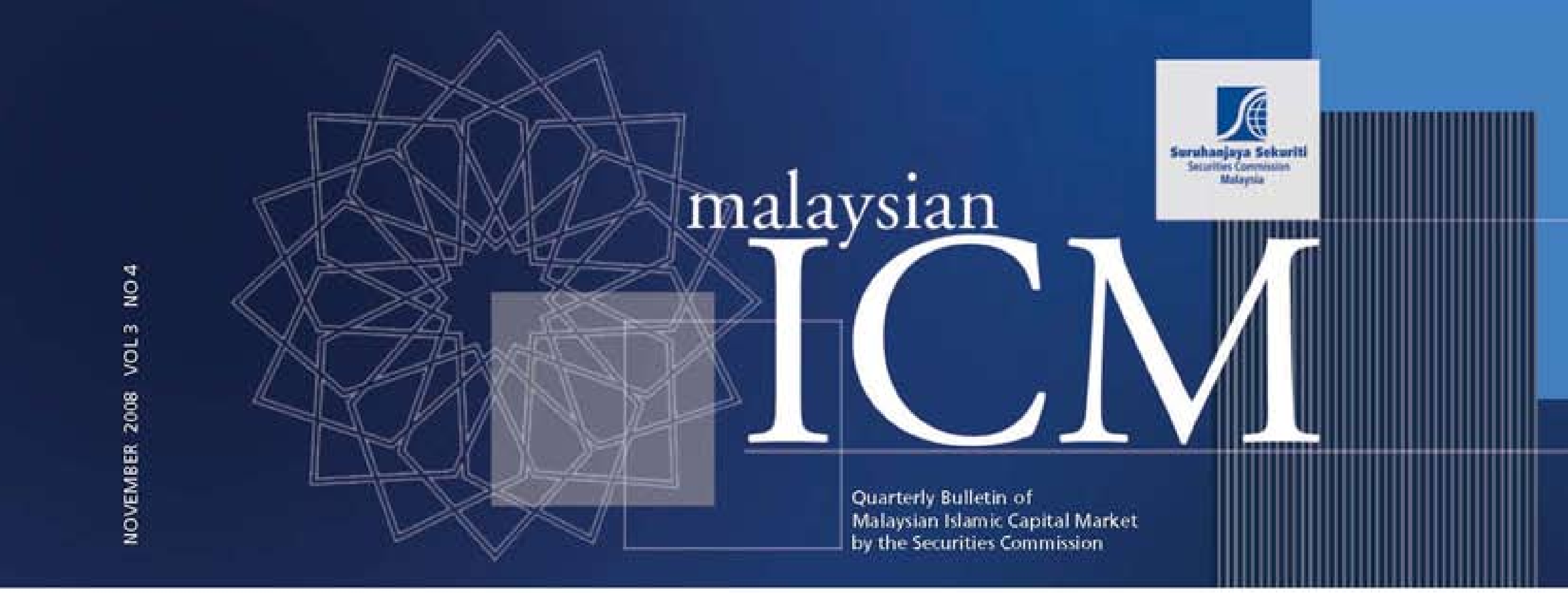

NOVEMBER 2008 VOL 3 NO 4
malaysian
ICM
Quarterly Bulletin of
Malaysian Islamic Capital Market
by the Securities Commission
Suruhanjaya Sekuriti
Securities Commission
Malaysia

Disclaimer

NOVEMBER 2008 VOL 3 NO 4

Suruhanjaya Sekuriti
Securities Commission
Malaysia

malaysian ICM

Quarterly Bulletin of
Malaysian Islamic Capital Market
by the Securities Commission

Contents

1 Resilience of Islamic Finance

SHARIAH

2 Islamic Alternative to Stock Borrowing and Lending

5 Appointment Of New SAC Member 2008–2010

REGULATORY

9 Budget 2009: Towards a Vibrant Islamic Capital Market

CAPITAL MARKET DEVELOPMENT

11 Sukuk

13 Collective Investment Scheme

FEATURES

15 Evolving from Meeting the Needs of Muslim Savers to Becoming a Global Hub

18 Financial Contagion and Its Impact on Private Equity

21 News Round-up

STATISTICAL UPDATES

22 Malaysian ICM – Facts and Figures

Resilience of Islamic Finance

Background of Sub-prime

The sub-prime meltdown which began in August 2007 has brought down several of the long established and large financial establishments in the US and Europe. Major banks and other financial institutions around the world have reported losses of approximately US$540 billion as of September 2008, and this has continued to increase. Despite concerted efforts by governments and central banks worldwide to cut interest rates and inject massive liquidity into the stock market and the banking system, the global crisis has yet to show any sign of abating. Countries are already experiencing recession while the more resilient economies are revising their economic growth downwards.

