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Malaysian Islamic Capital Market
by the Securities Commission Malaysia

Contents

Green Financing with Sustainable Growth – How Islamic Capital Market Can Play a Pivotal Role

The Securities Commission Malaysia's (SC) *Capital Market Masterplan 2* (CMP2) identifies the promotion of socially responsible financing and investment as a key thrust. It enables financial innovation to be harnessed to create market-based solutions and mobilises investments for projects that promote sustainable and inclusive development such as alternative energy sources or clean technology. Among the products identified in CMP2 are green bonds, green funds as well as longer-term opportunities for trading of environmental products such as carbon credits or weather derivatives. These products have led to many potential areas in green financing.

Under the Green Bond Principles (2015) issued by the International Capital Market Association, proceeds from the green financing must be used exclusively to finance or refinance eligible green projects such as renewable energy, energy efficiency, sustainable land use and biodiversity conservation. Furthermore, the eligible projects under the Climate Bond Standard include wind energy generalisation, solar energy generalisation, bus rapid transit and low carbon building.

Through green financing, Islamic finance can serve as the confluence for the growing number of both conventional and Shariah-compliant investors seeking to invest in ethical and socially responsible projects. It also serves the large unmet demand for the financing of these projects globally – for example; waste management, renewable energy and water treatment.

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ICM can play a pivotal role in green financing as there are strong synergies and complementarities between Islamic finance, ethical and sustainable and responsible investment (SRI). Islamic finance requires real assets and activities to support sustainable growth as it is directly linked to the real economy. As such, green financing can be the central component in facilitating the transition of Islamic finance to Shariah-compliant products in a manner that is universally acceptable and will allow it to gain greater acceptance from a larger segment of the community.

In August 2014, the SC introduced the SRI Sukuk Framework that encompasses environment and social elements to facilitate the financing of various sustainable and responsible investment initiatives. The framework aims to preserve and protect the environment and natural resources; conserve the use of energy; promote the use of renewable energy; reduce greenhouse gas emission and improve the quality of life for the society.

"Islamic finance requires real assets and activities to support sustainable growth as it is directly linked to the real economy."

With the emerging trend and awareness on SRI, green financing offers a natural appeal to investors and presents a perfect opportunity for Islamic finance particularly in ICM to expand its investor base and to gain better acceptance of these products, globally.

Note: The discussion on green financing and its role in the Islamic capital market was presented in the panel session on 'Islamic Finance for Green Technologies' at the 11th World Islamic Economic Forum, Kuala Lumpur.

New Shariah Advisory Council Resolutions

The Shariah Advisory Council (SAC) of the SC continues to play a crucial role and act as the scholarly reference centre in providing guidance for ICM issues related to Shariah. In 2015, the SAC resolved several resolutions in relation to the concepts and issues arising from industry proposals. These resolutions serve as a reference to practitioners and the public in developing and expanding ICM products for the Islamic finance industry. The following are among the new resolutions issued by the SAC:

(1) MIXED ASSET AS AN UNDERLYING FOR SUKUK IJARAH

The SAC had deliberated on a proposed issuance of a sukuk *ijarah*. The issue in deliberation was on the permissibility of using a mixed asset consisting of Shariah-compliant and Shariah non-compliant businesses / activities (mixed asset) as an underlying asset for sukuk *ijarah*.

The SAC resolved that it is permissible to use a mixed asset as an underlying asset for sukuk *ijarah* provided that:

(i) The rentals received from the Shariah non-compliant businesses / activities in the mixed asset must be less than 20 per cent of the total rentals received, if such rentals could be determined; or

(ii) The lettable area used for Shariah non-compliant businesses / activities in the mixed asset must be less than 20 per cent of the total lettable area, if the rentals could not be determined.

(2) REDEEMABLE CONVERTIBLE UNSECURED ISLAMIC DEBT SECURITIES TOGETHER WITH FREE DETACHABLE WARRANTS BASED ON MURABAHAH VIA TAWARRUQ ARRANGEMENT

The SAC deliberated on a proposed issuance of redeemable convertible unsecured Islamic debt securities (RCUIDS), together with free detachable warrants by a company which is listed on Bursa Malaysia, based on the Shariah principle of *murabahah* via *tawarruq* arrangement.

Among the issues raised were:

(i) The status of the RCUIDS and warrants in the event of the reclassification of the Shariah status of the issuer's securities from Shariah compliant to Shariah non-compliant by the SAC, during the tenure of the RCUIDS; and

(ii) The options available for the RCUIDS holders in the event of the reclassification of the Shariah status of the issuer's securities from Shariah compliant to Shariah non-compliant by the SAC, during the tenure of the RCUIDS.

Pursuant to the above issues, the SAC resolved the following:

(i) <u>RCUIDS has been issued and no conversion has been made</u>

If the RCUIDS has yet to be converted into new shares of the issuer and the issuer's securities has been reclassified from Shariah compliant to Shariah non-compliant by the SAC, the RCUIDS holders have the right to do the following:

(a) Discretion to convert the RCUIDS into new shares of the issuer.

In the event the RCUIDS is converted into new shares of the issuer, then the guidance on timing for disposal of Shariah non-compliant securities as provided in the *List of Shariah-Compliant Securities by the Shariah Advisory Council of the Securities Commission Malaysia* may be applicable;

(b) Sell the RCUIDS to third parties; or

(c) Require the issuer to redeem the RCUIDS in cash based on a formula to be agreed between the issuer and the RCUIDS holders.

(ii) <u>RCUIDS has been issued and converted into new shares of the issue</u>

If the RCUIDS has been converted into new shares of the issuer and the issuer's securities have been reclassified from Shariah compliant to Shariah non-compliant by the SAC, the guidance on disposal of Shariah non-compliant securities may be applicable.

(iii) <u>Warrants</u>

If the warrants have not been exercised and the issuer's securities have been reclassified from Shariah compliant to Shariah non-compliant, the guidance on disposal of Shariah non-compliant securities may be applicable.

The above requirements must be disclosed in the disclosure documents pertaining to the issuance of the RCUIDS and the Shariah pronouncement.

