU'ALAH (COMMISSION) FROM SHARIAH PERSPECTIVE¹

DEFINITION

Literally *ju'alah* carries two meanings:²

- (a) To determine – in the *ju'alah* contract, the party who wants to offer *ju'alah* will determine the rate of reward, which is referred to as *ju'l*.
- (b) To make an obligation – it is an obligation to reward the person who has completed a task successfully.

Thus, it can be concluded that *ju'alah* literally means something that is given to a person for completing a task.

Technically, the Hanafi and Shafi'i schools gave almost similar definitions. According to them, *ju'alah* is a commitment in granting a determined reward for either a specific or unspecified task that is described as difficult to perform³.

Meanwhile, according to the Maliki school, *ju'alah* is defined as commission paid for a task that can be possibly performed⁴.

JU'ALAH FROM FUQAHA' PERSPECTIVE

Fuqaha' gave different views relating to the permissibility of *ju'alah*, as follows:

The first view: *Ju'alah* is permissible

Maliki⁵, Shafi'i⁶ and Hanbali⁷ schools are of the opinion that *ju'alah* contract is permissible. Majority of the *fuqaha'* acknowledge *ju'alah* contract based on the Quranic

verse that reads as follows:

"They said: We are missing the measure of the king. And for he who produces it is [the reward of] a load camel, and I am responsible for it."⁸

The legality of *ju'alah* is further strengthened by *al-Sunnah* where the Prophet SAW had acknowledged the action of a *sahabah* (companion) who recited *Surah al-Fatihah* of the Quran on a patient for a sheep as his fee if the person is cured⁹.

In fact, *ju'alah* contract is in line with human needs in a number of specific situations. This is based on the need that was not catered for under *ijarah* contract. Under *ijarah*, the task must be specified whereas under *ju'alah* contract even though the task is not specified, the contract is still valid¹⁰.

The second view: *Ju'alah* is impermissible

Hanafi school does not permit *ju'alah* contract. This is due to *gharar/jahal* (uncertainty) in the task to be carried out and the period of employment as compared to the general rule governing *ijarah* contract which requires these matters to be known.

ISSUES RELATED TO PILLARS OF JU'ALAH

The pillars of *ju'alah* contract are as follows:¹¹

- (1) *Sighah* (offer and acceptance)
- (2) The contracting parties
- (3) Task/employment
- (4) Reward (*Ju'l*)

¹ This article is written by Prof Dr Ashraf Md Hashim, member of the SAC of the SC and Head of ISRA Consultancy Department, International Shariah Research Academy for Islamic Finance (ISRA).

² Al-Buhuti, *Kasyaf al-Qina'*, v. 3 p. 414.

³ Al-Sharbini, *Mughni al-Muhtaj*, v. 2, p. 554.

⁴ Ibn Rushd al-Hafid, *Bidayatul Mujtahid*, Dar al-Fikr, v. 2, p. 190.

⁵ *Ibid*.

⁶ Al-Shirazi, *Al-Muhazzab*, Beirut: Dar al-Kutub al-Ilmiyyah, 1416H, v. 2. p.271

⁷ Al-Buhuti, *Kashshaf al-Qina'*, v. 3, p. 414.

⁸ Surah Yusuf:72.

⁹ Al-Bukhari, *Sahih al-Bukhari*, v. 7, p. 133.

¹⁰ *Al-Mausu'ah al-Fiqhiyyah*, v. 15, p. 208.

¹¹ Al-Sharbini, *Mughni al-Muhtaj*, v. 2, p. 554.

First: Sighah

Among the issues discussed by the *fuqaha'* related to *sighah* are:

(1) The content of *sighah*

Under *sighah*, there must be an expression which indicates the permission to do a job, either in the form of command, or in the form of condition. Example of expression in the form of command is: "Find out my missing motorcycle and bring it to me. I will give you a reward (*ju'l*) of RM200". The expression is in the form of condition: "If you find my missing motorcycle and bring it to me, I will give you a reward (*ju'l*) of RM200".

Sighah must also states the type and the promised amount of reward (*ju'l*). This is because *ju'alah* contract falls under *mu'awadhah* contracts that requires the detail of *iwadh* (exchange)¹².

(2) General and specific *sighah*

Under *ju'alah* contract, *sighah* can be in general as well as specific to a particular person. The example of general *sighah* is, "To those who find and return my motorcycle, I will give a reward of RM100". The evidence of the permissibility of *ju'alah* contract through a general *sighah* is as Allah SWT says:

Meaning: "And for him who produces it is (the reward of) a load camel". (*Surah Yusuf: 72*)

Meanwhile, the example of specific *sighah* is: A says to B, "If you find my motorcycle and bring it to me, then I will give you a reward of RM100".

(3) Carrying out the task without consent

If a person performed the required task prior to the announcement of the reward (*ju'l*), he is not entitled

to such reward. This is because he was regarded as a person who performed the task voluntarily.

Similarly, if *ju'alah* contract is offered to a specific person, then other parties would not be entitled to the reward even though he has completed the task¹⁴.

(4) *Qabul* (acceptance) is not required

In *ju'alah* contract, only *ijab* (offer) is required, whereas *qabul* (acceptance) is not required.¹⁵ To illustrate, according to Al-Qamuli, if a person says to another person, "If you return my slave who ran away, I would reward you with one dinar". Then, he answered, "I will return your servant with the reward of a half dinar". In this situation, the reward to be considered is the reward mentioned in the *ijab* that is one dinar and not the one mentioned in the *qabul* which is the half dinar¹⁶.

Second: The contracting parties

Among the issues discussed by *fuqaha'* in relation to this pillar are as follows:

(1) Condition of contracting parties

The contracting parties are *ja'il* (who offers a reward in *ju'alah* contract) and *amil* (who accept the offer). It is required on the *ja'il* to be a party who is free to enter into transaction. Thus, *ju'alah* contract is not valid if the *ja'il* is a slave, insane or *mahjur* (those who are prevented from performing transactions including arising from bankruptcy).¹⁷

Generally, under *ju'alah* contract, it is not required for *amil* (employee/worker) to be a person who is capable to perform the task offered. Thus, if a person says, "Whoever finds and returns my motorcycle, I will give him a reward of RM200",

¹² Al-Sharbini, *Mughni al-Muhtaj*, v. 2, p. 554.

¹³ Al-Shirazi, *Al-Muhazzab*, v. 2, p. 272, Al-Buhuti, v. 3, p. 414.

¹⁴ Al-Sharbini, *Mughni al-Muhtaj*, v. 2, p. 554.

¹⁵ Al-Ghazali, *Al-Wajiz*, Beirut: Dar al-Arqam, t. 1418H, v. 1, p. 415, Al-Dardir, Al-Sharh al-Kabir, *Ihya Al-Kutub al-Arabiyyah*, v. 4, p. 60, Al-Sharbini, *Mughni al-Muhtaj*, v. 2, p. 554.

¹⁶ Al-Sharbini, *Mughni al-Muhtaj*, v. 2, p. 554.

¹⁷ Al-Sharbini, *Mughni al-Muhtaj*, v. 2, p. 556.

anyone – whether a male or a female, a child or an adult lunatic sane or insane person – can become an *`amil* to complete this job. What important is, they should be aware of the announcement of the offer or knows of the offer.¹⁸

However, if the offer is made to a particular person, it is a requirement that the person is capable to perform the task. Thus, individuals who are not capable to perform should not be an *`amil*, such as children or insane person. This requirement is related to our earlier discussion on general and specific *sighah*.

(2) *Ju`alah* offered by a non-owner

Under *ju`alah* contract, it is not required for the *ja'il* to be the owner of the lost property. Therefore, a *ju`alah* contract is valid if someone said, "Those who find and return my friend's motorcycle, I will give a reward of RM200". In this situation, the *ja'il* himself obliged wilfully to give the reward for the task.¹⁹

Third: Task/Employment

Among the issues discussed by the *fuqaha'* in relation to the third rule are:

(1) Type of task/employment that can be included in *ju`alah* Contract

The general rule spells out that any task which is valid for *ijarah* is also valid for *ju`alah*.²⁰ Consistently, *ju`alah* contract also cannot be concluded for illegal tasks, for example when someone says, "Those who steal a motorcycle for me, I will give him a reward of one dinar".

(2) Nature of task – known or unknown

Fuqaha' that allows *ju`alah* contract are unanimous in allowing for any type of tasks even though it is unknown²¹. This is to cater to the need that cannot be accommodated by *ijarah* contract.

Example of *ju`alah* for unknown task is when someone says, "Anyone who finds my slave who has run away and brings him back to me, I will give him a reward of one dinar". In this contract, the nature of the task is unknown because it is not known where the slave is located and how far the journey will take place to find him.