Cause and effect

The sub-prime crisis was mainly due to collateralised loan obligations (CLO), collateralised debt obligations (CDO) and mortgaged-backed securities (MBS) which were bundled and repackaged and combined with swap and options (swaptions). They then led to

▶▶ page 7

Part II: Islamic Alternative To Stock Borrowing and Lending

Part I of this article was published in the last bulletin and it discussed the role of regulated short selling (RSS) in the Malaysian capital market. It also highlighted that the Shariah Advisory Council (SAC) of the Securities Commission (SC) had resolved that RSS on eligible securities is permissible provided the stock borrowing and lending (SBL) structured is Shariah compliant.

Part II discusses how an Islamic alternative to replicate SBL can be structured. Due to the rapid growth and expansion of Islamic capital market (ICM), there is a need for a suitable framework for ICM products and services to meet the needs of both investors and players. The SBL is part of a requirement and a tool to facilitate a framework and products such as RSS and exchange traded funds (ETF). Therefore, there is a need to develop an alternative SBL which is in line with Shariah principles to facilitate the market.

Since borrowing and lending securities involves *riba* where the lender will charge the borrower interest on the securities borrowed, what alternative can be offered using the Islamic framework?

Generally, SBL refers to borrowing securities listed on Bursa Malaysia. Parties involved in the SBL model are:

1. Lender
2. Lending agent (local brokers)
3. Central lending agency (CLA) (Bursa Malaysia clearing house)
4. Borrower (local brokers)
5. Borrower's client

Securities lenders are organisations or bodies which hold a group of securities portfolio such as insurance companies, unit trusts, retirement funds and certain individual investors. The borrowers are normally broking companies and international investment banks.

Diagram 1 gives an overall view of the process of SBL.

SBL usually involves short selling which is selling a security that a seller does not own at the point of the transaction. Islam, however, prohibits the selling of an item which is not currently in one's possession or in the future because this involves the element of uncertainty, or *gharar*.

Shariah-compliant replicated SBL

To ensure that the ICM products in Malaysia adhere to Shariah principles, a detailed research was conducted to develop a suitable alternative for the conventional SBL. From the research, the SAC has declared that SBL will be Shariah compliant if it incorporates the principles of *bai`* and *wa`d*. Diagram 2 illustrates the workings of the Shariah-compliant replicated SBL.

Diagram 1

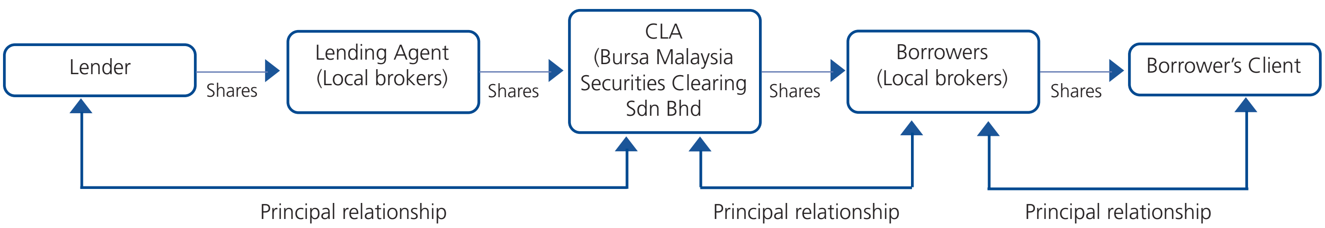


Diagram 2

Diagram 2 illustrates the following:

1. Supplier sells the stocks to CFA as an outright sale with a purchase undertaking (*wa`d* 1) to buy from CFA whenever CFA sells the stocks.

2. CFA sells the stocks to the user as an outright sale with a purchase undertaking (*wa`d* 2) from the user that whenever CFA asks for them, the user will sell the stocks to CFA.

3. Supplier's right and interest to recall the stocks is embedded in the rules and regulations of "Shariah-compliant replicated SBL" where CFA will sell the stocks to the supplier whenever the supplier asks for them.

4. User's rights and interest to sell the stocks is embedded in the rules and regulations of "Shariah-compliant replicated SBL" where CFA will buy from the user whenever the user sells the stocks to CFA.

