JANUARY–JUNE 2013 VOL 8 NO 1

Suruhanjaya Sekuriti
Securities Commission
Malaysia

malaysian ICM

Bi-annual Bulletin on the
Malaysian Islamic Capital Market
by the Securities Commission Malaysia

Contents

Supporting Further Growth of Islamic Finance[1]

The strength of domestic demand especially in the populous South East Asian markets has been credited as a key driver of economic growth in the region. Sustained domestic consumption following years of wealth accumulation during periods of strong economic performance, combined with robust infrastructure spending, has also enabled these nations to withstand the impact of external vulnerabilities during the global financial crisis and contributed to the relative stability that we are enjoying today within the region.

The resilience of the Asian economies amidst the global uncertainties has been partly an outcome of effective policy coordination among the Asian countries through regional co-operation, for example, ASEAN. It has been a model for a successful regional political and economic co-operation, in line with the growing interconnectivity between countries in the region. The target for the establishment of the ASEAN Community by 2015 represents another significant milestone and recognition of the need for and benefit of greater integration among Asian nations. While there are challenges in achieving regional integration among countries with varied cultural, economic and social backgrounds, the potential benefits of scale, co-ordinated resources and competitive advantages will drive stronger economic and financial performance for the region.

1 This article is extracted from the keynote address delivered by Datuk Ranjit Ajit Singh, the SC Chairman, at the World Islamic Banking Conference: Asia Summit 2013, in Singapore on 4 June 2013.

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The favourable economic outlook together with the strengthening of connectivity and linkages across the region will present significant opportunities for cross-border financing and investments. More specifically, there is strong and real potential for Islamic finance especially the Islamic capital market (ICM) to capitalise on these opportunities.

"The sukuk market registered strong growth in recent years with 2012 being a record with a total issuance size of US$131.2 billion globally, a 54% increase over 2011."

Development of the global Islamic financial services industry

The Islamic financial services industry has developed significantly across the globe in the past decade. The three main segments of Islamic finance – ICM, Islamic banking and takaful – have penetrated and established strong presence, either separately or collectively, in a growing number of jurisdictions across different continents.

In this regard, the sukuk segment has been prominently featured as a representation of this global development in view of the increasing number of both corporate and sovereign issuers tapping domestic and international capital. The sukuk market registered strong growth in recent years with 2012 being a record with a total issuance size of US$131.2 billion globally, a 54% increase over 2011. In 2012, Kazakhstan and France were among the jurisdictions that issued sukuk for the first time, while several other countries have indicated interest to issue sukuk in the future.[2] 2013 is developing another promising year with total issuance size of US$31.7 billion globally in the first quarter.[3]

Shariah-compliant equities are also a very significant segment of the ICM. Based on the Dow Jones Islamic Market World Index as an indicator of the size of Shariah-compliant equities globally (in the absence of an official measure), the market capitalisation of the 2,387 component stocks of the Index stood at US$19.3 trillion as at April 2013.

The large universe in terms of value and number, offers vast potential to drive further growth of the Islamic finance industry through development of Islamic equity-based products such as Islamic funds. While the size of assets under management in the Islamic fund management industry is still relatively small, at less than 1% of global mutual funds[4], the potential lies in serving the growing demand from Shariah-based investors who increasingly seek to diversify their investments not only from a geographical perspective but also in terms of product structures. In addition, the universality of the values underlying the Shariah principles of Islamic funds may also attract investors seeking ethical and socially-responsible investments.

According to the *Ernst & Young World Islamic Banking Competitiveness Report 2013*, global Islamic banking assets held by commercial banks amounted to US$1.3 trillion as at 2011 with the top 20 Islamic banks registering robust growth of 16% per annum in the last three years. The top three countries with the largest Islamic banking industry are Saudi Arabia, with an estimated US$207 billion of Islamic assets, followed by Malaysia with total assets of US$106 billion and the United Arab Emirates (UAE) with total assets of US$75 billion. Furthermore, the growth momentum is expected to be sustained as global Islamic banking assets are forecast to cross US$1.8 trillion by end-2013.

The growth of Islamic finance is reflected not just through the wide and still expanding range of products and services available in the market, but also in terms of the entry of new jurisdictions, such as Oman which witnessed the opening of its first Islamic bank in early 2013. Furthermore, the government of the United Kingdom, which already has an established presence in Islamic finance, renewed its commitment to further develop the industry by launching its Islamic Finance Task Force in

2 Source: KFH Research Ltd, Global Sukuk Report (January 2013).
3 Source: IFIS.
4 Ernst & Young Islamic Funds & Investments Report 2011.

March 2013. There are similar examples of the growing commitment towards developing or strengthening the Islamic finance industry in other jurisdictions, which will collectively serve to broaden the industry reach and promote greater internationalisation.

Sustaining the growth of Islamic finance

To sustain the growth of the Islamic finance industry, an enabling ecosystem is important to nurture further development of the industry. In this context, the following key areas that require specific focus are:

- Enhancing facilitative frameworks and cost efficiency;
- Broadening participation by investors, issuers and intermediaries; and
- Intensifying intra- and inter-regional collaborations.

The development of Islamic finance in the past decade or so has not been without its fair share of issues and challenges. To some extent, it has affected the pace of adoption of Islamic finance within certain jurisdictions, or limited the scope of participation by the stakeholders as these challenges effectively create obstacles or uncertainty in conducting Islamic finance transactions.

1. Enhancing facilitative frameworks and cost efficiency

Development of the relevant and supportive legal and tax frameworks have been a major challenge for the industry. To date, there remains some degree of uncertainty as to the legal enforceability of the Shariah relative to local or national laws when dealing with Islamic financial instruments and structures. As the present-day Islamic finance industry is still relatively nascent, there are only a few cases that may serve as legal precedents. It is imperative that both the public and private sectors collaborate towards enhancing legal certainty and clarity in Islamic finance transactions, including strengthening the dispute resolution mechanism and harmonising relevant documentation, to mitigate current market concerns.

The limited availability of an enabling tax framework in some jurisdictions has also hampered a more entrenched development of Islamic finance. As certain Islamic finance transactions or structures require relevant amendments to the tax laws to provide tax neutrality relative to similar conventional structures, any delay or reluctance in implementing these amendments will adversely affect the adoption of Islamic finance in these jurisdictions. Representatives must seek to overcome this challenge by sharing the experiences of jurisdictions that have adopted tax neutrality regimes on the additional value created through the offering of Islamic finance in their respective markets.

Islamic finance also faces the challenge of being generally less cost competitive from the issuers' perspective for certain products or in certain jurisdictions as a result of higher costs charged by the intermediaries or other service providers due to limited expertise and lack of scale, among others. The higher cost may in some cases be transferred to the customers, rendering the products less attractive compared to their conventional equivalents. It is important to address this issue effectively. For instance through knowledge transfer, sharing of group resources or facilitating market access, to ensure that Islamic finance products and services remain competitive and commercially relevant to enhance its sustainability.

Less widely understood than its conventional counterpart, Islamic finance has generated mixed perception on the risks it purportedly carries. The development of Islamic finance has created many opportunities and complemented the conventional system, but brings with it other challenges which the quote "less apparent understanding of the new environment can create a sense of greater risk, even if the objective level of risk in the system is unchanged or reduced" (Merton, 1995)[5] could relate.

However, once this misperception is addressed, it can unleash new opportunities for Islamic investments while facilitating the funding of economic growth, and making available the supply of risk capital to support the creation of new assets in the Asian financial market.

5 Merton, R. (1995). Financial innovation and the management and regulation of financial institutions. *Journal of Banking and Finance*, 19, 461–481.

2. Broadening participation by investors, issuers and intermediaries

An important aspect of broadening the participation in Islamic finance is through enhancing financial inclusion. Much work and study have been conducted in this area, including by the World Bank. Some communities have refrained from participating in the formal financial system due to the absence of a Shariah-compliant alternative. The increasing availability of Islamic finance will serve the financial and investment needs of these communities and become a significant growth driver in the future.

The broadening of participation is also critical as it addresses both the supply and demand for Islamic finance products and services. In this context, product innovation and development is an important element. The availability of Islamic finance products and services which are comparable to many of those in the conventional market, has contributed immensely to the development of the Islamic finance industry over the past decade as investors and consumers were familiar with these products and services, and therefore accepted them more readily although their range was relatively narrower due to the prohibitions under the Shariah principles such as on *riba*, *gharar* and *maysir*. Nevertheless, adherence to the Shariah requirements which promote universal values also embraced in other faiths is the key factor driving product development in the future, which in turn will attract broader participation that will cut across religious boundaries and geographical borders.

For example, the requirement for Islamic finance instruments to be structured based on real underlying economic or productive assets provides significant protection for investors in mitigating risk of substantial loss. Such structures are increasingly popular following the global financial crisis, the aftermath of which has been felt across many parts of the developed economies five years on. Furthermore, investors and issuers seeking more authentic, back-to-basic forms of investment or financing instruments based on the Shariah requirement on risk sharing, as opposed to risk transfer, will spur greater product innovation in Islamic finance thus attracting a wider range of participants into the market.