The SAC further resolved that the above resolutions are also applicable for any redeemable convertible secured instruments proposals which have similar convertibility features and structured based on the Shariah principle of *murabahah* via *tawarruq* arrangement.

Islamic Capital Market Capacity Building Programmes for OIC Member Countries: Workshop Report and Recommendations

The Standing Committee for Economic and Commercial Cooperation of the Organization of Islamic Cooperation (COMCEC) and SC co-organised the Islamic Capital Market Capacity Building Programme from 31 May to 4 June 2015. The outcome of discussions and proposals derived from the Programme have been summarised and compiled in a report entitled *Workshop Report and Recommendations*.

The Report covers key areas that may need to be addressed in developing policy recommendations for the enhancement of Islamic capital market that can be considered by COMCEC, and the regulatory and supervisory authorities within short to medium term (one to three years) and long term (more than three years). These include issues in Shariah, legal and regulatory as well as products and services. The Report also serves as a guide for practitioners, academicians and other interested parties.

Recommendations highlighted that it is vital to have strategic planning and policy implementation since there is no 'one-size-fits-all' strategy that can be adopted by the member jurisdictions. Strategies outlined should enable reviewing process according to priorities, feasibility and market dynamics.

The full content of the report can be downloaded via the COMCEC Capital Market Regulators Forum at www.comceccmr.org.

MyETF Thomson Reuters Asia Pacific Ex-Japan Islamic Agribusiness Index[1]

On 12 November 2015, Thomson Reuters announced the launch of its Asia Pacific Ex-Japan Islamic Agribusiness Index that covers 30 Shariah-compliant companies in the Asia-Pacific region with revenues derived directly from agricultural products.

The index is tracked by an exchange-traded fund (ETF) provided by i-VCAP Management Sdn Bhd which was launched on the same day named MyETF Thomson Reuters Asia Pacific ex-Japan Islamic Agribusiness. It offers investors exposure to the performance of the index and is the first agricultural-related Islamic ETF available globally and the first Islamic sector ETF available in the Asia-Pacific region, adding to ETFs worth US$2 billion based on Thomson Reuters indices globally.

The fund objective is to closely track the performance of the Thomson Reuters Islamic Asia Pacific ex-Japan Agribusiness Index which objectively and passively represents the stocks within the Asia-Pacific region that are primarily engaged in the upstream agricultural production activities. The Benchmark Index is free-float adjusted market capitalisation weighted and the total return index is designed to measure the equity performance of this unique agriculture-based sector.

1 http://thomsonreuters.com/en/press-releases/2015/november/thomson-reuters-launches-islamic-asia-pacific- ex japan-agribusiness-index.html and http://myetf.com.my/upload/fckeditor/MyETF-AGRI%20Factsheet%20(Dec15).pdf

Updated List of Shariah-Compliant Securities

The SC released the updated list of Shariah-compliant securities approved by its SAC on 27 November 2015. It features a total of 667 Shariah-compliant securities which constitute 74 per cent of the total 901 listed securities on Bursa Malaysia (Table1). The list includes 35 newly classified Shariah-compliant securities and excludes 39 from the previous list issued in May 2015. The full list which is updated twice a year based on the companies' latest annual audited financial statements is available at www.sc.com.my.

Table 1
Shariah-compliant securities on Bursa Malaysia

Main Market/ ACE Market	Number of Shariah-compliant securities	Total securities*	Percentage of Shariah-compliant securities
Consumer products	101	127	80
Industrial products	194	243	80
Mining	Nil	1	Nil
Construction	39	46	85
Trading/Services	150	210	71
Properties	65	93	70
Plantation	36	42	86
Technology	74	92	80
Infrastructure (IPC)	4	5	80
Finance	2	34	6
SPAC	2	3	67
Hotels	Nil	4	Nil
Closed-end funds	Nil	1	Nil
TOTAL	**667**	**901**	**74**

* *As at 23 November 2015*

Amendments to Securities Laws Come Into Force

The SC announced the *Capital Markets and Services (Amendment) Act 2015* (CMSA Amendment) and *Securities Commission (Amendment) Act 2015* (SCMA Amendment) on 15 September 2015. The amendments to securities laws were made to facilitate innovative fundraising structures, enhance investor protection, clarify responsibilities of issuers and advisers, and expand the scope of SC's supervisory powers.

The CMSA Amendment introduced a new recognised market framework to facilitate the establishment of alternative trading platforms including equity crowdfunding (ECF) platforms. Under this framework, private companies that are hosted on a registered ECF platform are provided a safe harbour from provisions in the *Companies Act 1965*, which prohibit private companies from offering shares to members of the public. The introduction of ECF is in line with the SC's objective to promote capital market inclusion and widen avenues for capital raising. The SC approved six crowdfunding operators including one Shariah operator as at end 2015.

To promote a more conducive environment for the issuance and subscription of corporate bonds, the CMSA Amendment has clarified the roles and responsibilities of persons in charge of preparing disclosure documents. A person who is aware of any false or misleading statement in a disclosure document is now required to inform SC immediately.

"…CMSA Amendment has clarified the roles and responsibilities of persons in charge of preparing disclosure documents."

Minority shareholder protection in relation to take-overs and mergers transactions is also strengthened where the SC is now empowered to appoint an independent adviser where the offeree fails to do so. The CMSA Amendment also seeks to preserve netting provisions of market contracts and strengthen crisis management of market institutions such as exchanges and clearing houses.

The SCMA Amendment was amended to align securities laws with International Organization of Securities Commissions (IOSCO) principles. To elevate the standards of auditors and quality of financial statements, the Audit Oversight Board's regulatory reach is extended to capital market institutions, scheduled funds and reporting accountants. The SC's examination powers have also been expanded to include persons performing outsourced functions for regulated entities including branches and subsidiaries.

Guidelines on Recognised Markets

The SC released the *Guidelines on Recognised Markets* on 11 December 2015. The guidelines facilitate the offering of Islamic capital market products on a recognised market.

These new guidelines require recognised market operators to appoint a Shariah adviser in cases where an Islamic capital market product is offered, on or through the recognised market. It also includes the roles of Shariah adviser and requirements to disclose the name of the adviser and the structure of the product when the product is offered.