5. Both rights and interests of the supplier and the user are covered in the rules and regulations of "Shariah-compliant replicated SBL" and made known to all contracting parties upfront. This is to ensure minimal issues with regard to Shariah where two purchase undertakings of the same contracting parties are in place.

Shariah-compliant replicated SBL is applicable to ICM products such as RSS, Islamic exchange-traded fund (ETF) and others.

Shariah views on RSS

Short selling involves the selling of shares not owned by the seller and this falls under the category of *bai` ma`dum*. Islam prohibits such transactions since the delivery of the goods is uncertain and this brings about the prohibited element of *gharar* (uncertainty).

However, with RSS, the *gharar* element is solved. This is based on the rules and regulations outlined by Bursa Malaysia which state that any party performing RSS must satisfy one of the following prerequisites:

i. Has borrowed the stock; or

ii. Has been given confirmation from an authorised SBL agent that the short selling stock is obtainable or ready to be borrowed

Based on the rules mentioned above, the RSS will only be successfully performed if one of the above prerequisites is satisfied.

"...the issue of gharar has been solved in RSS – the inclusion of SBL principles in RSS eliminates the element of gharar. In other words, the introduction of SBL can increase the probability that the shares sold will be delivered. When the probability of delivery is high, then the element of gharar will no longer be significant."

Situation 1: RSS is performed after Shariah-compliant replicated SBL

When Shariah-compliant replicated SBL replaces the conventional SBL, the shares will be traded only after all the prerequisites in Shariah-compliant replicated SBL have been satisfied. With Shariah-compliant replicated SBL, the particular traded stock becomes owned by the party performing the RSS because the party has purchased the stock. From the Shariah's perspective, the ownership is transferred from the seller to the buyer as soon as the sale is performed.

If the Shariah-compliant replicated SBL is performed but the stock has not been delivered to the buyer who initiated the RSS, it is still permissible for the buyer to sell the stock which is pending delivery, under the *qabd* principle. This is in reference to the *fuqaha*'s view in which it is permissible for a party to sell an item (except food items) that is pending in delivery. What must be understood is that the *aqad* of sale and purchase has been initiated during the Shariah-compliant replicated SBL process and that, in itself, is sufficient in terms of ownership transfer.

It is therefore clear that the issue of *bai` ma`dum* and *gharar* is not relevant in RSS, especially in performing short selling, as the Shariah-compliant replicated SBL will be engaged prior to that. However, this issue is relevant when dicussing naked short selling.

In dealing with RSS, the normal sale and purchase contract is applicable. In the situation above, there is no need for the *salam* principle as the seller owns the stock before the RSS is performed.

The discussion above is relevant where the Shariah-compliant replicated SBL is performed before the short selling is initiated.

Situation 2: RSS is performed after confirmation is given on the Shariah-compliant replicated SBL

In this situation, the seller can perform the RSS only after receiving confirmation that the short selling stock is obtainable or borrowable via SBL or Shariah-compliant replicated SBL. Here, the seller must complete the SBL as soon as the short selling is performed.

However, the issue of *gharar* has been solved in RSS – the inclusion of SBL principles in RSS eliminates the element of *gharar*. In other words, the introduction of SBL can increase the probability that the shares sold will be delivered. When the probability of delivery is high, then the element of *gharar* will no longer be significant. Consequently, when an obstacle which hinders the recognition of a certain activity as Shariah compliant is solved, then that activity can be classified as Shariah compliant. This fulfils a *fiqh* methodology:

إذا زال المانع عاد الممنوع

Meaning: When an issue that impedes (the permissibility) is removed, then the activity which was initially forbidden becomes permissible.

Conclusion

The existence of an alternative means to conventional SBL is of high importance to Islamic finance, as it will expand the number of products offered in ICM. This is made possible with the issue of *gharar* rendered as irrelevant. In RSS, the *gharar* element has been removed from the equation via the existence of Shariah-compliant replicated SBL that will act as a guarantee to the transfer of ownership of the stock.

Appointment of New SAC Members 2008–2010

For more than a decade the SC's SAC has been contributing to the development of ICM in Malaysia by advising the SC on Shariah-related matters. The SAC also serves as a point of reference for all issues relating to the ICM. Without doubt, its pivotal role in this area has been fruitful. This can be seen from the breadth and depth of ICM products and services such as Shariah- compliant securities, *sukuk*, Shariah-based unit trusts and Islamic fund management, Islamic stockbroking and Islamic REITs.