While product structures based on Shariah principles may appeal to segments of the population that extend beyond a specific community, the further growth and sustainability of Islamic finance will also require these products offer a competitive risk-return profile. In this regard, it is important that the risk-return comparisons are made between products which are alike in substance, to avoid misperception in the market.

> *‘The Organisation of Islamic Cooperation (OIC) Countries, the Islamic Development Bank and the Islamic Financial Services Board (IFSB) are among such organisations that can facilitate the development of Islamic finance globally by harnessing and mobilising the resources across jurisdictions, promoting common standards and practices, and establishing platforms and infrastructure.’*

3. Intensifying intra-regional and inter-regional collaborations

In the present globalised environment, cross-border collaborations are absolutely critical for the sustained and inclusive growth of Islamic finance. Collaborations within a region, for instance within ASEAN or the Gulf Co-operation Council (GCC), are the most effective and productive in view of the proximity of the markets as well as the generally closer cultural and social understanding within the region. Firmly established intra-regional collaborations will then set a conducive platform for inter-regional collaborations, for instance, between ASEAN and the GCC, to promote greater linkages and cross-border flows of Islamic finance transactions to support investment, financing and trading activities between the regions. Because of these potential benefits, the ASEAN Capital Market Forum has commenced work on identifying opportunities in the development of the ICM within the grouping.

Other forms of collaboration spearheaded by or under the auspices of multilateral groupings or institutions can also further increase the growth of Islamic finance. The Organisation of Islamic Cooperation (OIC) Countries, the Islamic Development Bank and the Islamic Financial

"A key aspect of the regulatory approach is the development of supervisory and risk management frameworks that emphasises disclosure, transparency, strong governance and investor protection to strengthen the resilience and soundness of the market and its institutions, while supporting innovation and competition."

Services Board (IFSB) are among such organisations that can facilitate the development of Islamic finance globally by harnessing and mobilising the resources across jurisdictions, promoting common standards and practices, and establishing platforms and infrastructure.

An initiative that has been introduced recently is the setting up of an Islamic Finance Task Force under the Standing Committee for Economic and Commercial Co-operation (COMCEC) Capital Markets Regulators Forum of the OIC, to explore potential areas for collaboration in the development of Islamic finance among member countries. Another initiative was a roundtable jointly organised by the Islamic Financial Services Board (IFSB), the International Organization of Securities Commissions (IOSCO) and the SC in September 2012 to discuss minimum disclosure requirements for ICM products, with the primary aim of working towards a set of standards that will ultimately facilitate cross-border offering of ICM products.

Opportunities for Islamic finance

The Asian economic landscape offers ample opportunities for Islamic finance to flourish. Infrastructure investment is an important component of economic development. The Asian Development Bank (ADB) has projected that ASEAN nations will require an average of about US$60 billion of infrastructure investment a year between 2010 and 2020. The McKinsey 2012 report has suggested that infrastructure investment in China will average US$1 trillion per annum up to the year 2030, while India's infrastructure investment is forecast to be US$1 trillion under its 12th five-year plan, between 2012 and 2017.

These substantial amounts provide tremendous potential for financing and capital raising through the issuance of sukuk, as many infrastructure assets are inherently Shariah compliant. Furthermore, sukuk will naturally capture a wider subscriber base as they appeal to both conventional and Shariah-based investors. Cross-border offering of sukuk will also promote greater diversity in terms of the issuing currency, as well as the industry and geographical profile of the issuers.

At the same time, growing affluence among the Asian middle class will generate increasing demand for investment and savings products. With a large proportion of the Asian population potentially seeking Shariah-compliant alternatives, especially in South East Asia, the opportunity for Islamic investments to meet this prospectively strong demand should not be underestimated.

In the medium to longer term, demand for more sophisticated and comprehensive services will help to spur the development of a vibrant Islamic wealth management industry that will serve regional and international customers, incorporating various aspects of Islamic finance including fund management, takaful and real estate.

Regulatory approach to Islamic finance

Arising from the vagaries of the financial markets in recent years, the role of regulators and the effectiveness of regulations have become even more important. It is, therefore, crucial that regulators develop appropriate and effective regulatory measures for the future to monitor and address emerging risks in an increasingly complex economic and financial environment.

A key aspect of the regulatory approach is the development of supervisory and risk management frameworks that emphasises disclosure, transparency, strong governance and investor protection to strengthen the resilience and soundness of the market and its institutions, while supporting innovation and competition.

In this regard, the SC has taken the view that Malaysia's ICM products will be subject to the same regulation as its conventional counterparts, with additional requirements to ensure Shariah compliance. This approach provides the participants – whether in Islamic or conventional products – of the assurance that the products and services are governed by the same standards of regulation and supervision.

Nevertheless, regulating for Shariah compliance is a critical process in respect of the ICM as it serves to increase market confidence on the products and services. The process therefore, should include appropriate and effective safeguards in the Shariah governance framework to ensure credibility, clarity and consistency.

Islamic finance is no longer confined to a narrow market segment but has gained traction in many other jurisdictions across the globe. While this development augurs well for the long-term growth of the industry, it further adds to the complexity of integration and to systemic risk trend that global regulators certainly face, and therefore represents a significant challenge.

Each jurisdiction may have its own regulatory approach for the development of its Islamic finance industry. However, in light of such rapid global growth today, the increasing need for a common understanding on regulatory issues in Islamic finance represents a crucial challenge that has to be addressed to facilitate its orderly global development and to ensure its sustainability.

Furthermore, regulatory co-operation to facilitate the internationalisation of Islamic finance should be explored, for instance establishing mutual recognition agreements for ICM products to be offered within the jurisdictions with minimal regulatory intervention. Collaborative efforts to develop regulatory standards that promote greater harmonisation should also be intensively pursued to facilitate faster development of cross-border Islamic finance transactions and activities.

For an industry that is still relatively young, Islamic finance also needs to be properly and sufficiently regulated to provide confidence to market participants. A well-regulated industry will attract the participation of high quality investors, issuers and intermediaries, which in turn will lead towards a vibrant and robust Islamic finance industry.

In conclusion, all stakeholders are encouraged to collaborate and co-operate in pursuing the developmental agenda for Islamic finance to unleash the full potential that it has to offer. Such initiatives should also include effective branding and profiling of Islamic finance and its value proposition on a global scale to generate greater appreciation and ultimately acceptance of Islamic finance as a viable and sustainable alternative. There is always much more that can be achieved when efforts and resources are harnessed and combined within and across the regions, so that Islamic finance can not only serve a niche market segment but also spur greater cross-border financial and investment activities that support economic, trade and business linkages.

Permissibility and Bindingness of Musharakah Mutanaqisah

INTRODUCTION

Musharakah mutanaqisah is a financing method based on partnership contract. Some scholars specify this contract as *musharakah muntahiyah bi tamlik*.[1]

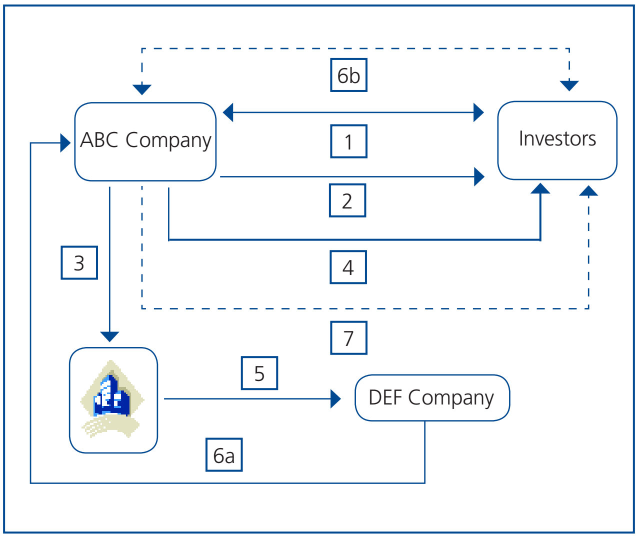
DEFINITION OF MUSHARAKAH MUTANAQISAH

According to Wahbah al-Zuhayli, *musharakah mutanaqisah* is a partnership contract between two partners or more where one of the partners agrees to grant his/her rights over the partnership to the other partner(s) by selling his/her portions in the partnership to his/her partner either in lump sum or by installment payment based on the terms and conditions agreed at the beginning of the contract.[2] Based on the *musharakah mutanaqisah* arrangement stated above, the asset which is financed by at least two partners at the beginning of the partnership contract will eventually be fully owned by one of the partners only at the end of the partnership contract.