It operationalises the new recognised market framework that was introduced by the CMSA Amendment. Effective 15 December 2015, it supersedes the *Guidelines on Regulations of Markets* under section 34 of the CMSA Amendment.

Electronic facilities registered under the previous guidelines including ECF platforms continue to operate as recognised markets under this new framework.

Other features of the *Guidelines on Recognised Markets* include extending the classes of sophisticated investors who may participate in ECF platforms to include any corporation registered with the SC under the *Guidelines on the Registration of Venture Capital and Private Equity Corporations and Management Corporations*.

Tax Incentives for Sukuk and Islamic Funds under Budget 2016

Malaysia's Prime Minister Dato' Sri Mohd Najib Razak when unveiling Budget 2016, announced several initiatives related to the capital market including ICM.

SUSTAINABLE AND RESPONSIBLE INVESTMENTS (SRI) SUKUK	RETAIL BOND AND RETAIL SUKUK	ISLAMIC FUNDS
To promote the issuance of SRI Sukuk and establish Malaysia as a regional issuance hub for SRI Sukuk, tax deduction be given for five years on issuance costs of SRI Sukuk approved by, or authorised by or lodged with the SC until year of assessment 2020.	To further encourage more investors' involvement particularly individual investors in the capital market, double deduction or further deduction for retail bonds and retail sukuk be extended for another three years until year of assessment 2018.	To further promote business management activities of Islamic funds, the tax exemptions on the statutory income derived from business of providing fund management services, business trust and real estate investment trust are extended for another four years until 2020.

INTERNATIONALISATION OF THE ISLAMIC CAPITAL MARKET[1]

There are two billion Muslims in the world today, capturing 20 per cent of the world population. By 2030, it is estimated that Muslims will make up 2.2 billion or 26 per cent of the world population. A total of 57 Muslim countries have a combined GDP of US$8 trillion. According to data from the World Bank, while global growth is projected at 3.4 per cent in 2014 and 4 per cent in 2015 (2013: 3.2 per cent), higher GDP growth ranging between 4.5 per cent to 6.7 per cent is expected in Middle East and North Africa (MENA), Asia and Sub-Sahara Africa – which host large Muslim populations. Massive amounts of capital will need to be mobilised to support this growth while the increasing wealth of individuals and institutions in these countries will necessitate more efficient and diversified investment opportunities. This means ICM cannot be confined to the domestic market.

In tandem with this, Islamic banking and financial assets which are expected to surpass US$2.5 trillion in 2015, is projected to reach US$3.4 trillion by end of 2018. The benefits that increased cross-border access may afford to investors include broader investment choices, lower transaction costs resulting from increased competition and technology, increased efficiency of transactions, greater opportunity for diversification, and more access to information about foreign investment opportunities.

The Internationalisation of ICM is therefore a critical way forward – for investors, intermediaries for countries and ICM itself. Evidence of the internationalisation of the ICM and its benefits can be seen in various components of the capital market.

Sukuk market

Despite uncertainties in the financial market, the global sukuk market has continued to see significant growth over the last few years. As at 31 December 2014, the size of sukuk outstanding globally was US$300.9 billion with Malaysia making up 57 per cent of the total market. Over the last five years, the market has grown at a CAGR of almost 20 per cent. According to KFH Research, total sukuk issuance reached US$118.8 billion in 2014, just slightly lower than the record US$119.7 billion in 2013.

Although ringgit Malaysia sukuk is still a significant component of the international sukuk market, there are now sukuk issuances denominated in major currencies such as US dollar, Euro, UK pound, HK dollar, Renminbi and Singapore dollar. Similarly while sukuk issuance used to be predominantly out of GCC and Malaysia, there are now several sovereign sukuk issuances originating from the respective home countries such as UK, Hong Kong, Luxembourg and South Africa. Sukuk issuers have expanded beyond domestic, corporate and government issuers to include supranationals and multinationals. In the US, Goldman Sachs issued a US$500 million sukuk *wakalah* in 2014 which attracted an order book of US$1.5 billion.

These international sukuk issuances have succeeded due to a number of reasons. Not all sukuk investors seek Shariah-compliant investments but to serve the need of those seeking Shariah-compliant products. Structures used for international offerings are those that are most widely accepted across the globe – typically those based on *ijarah* or *wakalah* to ensure widest possible acceptance. The participation of conventional investors also helps provide liquidity in the secondary market – so while most Shariah-compliant investors tend to hold their investment to maturity, conventional investors help to provide liquidity in the secondary market.

The global reach and strong demand for these sukuk is evidenced by the oversubscription and the diversity of the investor base for most international issues. The UK sovereign sukuk of £200 million in 2014 had orders totalling £2.3 billion (more than 10 times). Investors included sovereign wealth funds, central banks, UK and international institutions from Middle East, Asia and Britain. Hong Kong's first sovereign sukuk of US$1 billion was allocated to 120 institutional investors from Asia, Middle East, US and Europe.

A recent notable success is the inaugural sukuk issued by the International Finance Facility for Immunisation (IFFIm), amounting to US$500 million in 2014. This was followed with a second issuance of US$200 million in September 2015. The first was oversubscribed by 1.4 times and the second was oversubscribed by 1.6 times with investors mainly from the Middle East (65 per cent),

[1] This article is extracted from a speech by Dato Dr Nik Ramlah Mahmood, SC Deputy Chief Executive, at Islamic Finance Conference 2015 in Washington, US.

Asia (18 per cent) and Europe (17 per cent). This is an excellent example of how the international sukuk market has been used to mobilise funds to help those in the poorest countries.

This sukuk saw the coming together of Islamic finance and sustainable and responsible investment. The confluence Islamic finance and ethical finance is one area that will help bridge Islamic and conventional finance, and the success of the IFFIm Sukuk is proof of this. To tap this area, the SC in 2014 introduced SRI Sukuk Framework to facilitate the financing of sustainable and responsible investment to address shifts in investor demographics, growing concern over environmental and social impact of business and the growing demand for stronger governance and ethical conduct from business.