However, there are differences of opinion among *fuqaha'* if the nature of the task is known. For example, a person says, "Anyone who fetches my slave from my sister's house, I will give him a reward of one dirham."

An authoritative opinion in the Shafi'i and Hanbali schools shows that it is permissible to enter into *ju`alah* contract on a known task. This is because if the *ju`alah* contract for unknown task is allowed, then *ju`alah* for the known task should also be allowed.

(3) Period of employment

Fuqaha' opinions differ with regards to permitting the *ju`alah* contract if the party who offers the *ju`alah* has determined certain period of time to complete the required task. For example, a person says: "Those who return my slave who has run away, by today, I will give him one dinar".

According to Shafi'i school, *ju`alah* contract is not valid if the period is specified.²² Whereas in Hanbali's view, it is permissible. This is because if *ju`alah* for unspecified period is permissible, then *ju`alah* for a specified period should also be permitted.²³

(4) Task must involve some form of effort

Among conditions of the employment under *ju`alah* contract is that, the task must require some form of effort or involve difficulty (*masyaqqah*) in order to be accomplished. Hence, if a person offers a reward (*ju'l*) to anybody who manages to return his lost property, and there is a person who has found the goods and the goods are with him when the *ju`alah*

¹⁸ Al-Mawardi, *Al-Hawi Al-Kabir*, Beirut: Dar al-Fikr, v. 8, p. 31.

¹⁹ Al-Sharbini, *Mughni al-Muhtaj*, v. 2, p. 555.

²⁰ Ibn Qudamah, *Al-Sharh al-Kabir*, Dar Hajr, 1415, v. 16, p. 169, Al-Dardir, *Al-Sharh al-Kabir*, v. 4, p. 63.

²¹ Ibn Qudamah, *Al-Sharh al-Kabir*, v. 16, p. 170, Al-Sharbini, *Mughni al-Muhtaj*, v. 2, p. 554.

²² Al-Sharbini, *Mughni al-Muhtaj*, v. 2, p. 555.

²³ Ibn Qudamah, *Al-Sharh al-Kabir*, v. 16, p. 170.

was announced, he is therefore not entitled to the reward. This is because there is no effort taken or *masyaqqah* involved in such case²⁴.

Forth: Reward (*Ju`l*)

Among the issues discussed by the *fuqaha`* in relation to the fourth rule are:

(1) Things that can be made as reward (*ju`l*)

The general rule specified by *fuqaha`* is that whatever is valid to be an *ujrah* (fee) in *ijarah*, it is also valid to be a reward in *ju`alah*²⁵. Therefore, the reward in *ju`alah* contract has to be specified and known²⁶.

(2) Changing the amount of the reward (*ju`l*)

There was a discussion among the *fuqaha`* in connection with this issue on whether it is permissible to either increase or decrease the amount of the reward. For example, someone says, "Whoever find and bring back my missing motorcycle, I will give him a reward of RM200". Later, he made another announcement that the reward is decreased to RM100.

According to *fuqaha`* from Shafi'i and Hanbali schools, it is permissible to change the rate of the reward (*ju`l*) with the condition that the change must be done before the commencement of the task by the party receiving the *ju`alah* offer²⁷.

(3) The task is done by more than one person

This situation happens if someone says, "Whoever finds my missing motorcycle and returns it to me, I will give him RM300", then there are three individuals who found it and returned it to the owner.

According to Ibn Qudamah, al-Buhuti and al-Dardir, the solution to this issue is the reward (*ju`l*) is to be

divided equally between the three of them and each of them will receive one third of the reward, i.e. RM100.²⁸

Similarly, if the offer of *ju`alah* was made to three individuals with different rate of reward, such as a person said, "If Ahmad found my motorcycle, then I would give him a reward of RM900, if Ali found my motorcycle then I would give a reward of RM600, and if Zaid found my motorcycle then I would give him a reward of RM300".

When the three individuals finds the motorcycle and returns it to its owner, each of them will get one-third of the individual reward offered.²⁹ So, Ali is entitled to 1/3 of RM900 (i.e. RM300), Ali gets 1/3 of RM600 (i.e. RM200) and Zaid gets 1/3 of RM300 (i.e. RM100).

(4) The reward is not specified in the contract

There are differences of opinion among the *fuqaha`* in relation to this issue. This situation happens if a person says to another, "Find my missing motorcycle and bring it to me". A question arises here on whether this can be considered as the *ju`alah* contract and whether the employee is entitled to receive any reward or otherwise. According to Al-Mawardi, there are four views given by *fuqaha`* in this issue, they are as follows:

- (a) Shafi'i school is of the opinion that this is not a valid *ju`alah* contract and the worker is not entitled to any reward.
- (b) Al-Muzani is of the opinion that the worker is entitled to a comparable reward (*ju`l mithli*) for such a task that has been performed.
- (c) The opinion of Ibn Surayj is that if the worker is an expert in the required work, the reward must be comparable to the similar task completed. However, if he is not a person who

²⁴ Al-Sharbini, *Mughni al-Muhtaj*, v. 2, p. 556.

²⁵ Ibn Qudamah, *Al-Sharh al-Kabir*, v. 16, p. 169.

²⁶ Al-Shairazi, *Al-Muhazzab*, v. 2, p. 272, Al-Dardir, *Al-Sharh al-Kabir*, v. 4, p. 60.

²⁷ Al-Shairazi, *Al-Muhazzab*, v. 2, p. 273, Ibn Qudamah, *Al-Sharh al-Kabir*, v. 16, p. 171, Al-Buhuti, *Kashshaf al-Qina`*, v. 3, p. 417.

²⁸ Ibn Qudamah, *Al-Sharh al-Kabir*, v. 16, p. 164, Al-Buhuti, *Kashshaf al-Qina`*, v. 3, p. 415, Al-Dardir, *Al-Sharh al-Kabir*, v. 4, p. 65.

²⁹ Al-Shafi'i, *Mukhtasar al-Muzani*, Beirut: Dar al-Makrifah, p. 136, Al-Buhuti, *Kashshaf al-Qina`*, v. 3, p. 415.

has expertise for the job, he is not entitled to any reward.

- (d) Ishaq al-Marwazi opines that if the owner assigned a person to do a task, then the person is entitled to receive wages commensurate with his task. But if the person makes a prior request to allow him to do the task, then the owner granted the request, the worker is not entitled to any reward³⁰.

It is not the intention of this brief note to discuss the above four opinions in details. Nevertheless, it can be observed here that the unspecified reward in a *ju`alah* contract is contentious in nature and should be avoided.

OTHER ISSUES RELATING TO JU`ALAH

Apart from the issues discussed above, there are also other issues relating to *ju`alah* as follows:

(1) Revocation of *ju`alah* contract

Ju`alah contract is categorised as a permissible contract (*ja'iz*). Therefore, it can be revoked at any time by any of the contracting parties. The details are as follows:

- (a) Revocation by *`amil*: If the revocation is made before the commencement of the work, he is not entitled to any compensation. If the revocation is made after commencing the work, he still has no claim against the offeror, unless both parties agrees otherwise.
- (b) Revocation by *ja'il*: If the revocation is made before the commencement of the task, he is not required to give any reward to the worker. But if the revocation is made after the worker has commenced the task, the offeror is bound to pay reasonable reward/compensation³¹.

(2) The revocation of *ju`alah* must be made known

If the *ju`alah* contract is made specifically to a particular person, for example, the *ja'il* determines

his *`amil* is Ahmad, he must tell Ahmad that he wants to withdraw the offer. However, if the *ju`alah* contract was made in general, for example a person says, "Whoever returns my missing property, I will give him RM200", the revocation must be announced in public, but the offeror is not required to inform everyone, because it is impossible to do that.

Thus, in the general *ju`alah* contract, if the offeror has advertised the revocation of *ju`alah* contract and withdrew the offer, but there is someone who is not made aware of the revocation, he is not entitled to any reward. This is because the contract was already revoked despite he not being aware of it.³²

The difference between *ju`alah* and *ijarah*

Ju`alah is similar to *ijarah* in the sense that both are contracts to perform a particular task with the payment of wages or reward. However, there are some differences between the two contracts as follows:

Differences between *ju`alah* and *ijarah* contract

	<i>Ju`alah</i> contract	<i>Ijarah</i> contract
Acceptance (<i>qabul</i>)	Not required	Required
Uncertainty of task	The nature of the task to be done can be in the form of known or unknown.	The task and period of employment must be determined.
Entitlement of reward/ <i>ujrah</i>	Can not be given upfront.	It is permissible to pay the wages/ <i>ujrah</i> upfront
Nature of contract	The nature of the contract is permissible (<i>ja'iz</i>) and not binding, which can be revoked by one of the contracting parties.	The contract is binding and it cannot be revoked without the consent of the other party.
General/specific <i>ju`alah</i>	May be made generally without specifying any party who will do it.	The person who will undertake the task must be determined.
Control over worker	No	Yes

³⁰ Al-Mawardi, *Al-Hawi Al-Kabir*, v. 8, p. 30.