According to the Shari`a Standards issued by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), *musharakah mutanaqisah* is a form of partnership in which one of the partners promises to buy the equity portion of asset of the other partner(s) gradually until the ownership to the asset is completely transferred to him. The transaction starts with the formation of partnership, after which the contract of buying and selling of the equity portion will take place gradually between the two partners. It is important to note that the buying and selling contract should not be stipulated in the partnership contract. The buying partners are allowed to give only a promise to buy. This promise should be independent from the partnership contract. In addition, the buying and selling agreement must be independent of the partnership contract.[3]

APPLICATION OF THE MUSHARAKAH MUTANAQISAH CONCEPT IN SUKUK STRUCTURE

The application of the *musharakah mutanaqisah* concept in a sukuk structure can be illustrated in the following diagram.



Brief explanation:

Step 1 – ABC Company and the Investors enter into a *musharakah* (partnership) venture to purchase a property by executing a *musharakah* contract. The capital needed to purchase the property is RM80 million. According to the *musharakah* contract, 10% of the capital is contributed by ABC Company while 90% of the capital is contributed by the Investors. The capital contribution in the partnership may be either in the form of cash or in kind.

1 Al-Sowi, Muhammad Solah, *Musykilah al-Istithmar fi al-Bunuk al-Islamiyyah wa Kaifa `Ala Jaha al-Islam* (Kaherah: Dar al-Wafa, 1990), p. 619 & 621. Muhammad Uthman Syabir, *al-Mu`amalah al-Maliyyah al-Mu`asirah fi al-Fiqh al-Islami*, (Jordan: Dar al-Nafais, 2007), 6th Edition, p. 334.

2 Wahbah al-Zuhayli, his article on *'Al-Musyarakah al-Mutanaqisah wa Suwaruha fi Dhawi Dhawabit al-`Uqud al-Mustajiddah'*, p. 1.

3 AAOIFI, Shari`a Standards No. 12, Paragraph 5/1, p. 217.

Step 2 – ABC Company (as the issuer) issues sukuk *musharakah* to evidence the involvement of the Investors (as the sukuk holders) in the partnership.

Step 3 – ABC Company (appointed as an agent to the partnership) purchases a property priced at RM80 million using the capital that is contributed by itself and the Investors with the ratio of capital contribution of 10:90.

Step 4 – ABC Company issues a purchase undertaking in favour of the Investors whereby ABC Company undertakes to the Investors to purchase the Investors' undivided proportionate portions in the partnership (i) from time to time; and (ii) at a predetermined exercise price upon the maturity date of the sukuk *musharakah* or date of declaration of a dissolution event, whichever is the earlier.

Step 5 – ABC Company (as an agent to the partnership) leases the property to DEF Company for the period of 10 years at the amount of RM120 million based on the Shariah principle of *ijarah*.

Step 6a – DEF Company shall pay RM6 million semi-annually to ABC Company as the semi-annual lease payment of the property.

Step 6b – ABC Company and the Investors shall share the proceeds of the semi-annual lease payment based on their ratio of ownership portions in the partnership.

Step 7 – Throughout the period of partnership, ABC Company shall purchase the portions owned by the Investors in the partnership gradually. At the end of the *sukuk musharakah* period, all portions in the partnership will be wholly owned by ABC Company and as a result thereof the partnership will be dissolved accordingly.

(i) Permissibility of musharakah mutanaqisah

Most contemporary jurists permit *musharakah mutanaqisah* contract as a method which can be used in the capital market to meet the current need as well as an alternative to interest-based financing instruments.[4] This is because it contains elements which do not contravene with the text of Shariah and the objectives of contract (*muqtadha `aqd*).[5] According to Uthman Syabir[6] and Wahbah al-Zuhayli, the elements that form *musharakah mutanaqisah* contract are as follows:

(a) *Sharikah `inan*

Sharikah `inan is a form of partnership where two or more individuals/parties contribute the capital stipulating that any profit they earn will be shared among them.[7]

In the context of *musharakah mutanaqisah*, it does not contradict with the concept of *sharikah `inan*, the text of *Syara`* nor any Shariah principle in general. Hence, *musharakah mutanaqisah* contract is permissible.

(b) *Wa`d* (Promise)

Promise from one of the partners to purchase the portions of asset owned by his/her partner(s).

Generally, in sukuk structures based on the Shariah principle of *musharakah mutanaqisah*, the sukuk issuer promises to purchase the portions of asset owned by the investors.

(c) The selling of portions of ownership to the partner(s)

One of the partners sells his/her portions of ownership to other partner(s) through a separate contract which is independent from the *musharakah* contract either in whole or in part with a lump sum payment or by installments payment.

4 Markaz al-Iqtisad al-Islami, *Dalil al-Fatawa al-Syar`iyyah fi al-A`mal al-Masrafiyyah* (Kaherah: 1989), pp. 66–67.
5 Wahbah al-Zuhayli, his article on '*Al-Musyarakah al-Mutanaqisah wa Suwaruha fi Dhawi Dhawabit al-`Uqud al-Mustajiddah,' op. cit.*, p. 1.
6 *Ibid*., p. 2, Muhammad Uthman Syabir, *al-Mu`amalat al-Maliyyah al-Mu`asirah Fi al-Fiqh al-Islami*, *op.cit.*, p. 336.
7 Wahbah al-Zuhayli, *al-Fiqh al-Islami wa Adillatuh*, (Damsyik: Dar al-Fikr, 1985) 2nd Edition, vol. 4, p. 796.

In the context of *musharakah mutanaqisah* in sukuk structures, the investors have complete ownership in respect of its part of the partnership asset. As partners, the investors have partnership rights and must comply with all rules of partnership. It involves promise from the investors to sell their portions in the partnership when the other partner pays the purchase price to acquire the investors' portions either in lump sump payment or by installment.

The permissibility of the *musharakah mutanaqisah* is also due to the agreement by the contracting parties based on mutual consent (*taradhi*) and freedom of contract among the contracting parties by taking into account the objectives and text of Shariah.[8] According to Wahbah al-Zuhayli, contemporary scholars from Mazhab Hanbali state that the validity of a contract is that it must not deny the objectives of contract.[9]

(ii) Bindingness of musharakah mutanaqisah

Originally, jurists categorise *musharakah* contract as one of non-binding contracts (*`uqud ghair lazimah*)[10] on the contracting parties. It means that any partners can terminate their partnership unilaterally at any time after giving proper notice to the other partner(s).[11]

Nevertheless, *musharakah* contract may become binding when it is combined with other elements which are binding in nature. Al-Zarqa' has explained in detail in his book *Madkhal Al-Fiqhi Al-`Am* stipulating that a contract which is initially a non-binding contract may transform into a binding contract when it is attached with other binding elements. For instance, in the borrowing contract (*al-`ariyah*) which is originally a non-binding contract, it may become a binding contract when there are other binding elements which are attached to it such as when there is a requirement of payment of fee (*ujrah*) in the contract.[12] The same principle is also applicable in *wakalah* contract when such contract is attached with the payment of fee (*ujrah*) it will be classified as a binding contract although originally it is not a binding contract.[13]

This article will focus on the discussion on the issue of whether *musharakah mutanaqisah* is classified as a binding contract or non-binding contract. The details of the discussion are as follows:

(a) *Musharakah mutanaqisah*: Is it a binding contract (`*aqd lazim*) or non-binding contract (`*aqd ghair lazim*)?

According to Abdul Sattar Abu Ghuddah, he accepted the view of the jurists that partnership by contract (*syirkah al-`aqd*) is non-binding.

Nevertheless, according to him, among the Maliki's, there are views that partnership by contract will become binding under certain circumstances or will become binding when the contract is signed. Thus, in that situation, one of the partners cannot retract any agreement of partnership made after the contract is signed without obtaining the permission from the other partner(s). There is also other view among the Maliki's that if there are other elements associated with *musharakah* contract (such as sale and purchase, *ijarah* and *wa`d*), then the *musharakah* contract will become a binding contract.[14]

Based on the Shari`a Standards issued by AAOIFI, a partnership contract is categorised as a non-binding contract. According to AAOIFI, every partner has the right to terminate the partnership contract (i.e to withdraw from the partnership) after giving his partner(s) due notice to this effect in which case he shall be entitled to his share in the

8 Wahbah al-Zuhayli, his article on *'Al-Musyarakah al-Mutanaqisah wa Suwaruha fi Dhawi Dhawabit al-`Uqud al-Mustajiddah,' op. cit.*, p. 1.
9 *Ibid*., p. 2.
10 Non-binding contract is a contract which allows any contracting parties to terminate the contract without the need to obtain the consent from the other parties. Meanwhile a binding contract is a contract where any of the contracting parties cannot terminate the contract without obtaining the consent from the other parties. Wahbah al-Zuhayli, *Al-Fiqh al-Islami wa Adillatuh*, *op.cit.*, p. 241.
11 *Ibid*., p. 242.
12 Mustafa Al-Zarqa, *Madkhal Al-Fiqhi Al-`Am*, (Damsyik: Dar al-Qalam, 2004), 2nd Edition, vol.1, pp. 449-450.
13 Al-Dusuki, *Hasyiyah al-Dusuki `Ala Syarh al-Kabir*, (Ihya' al-Kutub al-`Arabiyyah), vol. 3, p. 397.
14 Abu Ghuddah, Abdul Sattar, *Takyiif Syarikat al-`Aqd wa al-Mulk wa Atharuhu fi Tatbiqaat al-Sukuk wa Musyarakah Mutanaqisah*, pp. 9,17–18.

partnership. However, the withdrawal of the partner does not terminate the partnership of the remaining partners where the other partners can continue with the partnership.[15]

However, if the *musharakah* contract is associated with other elements such as *wa`d mulzim* (binding promise), the AAOIFI Shari`a Standards states that partners are allowed to continue the partnership for a certain period of time (until maturity). In this case, it is permissible for the partners to agree to terminate the partnership contract before the contract period expires.[16] The existence of *wa'd* resulted the partnership contract to become binding.