Equity market

The equity component of the ICM is perhaps not as well-known as the sukuk market. However, Shariah-compliant stocks in fact offer tremendous investment opportunities for investors seeking exposure to businesses from around the globe. There currently exist numerous Shariah indices which provide the opportunity for investors to invest in stocks listed on the world's major exchanges.

The Dow Jones Islamic Market World Index (DJIM), for example, provides subscribers with access to Shariah-compliant companies comprising over 2,600 stocks[2] from 58 countries covering all regions across both developed and emerging markets with market capitalisation of US$23.5 trillion. As at September 2015, US stocks made up 60 per cent of the total market capitalisation of DJIM World Index. The large portion from the US markets is due to the availability of many technology and healthcare stocks given that these are generally Shariah compliant.

Other index providers like MSCI and FTSE also provide Islamic Indices. The FTSE Shariah Global Equity Index Series has 1,435 constituents stocks with a market capitalisation of US$15.3 trillion from stocks listed in 45 jurisdictions. The MSCI World Islamic Index measures the performance of the large and mid-cap segments of the 21 developed markets that are relevant for Islamic investors. The index comprises 593 constituents with market capitalisation of US$10.6 trillion as at September 2015.

In Malaysia, companies listed on Bursa Malaysia are screened by the SAC of the SC. Of the 903 stocks, 75 per cent are listed on the exchange are Shariah compliant. Based on Malaysia's experience, the availability of Shariah-compliant stocks provide the necessary impetus for the development of the Islamic funds industry and provides an opportunity for investors seeking Shariah-compliant investments including *takaful* companies.

Islamic funds

The third component of the ICM is the mutual funds sector. Islamic mutual funds have registered a double digit CAGR of 11 per cent from 2008 to 2013 in terms of number of funds with the biggest number being in Malaysia and followed by Saudi Arabia. Although in term of assets under management (AUM), the size of Saudi Arabia far exceed that of Malaysia.

Perhaps more interestingly the third largest Islamic fund centre is Luxembourg with more than 111 funds. According to Lipper, 18 per cent of all Islamic funds created in 2012 were established in Luxembourg. Other Islamic fund domiciles includes Ireland, Indonesia and Pakistan.

The interest in structuring Islamic investment funds in Luxembourg emanates from both international asset management groups as well as groups based in Muslim countries, attracted by the opportunities of the Undertaking for Collective Investment in Transferable Securities (UCITS) passport, the sound regulatory and supervisory environment and the multiproduct fund administration platform. The global success of UCITS funds makes obtaining a UCITS status worth the effort for Islamic fund managers; given the European investor community's being largely unaware of Shariah-compliant propositions. However, at present, only a handful of Islamic fund managers have domiciled UCITS funds in European jurisdictions (estimated 26 in Luxembourg and Ireland)[3]. Many international fund managers have seized the opportunities offered by the Islamic funds sector. In Malaysia, there are fund managers that are licensed to manage only Islamic funds and this include many international names.

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2 DJIM World Index Fact Sheet, December 2014.
3 MIFC report.

Regulatory initiatives to facilitate internationalisation

One of the critical factors supporting the internationalisation of the ICM is government support. This is so not only in Muslim majority countries like Malaysia where the development of Islamic finance is part of the agenda. Increasingly other governments have played a facilitative role by removing tax and regulatory impediments and issuing sovereign sukuk. These efforts have taken ICM to a level of international prominence that could not have been achieved by Muslim countries alone.

There are also numerous regulatory and government initiatives that have been introduced or are being worked on that will help with the internationalisation of the ICM. These initiatives are not necessarily confined to ICM. Regional efforts to foster integration of capital market can also help with internationalisation of ICM. For instance, a lot of work is being done by the ASEAN Capital Markets Forum (ACMF) in ASEAN to promote and facilitate cross-border transactions, including the cross-distribution of collective investment schemes through a fund-passporting model. This allows Islamic funds from Malaysia to be offered to investors in other ASEAN countries who have signed on, such as Singapore and Thailand.

The International Organization of Securities Commissions (IOSCO) started looking at ICM more than a decade ago. Two Reports on ICM published in 2004 and 2008 affirmed the applicability of IOSCO principles to ICM regulation can be offered in any well-regulated markets. Efforts to enhance disclosures for ICM products are currently being pursued with the Islamic Financial Services Board (IFSB). Both the IFSB and SC are currently identifying the scope of disclosures to be published for industry reference.

The IFSB whose members comprise central banks and capital market regulators, promotes and enhances the soundness and stability of the Islamic financial services industry by issuing global prudential standards and guiding principles for the industry. To date, it has issued three guiding principles relevant to ICM[4], relating to governance for CIS, conduct of business for Institutions offering Islamic financial services (including ICM) and Shariah governance systems for Islamic financial institutions.

To ensure standardisation and harmonisation of global practices, the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) has produced numerous standards on Shariah, accounting, auditing and governance standards. To date, AAOIFI has gained full support for the implementation of its standards which are now adopted in totality in Bahrain, Dubai International Financial Centre (DIFC), Jordan, Lebanon, Qatar, Sudan and Syria. Though other jurisdictions such as Indonesia, Malaysia, Pakistan and Kingdom of Saudi Arabia do issue specific rulings on practices, references are also made to AAOIFI's standards[5].

Conclusion

Global capital markets are entering a new era in which cross-border linkages and regional integration will enable greater access to investors and issuers, regionally and globally. This not only helps broaden the investor base and range of products but will also strengthen domestic capital markets and provide the liquidity, scale and capacity to compete globally. Internationalisation brings depth to the capital market and helps diversify sources of financing, investment channels and investor base.

Intermediaries involved will benefit from economies of scale, leading to improved and more innovative services at lower prices as well as from the opportunity to tap a bigger market. This will demand for harmonisation of practises and standards that will lead to reduction of administrative burden and costs by replacing many different sets of diverging rules with a single set.

Finally, internationalisation will lead to a more efficient allocation of capital, arising from the fact that savings can flow more easily and at lower cost to investment and because barriers will have been dismantled. Through sequenced liberalisation and integration process, regulation of cross-border trades and investment will be strengthened, and regulators are able to offer greater protection for investors, fostering fair and orderly markets and facilitating capital formation. It is therefore absolute vital that efforts to promote ICM be pursued not just at the national but international level.