³¹ Al-Shairazi, *Al-Muhazzab*, v. 2, p. 273, Ibn Qudamah, *Al-Sharh al-Kabir*, v. 16, p. 171

³² Al-Mawardi, *Al-Hawi Al-Kabir*, v. 8, p.32.

CONCLUSION

According to most Muslim scholars, *ju`alah* is permissible to fulfill the need of human beings under certain circumstances where the nature of task is unknown in order to achieve a determined outcome.

In the past, *ju`alah* may be applied to achieve certain objectives such as to reward those who can return lost property. Today, *ju`alah* contract is still relevant and can be regarded as a supportive instrument to support financing structure. In doing so, it is vital to ensure that all rules and conditions are met in order to avoid any disputes and injustice between contracting parties.



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MALAYSIA REVISES SCREENING METHODOLOGY DETERMINING SHARIAH-COMPLIANT STATUS OF LISTED COMPANIES

The Shariah Advisory Council (SAC) of the SC announced the adoption of a revised screening methodology to determine the Shariah-compliant status of listed companies.

In view of the developments and growing sophistication of the Islamic finance industry since the introduction of the current screening methodology in 1995, the SAC has revised the methodology by adopting a two-tier quantitative approach which applies the business activity benchmarks and the newly-introduced financial ratio benchmarks. The outcome of the revised methodology will be reflected in the *List of Shariah-compliant Securities* by the SAC of the SC effective from November 2013.

In addition to the above two-tier quantitative assessment, the existing qualitative assessment will continue to be applicable while the release of the list of Shariah-compliant securities will remain twice a year.

The revision to the screening methodology will further facilitate the orderly development of the Islamic equity market and fund management industry at both domestic and international levels, in line with the growth strategies outlined under the *CMP2*.

Frequently-Asked Questions on Revised Shariah Screening Methodology

1. Why has the SC's SAC revised the Shariah screening methodology for companies listed and to be listed on Bursa Malaysia?

In 1995, the SC's SAC established the methodology to undertake Shariah screening process for listed companies. The methodology comprises quantitative and qualitative assessments.

In view of the current development and sophistication of the Islamic finance industry, the screening methodology has now been revised by adopting a two-tier approach to the quantitative assessment which applies the business activity benchmarks and the

newly-introduced financial ratio benchmarks while at the same time maintaining the qualitative assessment.

This revision is in line with the SC's initiatives to further build scale in the Shariah-compliant equity and investment management segments as well as expand the Islamic capital market's (ICM) international reach, as outlined in the *CMP2*.

2. What are the changes in the Shariah screening methodology?

The changes are as follows:

Quantitative Assessment	Revised Shariah Methodology	Current Shariah Screening Methodology
Business activity benchmarks	5% 20%	5% 10% 20% 25%
Financial ratio benchmarks	33%	Not Applicable

Business Activity Benchmarks

The five per cent benchmark would be applicable to the following business activities:

- conventional banking;
- conventional insurance;
- gambling;
- liquor and liquor-related activities;
- pork and pork-related activities;
- non-halal food and beverages;
- Shariah non-compliant entertainment;
- interest income from conventional accounts and instruments;
- tobacco and tobacco-related activities; and
- other activities deemed non-compliant according to Shariah.

The 20% benchmark would be applicable to the following activities:

- hotel and resort operations;
- share trading;
- stockbroking business;
- rental received from Shariah non-compliant activities; and
- other activities deemed non-compliant according to Shariah.

The contribution of Shariah non-compliant activities to the overall revenue and profit before tax of the company will be calculated and compared against the relevant business activity benchmarks.

The current Shariah screening methodology is as follows:

Benchmark	Activities
5%	Conventional banking; Conventional insurance; Gambling; Liquor and liquor-related activities; Pork and pork-related activities; Non-halal food and beverages; Shariah non-compliant entertainment; and other activities deemed non-compliant according to Shariah
10%	Interest income from conventional accounts and instruments; Tobacco and tobacco-related activities; and other activities deemed non-compliant according to Shariah
20%	Rental received from Shariah non-compliant activities; and other activities deemed non-compliant according to Shariah
25%	Hotel and resort operations; Share trading; Stockbroking business; and other activities deemed non-compliant according to Shariah

Financial Ratio Benchmarks

The financial ratios applied are as follows:

(i) Cash over Total Assets

Cash will only include cash placed in conventional accounts and instruments, whereas cash placed in Islamic accounts and instruments will be excluded from the calculation.

(ii) Debt over Total Assets

Debt will only include interest-bearing debt whereas Islamic debt/financing or sukuk will be excluded from the calculation. Both ratios, which are intended to measure *riba* and *riba*-based elements within a company's balance sheet, must be lower than 33%.

3. What is the primary implication of the revised screening methodology?

The streamlining of the business activity benchmarks and the inclusion of the financial ratio benchmarks will enhance the robustness of the screening methodology for listed securities and, in turn, is expected to bolster the competitiveness of the Malaysian Islamic equity market and Islamic fund management industry.

4. How does the revised methodology affect the Shariah-compliant status of listed companies?

The Shariah-compliant status of the company may be affected in the following manner:

- Companies with mixed activities which are currently assessed under the 10% or 25% benchmarks may be affected because their activities are now assessed under the 5% or 20% benchmarks.

Example:

Company A listed on Main Market, Bursa Malaysia	Shariah non-compliant activity	Current methodology (10% benchmark)	Revised methodology (5% benchmark)
Business activities: Property development, trading of building materials and manufacture and distribution of cigarettes (tobacco)	Tobacco's revenue/ Group revenue = 9%	Status: Shariah compliant	Status: Shariah non-compliant

- Companies with high level of conventional debt may be affected as currently there is no screening based on the total conventional debt of the company.

Example:

Company B listed on Main Market, Bursa Malaysia	Level of conventional debt	Current methodology (not applicable)	Revised methodology (33% benchmark)
Business activities: Property development, trading of building materials and construction works	Total conventional debt/ Group total asset = 36%	Status: Shariah compliant	Status: Shariah non- compliant

5. When is the effective date?

The outcome of the revised methodology will be reflected in the *List of Shariah-compliant Securities by the SAC of the SC* effective from November 2013.

To ensure a smooth transition under the revised methodology, collective investment schemes and other funds approved by the SC as Shariah-compliant are given a grace period of six months from the effective date of the list of Shariah-compliant securities in November 2013 to dispose of securities that are excluded from the list. During the grace period, all capital gains realised from the sale of such securities may be retained by the collective investment schemes or funds, without the need to channel any portion of the capital gains to charitable bodies or baitulmal.

Note: Original investment cost may include brokerage cost or other related transaction costs.

SC NAMES NEW SHARIAH ADVISORY COUNCIL LINE-UP

The SC announced the members of its Shariah Advisory Council (SAC) who will serve for a two-year period commencing 1 July 2012. The SAC is the central authority responsible for determining the Shariah principles of the ICM in Malaysia.

The 11 SAC members, appointed by the DYMM Seri Paduka Baginda Yang di-Pertuan Agong under section 316C of the *Capital Markets and Services Act 2007* (CMSA), are:

1. Dr Mohd Daud Bakar, Chairman, SAC of SC and Bank Negara Malaysia and CEO of Amanie Advisors Sdn. Bhd.
2. Tun Abdul Hamid Haji Mohamad, Former Chief Justice of the Federal Court, Malaysia.
3. Tan Sri Sheikh Ghazali Haji Abdul Rahman, Shariah Legal Advisor, Attorney General's Chambers.
4. Dato' Dr Abdul Halim Ismail, Pro-Chancellor Insaniah University College and Chairman, Shariah Committee of Shariah-Compliant Funds of Amanah Mutual Bhd.
5. Professor Dr Mohammad Hashim Kamali, Founding Chairman and CEO of the International Institute of Advanced Islamic Studies, Malaysia.
6. Professor Dr Ashraf Md Hashim, Head of Consultancy Department, International Shariah Research Academy for Islamic Finance (ISRA).
7. Associate Professor Dr Shamsiah Mohamad, Lecturer, Department of Fiqh and Usul, Academy of Islamic Studies, University of Malaya.
8. Associate Professor Dr Engku Rabiah Adawiah Engku Ali, Institute of Islamic Banking and Finance (IIBF), International Islamic University Malaysia.
9. Associate Professor Dr Azman Mohd Noor, Department of Fiqh and Usul al Fiqh, Kulliyyah of Islamic Revealed Knowledge and Human Sciences, International Islamic University Malaysia.