Even though the AAOIFI Shari`a Standards do not specifically discuss on whether *musharakah mutanaqisah* contract is binding or non-binding, the AAOIFI Shari`a Standards states that in executing the *musharakah mutanaqisah* contract, it is compulsory to comply with the general rules of *musharakah* particularly the rules of *sharikah `inan*. Therefore, in the *musharakah mutanaqisah* contract it is not permitted to include any clause which gives any of the partners a right to withdraw his share in the capital.[17] Thus, based on the information stated above, it clearly shows that *musharakah mutanaqisah* contract also can be classified as a binding contract.

The AAOIFI's view is supported further with the view of Majma` Fiqh Islami. In the context of *musharakah mutanaqisah* contract, it is associated with the elements of *wa`d mulzim* from one of the partners to own the portions of asset of the other partner(s). Besides that, sale and purchase contract will be executed between the partners stipulating that one of the partners will acquire all portions of the partnership.[18] This clearly indicates that Majma` Fiqh Islami also relate the *musharakah* contract with other elements which are binding (*lazim*) which are *wa`d* and sale and purchase contracts. This can further strengthen the proposition that *musharakah mutanaqisah* contract is binding.

According to Uthman Syabir, in the context of *musharakah mutanaqisah* transaction, the partners must comply with all partnership rights and commitments whether they relate to the partnership contract or the sale contract. This is because, according to him, the element of *wa`d* provided by the bank (financier) (in the sukuk structure it involves investors) to sell its portions of partnership to its partner(s) (client) (in the sukuk structure it involves sukuk issuer) has made the *musharakah mutanaqisah* contract binding on the contracting parties.[19]

Meanwhile, from the perspective of Islamic economist, *musharakah mutanaqisah* contract normally comprises the elements of sale and purchase and also lease (*ijarah*) contracts. These two elements of contracts are combined together as integral parts to ensure that no element of interest (*riba*) is involved in the transaction.[20] With the existence of the two elements above, it will further strengthen the binding effect of the *musharakah mutanaqisah* contract on the contracting parties. This is because both contracts above (i.e sale and purchase and lease contracts) are classified in the category of binding contracts (*`uqud lazimah*).

The view of the jurists that it is compulsory for the contracting parties of a binding contract to fulfill their obligations in such contract is based on the following Quranic verse:

Translation: "O you who believe fulfill your obligation in contracts".[21]

Ibn Taymiyyah has urged that in an exchange contract, it is the duty of the contracting parties to perform

15 AAOIFI, Shari'a Standards No. 12, Paragraph 3/1/6/1, p. 209.
16 *Ibid*.
17 *Ibid,* Paragraph 5/2, p. 217.
18 *Qarar Majma` al-Fiqh al-Islami al-Duwali*, No.136 (15/2).
19 Muhammad Uthman Syabir, *al-Mu`amalat al-Maliyyah al-Mu`asirah Fi al-Fiqh al-Islami*, *op.cit.*, pp. 336–337.
20 Majallah Majma` al-Fiqh al-Islami, bil. 10, vol. 2, p. 554.
21 *Surah al-Maidah*: 1.

their respective duties and responsibilities. The obligation to perform the contract is an obligatory requirement according to the Shariah.[22]

Hence, based on the justifications above, it can be concluded that *musharakah mutanaqisah* contract which originally is non-binding can change its status to become a binding contract and must be fulfilled by all contracting parties if certain elements which are binding in nature exist such as sale and purchase, *ijarah* and *wa`d mulzim* from one of the contracting parties involved in the partnership contract.

Based on the sukuk structure illustration stated above, the elements that make the *musharakah mutanaqisah* contract binding are as follows:

(i) The existence of *wa`d mulzim* by the sukuk issuer i.e. ABC Company to purchase all portions of asset owned by the Investors in the partnership; and

(ii) The execution of sale and purchase agreement between ABC Company and the Investors where ABC Company will gradually purchase the portions of asset owned by the Investors in the partnership to ensure that ABC Company will eventually acquire full interest and ownership over the asset which is co-owned by ABC Company and the Investors upon expiry of the partnership period.

(b) Binding effects on a contract

Effect on a contract can occur either directly or indirectly. According to al-Zarqa', such effects can be divided into two types namely:[23]

(i) Direct effect of bindingness in a contract

The original ruling of a contract (*al-hukm al-asl li al-`aqd*) or known as the qualitative effect (*al-athar al-naw`i*) of a contract such as the transfer of ownership in exchange of a consideration (*`iwadh*) in sale contract, or transfer of ownership without consideration in the contract of *hibah* and so on (depending on the nature of the contract concluded).

(ii) Indirect effect of bindingness in a contract

The obligation resulting from a contract (*al-iltizamat al-nasyi'ah bi al-`aqd*) is a commitment to do certain tasks as agreed in the contract such as delivery of the sale object, guarantee against the defect or damage of the sale object, payment of the price and so on.

In the context of *musharakah mutanaqisah*, both of the aforementioned binding effects occur in *musharakah mutanaqisah* contract whereby in term of direct effect, transfer of ownership in exchange of a consideration (*`iwadh*) will occur when the sale of the portions of ownership of a partner in a partnership occurs either in part/stages or all at once to the other partner(s).

Meanwhile, in term of indirect effect, the commitment of the parties who are involved in the shared asset is as follows:

(i) A partner (for example, sukuk issuer) has to pay the purchase price for the applicable portions of partnership which it intends to purchase either in lump sump or by installment in order to acquire all of the portions of the partnership.

(ii) A partner (for example investors) has to transfer the applicable portions of partnership sold to the sukuk issuer based on the ratio which is agreed at the beginning of the partnership.

The aforementioned binding effect is in line with the sukuk structure illustration highlighted above

22 Al-Imam Abu Zuhrah, *Al-Milkiyyah wa Nazoriyyah al-`Aqd Fi al-Syari`ah al-Islamiyyah*, (Dar al-Fikr al-`Arabi), p. 230.
23 Mustafa Al-Zarqa, *Madkhal Al-Fiqhi Al-`Am*, *op.cit*, vol. 1, p. 517.

where the effect of bindingness from sale and purchase contracts of the portions of partnership occurs directly and indirectly as follows:

(i) *Direct effect*

The Investors' portions of ownership over the asset (property) will diminish and change ownership gradually when ABC Company purchases the portions owned by the Investors in the partnership gradually.

(ii) *Indirect effect*

ABC Company will purchase the investors' portions in the partnership gradually by paying the specified price for such purchase while the Investors will transfer the portions sold to the ABC Company according to the agreed ratio.

CONCLUSION

Based on the information stated above, it can be concluded that the *musharakah mutanaqisah* contract is acceptable by most of the contemporary jurists. The outcome of the aforementioned discussion indicates that *musharakah mutanaqisah* contract is a binding contract which should be fulfilled by the contracting parties. The bindingness of such *musharakah mutanaqisah* contract is not just the bindingness as partners (*syarik*) but also the bindingness as seller and purchaser in sale and purchase contract and as lessor and lessee in lease contract where such elements may exist in the *musharakah mutanaqisah* contract.

World's First Islamic Stapled Securities

In May 2013, Malaysia witnessed the listing of the first-ever Islamic stapled securities, KLCC Property Holdings Bhd Stapled Group (KLCCP Stapled). These stapled securities were endorsed as Shariah-compliant by the Shariah Advisory Council (SAC) of the SC.

A stapled security is where investors own two or more securities which are generally related and contractually bound together, usually via a deed, through a single vehicle that cannot be traded separately. For example, shares of a company can be bound to units of an investment trust and they must be purchased and sold together. The concept of stapled securities is not new and has been in existence in many developed markets such as Australia, Hong Kong, the US and Canada.

Given the contractual nature of the stapling exercise, stapled securities can be implemented and governed within existing regulatory framework governing the individual securities such as listed shares and real estate investment trusts (REIT) without a need to develop a new regulatory framework specifically to govern stapled securities.

In the KLCCP Stapled case, it involves stapling units in a newly established Islamic REIT with shares in KLCC Property Holdings Bhd. An investor holding the stapled securities will effectively hold both shares in the company and units in the REIT, and will reap the combined economic interest and benefits from both the company and the REIT. In this stapling exercise, an independent trustee is appointed to act on behalf of unit holders and to hold custody of the REIT or trust assets. A REIT manager is also established to manage the REIT/trust's investment and financing strategies, asset acquisition and disposition policies as well as the overall management of the assets.