The SAC members comprise individuals who have sound credentials in the area of Islamic jurisprudence and who are in a position to present opinions on issues and matters pertaining to the ICM. In addition, they have vast experiences in the application of Shariah, particularly in areas of Islamic economics and finance.

At present, the SAC consists of 10 members. Below are the three newly appointed members.

1. Professor Dr Hj Abdul Samat Musa

Prof Dr Hj Abdul Samat Musa is currently the Dean, Faculty of Shariah and Law, Islamic Science University of Malaysia (USIM).

Prof Dr Hj Abdul Samat obtained a BA in Islamic Studies in 1976. He holds an MA in Comparative Law from University of Malaya (1980) and a PhD in Law from Manchester, England. He started his career as a tutor in 1976. He was promoted to lecturer in 1979 and was appointed as Professor in 2002. He is a committee member for various organisations within and outside UKM and USIM. He has written various books, journals and articles on Islamic constitutions, governance and administration.

At present, he also serves as Chairman, Shariah Committee of RHB Islamic Bank and RHB Groups. In addition, he is a registered Shariah Adviser for Islamic unit trust with the SC.

2. Associate Professor Dr Isma-Ae Alee

Associate Professor Dr Isma-ae Alee obtained his BA in Islamic Law (Shariah), and BA in Islamic Calls (Dakwah) and Theology from the Islamic University of Madinah in 1977. He completed his MA and PhD in Islamic Jurisprudence from the same university in 1981 and 1985 respectively.

At present, Dr Isma-ae Alee is a lecturer at the College of Islamic Studies, Prince of Songkhla University, Thailand. He is also a member of Advisory Committee of Islamic Bank of Thailand. This has provided him with an exposure on issues related to Islamic banking and finance. Furthermore, he participated and presented various papers on Islamic banking and finance in the seminars and conferences held in Saudi Arabia, Indonesia, Malaysia and Sri Lanka. He has also written a few books on his area of expertise such as Introduction to Islamic Jurisprudence, Islamic Law of Transactions and Islamic Law of Inheritance and Will.

Dr Isma-ae Alee also serves as Chairman of Halal Committee and Chairman of Islamic Charity Foundation for Islamic Education in the South of Thailand.

3. Associate Professor Dr Shamsiah Mohamed

Associate Professor Dr Shamsiah Mohamed obtained her BA and MA in Shariah from the University of Malaya in 1991 and 1995 respectively. She obtained her PhD in Shariah from the University of Jordan in 1999. She specialises in *fiqh muamalat*, which deals with socio-economic issues. She started her career as a tutor at the University Malaya in 1991. Since 1999, she has been lecturing in Department of Fiqh and Usul, Academy of Islamic Studies, University of Malaya.

From July 2005 to July 2008, Dr Shamsiah was on secondment to the SC, where she served as Specialist (Shariah) at the Islamic Capital Market Department. Her responsibilities included researching on ICM-related matters from Shariah perspectives, and presenting the findings to the SAC members. She was also involved in conducting training programmes for Shariah advisers registered with the SC and scrutinising *sukuk* proposals from the industry.

Dr Shamsiah Mohamad has been a member of the Shariah Consultative Committee of Standard Chartered Bank Malaysia Bhd since 2000.

Members of the SAC

1.	Tan Sri Sheikh Ghazali Hj Abdul Rahman (Chairman)	Shariah Legal Adviser Shariah Section, Advisory Division Attorney General's Chambers
2.	Tun Dato' Seri Abdul Hamid Hj Mohamad	Former Chief Justice of the Federal Court Malaysia
3.	Datuk Hj Md Hashim Hj Yahaya	Very Distinguished Academic Fellow Ahmad Ibrahim Kulliyyah of Laws International Islamic University Malaysia
4.	Sahibus Samahah Dato' Hassan Hj Ahmad	Mufti of Penang
5.	Dato' Dr Abdul Halim Ismail	Executive Director BIMB Securities Sdn Bhd
6.	Professor Dr Abdul Samat Musa	Dean, Faculty of Shariah & Law Islamic Science University of Malaysia (USIM)
7.	Dr Mohd Daud Bakar	President/CEO Amanie Business Solutions Sdn Bhd
8.	Associate Prof Dr Abdul Halim Muhammad	Lecturer Law Faculty Universiti Kebangsaan Malaysia (UKM)
9.	Associate Prof Dr Isma-ae Alee	Director College of Islamic Studies Prince of Songkhla University, Pattani Campus, Thailand
10.	Associate Prof Dr Shamsiah Mohamad	Lecturer, Department of Fiqh and Usul Academy of Islamic Studies University Malaya

the creation of the sub-prime loans when interest rates were low which then fuelled an artificial mortgage growth, leading to a property bubble. In some cases, the derivatives originated by the investment banks surprisingly found their way back into the originators' books. Thus, this time round, the investment banks themselves became victims of their own doings.