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4 *Guiding Principles on Governance for Islamic Collective Investment Schemes, Guiding Principles on Conduct of Business for Institutions Offering Islamic Financial Services* and *Guiding Principles on Sharîah Governance Systems for Institutions offering Islamic Financial Services.*

5 http://www.aaoifi.com/en/about-aaoifi/about-aaoifi.html.

Islamic Finance and Socially Responsible Investing[1]

Islamic finance is embedded on the principles of fairness, equality and ethics that lead to social well-being. It seeks social justice and economic prosperity of the society and encourages sustainable economic activity. Islamic finance is derived from fundamental requirements set by principles of the Islamic law. Socially Responsible Investing (SRI) has a similar rationale. SRI is sometimes referred to as 'sustainable', 'socially conscious', 'mission,' 'green' or 'ethical' investing. In general, socially responsible investors are guided by an ethical or moral code for Environmental, Social and Governance (ESG) investments.

Islamic finance could broaden its investor portfolio by connecting these overlapping core values to access the large amount of SRI funds available in global markets. In some markets, it is clear that momentum is being built towards realising the connectivity of Islamic funds with the global socially responsible investment funds where Islamic Finance and Socially Responsible Investing stands at about US$3.7 trillion. In 2014, climate themed bonds were estimated to total approximately US$502.6 billion globally (an exponential jump from US$174 billion in 2012). Estimates record that nearly US$10 trillion in cumulative capital investments will be moved towards low carbon energy alone between 2010 and 2020. Furthermore, over 1,300 signatories to the United Nations Principles for Responsible Investment (UN PRI) represent over US$45 trillion in managed assets (from US$4 trillion in 2006).

In relation to these figures, Islamic finance remains a niche area that can benefit from broadening its horizon to tap into socially conscious investments. This will appeal and attract both Islamic capital as well as a wider global interest. Therefore, understanding the scope of SRI is pivotal for Islamic finance practitioners to match the segment opportunity available in the SRI space.

Commonalities: Islamic finance and SRI

Islamic finance and SRI have been two of the most rapidly growing areas of finance over the last two decades. During this period, they have each grown at rates that far exceed that of the financial markets as a whole. By some estimates, the total volume of Islamic financial assets has grown by 15 – 20 per cent a year and now exceeds US$1 trillion. In 2013, the total volume of assets held by explicitly SRI investors exceeded US$3 trillion, having increased by more than 30 per cent since 2005. In both instances, investors seek to achieve a strong return on their investments; and similarly, they also take into account social returns to the society and not only pure economic return.

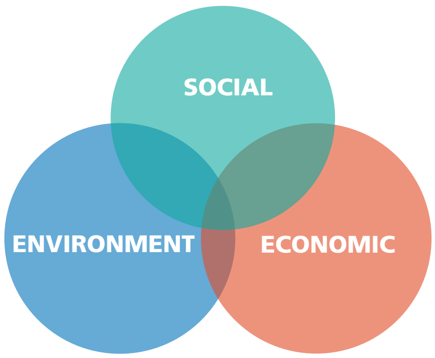
Ethical, equitable, social and sustainable investments are all synonymous to both Islamic finance and SRI, and global efforts have been made to integrate these commonalities. Examples among others include the UK Financial Services Authority which adopts a broad spectrum policy of fairness and justice, and similarly this policy has also been strongly endorsed for Islamic finance by the Islamic Financial Services Board (IFSB 2009b: Principle 1). Apart from the above, the UK based BMO Global Asset Management's F&C Responsible Shariah Global Equity fund which was launched in 2011, aims to achieve long-term capital growth through a portfolio of global equities and seek out companies whose products and operations are not felt to be harming the world, its people or its wildlife, and are considered to be making a positive contribution to society. Furthermore, sustainability is a key common factor between Islamic finance and SRI. A notable initiative is traced back to 2009 with Sustainable Asset Management (SAM), one of the leading asset managers in the field of sustainability investments, partnered with Gatehouse Bank to introduce the first ever Shariah-compliant water–focussed investment strategy.

Sustainable development

Sustainable development is a process whereby human development objectives are achieved through natural systems. This can be achieved by providing natural resources and ecosystem services upon which the economy and the society depends. Sustainable development is centric to the overlapping factors for both Islamic finance and SRI, which are the economy, the environment and social impact. Resorting to bearable social environments, equitable socio-economies and viable enviro-economies will result in sustainable models that will ensure the well-being of the society (*Diagram 1*).

[1] This article is extracted from the *MIFC Newsletter* entitled 'Socially Responsible Investing: An Opportunity for Islamic Finance' (2015).

Diagram 1
Sustainable development



Source: Adapted from *The Future of Sustainability: Re-thinking Environment and Development in the Twenty-first Century"* Adams, W.M.

There is a great need for convergence between business and societal interests to:

- Promote shared values emphasising ethical and socially responsible conduct.
- Broaden inclusiveness to ensure benefits are fairly shared across society.
- Achieve sustainability and better living conditions through more efficient use of natural resources and public infrastructure.

Thus, sustainable investments which are a subset of SRI may very well serve as a viable platform for Islamic finance to grow its SRI portfolio. This is because through sustainable development initiatives, it is symmetric in meeting the objectives of both Islamic finance and SRI.

Sustainable investment market in Asia

In Asia, sustainable investments are robust and growing. Indonesia and Singapore lead the sustainable investments sector in the Asian Market with 39 per cent and 38 per cent Compounded Annual Growth Rate (CAGR), respectively. Hong Kong and Malaysia stand in third and fourth place with 24 per cent CAGR and 23 per cent CAGR17 respectively (*Table 1*). In the case of Malaysia, Shariah-compliant investing represents the largest part of their sustainable investment strategy.