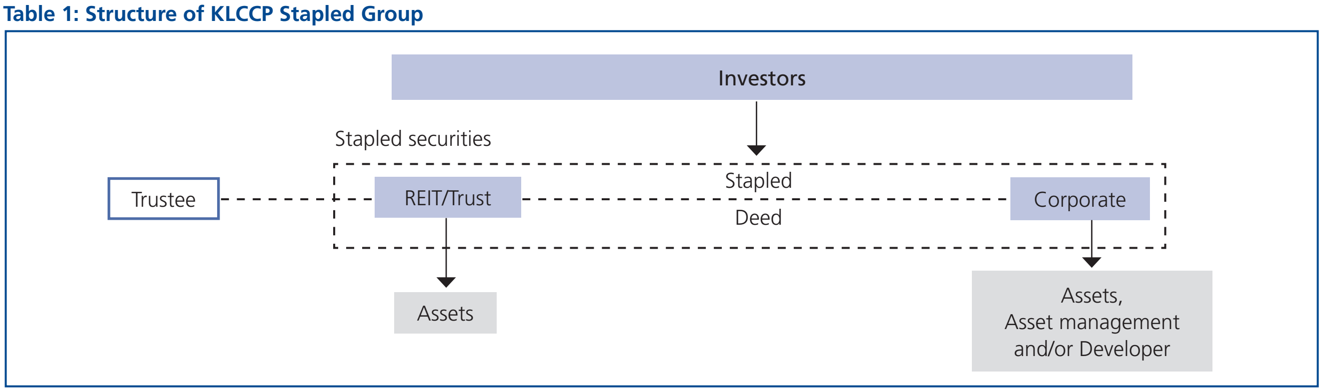
The SAC of the SC has ruled that for any stapled securities to be recognised as Islamic stapled securities, each individual security must be Shariah compliant. KLCCP shares have been designated as Shariah compliant since 2004. Pursuant to *Guidelines for Islamic Real Estate Investment Trusts* (Islamic REIT Guidelines), an Islamic REIT must ensure that all forms of investment, deposit and financing instruments comply with the Shariah principles.

CIMB Islamic Bank Bhd was appointed as Shariah adviser to ensure activities of the above REIT which comprise assets of PETRONAS Twin Tower, Menara ExxonMobil and PETRONAS Tower 3 are Shariah compliant. As required by the Islamic REIT Guidelines, the Shariah adviser will certify on annual basis that the REIT is managed in accordance with Shariah principles.

The SAC has also decided that once the above stapled securities are listed, the Shariah status of the stapled securities would depend on the Shariah status of the securities of KLCCP, based on the review of the audited financial statements by the SAC.

The KLCC Stapled is the first Islamic stapled securities globally, the largest REIT in Malaysia and ranks amongst the largest in Asia with RM15.4 billion in assets and nearly RM13 billion market capitalisation. It is also the first stapled securities to be listed on Bursa Malaysia. By stapling its securities, KLCCP Stapled would enhance or maximise value to the existing shareholders through the shift towards a yield-based valuation matrix and from the relevant tax exemptions at the REIT level.

Table 1: Structure of KLCCP Stapled Group



Updated List of Shariah-compliant Securities

The SC released an updated list of Shariah-compliant securities approved by its Shariah Advisory Council (SAC). The updated list, which took effect on 31 May 2013, features a total of 801 Shariah-compliant securities. These counters constitute 88 per cent of the total 910 listed securities on Bursa Malaysia.

The list includes five newly classified Shariah-compliant securities and excludes four from the previous list issued in November 2012. It also indicates that Shariah-compliant securities are well represented in all sectors of industry.

The full list, which is updated twice a year, is available on the SC website. The next updated list, to be based on the revised Shariah screening methodology, will be made available in November 2013

Table 1: Newly classified Shariah-compliant securities

No.	Stock code	Name of securities
1.	5229	China Automobile Parts Holdings Ltd*
2.	5234	CLIQ Energy Bhd
3.	0160	Hiap Huat Holdings Bhd
4.	0017	M3 Technologies (Asia) Bhd
5.	6114	MKH Bhd

** The securities of this company have been classified as Shariah compliant at IPO stage.*

Table 2: Newly classified Shariah non-compliant securities

No.	Stock code	Name of securities
1.	7668	Hai-O Enterprise Bhd
2.	6548	Malaysia Pacific Corporation Bhd
3.	0169	Smartag Solutions Bhd
4.	5622	TRIplc Bhd

Table 3: Shariah-compliant securities on Bursa Malaysia

Main market/ACE market	Shariah-compliant securities	Total securities*	Percentage of Shariah-compliant securities (%)
Consumer products	122	132	92
Industrial products	253	263	96
Mining	1	1	100
Construction	41	44	93
Trading/Services	174	202	86
Properties	71	84	85
Plantation	37	40	93
Technology	93	95	98
Infrastructure (IPC)	6	6	100
Finance	2	37	5
SPAC	1	1	100
Hotels	Nil	4	Nil
Closed-end fund	Nil	1	Nil
Total	**801**	**910**	**88**

** As at 23 May 2013.*

2ND SC-OCIS SCHOLAR IN RESIDENCE PROGRAMME

The 2nd SC-OCIS Scholar in Residence Programme (SiR) in Islamic finance for the academic year will commence in October 2013. SiR is a joint initiative between the SC and the Oxford Centre for Islamic Studies (OCIS).

Application for the Visiting Fellowship under the SiR was closed on 17 May 2013. Applicants 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. Applicants and nominees must be able to demonstrate competence to conduct independent academic research.

The successful applicant will be expected to conduct research related to the development of Islamic finance on a topic of contemporary relevance to this 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 OCIS 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.

8TH SHARIAH ADVISERS WORKSHOP

Ranking of Rights in Capital Market Products

24 October 2013
Securities Commission Malaysia

Shariah Advisers Workshop is an annual event organised by the SC since 2006. Throughout the years, the workshop has covered various topics related to products and services offered in ICM. Participants comprise Shariah advisers registered with the SC and Bank Negara Malaysia, as well as Shariah officers of Islamic financial institutions

Capital market products such as sukuk and bonds that provide different classes or ranking of rights to investors apply the principle of tranching. In this regard, Shariah scholars have debated and provided various views from Shariah perspective on the permissibility of having different classes or ranking of rights over the same underlying assets or pool of assets.

As a result of having different classes or ranking of rights, some investors would therefore enjoy priority rights compared to other investors. Question remains with regard to the reason why the principle of tranching is considered as Shariah non-compliant by some Shariah scholars.

In order to address this issue, the workshop is organised to provide platform for participants to gain better understanding on the issue of ranking of rights in capital market products. There will be interactive sessions for participants to discuss on potential Shariah issues resulting from the ranking of rights and possible solutions on unresolved issues.

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SHARIAH ADVISERS WORKSHOP IS BY INVITATION ONLY

Facilitating Retail Participation in the Sukuk Market[1]

Malaysia's Islamic finance industry was driven by the need to provide financial access to Malaysians who require savings and investment products that are not inconsistent with the Shariah. Hence, our focus in the early years of development was to ensure the availability of such products and services to Muslims across the country to fulfill this demand. It was only after the domestic market had developed critical mass in all the key areas of banking, takaful and capital market (attracting both Muslims and non-Muslims) that we set our eyes on establishing Malaysia as the marketplace for international Islamic finance intermediation.

In pursuing the development agenda of the ICM, we continue to be guided by asking how the industry can best serve the *ummah*, that is the investing public and the business community as a whole. After all, the first Islamic Principles[2] of Commercial Law asserts that wealth (and property) should be circulated among the general public and actively transferred from one hand to another in the form of investment (and expenditure). It is for this reason that ensuring investment access to the masses has and continues to be a key driver for the development of Islamic markets in Malaysia. It is for this reason too that Malaysia's ICM has been systematically designed to ensure accessibility and inclusiveness whilst ensuring the protection of investors, efficiency in intermediation, fair and orderly markets and risk mitigation.

The democratisation of financial capital or the broadening of access to financial investments and capital has been receiving increasingly more attention in the Islamic finance space. This is rightly so given that many Muslim nations are developing economies and many Muslims still do not have access to basic savings and banking facilities, let alone those that are Shariah compliant. Faced with issues of poverty, community development and rural-urban economic divide, scholars and policy makers have looked to the objective of Shariah (*maqasid al Shariah*), the ethical and religious-based economic systems for solutions.

Widening access to the ICM is also critical to the development of a successful and inclusive Islamic finance industry. In supporting this, key stakeholders such as the policy makers, supervisory authorities, Islamic financial institutions and scholars have to explore innovative and inclusive financial solutions that serve the needs of both high finance and high street. For individual investors, widening financial access provides them with investment choices commensurate with their risk appetite.