SC names new Shariah Advisory Council line-up



Chairman of SAC,
Dr Mohd Daud Bakar



Tun Abdul Hamid
Haji Mohamad



Tan Sri Sheikh Ghazali
Haji Abdul Rahman



Dato' Dr Abdul Halim
Ismail



Professor Dr
Mohammad Hashim
Kamali



Professor Dr Ashraf
Md Hashim



Associate Professor
Dr Shamsiah Mohamad



Associate Professor
Dr Engku Rabiah
Adawiah Engku Ali



Associate Professor Dr
Azman Mohd Noor



Assistant Professor Dr
Aznan Hasan



Dr Muhammad Syafii
Antonio

10. Assistant Professor Dr Aznan Hasan, Department of Islamic Law, Ahmad Ibrahim Kuliyah of Laws, International Islamic University Malaysia.
11. Dr Muhammad Syafii Antonio, Rector of TAZKIA University College of Islamic Economics, Bogor, Indonesia.

The SAC is a key pillar in the development of the ICM in Malaysia especially in facilitating innovation and ensuring a robust Shariah governance process. The SAC provides greater consistency and clarity to issuers, intermediaries and investors in the Malaysian ICM.

The SAC, given the expertise of its members, also plays an instrumental role in strengthening the country's position as a leading international Islamic financial centre.

Under the CMSA, the SAC is empowered to ascertain the application of Shariah principles on any matter pertaining to ICM business or transaction, and to advise the SC on Shariah issue relating to ICM business or transactions.

The SAC is also empowered to provide advice to any person on Shariah issues relating to ICM business or transaction.

UPDATED LIST OF SHARIAH-COMPLIANT SECURITIES

The SC released an updated list of Shariah-compliant securities approved by its SAC. The updated list, which took effect on 25 May 2012, features a total of 825 Shariah-compliant securities. These counters constitute 89 per cent of the total 930 listed securities on Bursa Malaysia.

The list adds five newly classified Shariah-compliant securities and there were no exclusions from the previous list issued

in November 2011. It also indicates that Shariah-compliant securities are well represented in all sectors of industry (see Tables 1 & 2).

The full list, which is updated twice a year, is available at www.sc.com.my. The next updated list will be available in November 2012.

SHARIAH-COMPLIANT SECURITIES

Table 1: Newly classified Shariah-compliant securities

No.	Stock code	Name of securities	No.	Stock code	Name of securities
1.	5214	China Stationery Ltd	4.	2011	Lingui Development Bhd
2.	5208	EITA Resources Bhd*	5.	5218	Sapura Kencana Petroleum Bhd*
3.	3689	Fraser & Neave Holdings Bhd			

* The securities of these companies have been classified as Shariah-compliant at IPO stage.

Table 2: Shariah-compliant securities on Bursa Malaysia

Main Market/ ACE Market	Shariah-compliant Securities	Total securities ¹	Percentage of Shariah-compliant securities (%)
Consumer Products	125	134	93
Industrial Products	262	270	97
Mining	1	1	100
Construction	41	42	98
Trading / Services	171	200	86
Properties	76	90	84
Plantation	39	42	93
Technology	100	102	98
Infrastructure (IPC)	7	7	100
Finance	3	36	8
SPAC	Nil	1	Nil
Hotels	Nil	4	Nil
Closed-end Fund	Nil	1	Nil
TOTAL	825	930	89

¹ As at 18 May 2012.

MALAYSIA'S EXPERIENCE IN DEVELOPING THE ISLAMIC CAPITAL MARKET AND ITS GROWTH POTENTIAL

Introduction and Overview

Islamic finance has been a remarkable growth story especially over the past decade. With average growth of about 15% per annum globally during this period, notwithstanding the global financial crisis, and an estimated size of just over US\$1 trillion presently, Islamic finance has expanded in breadth and depth in many aspects including its range of products and services, the number and diversity of its stakeholders, its infrastructure and capabilities, and its geographical reach.

During this period, the range of Shariah-compliant products has broadened from those introduced merely to address the issue of *riba* or interest, to instruments that have been developed to cater to differing needs and users, such as Islamic investment funds and participatory instruments. In recent years, the world has also witnessed a number of multinational conventional-based financial institutions embarking into Islamic finance activities, for instance in the areas of fund management and sukuk advisory, while global companies have elected to issue sukuk instead of or in addition to conventional bonds, to raise financing for their business requirements.

At the same time, several countries have introduced legislative and tax changes to provide a level playing field for Islamic finance transactions vis-a-vis the conventional market. Furthermore, some countries that are deemed to be non-traditional jurisdictions for Islamic finance either have expressed strong interest to expand their financial industry to include Islamic finance or have actually begun to do so.

In Malaysia, Islamic finance has achieved tremendous progress. From the establishment of the first Islamic bank in the country in 1983, the Malaysian Islamic finance industry has developed very steadily over the years to expand beyond its shores and achieve the international leadership position it is firmly occupying today.

As one of the key segments of the Islamic finance industry, the ICM has played a crucial role in the overall growth of Islamic finance in the country. Malaysia's ICM recorded a 13.6% annualised growth rate over the 10-year duration of the first Capital Market Masterplan (CMP) – expanding from RM294 billion (US\$95 billion) as at end-2000 to RM1.05 trillion (US\$340 billion) as at end-2010.

The SC believes that this growth momentum is sustainable. Under the CMP2, the ICM in Malaysia is projected to grow further at an average rate of 10.6% per annum over the 10-year period to 2020, to take its value to RM2.9 trillion (or almost US\$1 trillion) by the end of year 2020.

Historical Development of ICM in Malaysia

The establishment of the Pilgrims Fund Board in 1969 has been widely credited as one of the catalysts for the development of the present-day Islamic finance industry in Malaysia, as it created a clear need for Shariah-compliant instruments and vehicles to mobilise the savings in the Fund towards productive economic activities in order to generate returns for the members or depositors.

From a more formal perspective, the introduction of the *Islamic Banking Act* and the *Takaful Act* in 1983 and 1984 respectively paved the way for a more structured development of Islamic finance as it provides specific legal

“ Malaysia's ICM recorded a 13.6% annualised growth rate over the 10-year duration of the first Capital Market Masterplan ”

⁴ This article is extracted from the keynote address delivered by Zainal Izlan Zainal Abidin, the SC's Executive Director, at the 2nd International Shariah Investment Convention 2012, in Cairo, Egypt on 20 March 2012.

framework for Islamic financial institutions to operate within.

The ICM in Malaysia began to make significant presence in the 1990s as demand for Shariah-compliant products and services for capital raising and financing, investment and liquidity management intensified. The world's first ringgit Malaysia corporate sukuk was issued in 1990 by a Malaysian subsidiary of the Shell group, and the first unit trust fund to be recognised as Shariah-compliant in the country was launched in 1993. In addition, some of the large domestic institutions started appointing fund management companies in the mid-90s to manage equity portfolios based on mandates that comply with Shariah requirements.

The year 1996 witnessed a highly important, and ground breaking, progress when the SAC of the SC was established to provide Shariah rulings pertaining to ICM products and services in Malaysia. In this regard, one of the key early contributions of the SAC was the development of the Shariah screening methodology for public-listed companies which has led to the periodic issuance, since 1997, of the list of Shariah-compliant securities. This development has contributed to the broadening of the Islamic equity capital market, especially in respect of Islamic fund management activities and expansion of the investor base.

Another significant milestone in the development of the Islamic equity market is the launch by the Malaysian stock exchange, then known as the Kuala Lumpur Stock Exchange, of its first Islamic equity index – the KLSE Shariah Index – in 1999. This launch, which followed the introduction of an Islamic equity index under a private sector initiative several years earlier, provides investors and other market participants with a performance benchmark specifically for Islamic equities, thus enabling more robust and effective measurement of investment performance which is essential for an orderly development of the Islamic equity and fund management segments.

Building Blocks for ICM

The key value proposition that has helped to drive the rapid development of Malaysia's Islamic finance industry is its comprehensiveness which, in turn, is a result of a meticulously planned and carefully crafted long term national strategy that has taken into consideration a wide range of critical factors that would contribute towards its viability, vibrancy and sustainability.

“A facilitative and clear regulatory framework is essential in promoting an orderly growth of the ICM...”

In this regard, with ICM having been identified as one of the strategic areas for development under the first CMP from 2000 to 2010, a more holistic approach was undertaken to broaden and deepen the ICM through the implementation of a set of strategic initiatives that focused on strengthening the necessary legislative and regulatory framework, as well as enhancing the relevant infrastructure and capacity.

A facilitative and clear regulatory framework is essential in promoting an orderly growth of the ICM as it provides a conducive and sound foundation for product development and service intermediation, while ensuring a robust market supervision regime in order to sustain investor confidence and encourage broader market participation.