Growth trends of Islamic finance

The Islamic financial industry has experienced robust expansion in the past five years, recording a 17.3 per cent CAGR between 2009 and 2014 (Chart 1). During this period, Islamic finance activities expanded to non-key Islamic finance jurisdictions. For example, in Africa,

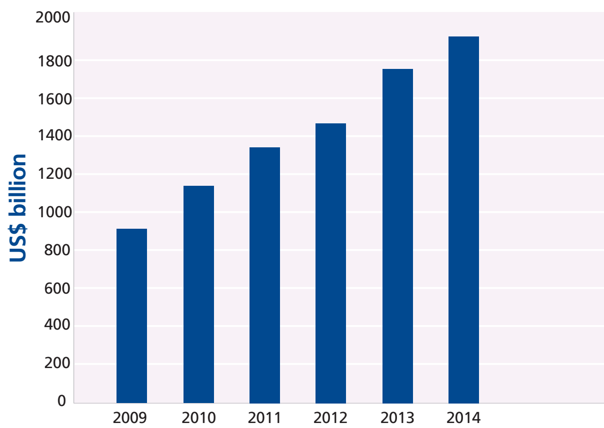
Table 1
Sustainable investment market in Asia (US$ million)

ASIA	2011	2013	CAGR (%)
Bangladesh	NA	14	NM
China	1,535	1,729	6
Hong Kong	7,328	11,329	24
India	153	115	-13
Indonesia	595	1,142	39
South Korea	6,288	8,426	16
Malaysia	**9,956**	**15,087**	**23**
Pakistan	427	505	9
Singapore	2,967	5,660	38
Taiwan	724	714	-1
Thailand	14	20	19
Vietnam	NA	195	NM
TOTAL	**29,988**	**44,937**	**22**

Source: Adapted from *Asia Sustainable Investment Review 2014 – Association for Sustainable and Responsible Investments in Asia*

Chart 1

Compounded annual growth rate between 2009 and 2014



Source: *Central Banks, Annual Reports, Bloomberg, IFIS, Zawya, ISRA*

Table 2

Proportion of SRI relative to total managed assets (percentage)

	2012	2014
Europe	49.0	58.8
Canada	20.2	31.3
US	11.2	17.9
Australia	12.5	16.6
Asia	0.6	0.8
Global	21.5	30.2

Source: Adapted from *the Global Sustainable Investment Review, 2014*

countries such as Senegal, Kenya, South Africa and Nigeria have all made progressive efforts to tap the Islamic finance market. Moving to Asia, countries like Bangladesh and the Maldives have also shown progress in growing their Islamic finance portfolios. More developed economies such as US, Europe and Singapore have also witnessed more Islamic finance activities in their countries. Notably, the recent expansion of the industry in the latter part of the last decade has spurred further growth and busted it into a more competitive and resilient industry. Moving forward, the industry's assets are expected to expand further to US$3.4 trillion by end of 2018.

Growth trends of SRI

As shown in the Table 2 above, globally, the proportion of SRI in relation to professionally managed assets has increased to 30.2 per cent in 2014, from 21.5 per cent in 2012. Among the fastest growing region in these two year period are US, Canada and Europe. These two regions are also the largest in terms of assets, accounting to 99 per cent of global SRI. Islamic finance requires scalability. Penetrating the SRI and conventional market will provide the impetus to mainstream Islamic finance.

Global initiatives – Islamic finance and SRI

Recent years has seen great development, particularly in the capital markets, in both Islamic finance and SRI. Some key developments such as Social Impact bonds (SIB), Green Bonds and SRI Sukuk initiatives should be extended to further explore avenues in which these two sectors can converge.

Social impact bonds and sukuk

Social Impact Bonds (SIB) sees private investors invest capital and manage public projects, usually aimed at improving social outcomes for at-risk individuals, with the goal of reducing government spending in the long term. Government will only pay out if projects achieve outcome and investors are typically NGOs, charities and foundations. For example, in 2010, Social Finance UK launched the first SIB with an oversubscribed fund of £5 million (US$7.57 million) to finance prisoners' rehabilitation program.

Similarly, in 2012, the state of Massachusetts, US, became the pioneer state to use a competitive procurement process to secure social innovation financing of US$50 million for social services from an allocated US$100 million SIB pilot scheme set up in 2011. On the sukuk front, the International Finance Facility for Immunisation (IFFIM) Company issued a US$500 million Immunisation Sukuk in November 2014. The proceeds are to be utilised for vaccination programmes under the Global Alliance for Vaccines and Immunisation (GAVI).

Green bonds and Green sukuk

Green bonds are issued to raise financing for climatic change solutions and environmental causes. The first widely known 'green bond' was issued in 2007 by the

European Investment Bank. These instruments were well received by SRI investors. The Islamic finance sector in Malaysia, as of last year, contributed almost 20 per cent or RM300 million (US$80.78 million) of the RM1.5 billion (US$403.9 million) financing for 120 projects approved by the Malaysian Green Technology Financing Scheme. The Green Sukuk and Working Party (GSWP) has been established by the Clean Energy Business Council (MENA), the Climate Bonds Initiative and the Gulf Bond and Sukuk Association (GBSA), to promote and develop Shariah-compliant financial products to invest in climate change solutions. However, it has yet to make its debut.

SRI sukuk

To further promote SRI sukuk, key Islamic finance jurisdiction such as Malaysia has recently issued this type of sukuk. For example, in 2015, Khazanah Nasional Bhd through a Malaysian-incorporated independent special purpose vehicle (SPV) Ihsan Sukuk Bhd established a RM1 billion (US$225 million) SRI sukuk programme which was the first of its kind to be approved under the SC's SRI Sukuk Framework. Bursa Malaysia is also working with the FTSE to implement the FTSE4Good Index series based on companies listed on the Malaysian exchange. This ESG Index series is expected to attract US$3.4 trillion SRIs from around the world.

Moving forward

Central values in Islamic finance and SRI could be matched to optimise prospects for Islamic finance to tap a large pool of global SRI funds. Moving forward, greater interplay between these markets should be explored. Key stakeholders on both ends including financial experts, research centres, rating agencies, non-governmental organisations and even regulators should pursue ways to consolidate the connectivity of these markets.

NEWS ROUND-UP

10th Islamic Markets Programme

The SC, through the Securities Industry Development Corporation organised the 10th Islamic Markets Programme (IMP) from 7 to 10 September 2015. Themed 'Revving up Islamic Finance to the Next Phase of Growth and Development', this annual programme attracted a total of 50 participants from Malaysia, Taiwan, Hong Kong and Brunei.