The sukuk market

Sukuk have provided an avenue for issuers to tap new sources of funding and provided a new asset class for investors. Sukuk issuers have ranged from sovereigns, multi-lateral institutions, multinationals and corporations. Sukuk have become an increasingly popular choice for issuers due to the attraction of a wider investor base, better profiling and in the context of the Malaysian sukuk market, pricing advantage. Sukuk also serve as tool for liquidity management especially among institutions offering Islamic financial services by providing a means for these institutions to remain competitive.

As at 31 December 2012, the size of sukuk outstanding globally was £160 billion[3] with Malaysia making up 68% of the market. This global figure represents a compound annual growth rate (CAGR) of almost 35% for the past five years[4]. According to a report by KFH-Research, the total sukuk issuance reached £86.5 billion in 2012, an increase of 54 per cent from 2011 despite the challenging financial and economic conditions in many parts of the world. In the last couple of years, sovereigns and quasi-government institutions from Turkey, Kazakhstan, and Indonesia have all issued sukuk, a clear reflection of the sustained expansion of the global sukuk market.

Despite the increasingly impressive figures, like bonds,

1 This article is extracted from the special address delivered by Dato Dr Nik Ramlah Mahmood, Deputy Chief Executive, SC Malaysia, at the 2013 London Sukuk Summit, Jumeirah Carlton, London on 12 June 2013.
2 The principle of wide circulation of wealth; The principle of transparency in commercial dealings; The principle of ownership certainty and sanctity of the contract; Justice and fair dealings; and Wealth Acquisition & Investment.
3 Source IFIS.
4 US dollar as base.

sukuk continues to be the domain of the 'big boys', both on the demand and supply sides. Issues like rating requirements, cost of issuance and complexity of documentation meant that capital raising through sukuk is predominantly by larger corporations and entities. The sizeable denomination and the fact that sukuk are almost always traded in the over-the-counter (OTC) market, limits the subscription capacity to institutional and high net worth investors. All these factors means that sukuk while successful, offers no opportunity for direct investments by retail investors. Therefore, how do we ensure that the phenomenal success of the sukuk market can be shared with the man in the street, the small investors?

Retail sukuk in Malaysia

With a view to facilitating greater direct retail participation in the corporate bonds and sukuk market, the SC in 2012 developed the framework for retail bonds and sukuk as envisaged under the *Capital Market Masterplan 2*. Retail sukuk is part of the agenda to extend ICM offerings to the masses, enabling retail investors access to a wider range of investment products. Under the Exchange-traded Bonds and Sukuk (ETBS) Framework, retail investors will have direct access to sukuk, thereby broadening the range of low-risk investment products available to them and facilitating diversification for risk management purposes. Under the framework, sukuk issued by a public company guaranteed by the government, public-listed companies on Bursa Securities, Cagamas Bhd and licensed Malaysian banks can be offered to retail investors. In addition, all sukuk issued to retail investors must be rated although no minimum rating requirement is required.

> *'The sizeable denomination and the fact that sukuk are almost always traded in the over-the-counter (OTC) market, limits the subscription capacity to institutional and high net worth investors. All these factors means that sukuk while successful, offers no opportunity for direct investments by retail investors.'*

Pursuant to the release of the framework, Malaysia's first retail (exchange-traded) sukuk was issued by a government-owned entity, Danainfra Nasional Bhd, a company tasked to undertake the development of the country's first mass rapid transit (MRT) project. The retail sukuk tranche was part of a £323 million (RM1.5 billion) government-guaranteed issuance, of which £65 million or 20 per cent was allotted to retail investors and was listed on Bursa Malaysia in February 2013. The project is expected to make further sukuk issuances in the future and plans to allocate one-fifth of any given issue to the retail investors. Danainfra retail sukuk thus provides not only a new investment product for investors, but also allows them to have a direct stake in a massive infrastructure development in Kuala Lumpur.

Of course, as with anything new, the introduction of retail bonds and sukuk in Malaysia has not been without challenges.

One area that requires considerable effort is investor education. While Malaysian investors have a long history of affiliation and familiarity with the equity market, they have had no direct exposure to bonds and sukuk. In this regard, Bursa Malaysia supported by the SC, plays a pivotal role in providing educational information to investors in the form of online FAQs about exchange-traded bonds and sukuk on its website. The information provided includes details on products, rights and obligations of investors, trading, payments and settlements. Danainfra the issuer of the first retail sukuk also used billboards and other advertisements to introduce retail sukuk to the public.

While the introduction of retail sukuk gives retail investors in Malaysia direct access to the sukuk market, it is important to note that long before that retail investors have already been participating in the sukuk market albeit indirectly – through Shariah-compliant unit trust funds which in itself is a huge success story in Malaysia. Big strides have been made since the launch of the first Shariah-compliant unit trust funds in 1993. While early Shariah-compliant unit trust funds were largely equity based, these funds also began to invest in sukuk, which was only accessible by institutional investors. With the growth of the sukuk market, there were more opportunities for unit trust management companies to offer other types of funds including Islamic mixed asset funds, balanced funds and sukuk funds.

The first retail sukuk fund in Malaysia was offered in 2000 and there are currently 23 sukuk funds with the net asset value (NAV) of RM4.7 billion. Thus, efforts to strengthen the investment management industry especially in the context of developing the sukuk funds remains an important means to widen retail participation in the sukuk market.

Extending the reach of Islamic finance through other asset classes

Viewing the development of retail sukuk in isolation does not do justice to the many other efforts that have and continue to be pursued in Malaysia to extend the reach and relevance of ICM products and services to a wider spectrum of issuers and investors.

In Malaysia, products such as Shariah-compliant REITs and ETFs have gained traction among retail investors. Listed Islamic REITs for example, remain a popular alternative asset class that enables retail investors to have exposure in a portfolio or pool of real estate from various segments of the economy either domestic or global. These products are being offered and traded in an ecosystem that is supported by a strong regulatory and supervisory framework such as product regulation, trusteeship and custodian for the protection of investors' interest.

May 2013 saw the listing of the first Shariah-compliant stapled securities which comprise a combination of ordinary shares of a public-listed company and units of an Islamic REIT with the underlying being the Petronas Twin Tower and its commercial buildings. The listing of the Shariah-compliant stapled securities marks retail participation in an asset class that provides a stable and sustainable income stream to investors. A new fund raising framework has also been introduced in the form of business trusts that provides access to investments in an Islamic product with characteristics that resemble a normal listed company. These initiatives enable the masses to tap into such offerings, create liquidity and a sustainable marketplace for wealth creation and extends the reach of the capital market.

Case Studies on Revised Shariah Screening Methodology

In June 2012, the SC announced a revised Shariah screening methodology to determine the Shariah-compliant status of listed companies. A two-tier quantitative approach would be adopted, which entails the streamlining of existing business activity benchmarks and inclusion of new financial ratio benchmarks. The revised methodology as summarised in Table 1, will enhance the competitiveness of and further develop Malaysia's Islamic equities and fund management sengments. To provide better understanding, Table 2 illustrates the application and computation on the revised methodology to the listed companies under different scenario. The revised methodology will take effect from 29 November 2013 onwards.

Table 1: Revised screening methodology

1. Quantitative		
First Tier: Business Acitivtiy Benchmark		
Activity	**Computation**	**Benchmark**
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.	$\frac{\text{Revenue of activity}}{\text{Group revenue}}$ or $\frac{\text{Profit before tax of activity}}{\text{Group profit before tax}}$ (whichever is higher)	Must be less than 5%
Hotel and resort operations, share trading, stockbroking business, rental received from Shariah non-compliant activities and other activities deemed non-compliant according to Shariah.	$\frac{\text{Revenue of activity}}{\text{Group revenue}}$ or $\frac{\text{Profit before tax of activity}}{\text{Group profit before tax}}$ (whichever is higher)	Must be less than 20%
Second Tier: Financial Ratio Benchmark		
Financial instrument	**Computation**	**Benchmark**
Cash and cash equivalent placed in conventional accounts and instruments	$\frac{\text{Cash and cash equivalent}}{\text{Total assets}}$	Must be less than 33%
Interest bearing debt	$\frac{\text{Debt}}{\text{Total assets}}$	Must be less than 33%
2. Qualitative		
The SAC takes into account the qualitative aspect which involves public perception, *maslahah* or image of the company's activities toward Islam. This qualitative method does not refer to the any of the above benchmarks for activities which do not comply with the Shariah in deciding the status of the listed company.		