The International Organization of Securities Commissions (IOSCO), in a 2004 report, stated that the conventional securities regulation framework and principles equally apply to the ICM, with the addition of some form of a Shariah approval or certification process, therefore there was not a need to formulate separate regulatory principles for the ICM. By extension, IOSCO's objectives and principles of securities regulation – which emphasise on the protection of investors, ensuring that markets are fair, efficient and transparent, and the reduction of systemic risks – can be applied to the ICM.

Malaysia adopts a two-tier approach in regulating the ICM, which has proven to be efficient and effective. The first-tier universal or general regulatory requirements which all capital market products – conventional and Islamic – are subjected to, are supplemented by the second-tier specific Shariah-related requirements that apply exclusively to ICM products. In certain areas where these specific requirements are relatively more extensive, separate guidelines have been introduced, for instance the *Islamic Securities Guidelines* (for sukuk), *Guidelines on Islamic Real Estate Investment Trusts* and *Guidelines on Islamic Fund Management*. This approach ensures that investors of ICM products enjoy the same degree of

certainty, clarity and regulatory protection as those investing in conventional products.

A robust Shariah governance framework represents another key element of an orderly ICM as the requirement for its products and services to adhere to Shariah principles creates a need for an effective mechanism to ensure their adherence. In Malaysia, the national-level SAC of the SC – established under an Act of Parliament and whose members are appointed by His Royal Highness the King of Malaysia – serves as the highest authority that issues Shariah rulings pertaining to the ICM in the country. This provision ensures greater certainty and consistency on Shariah-related matters for industry participants and allows them to operate on a common Shariah platform.

The SC also requires companies that issue or offer ICM products, such as Islamic funds and sukuk, to appoint Shariah committees or Shariah advisers to advise on, review and endorse the compliance of these products with Shariah principles.

Similarly, companies licensed by the SC to offer solely ICM services such as Islamic fund management companies are required to appoint Shariah committees or advisers to provide advice and ultimately certification that the companies are operating and being managed in accordance with Shariah principles.

To ensure proper and timely advice to the industry as well as to facilitate regulatory reach, the Shariah committees and advisers that are appointed in relation to ICM products and services offered in Malaysia must be registered with the SC under the *Registration of Shariah Advisers Guidelines*, which include stipulations on general roles and responsibilities, fit and properness, academic qualification and experience, and requirements for continuous professional development. The pace of development of the ICM is also dependent

on having a facilitative legal framework. In this area, the Malaysian laws have been and continue to be reviewed for the purpose of introducing legislative changes to remove legal impediments to Islamic finance transactions in Malaysia and to achieve greater certainty and enforceability in respect of Islamic finance contracts.

In addition, the Law Harmonisation Committee was established in 2010 to further strengthen the legal system and infrastructure in Malaysia to cater for the continuing development of Islamic finance, by reviewing relevant existing and new laws with the objective of harmonising those laws to be Shariah compatible, and in turn making Malaysian laws the reference law for international Islamic finance transactions.

Furthermore, the SAC of the SC has been empowered to make rulings on any Shariah matter relating to the ICM referred to it by the courts. The binding effect of such rulings addresses the issue of uncertainty in respect of dispute resolution on contracts and transactions based on Shariah. The SAC of the Central Bank of Malaysia also has similar powers in respect of Islamic banking and *takaful*.

Malaysia's tax framework which provides neutrality between Islamic and conventional capital market transactions, where ICM transactions do not attract higher tax liabilities, has also been instrumental in spurring the growth of the ICM in the country, as it ensures viability in undertaking ICM transactions. For sukuk issuers, there is a significant added advantage of attracting a wider subscriber base to include investors who prefer or need to invest in Shariah-compliant instruments, resulting in more competitive pricing relative to issuing a conventional bond.

A range of tax and other incentives further support the growth of the various segments of the ICM in Malaysia, in addition to encouraging the development of innovative instruments. In the sukuk segment, incentives for issuers among others include tax deductions on issuance-related expenses and for using certain structures such as *wakalah*, stamp duty exemptions and flexibility to swap issuance proceeds into foreign currencies. Investors benefit from tax exemption on profits received from investing in sukuk, while intermediaries receive tax exemption on certain fees and profits earned in relation to the arranging, underwriting, distribution and trading of non-ringgit sukuk issued from Malaysia.

In fund management, Islamic fund management companies are allowed to be wholly owned by non-Malaysian

“For sukuk issuers, there is a significant added advantage of attracting a wider subscriber base to include investors who prefer or need to invest in Shariah-compliant instruments, resulting in more competitive pricing relative to issuing a conventional bond.”

shareholders in order to attract global fund management houses to establish Islamic fund management subsidiaries in Malaysia and to make these subsidiaries their hub for their global Islamic fund management activities. These Islamic fund management companies are also permitted to invest up to 100% of their assets under management in non-Malaysian securities. This allowance is to enable these companies to offer a broader range of Islamic fund management services and capabilities to both domestic and foreign investment clients. Furthermore, management fees received by all licensed fund management companies in Malaysia for the management of Shariah-compliant investment portfolios and funds are tax-exempt until 2016.

One of the prerequisites for a vibrant ICM is the presence of an extensive range of products and services with a diverse group of market participants. Having depth and breadth in terms of products and services enables the industry to cater to the demand and requirements of a wider market, while diversity of market participants ensures a more competitive industry landscape that promotes greater efficiency and innovation.

In this context, Malaysia probably has the most comprehensive range of ICM products e.g Shariah-compliant equity securities, where as at end-2011 about 89% of companies listed on the Malaysian stock exchange are Shariah-compliant, sukuk, Islamic unit trusts, exchange traded fund and real estate investment trusts, to name a few. At the same time, Malaysia is home to 16 licensed Islamic fund management companies and one full-fledged Islamic stockbroking company. In addition, there are over 30 fund management and six stockbroking companies that offer Islamic fund management and stockbroking services respectively alongside their conventional businesses.

Malaysia also offers a selection of investment banks, legal firms and Shariah advisers that possess structuring and advisory capabilities for ICM products such as sukuk. Furthermore, Malaysia has an extensive representation of Islamic banks and *takaful* operators that play a synergistic role with their ICM counterparts.

Notwithstanding all these building blocks that are key to the development of the ICM, the most critical success factor for Malaysia is the firm commitment of the government towards positioning Malaysia as an international Islamic financial centre. In working towards this objective, the government has been instrumental in facilitating the development of the relevant infrastructure

for the Islamic finance industry and in incentivising Islamic finance transactions and activities.

In line with this, the Malaysia International Islamic Financial Centre (MIFC), is an initiative that is represented by the country's regulators, government ministries and agencies, industry players and other relevant organisations, with the primary aim of attracting international institutions to use Malaysia as a platform for their Islamic finance transactions and activities.

Malaysia's Achievements in ICM

In tandem with its substantial progress over the years, the Malaysian ICM has played a leading role in pioneering the development of ICM products and services. These include the first listed Islamic real estate investment trust (Islamic REIT) in the world and the first Islamic exchange-traded fund (Islamic ETF) in Asia. In addition, Malaysia is the only jurisdiction to issue specific licence to companies undertaking solely Islamic fund management activities, and the first to establish an international Shariah-compliant commodity trading platform, *Bursa Suq al-Sila'*, to facilitate liquidity management of Islamic financial institutions.

Malaysia is also the global leader in sukuk. In 2011, which was a record year for sukuk issuance globally with total value of US\$92 billion, Malaysia accounted for 73% or US\$67 billion of the total. Malaysia is also the domicile for 68% of the US\$210 billion total sukuk outstanding globally as at end-2011.

Adding to the many firsts in sukuk origination recorded by Malaysia over the years is the exercise by Khazanah Nasional, Malaysia's sovereign wealth fund and strategic investor, involving an exchangeable sukuk issue which was the first to be priced at a negative yield. This issuance also demonstrated the broadening demand for sukuk globally as 49% and 39% of the issuance size were taken up by a diverse group of European-based and Asian-based investors respectively.

Future of ICM

The Global Financial Crisis of 2008 to 2009 has helped to direct the international financial community to focus more intently and intensively on the virtues of Islamic finance and its viability as an alternative to conventional finance. While

it remains unlikely that there will be a major paradigm shift in the near term, the very fact that a growing number of jurisdictions are displaying keen interest augurs well for the future of the Islamic finance industry. Furthermore, given that Islamic finance presently still accounts for a very small percentage of global financial assets, even a modest allocation of financial transactions and activities to Islamic finance by the conventional players can generate significant growth potential for the overall Islamic finance industry.

As reflected in the growth projection for Malaysia's ICM under the *CMP2*, the SC believes that the long-term potential for the ICM remains promising, not only in Malaysia but also internationally. In fact, the projections under the Masterplan are premised largely on the ICM achieving greater internationalisation.