Apart from topics on the need to address cross-border offering, the IMP also covered areas that are potential growth drivers for the industry. This includes promoting responsible innovation through development strategies that would bring balance to commercial viability and sustainability by way of incorporating the social equity equation; facilitating *waqf* development to harness its social objectives by addressing its issues of capital, capability and confidence; and bridging the halal industry and Islamic finance through fundraising such as crowdfunding.

11th World Islamic Economic Forum

The SC participated at the 11th World Islamic Economic Forum held from 3 to 5 November 2015 in Kuala Lumpur. During the event, the SC organised a panel discussion entitled 'Malaysia's Islamic Capital Market – Promoting Inclusiveness' that covered topics of sustainable and responsible invesment, Islamic crowdfunding, SME financing, social finance and *waqf*.

The session served as a platform for promoting SRI and financial inclusion through various capital market products. It also enabled participants to develop greater understanding in developing SRI funds as well as managing *waqf* assets using ICM products and services. Participants comprising senior representatives from fund management companies, investment banks and academia attended the session. The SC also managed an exhibition booth to profile the value proposition and capabilities of Malaysia's ICM, and its intermediaries as well as showcase the investment and fundraising opportunities.

Stakeholders engagement

During the second half of 2015, the SC's representatives participated as speakers in the following events organised by various organisations to support sustainable development and growth of Islamic finance particularly the ICM:

- MIFC Business Mission to Melbourne, 16 -18 August (Australia)
- Global Ethical Finance Forum, 1 - 2 September (Scotland)
- Green Financing Forum, 9 September (Malaysia)
- Amanie Unitar Islamic Finance Forum 2015, 17 September (Malaysia)
- International Participative Finance Forum Casablanca 2015, 20 October (Morocco)
- IFSB-FIS Workshop for Islamic Capital Market, 20 October (Malaysia)
- Islamic Finance Conference 2015, 21-22 October (US)
- Mobilizing Islamic Finance for Long-term Investment Financing, 19 November (Turkey)
- Malaysia Investment and Stock Exchange Expo 2015, 20 November (Malaysia)
- Sukuk Forum for Ministry of Finance, Indonesia, 26 November (Indonesia)
- Kuala Lumpur Islamic Finance Forum, 2 December (Malaysia)
- Accounting and Auditing Organization for Islamic Financial Institutions – World Bank Annual Conference, 6 December (Bahrain)

Malaysian ICM – Facts and Figures

Shariah-compliant securities on Bursa Malaysia

	Dec 2015	Dec 2014
Number of Shariah-compliant securities	667	673
Total listed securities	903	906
% to total listed securities	73.9%	74.3%
Market capitalisation (RM billion):		
Shariah-compliant securities	1,086.18	1,012.14
Total market capitalisation	1,694.78	1,651.17
% to total market capitalisation	64.1%	61.3%

Source: SC

Equity market indices

	31 Dec 2015	31 Dec 2014	% change
FBM KLCI	1,692.51	1,761.25	-3.9%
FBM EMAS Shariah	12,800.65	12,507.03	2.3%
FBM Hijrah Shariah	14,332.58	14,468.70	-0.9%
DJIM Malaysia Titans 25	1,033.82	1,005.75	2.8%

Source: SC

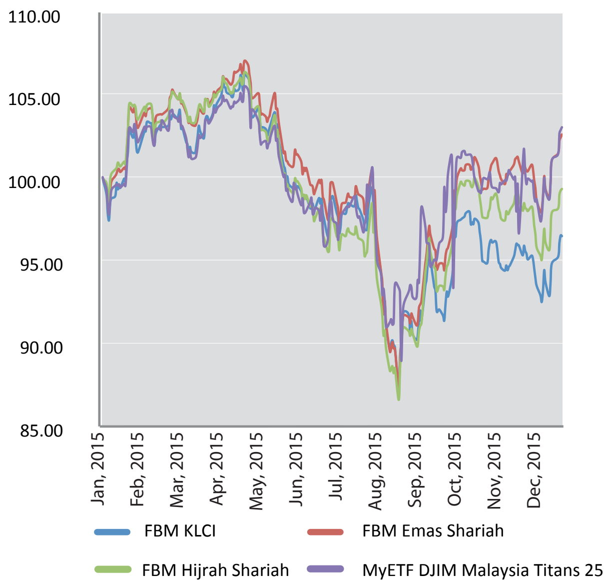
Sukuk

Corporate sukuk approved	2015	2014
Number of sukuk	25	47
Size of sukuk (RM billion)	48.33	76.07
Size of total bonds approved (RM billion)	118.46	138.15
% of size of sukuk to total bonds approved	40.8%	55.1%
Total sukuk issued (RM billion)	**2015**	**2014**
Size of sukuk issued	117.70	262.76
Size of total bonds issued	270.15	492.23
% of sukuk issued to total bonds issued	43.6%	53.4%
Total sukuk outstanding (RM billion)	**2015**	**2014**
Size of outstanding sukuk	607.93	576.31
Size of total outstanding bonds	1,124.84	1,109.71
% of sukuk to total outstanding bonds	54.0%	51.9%

Source: SC

Chart 1

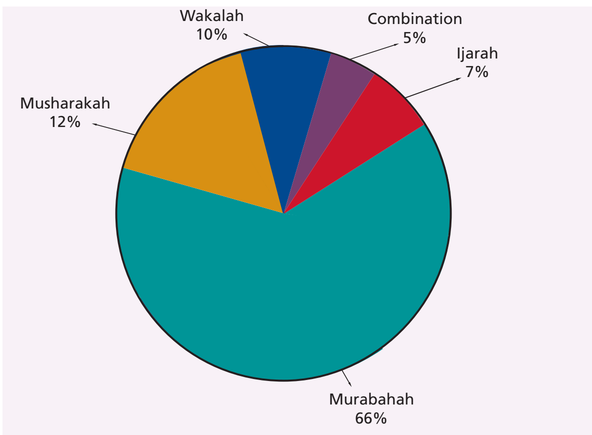
KLCI and Shariah Index 1-year performance