Table 2: Case studies to illustrate the application and computation

CASE STUDY 1:
Company with mixed activities which are currently assessed under the 10% or 25% benchmark may be affected because their activities are now assessed under the 5% or 20% benchmark

Company	Shariah non-compliant activity	Current methodology [10% benchmark]	Revised methodology [5% benchmark]
Company A listed on Main Market, Bursa Malaysia with following principal activities: 1. Property development 2. Manufacture and distribution of cigarettes	Tobacco's revenue / Group revenue = 9%	Status: Shariah-compliant	Status: **Shariah non-compliant**

CASE STUDY 2:
Company with high level of conventional debt may be affected as currently there is no screening based on the total conventional debt of the company

Company	Level of conventional debt	Current methodology [Not applicable]	Revised methodology [33% benchmark]
Company B listed on Main Market, Bursa Malaysia with following principal activities: 1. Plantations 2. Construction works	Total debt/Total assets = 36%	Status: Shariah-compliant	Status: **Shariah non-compliant**

CASE STUDY 3:
Company with high level of cash in conventional banks may be affected as currently there is no screening based on the total cash of the company

Company	Level of cash and cash equivalent	Current methodology [Not applicable]	Revised methodology [33% benchmark]
Company C listed on Main Market, Bursa Malaysia with following principal activities: 1. Wholesale retailers 2. Warehousing	Total cash/Total assets = 33%	Status: Shariah-compliant	Status: **Shariah non-compliant**

News Round-up

ASEAN Capital Market Forum – ICM Workshop

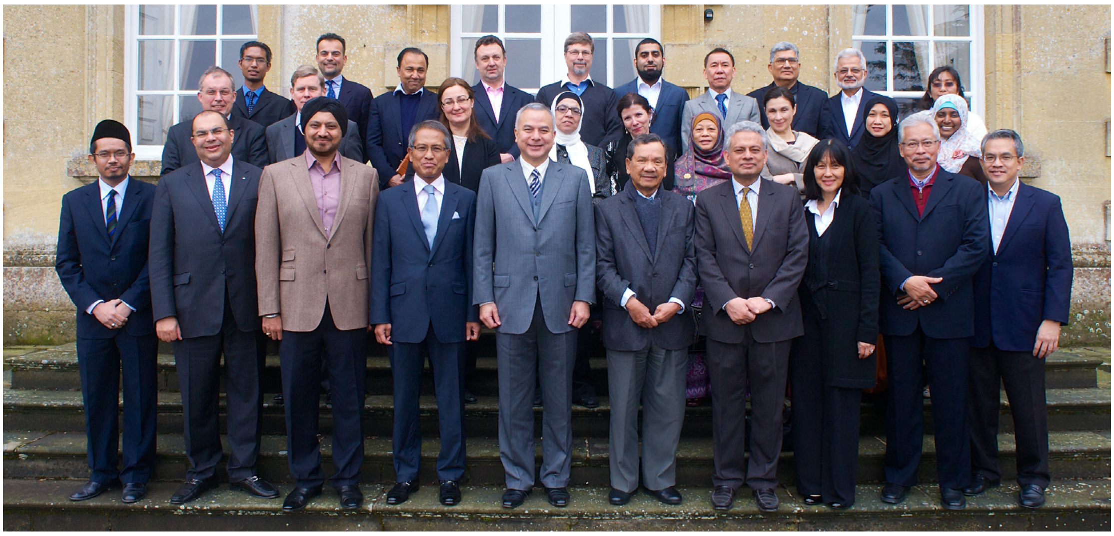
Supported by the Asian Development Bank, the SC organised a two-day ICM Workshop for the ASEAN regulators from 15 to 16 January 2013. Among the objectives of the workshop was to discuss regional co-operation in ICM as part of the efforts by the ACMF to better integrate the region's capital markets. It also served as a platform to discuss key issues and challenges relating to regulatory, operational and Shariah matters. Prior to the organisation of the workshop, the SC conducted a survey to assist in designing the content of the Workshop to the different levels of ICM development among the member countries.

4th SC-OCIS Roundtable on Islamic Finance

The SC and the Oxford Centre for Islamic Studies (OCIS) convened the 4th SC-OCIS Roundtable from 9 to 10 March 2013 at Ditchley Park, Oxfordshire, UK. The theme, 'Completing the Islamic Financial System Cycle: from a Shariah-compliant to a Shariah-based Approach' aimed at discussing issues and challenges in transitioning from a largely Shariah-compliant structure to an all-encompassing Shariah-based approach.

In order to facilitate the dialogue and debate, a select group of about 40 key industry practitioners, senior academicians, Shariah scholars, standard setters and regulators from around the world were invited for a closed-door roundtable. His Royal Highness Raja Dr Nazrin Shah graced the Roundtable and delivered a special address.

In conjunction with the SC-OCIS Roundtable, the SC and OCIS hosted a special dinner on 8 March 2013 at the Lancaster House, London. The dinner provided a platform for informal discussions among key financial and corporate leaders to further strengthen business linkages and explore cross-border collaboration potential between the UK and Malaysia, particularly in the financial and capital markets area.



SC Deputy Chief Executive receives Award of Excellence at the London Sukuk Summit Awards 2013

The 7th London Sukuk Summit Awards for 2013, held on 12 June, was to recognise the outstanding contribution by and achievements of individuals, institutions, supra-nationals and financial centres serving the global Islamic financial services industry, especially the proliferating global sukuk market. The Award for Dato Dr Nik Ramlah Mahmood, the SC Deputy Chief Executive, recognises her contribution to the ICM reform and development over the last 18 years.

Dato Dr Nik Ramlah Mahmood receiving the award from Mushtak Parker at the London Sukuk Summit Award 2013

IFSB Roundtable on Mid-term Review of the Islamic Financial Services Industry Development: 10-Year Framework and Strategies

Hosted by the Qatar Central Bank, the Roundtable was jointly organised by IFSB and Islamic Research and Training Institute (IRTI) on 6 April 2013 in Doha, Qatar, on the sidelines of the IFSB Annual Meeting. The Roundtable aimed to garner feedback for a project that the IFSB was undertaking i.e the mid-term review of the Framework and Strategies, which was published by the IFSB-IRTI-Islamic Development Bank (IDB) in 2007. The SC Executive Director of ICM, Zainal Izlan Zainal Abidin presented a paper on 'Islamic Financial Architecture and Infrastructure Development: Review of the Broad Strategies and Initiatives Identified in the 10-Year Framework'.

Dialogue session with PLCs on the revised Shariah screening methodology

The SC participated in a dialogue session with public listed companies which was organised by Bursa Malaysia from 20 to 21 February 2013. The objective of the two-day dialogue session was to provide explanation on the revised Shariah screening methodology to be adopted by the SAC from November 2013 onwards as well as the rationale for adopting such methodology.

8th Islamic Capital Market Graduate Training Scheme

The 8th ICMGTS was held from 15 March to 15 May 2013 with the participation of 40 graduates. ICMGTS is designed for graduates to transform themselves into forward-thinking ICM professionals by acquiring sound technical knowledge and good communication skills to enter the industry. Graduates underwent an 8-week training on six technical ICM modules and five soft skills modules.

5th Series of i-Advisor Programme

The 5th series of i-Advisor programme was conducted from March to July 2013. It provides continuous professional development in the area of Shariah Advisory relating to the ICM. This customised programme integrates theoretical and practical aspects of industry knowledge and enables participants to generate innovative solutions related to key issues and challenges in the ICM. In every series, participants are offered six modules that are completed in 13 days.

Talk by Iqbal Khan

The SC organised a talk by Iqbal Khan, the recipient of the 2nd Royal Award for Islamic Finance (RAIF) and Chief Executive Officer of Fajr Capital, at Universiti Tun Abdul Razak (UniRazak) on 30 April 2013. The Talk on 'Accelerating the Global Growth and Accessibility of Islamic Finance' was intended mainly for UniRazak students and faculty members.

Workshop for Regulatory and Supervisory Authorities for Islamic Capital Market Sector

From 11 to 13 March 2013, the IFSB organised a Workshop for Regulatory and Supervisory Authorities for the ICM sector in Kuala Lumpur. The purpose of the workshop was to address among others, the IFSB Standards and Guiding Principles in relation to Governance for Islamic Collective Investment Schemes, Capital Adequacy Requirements for Sukuk, Securitisation and Real Estate Investment, Conduct of Business for Institutions Offering Islamic Financial Services and Shariah Governance Systems for Institutions Offering Islamic Financial Services. The SC's representative delivered a presentation entitled the 'Experience of the Securities Commission Malaysia in Regulation and Supervision of Malaysia's Islamic capital Market'.

Malaysia-Australia: Navigating Islamic finance and market opportunities

This information sharing and networking session was hosted by Bank Negara Malaysia (BNM) for the trade mission from the State Government of Victoria, Australia on 18 June 2013 in Kuala Lumpur. The aim was to provide delegates with greater understanding of the Malaysian financial services sectors, in particular, Islamic finance. During the session, they were briefed on Malaysia's Islamic finance and ICM landscape while the Malaysian audiences which comprised senior management of Malaysia's Islamic banking and financial community, were given presentations on investment opportunities in Australia. The SC's representative delivered a presentation entitled 'Islamic Capital Market – Financing Instruments and Investment Products'.