Achieving greater internationalisation is envisaged to include several key strategic measures, such as facilitating the expansion of domestic players and intermediaries into other markets, establishing linkages with other regulators and jurisdictions, nurturing growth of high value-add segments like private equity and venture capital, as well as strengthening product innovation and development capabilities.

For the ICM to expand its global reach, it is imperative to establish and enhance international linkages to facilitate cross border transactions. Governments and regulators have a role to play in providing a conducive platform for market participants to undertake ICM transactions in an orderly manner. In this regard, challenges in having different legal, tax and regulatory frameworks across various jurisdictions would need to be addressed.

At this point, it is appropriate to highlight the roles of the multilateral organisations in the context of facilitating greater internationalisation of the ICM. The Islamic Financial Services Board (IFSB), the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and the International Islamic Financial Market (IIFM) are among these organisations that have contributed significantly to the enhancement of the global Islamic finance industry through the development of standards and guidelines that serve, among others, to strengthen Islamic financial institutions and to facilitate cross-border Shariah-related transactions as well as comparability.

Opportunities involving cross border transactions and activities, and for potential collaborations among industry players across jurisdictions, are numerous, and three of

“...greater internationalisation of the ICM is achieved when industry stakeholders have the ability to offer and invest in ICM products and services virtually without restrictions across borders.”

them will be highlighted. First, capital raising to fund large infrastructure projects can be undertaken through a global or regional sukuk issuance to tap on pools of liquidity that are seeking Shariah-compliant instruments. Such issuance will also provide diversification benefits for both the issuers and the investors.

Second, provision of Islamic fund management products and services across jurisdictions will enable the investment managers to expand and broaden their businesses and meet the demands of fund owners who seek potential for more diversified investment opportunities and better returns. In this regard, the SC has entered into mutual recognition agreements with several of our counterparts to facilitate cross offering of Islamic funds in the respective jurisdictions.

Third, demand for investment vehicles that comply with Shariah principles to cater to growing cross-border investment flows will spur the development of certain capital market structures, such as Islamic private equity and venture capital.

In short, greater internationalisation of the ICM is achieved when industry stakeholders have the ability to offer and invest in ICM products and services virtually without restrictions across borders. Eventually, this will drive the quantum leap of the ICM, thus putting it firmly and undoubtedly in the global mainstream.

Mainstreaming ICM into the global capital market also requires the offering of value propositions that apply beyond religious boundaries. In this regard, the underlying principles and values of the Shariah are very much in line with ethical and socially responsible values espoused by some conventional global investors, thus providing substantial opportunity for ICM products and services to be offered and attract a wider international investor base.

Additionally, returns or investment performance represents a major consideration for investors in ICM products and services. In this respect, if we use the Dow Jones Islamic Market indexes as a proxy to the performance of Shariah-compliant equities, seven of the eight broad-market indexes under this Islamic Market Global index series outperformed their conventional equivalents over one, three, five and ten year-periods up to 31 December 2011, thus dispelling a common market misconception that Islamic investments typically underperform conventional ones due to the Shariah screening criteria.

International Collaboration

In striving towards further development of and stronger linkages within the global Islamic finance industry, there are also several other main areas for jurisdictions to collaborate on.

In the area of capacity building, which includes creating and enhancing awareness and understanding of the Islamic capital market, joint programmes such as international conferences and seminars for diverse and broad stakeholder groups are effective means of achieving the objectives. Roundtables and workshops, on the other hand, can provide a more focused approach for smaller and targeted groups to deliberate on specific issues.

Malaysia has consistently undertaken a number of capacity building programmes over the years to support the sustainable growth of the Islamic finance industry.

One such programme is a collaboration between the SC and the OCIS of the University of Oxford to provide an international platform for intellectual discourse to bring about greater awareness and understanding of Islamic finance issues amongst scholars, regulators, industry practitioners, academia and investors globally. The result has been the highly successful annual SC-OCIS Roundtable – where the third Roundtable was held in March 2012 in Kuala Lumpur.

The International Centre for Education in Islamic Finance (INCEIF) is a graduate level academic institution in Malaysia that focuses solely on Islamic finance. With a distinguished faculty and a diverse international student body, INCEIF is contributing significantly to building and enhancing the human capital resources and expertise in the Islamic finance industry.

Another opportunity for jurisdictional collaboration to enhance international linkages is in the area of Shariah. Differences in Shariah interpretations have been one of the challenges facing this industry. For this, the sharing of the rationale for Shariah rulings or interpretation across jurisdictions can create better awareness, and hopefully appreciation, within the industry. In this respect, international Shariah scholars and advisers who sit on Shariah boards and committees of financial institutions in different jurisdictions can serve to bridge the gap through constructive discussions during the course of discharging their duties.

Extending this initiative further, collaboration on Shariah research will provide a platform to address some of the main issues in Shariah, which in turn can reduce limitations on cross-border ICM activities arising from any differences across jurisdictions.

Conclusion

In conclusion, all participants in the Islamic finance industry are urged to foster greater collaboration and seek ways to overcome significant disparity across jurisdictions in order to create an effectively borderless environment for Islamic finance.

While we acknowledge the different stages of development of the Islamic finance industry across the various jurisdictions, it is highly constructive for all these jurisdictions to share information so that the newer markets can take advantage of the learning process of those that have embarked on this journey much earlier, and therefore minimise the pitfalls of venturing into a relatively new frontier.

MALAYSIA'S ROYAL AWARD RECEIVES GLOBAL NOMINATIONS



A total of 32 nominations for the Royal Award for Islamic Finance (The Royal Award) were received globally. Nominations closed on 1 June 2012.

The list of nominees, comprising influential drivers of the Islamic finance industry with diverse backgrounds, come from various regions around the world namely the Middle East, Europe, Africa, North America and the Asia Pacific region, reflecting the global reach and acceptance of Islamic finance today. The nominations reflect the diversity of stakeholder groups in Islamic finance, including Shariah, academia, market practitioners, financial institutions, research institutions, Government agencies and NGOs.

An independent seven-member international jury, chaired by the former Malaysian Deputy Prime Minister and current Chairman of the World Islamic Economic Forum Foundation, Tun Musa Hitam, will select the recipient of the Royal Award.

The selection criteria of The Royal Award encompass both qualitative and quantitative aspects to assess the candidates' exceptional contribution and reach in global Islamic finance. These include financial innovation and

pioneering work, exceptional leadership, adoption and acknowledgement of their contributions within the industry, and inspiration and influence towards future progress and development.

His Majesty the Yang di-Pertuan Agong of Malaysia will present the Royal Award to the 2012 recipient at the Royal Gala Dinner and award Presentation which will be held on 19 September in Kuala Lumpur, in conjunction with the 3rd Global Islamic Finance Forum (GIFF), a premier high-level multi-track event which aims to create greater connectivity and cross-border transactions in Islamic finance.

The Royal Award which was inaugurated in 2010 as a biennial award, is spearheaded by Bank Negara Malaysia and the SC in support of the MIFC initiative. The Royal Award focuses on an individual's record of achievement and outstanding contribution to the global development of Islamic finance.

The recipient of the inaugural Royal Award for Islamic Finance in 2010 was Sheikh Saleh Abdullah Kamel of Saudi Arabia whose work over four decades had contributed to the global adoption of Islamic finance and continues to have sustained financial, economic and social impact around the world. The recipient of the award will serve as a role model to inspire others to contribute to the development of the industry. For more information on the award, please visit www.mifc.com/award.

SHARIAH ADVISOR PROGRAMME (i-Advisor)

The i-Advisor Programme is one of the initiatives by the SC to provide continuous professional development in the area of Shariah advisory relating to the ICM. The programme, funded by the Capital Market Development Fund (CMDf) and organised by the Securities Industry Development Corporation (SIDC), is exclusively developed to integrate the theoretical and practical aspects of industry knowledge.

The 13-day i-Advisor programme will be offered on a modular basis, with the duration of each module ranging from one to three days. Participants are allowed to enrol for any module without any prerequisite, subject to the availability of the module. The programme will be conducted on weekends. The first series of the programme for 2012 commenced from March to June and the second series commenced from July to November.