Source: SC

Chart 2

Size of corporate sukuk approved based on Shariah principle in 2015



Source: SC

Sukuk listing on LFX as at 31 Dec 2015

No.	Issuer name	Listing date	Maturity Date
1.	Danga Capital Bhd – SG$900 million Trust Certificates due 2020	12-Aug-10	11-Aug-20
2.	Wakala Global Sukuk Bhd – US$1.2 billion due 2016	07-Jul-11	06-Jul-16
3.	Wakala Global Sukuk Bhd – US$800 million due 2021	07-Jul-11	06-Jul-21
4.	Indah Capital Limited – SG$600 million Exchangeable Trust Certificates due 2019	25-Oct-13	24-Oct-18
5.	Exim Sukuk Malaysia Bhd – US$300 million Multi-currency Senior Sukuk due 2019	20-Feb-14	19-Feb-19
6.	Cahaya Capital Limited – US$500 million Multi-currency Senior Sukuk due 2021	19-Sep-14	18-Sep-21
7.	PETRONAS Global Sukuk Ltd – US$1.25 billion Trust Certificates due 2020	19-Mar-15	18-Mar-20
8.	Malaysia Sovereign Sukuk Bhd – US$1 billion Trust Certificates due 2025	23-Apr-15	22-Apr-25
9.	Malaysia Sovereign Sukuk Bhd – US$500 million Trust Certificates due 2045	23-Apr-15	22-Apr-45

Source: Labuan International Financial Exchange (LFX)

Sukuk listing under Bursa Malaysia's exempt regime as at 31 Dec 2015

No.	Issuer name	Description
1.	1Malaysia Sukuk Global Bhd	US$1.25 billion Trust Certificates
2.	AmIslamic Bank Bhd	RM3 billion Senior Sukuk Musharakah Programme RM2 billion Subordinated Sukuk Musharakah RM3 billion Subordinated Sukuk Murabahah Programme
3.	Axiata SPV2 Bhd	US$1.5 billion Multi-currency Sukuk Issuance Programme
4.	Cagamas MBS Bhd	RM2.05 billion Sukuk Musharakah 2005 RM2.11 billion Sukuk Musharakah 2007
5.	Cahaya Capital Limited	US$500 million Exchangeable Trust Certificate due 2021
6.	CIMB Islamic Bank Bhd	RM2 billion Junior Sukuk Programme
7.	Danga Capital Bhd	RM10 billion Multi-currency Islamic Securities Programme
8.	Hong Kong Sukuk 2014 Limited	US$1 billion Trust Certificate due 2019
9.	Hong Kong Sukuk 2015 Limited	US$1 billion Trust Certificate due 2020
10.	IDB Trust Services Limited	US$10 billion Trust Certificate Issuance Programme
11.	Indah Capital Limited	SG$600 million Exchangeable Trust Certificate due 2018
12.	Khazanah Nasional Bhd	RM20 billion Sukuk Musharakah Programme
13.	Malaysia Airports Capital Bhd	RM1 billion Islamic Medium Term Notes Programme
14.	Malaysia Sovereign Sukuk Bhd	US$1 billion Trust Certificate due 2025 US$500 million Trust Certificate due 2045
15.	Petronas Global Sukuk Limited	US$1.25 billion Trust Certificate due 2020
16.	Rantau Abang Capital Bhd	RM7 billion Islamic Medium Term Notes Programme
17.	Sime Darby Bhd	RM4.5 billion Islamic Medium Term Notes Programme
18.	Sime Darby Global Bhd	US$1.5 billion Multi-currency Sukuk Programme
19.	Tadamun Services Bhd	RM1 billion Islamic Medium Term Notes Programme
20.	Wakala Global Sukuk Bhd	US$2 billion Trust Certificate

Source: Bursa Malaysia

Islamic assets under management (AUM)

(RM billion)	Dec 2015	Dec 2014
Islamic AUM of FMCs	132.38	110.60
Total fund management industry	667.88	629.98
% Islamic AUM of FMCs to total industry	19.8%	17.6%

Note: The AUM includes assets that are sourced from collective investment schemes as well as private mandates
Source: SC

Launched funds

Unit trust fund (UTF)	Dec 2015	Dec 2014
Islamic UTF	193	188
Total industry	612	612
NAV Islamic UTF (RM billion)	52.12	46.66
NAV total industry (RM billion)	346.58	343.02
% to total industry	15.0%	13.6%

Wholesale funds (WF)	Dec 2015	Dec 2014
Islamic WF	93	69
Total industry	293	230
NAV Islamic WF (RM billion)	31.66	23.45
NAV total industry (RM billion)	84.53	73.30
% to total industry	37.5%	32.0%

Private retirement scheme (PRS)	Dec 2015	Dec 2014
Islamic PRS	20	18
Total industry	50	46
NAV Islamic PRS (RM million)	377.91	207.50
NAV total industry (RM million)	1,171.97	716.05
% to total industry	32.2%	29.0%

Exchange-traded funds (ETF)	Dec 2015	Dec 2014
Islamic ETF	4	2
Total industry	8	6
Market cap Islamic ETF (RM million)	355.91	310.27
Market cap total industry (RM million)	1,707.5	1,010.79
% to total industry	20.8%	30.7%

Real estate investment trusts (REIT)	Dec 2015	Dec 2014
Islamic REIT*	4	3
Total industry	17	16
Market cap Islamic REIT (RM billion)	16.11	15.06
Market cap total industry (RM billion)	37.48	35.67
% to total industry	43.0%	42.2%

** Including 1 stapled securities (equity + REIT)*
Source: SC

List of Islamic fund managers as at 31 Dec 2015

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

Source: SC

List of companies offering Islamic stockbroking services as at 31 Dec 2015

No.	Company	Type
1.	BIMB Securities Sdn Bhd	Full Fledged
2.	Affin Hwang Investment Bank Bhd	Window
3.	AmInvestment Bank Bhd	Window
4.	CIMB Investment Bank Bhd	Window
5.	Jupiter Securities Sdn Bhd	Window
6.	Kenanga Investment Bank Bhd	Window
7.	Maybank Investment Bank Bhd	Window
8.	RHB Investment Bank Bhd	Window

Source: Bursa Malaysia

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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