Seminar on Strategies for the Development of ICM and Roundtable on the Development of Islamic Real Estate Investment Trusts

Organised by the IFSB and hosted by the Hong Kong Monetary Authority, the Seminar and the Roundtable were held on 27 and 28 June 2013 respectively in Hong Kong. Both events were aimed at providing an overview on the potential and prospects of ICM in light of the current developments, deepening the understanding, discussing issues and sharing experiences. At the seminar, Executive Director of ICM, Zainal Izlan Zainal Abidin was one of the panelists for a session entitled 'Development of Islamic Collective Investment Scheme', whereas for the roundtable, he chaired a session on 'Infrastructures Conducive to Develop Islamic Real Estate Investment trusts'.

Malaysian ICM – Facts and Figures

Shariah-compliant securities on Bursa Malaysia

	Jun 2013	Jun 2012
No. of Shariah-compliant securities	800	818
Total listed securities	910	927
% to total listed securities	87.9%	88.2%
Market capitalisation (RM billion)		
Shariah-compliant securities	1,007.72	864.30
Total market capitalisation	1,598.81	1,367.88
% to total market capitalisation	63.0%	63.2%

Islamic unit trust funds (UTF)

No. of launched funds	Jun 2013	Jun 2012
Islamic UTF	173	166
Total industry	599	597
NAV (RM billion)	**Jun 2013**	**Jun 2012**
Islamic UTF	37.48	31.37
Total industry	326.40	277.83
% to total industry	11.5%	11.3%

Islamic wholesale funds (WF)

Number of launched funds	Jun 2013	Jun 2012
Islamic WF	48	30
Total industry	185	154
NAV (RM billion)	**Jun 2013**	**Jun 2012**
Islamic WF	15.73	11.18
Total industry	57.62	35.45
% to total industry	27.3%	31.5%

Islamic assets under management (AUM)

(RM billion)	Jun 2013	Jun 2012
Islamic AUM	82.23	63.00
Total industry	555.32	451.00
% to total industry	14.8%	14.0%

Chart 1

KLCI and Shariah Index Performance

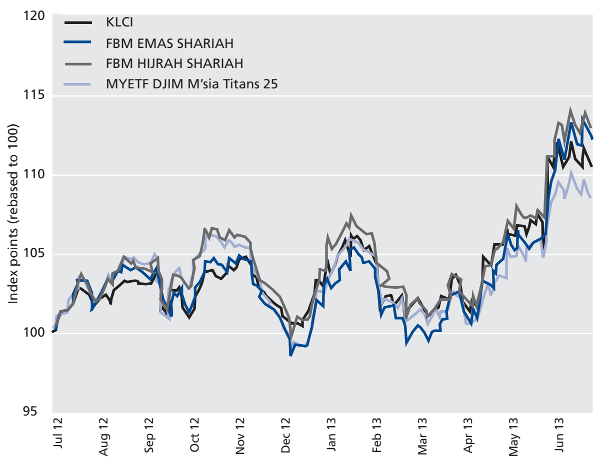
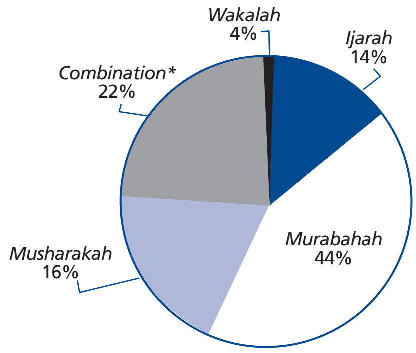


Chart 2

Size of corporate sukuk approved based on Shariah principles in H1 2013



*Combination between multiple Shariah principles

Equity market indices

Equity market indices	30 Jun 2013	30 Jun 2012	% change
FBM KLCI	1,773.54	1,599.15	10.9%
FBM EMAS Shariah	12,294.50	11,003.17	11.7%
FBM Hijrah Shariah	13,357.33	11,853.05	12.7%
DJIM Malaysia Titans 25	1,024.89	936.71	9.4%

Islamic exchange-traded funds (ETF)

Number of ETF	Jun 2013	Jun 2012
Islamic ETF	1	1
Total industry	5	5
Market capitalisation (RM billion)	**Jun 2013**	**Jun 2012**
Islamic ETF	0.30	0.31
Total industry	1.04	0.91
% to total industry	28.4%	33.7%

Islamic real estate investment trusts (REIT)

No. of REIT	Jun 2013	Jun 2012
Islamic REIT	4	3
Total industry	17	15
Market capitalisation (RM billion)	**Jun 2013**	**Jun 2012**
Islamic REIT*	16.05	3.35
Total industry	37.89	17.93
% to total industry	42.4%	18.7%

* Including one stapled securities (equity + REIT).

List of companies offering Islamic stockbroking services as at June 2013

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

Sukuk

Corporate sukuk approved	H1 2013	H1 2012
Number of sukuk	23	10
Size of sukuk (RM billion)	25.97	22.30
Size of total bonds approved (RM billion)	46.24	44.90
% of size of sukuk to total bonds approved	56.2%	50.0%
Total sukuk issued (RM billion)	**H1 2013**	**H1 2012**
Size of sukuk issued	142.94	152.26
Size of total bonds issued	257.74	316.17
% of sukuk issued to total bonds issued	55.5%	48.2%
Total sukuk outstanding (RM billion)	**Jun 2013**	**Jun 2012**
Size of outstanding sukuk	492.02	422.76
Size of total outstanding bonds	998.82	952.70
% of outstanding sukuk to total outstanding bonds	49.3%	44.4%
Retail sukuk – Danainfra Nasional Bhd	**Jun 2013**	**May 2013**
Market capitalisation (RM million)	303.90	306.45

Sukuk listing on Labuan International Financial Exchange (LFX)

No.	Issuer Name	Listing Date
1.	Petronas Global Sukuk Ltd	14 Aug 2009
2.	1Malaysia Sukuk Global Bhd	8 Jun 2010
3.	Danga Capital Bhd – SG$600 million Trust Certificates due 2015	12 Aug 2010
4.	Danga Capital Bhd – SG$900 million Trust Certificates due 2020	12 Aug 2010
5.	Wakala Global Sukuk Bhd – US$1.2 billion due 2016	7 Jul 2011
6.	Wakala Global Sukuk Bhd – US$800 million due 2021	7 Jul 2011
7.	Danga Capital Bhd – CNY500 million Trust Certificates due 2014	21 Oct 2011
8.	Pulai Capital Limited (Khazanah) – US$357.8 million due 2019	22 Mar 2012

Source: LFX

Sukuk listing under Bursa Malaysia's exempt regime as at June 2013

No.	Issuer Name	Listing Date
1.	Sime Darby Global Bhd	30 Jan 2013
2.	Axiata SPV2 Bhd	19 Sep 2012
3.	Pulai Capital Limited	22 Mar 2012
4.	Wakala Global Sukuk Bhd	7 Jul 2011
5.	IDB Trust Services Limited (Islamic Development Bank)	1 Dec 2010
6.	Malaysia Airports Capital Bhd	30 Nov 2010
7.	AmIslamic Bank Bhd	1 Oct 2010
8.	Tadamun Services Bhd (Islamic Development Bank)	24 Aug 2010
9.	1Malaysia Sukuk Global Bhd (Government of Malaysia)	8 Jun 2010
10.	Sime Darby Berhad	28 Jan 2010
11.	Khazanah Nasional Berhad	31 Dec 2009
12.	Danga Capital Berhad	31 Dec 2009
13.	Rantau Abang Capital Berhad	31 Dec 2009
14.	CIMB Islamic Bank Berhad	29 Dec 2009
15.	G.E Capital Sukuk Limited (General Electric)	30 Nov 2009
16.	Cagamas MBS Berhad	14 Aug 2009
17.	Petronas Global Sukuk Limited	14 Aug 2009

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

List of Islamic fund managers as at 30 June 2013

No.	Company	Date of Licence Issued
1.	Aberdeen Islamic Asset Management Sdn Bhd	Mar 2009
2.	AmIslamic Funds Management Sdn Bhd	Jan 2009
3.	Amundi Islamic Malaysia Sdn Bhd	Nov 2009
4.	Asian Islamic Investment Management Sdn Bhd	Nov 2008
5.	BIMB Investment Management Bhd	Sep 2007
6.	BNP Paribas Investment Partners Najmah Malaysia Sdn Bhd	Mar 2009
7.	CIMB-Principal Islamic Asset Management Sdn Bhd	Jun 2008
8.	Eastspring Al-Wara' Investments Bhd	Oct 2009
9.	Franklin Templeton GSC Asset Management Sdn Bhd	Jan 2010
10.	Guidance Investments Sdn Bhd	May 2013
11.	i-VCAP Management Sdn Bhd	Jan 2008
12.	Kenanga Islamic Investors Bhd	Sep 2008
13.	KFH Asset Management Sdn Bhd	Dec 2008
14.	Muamalat Invest Sdn Bhd	Sep 2007
15.	Nomura Islamic Asset Management Sdn Bhd	Jan 2009
16.	OSK-UOB Islamic Fund Management Bhd	Jun 2010
17.	Reliance Asset Management (M) Sdn Bhd	Aug 2009
18.	RHB Islamic Asset Management Sdn Bhd	Jan 2011
19.	Saturna Sdn Bhd	Sep 2007

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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