The modules offered are as follows:

Modules	Topics
Module 1	Fundamentals of Shariah Rulings (Elective)
Module 2	Regulatory Requirements and Legal Documentation in ICM
Module 3	Accounting, Auditing and Taxation in ICM
Module 4	Islamic Equity Market
Module 5	The Sukuk Market
Module 6	ICM: Contemporary Shariah Issues & Challenges



www.sidc.com.my

To find out more, please log on to www.sidc.com.my or speak to the i-Advisor Secretariat at tel: 603 6204 8549/8664/8040, or email at sidc@sidc.com.my

Securities Industry Development Corporation

3, Persiaran Bukit Kiara, Bukit Kiara, 50490 Kuala Lumpur

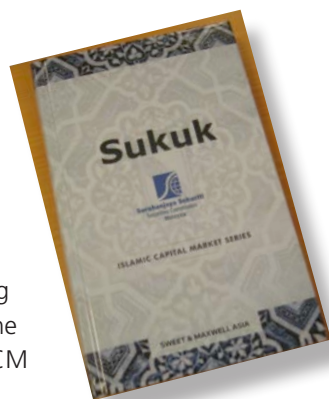
Tel : 03 6204 8889 Fax : 03 6204 8298

www.sidc.com.my

ICM BOOK SERIES

Sukuk

Sukuk is a publication which is endorsed by the SC and published by Thomson Reuters. The publication of the book is in response to the expanding role of ICM, resulting from the phenomenal growth of ICM globally.



Malaysia has achieved many milestones in Islamic finance and, with the advent of sukuk, Islamic finance is firmly entrenched in the realm of ICM. Malaysia offers a variety of investment opportunities in sukuk, which have seen considerable growth with the issuance of innovative structures using various underlying Shariah principles, among others, *murabahah*, *istisna'*, *istithmar*, *ijarah*, *salam*, *musharakah*, *mudharabah* and *wakalah*.

Sukuk has been instrumental in financing, among other things, major national infrastructure and utilities in Malaysia, and facilitating balance sheet management of companies and banks through the securitisation of properties and mortgages.

Considered an important innovation, sukuk offers the flexibility of cash-flow financing structures with participation offered through equity. Sukuk strengthens the link between investments and real assets, and address the ethical considerations underscored by Shariah. Users are better positioned to manage balance-sheet risks, diversify investments, lower the cost of funding and maintain capital adequacy through financial practices that comply with Shariah.

Managing Fund Flows, Risks and Derivatives: Applications in Islamic Institutions

Managing Fund Flows, Risks and Derivatives: Applications in Islamic Institutions is an independent Islamic finance resource for bankers, particularly treasury teams, asset-liability committees, forex desks and risk management departments. Regulators, Shariah scholars, lawyers, academicians and students may also benefit from reading this book. Its primary focus is to build a clear consciousness of Islamic principles, rules, structures, and how these fit within a banking and treasury environment.



The unique character of Shariah gives rise to a complex Islamic market that is an asset market and not simply as money market. This requires the Islamic banker to consider the commercial, as opposed to monetary, aspect of transaction. Within this context, the book deals with the issues of asset liability management, cash flow management and "in the bank" departmental integration by introducing asset concepts. Hedging concepts and approaches used in the Islamic market are discussed in detail and common hedging problem addressed. The focus is to understand how a decision to apply Shariah principles causes profound change in philosophy and methodology.

Readers will be introduced to the prevailing business practices of the Gulf Cooperation Council (GCC) as well as Malaysia, with clear examples of each provided along a presentation of how best to manage the procedural differences between the two regions. Sample balance sheets, transaction and processes are reviewed to assist readers in seeing the Islamic concept play out in hypothetical business transactions.

For enquiries, please contact:

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SC AND OCIS OFFER A SCHOLAR IN RESIDENCE FELLOWSHIP

A Visiting Fellowship at the Oxford Centre for Islamic Studies for the academic year will be commencing in October 2012, under a new Scholar in Residence Programme in Islamic Finance. This programme is jointly supported by the SC and the OCIS.

The Scholar in Residence Programme is another collaborative initiative between the SC and OCIS. The Scholar in Residence Fellowship must be specialists in Islamic finance and/or a closely-related discipline, preferably with practical experience of policy-making with an international or comparative component. The recipient not only must be able to demonstrate competence to conduct independent academic research but he/she will be

expected to conduct research on a topic of contemporary relevance to the field and to participate in a range of academic activities at OCIS. The tenure of the fellowship is for one academic year.

The Visiting Fellow will have membership of the Centre and enjoy full access to its facilities including shared office accommodation. A grant of £10,000 will be made to contribute to the Visiting Fellow's living, travel and incidental research expenses.

More information on the Scholar in Residence Programme is available at the fellowship section of the OCIS website: www.oxcis.ac.uk

NEWS ROUND-UP

Establishment of CIMB-Principal Islamic's International Fund Platform in Ireland

In November 2011, the SC entered into an memorandum of understanding (MoU) with the Central Bank of Ireland. The MoU provides an arrangement for the two regulators to exchange information and co-operate in the area of regulation and supervision of authorised entities offering collective investment schemes. Subsequent to this, the CIMB-Principal Islamic Asset Management (CIMB-Principal Islamic) has taken a pioneering initiative to establish its Islamic fund platform in Ireland, as part of its strategy to internationalise its product offerings and enhance the visibility of its Islamic funds among global investors.

Under this platform, the CIMB-Principal Islamic will register three new Undertakings for Collective Investment in Transferable Securities (UCITS)-compliant equity funds namely CIMB-Principal Islamic Global Emerging Markets Fund, CIMB Principal Islamic Asia-Pacific ex-Japan Fund and CIMB-Principal Islamic ASEAN Fund. To commemorate the establishment of this new platform, a ceremony was held on 16 Jan 2012 in Kuala Lumpur, which was officiated by His Royal Highness Crown Prince of Perak, Raja Dr Nazrin Shah Ibni Sultan Azlan Muhibbuddin Shah, who is also the MIFC Financial Ambassador. The SC Chairman (then), Tan Sri Zarinah Anwar, delivered a special address at the ceremony.

Oman First Islamic Banking and Finance Conference

Oman Islamic Banking and Finance Conference was held from 23 to 24 January 2012. The event, held in Muscat, aimed to provide a platform for dialogue and discussions between top leaders, key policy makers and the brightest minds in the industry in formulating winning strategies that will revolutionise the Sultanate's current financial structure and investment climate. The conference also aspired to

develop a concrete blueprint on how to meet the emerging challenges posed by the outcome of financial liberalisation including ways to leverage opportunities in introducing Shariah-compliant products and banking solutions. The SC Executive Director, Zainal Izlan Zainal Abidin, moderated one of the panel sessions during the event.

2nd International Shariah Investment Convention in Cairo

The 2nd International Shariah Convention (ISIC) which took place from 20 to 21 March 2012 was held in Cairo. The key theme was a cross-border investment into Egypt using Shariah-compliant structures. The event, jointly organised by Amanie Advisors, Sarie-Eldine & Partners and

Higazy & Associates, gathered top experts to discuss the opportunities available for Islamic finance in North Africa and the Southern Mediterranean. The SC Executive Director, Zainal Izlan Zainal Abidin, delivered a keynote address at the event.

3rd SC-OCIS Islamic Finance Roundtable focuses on 'Solutions for Liquidity Management'

The SC and the OCIS jointly held the 3rd SC-OCIS Roundtable on Islamic Finance, a closed-door forum for Islamic finance experts, Shariah advisers and scholars from around the world on 12 and 13 March 2012 in Kuala Lumpur.

The Roundtable, which was officiated by His Royal Highness, Raja Dr Nazrin Shah, Crown Prince of Perak, and the MIFC Financial Ambassador, focused on 'Solutions for Liquidity Management' in Islamic finance, with the aim of identifying pathways to strengthen the international sukuk market, to address infrastructure constraints and issues relating to

global connectivity, and to improve overall market integration.

Inaugurated in 2010 as a thought-leadership platform for international debate and discussion on Islamic finance issues, the annual Roundtable has been effective in creating a forum for distinguished Shariah scholars, academicians, regulators and Islamic finance practitioners in various fields including banking, asset management as well as accounting, to explore solutions to the issues and challenges which impact the Islamic finance landscape.



ICM Roundtable in Turkey

The SC hosted the ICM Roundtable in Turkey on 15 May 2012 in conjunction with the IFSB Annual Summit. The main objectives of the Roundtable were to profile Malaysia's capabilities in ICM and to provide networking opportunities

between Malaysian and Turkish industry players. Speakers and panelists at the Roundtable included representatives from investment and commercial banks and fund managers.

7th Islamic Markets Programme

The SC through SIDC organised the 7th Islamic Markets Programme (IMP) from 26 to 28 June 2012. The IMP, designed for senior regulators and participants in the financial industry, form an important platform for discussion of topic related to Islamic finance and capital market.

Themed 'Building the Environment for the Growth of Islamic Finance', the IMP attracted local and international participants including Islamic finance practitioners, members of academia and regulators.

Speakers at the programme include senior industry practitioners, namely, Rafe Haneef, Managing Director of HSBC Amanah Malaysia; Rafiza Ghazali, Head of Islamic Finance (then), Asia of Thomson Reuters; prominent academician Professor Datuk Dr Syed Othman Alhabshi, Chief Academic Officer of INCEIF; and Ijlal Ahmed Alvi, CEO of IIFM.



Islamic Capital Market Graduate Training Scheme

The sixth ICMGTS, which commenced on 9 March, ended on 4 May 2012 with the participation of 39 graduates. Similar to the previous ICMGTS, participants were exposed to a combination of structured and experiential learning comprising lectures, illustrative examples, case studies, simulation, and interaction to equip them with the necessary technical knowledge and skill to enter the industry.



FACTS AND FIGURES

Shariah-compliant securities on Bursa Malaysia

	June 2012	June 2011
No of Shariah-compliant securities*	825	847
% to total listed securities	89%	89%
Market capitalisation:		
Shariah-compliant (RM billion)	864	836
Total market (RM billion)	1,368	1,342
% of Shariah-compliant securities to total market	63%	62%

+ The SAC of SC releases the updated Shariah-compliant securities list twice a year in May and November.

Islamic unit trust funds (UTF)

Number of launched funds	June 2012	June 2011
Islamic UTF	166	157
Total industry	597	584
NAV (RM billion)		
Islamic UTF	31	26
Total industry	278	250
% to total industry	11%	10%

Islamic wholesale funds (WF)

Number of launched funds	June 2012	June 2011
Islamic WF	30	24
Total industry	154	122
NAV (RM billion)		
Islamic WF	11	7
Total industry	35	23
% to total industry	31%	30%

Equity market indices*	29 June 2012	30 June 2011	% change
KL Composite Index (KLCI)	1,599.15	1,579.07	1
FBM EMAS Shariah	11,003.17	10,517.49	5
FBM Hijrah Shariah	11,853.05	10,995.91	8
DJIM Malaysia Titans 25	936.71	891.88	5

* Date based on last trading day

List of Islamic fund management companies as at 30 June 2012

No.	Company	No.	Company
1.	Aberdeen Islamic Asset Management Sdn Bhd	10.	i-VCAP Management Sdn Bhd
2.	AmlIslamic Funds Management Sdn Bhd	11.	Kenanga Islamic Investors Bhd
3.	Amundi Islamic Malaysia Sdn Bhd	12.	KFH Asset Management Sdn Bhd
4.	Asian Islamic Investment Management Sdn Bhd	13.	Muamalat Invest Sdn Bhd
5.	BIMB Investment Management Bhd	14.	Nomura Islamic Asset Management Bhd
6.	BNP Paribas Investment, Partners Najmah Malaysia Sdn Bhd	15.	OSK-UOB Islamic Management Sdn Bhd
7.	CIMB-Principal Islamic Asset Management Sdn Bhd	16.	Reliance Asset Management Sdn Bhd
8.	Eastspring Al-Wara' Investments Bhd	17.	RHB Islamic Asset Management Sdn Bhd
9.	Franklin Templeton GSC Asset Management Sdn Bhd	18.	Saturna Sdn Bhd

Chart 1
KLCI and Shariah Index Performance

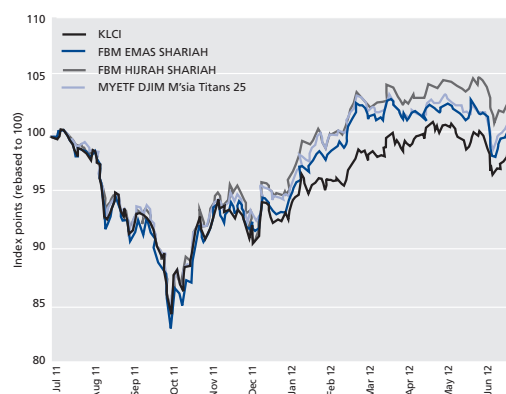
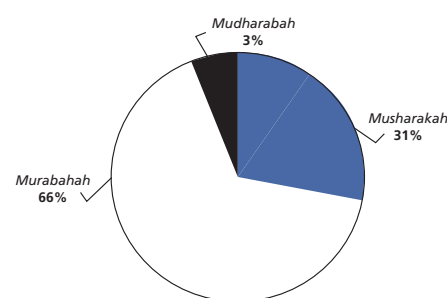


Chart 2
Sukuk approved based on various Shariah-principles in H1 2012



Islamic real estate investment trusts (REITs)

Number of REITs	June 2012	June 2011
Islamic REIT	3	3
Total REITs	15	14
Market capitalisation (RM billion)		
Islamic REIT	3.3	2.5
Total REITs	17.9	11.5
% total industry	18%	22%

Islamic exchange-traded funds (ETF)

Number of approved ETF	June 2012	June 2011
Islamic ETF	1	1
Total industry	5	5
NAV (RM billion)		
Islamic ETF	0.3	0.6
Total industry	0.93	1.19
% to total industry	32%	50%

Islamic assets under management (AUM)*

(RM billion)	June 2012	June 2011
Islamic AUM	63	58
Total industry	451	418
% total industry	14%	14%

* Includes assets that are sourced from collective investment schemes as well as private mandates.

List of companies offering Islamic stockbroking services as at June 2012

No.	Company Type	Type
1.	BIMB Securities Sdn Bhd	Full Fledge
2.	Affin Investment Bank Bhd	Window
3.	AmlInvestment Bank Bhd	Window
4.	CIMB Investment Bank Bhd	Window
5.	Jupiter Securities Sdn Bhd	Window
6.	Maybank Investment Bank Bhd	Window
7.	RHB Investment Bank Bhd	Window

Sukuk listing on LFX as at June 2012

No.	Issuer Name	Listing Date
1.	Cherating Capital Limited	6 Jul 2007
2.	Dar Al-Arkan International Sukuk Company	31 Jul 2007
3.	Paka Capital Limited	14 Mar 2008
4.	Petronas Global Sukuk	14 Aug 2009
5.	1Malaysia Sukuk Global Bhd	8 Jun 2010
6.	Danga Capital Bhd – SGD600 million trust certificates due 2015	12 Aug 2010
7.	Danga Capital Bhd – SGD900 million trust certificates due 2020	12 Aug 2010
8.	Wakala Global Sukuk Bhd – US\$1.2 billion due 2016	7 Jul 2011
9.	Wakala Global Sukuk Bhd – US\$800 million due 2021	7 Jul 2011
10.	Danga Capital Bhd – CNY 500 million trust certificates due 2014	21 Oct 2011
11.	Pulai Capital Limited (Khazanah), USD357.8 million due 2019	22 Mar 2012

Source: Labuan International Financial Exchange (LFX)

Sukuk

Corporate Sukuk approved	H1 2012	H1 2011
Number of sukuk	10	19
Size of sukuk (RM billion)	22.3	32
Size of total bonds approved (RM billion)	44.9	47.9
% of size of sukuk to total bonds approved	50%	68%

Public and Corporate Sukuk issued (RM billion)	H1 2012	H1 2011
Size of sukuk issued	153.9	90.6
Size of total bonds issued	315.3	259.8
% of sukuk issued to total bonds issued	49%	35%

Public and Corporate Sukuk outstanding (RM billion)	June 2012	June 2011
Size of outstanding sukuk	420.8	315.6
Size of total outstanding bonds	939	818.9
% of outstanding sukuk to total outstanding bonds	45%	39%

Sukuk Listing on Bursa Malaysia's Exempt Regime as at June 2012

No.	Issuer Name	Listing Date
1.	Pulai Capital Limited	22 Mar 2012
2.	Wakala Global Sukuk Bhd	7 Jul 2011
3.	IDB Trust Services Limited (Islamic Development Bank)	1 Dec 2010
4.	Malaysia Airports Capital Bhd	30 Nov 2010
5.	AmlIslamic Bank Bhd	1 Oct 2010
6.	Tadamun Services Berhad (Islamic Development Bank)	24 Aug 2010
7.	1Malaysia Sukuk Global Bhd (Government of Malaysia)	8 Jun 2010
8.	Sime Darby Bhd	28 Jan 2010
9.	Paka Capital Limited	31 Dec 2009
10.	Khazanah Nasional Bhd	31 Dec 2009
11.	Danga Capital Bhd	31 Dec 2009
12.	Rantau Abang Capital Bhd	31 Dec 2009
13.	CIMB Islamic Bank Bhd	29 Dec 2009
14.	G.E Capital Sukuk Limited (General Electric)	30 Nov 2009
15.	Cagamas MBS Bhd	14 Aug 2009
16.	Petronas Global Sukuk Limited	14 Aug 2009

For more information on Sukuk listed on Bursa Malaysia, please visit www.bursamalaysia.com

We appreciate your feedback and comments. If you would like to know more about the Malaysian Islamic capital market or require further information from the Securities Commission Malaysia, please contact the following persons at the Islamic Capital Market Business Group:

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