In the early months preceding the crisis, proponents of Islamic finance were quick to point out that the crisis would not affect Islamic banks because Islamic finance transactions are asset-based and shuns *gharar* – excessive risk or lack of transparency. Critics on the other hand say that the reason is simply because Islamic finance has not achieved the level of sophistication of the conventional finance and therefore, not exposed to derivatives.

Impact to the GCC

The Gulf Co-operation Council (GCC) was not spared the spill-over of the sub-prime crisis. The impact of the sub-prime crisis on Islamic finance has become more obvious by the day. The problem however was not from sub-prime loans, although the GCC sovereign funds have stakes in several of the troubled banks in the US and Europe. Instead the causes were a combination of effects from the decline in world oil prices and property bubble burst. In anticipation of the local currencies appreciating against the US dollar, investors in the GCC began withdrawing funds when instead the dollar appreciated thus causing further liquidity problems among the banks. It was reported that one central bank in a GCC country has intervened to rescue a bank. The banking authorities in various GCC countries have begun pumping in cash to ensure the banks can meet liquidity requirements.

Impact to Malaysia's Islamic finance industry

- The Malaysian Institute of Economic Research (MIER) has revised its growth forecast for 2009 to 3.4% from its earlier forecast of 5%. The government has introduced a multi-pronged economic stabilisation package aimed at mitigating a sharp slowdown in domestic demand given the substantial weak external environment. The contraction is expected to hurt banks' income and Islamic financial institutions will not be spared.

- Bursa Malaysia lost 40% of its value as at 31 October 2008. Shariah-compliant stocks (SCS) also took a beating. The impact on the Islamic indices, in most cases, was less severe compared to the overall index because finance counters, being the most adversely affected were precluded from SCS. However, in some cases the off-set effects were the absence of non-SCS but defensive large market cap stocks such as tobacco, gaming and brewery companies.

- The value of *sukuk* approved until September 2008 was RM24.6 billion, down from RM121.3 billion at end–2007. In the near future, it is expected that prospective issuers may reconsider issuing *sukuk* as they face higher yields, and the fact that the economic slowdown would require them to re-examine their financing requirements.

"It is rather fortunate that we have not fully liberalised our banking and financial infrastructure. Despite recognising that foreign participation is necessary to help accelerate growth and improve consumer choice, Malaysia operates on a gradual and phased approach to liberalisation based on the framework set out in the Capital Market Masterplan."

- It is rather fortunate that we have not fully liberalised our banking and financial infrastructure. Despite recognising that foreign participation is necessary to help accelerate growth and improve consumer choice, Malaysia operates on a gradual and phased approach to liberalisation based on the framework set out in the Capital Market Masterplan. At each stage of phased liberalisation, an assessment is conducted on the impact and benefits of proposals. By adopting these measures, Malaysia will meet its agenda of building a resilient core of domestic financial institutions and preserve financial stability.

When reality bites

Islamic finance does not operate in a vacuum as it co-exists and interacts with the global financial market and economies. It will, therefore, be affected, albeit perhaps to a lesser extent:

- Where Islamic finance is asset-based, it will be susceptible to a property bubble burst, i.e. when the value of the security falls and becomes inadequate to cover the capital, e.g. the mortgage failures in the US.

- For Islamic financial centres which are highly liberalised and where the foreign/conventional players are market dominant, capital flights will have a more serious impact on the market.

- A bank run (triggered by external factors) does not differentiate between Islamic or conventional finance.

- There are other factors such as currency trades and contingent liabilities (involving counter-party risk) which may impinge on an Islamic bank's performance.

Challenges for Malaysia

Malaysia's challenge lies in the following areas:

- Demands from rising inflation which put pressure on the low interest rate regime when savings cannot meet the demands;

- Capital flights and repatriations, which have occurred;

- Since the Asian financial crisis, Malaysian banks too have been aggressively extending retail credit in the form of credit cards and refinancing of mortgages with higher margins. How banks manage the NPL during the contracting economy will be of concern; and

- Property overhang is already evident by many unsold commercial and high-end units with developers deferring launch of new projects indefinitely.

Conclusion

Events like the sub-prime crisis provide important lessons to Islamic finance. The Islamic market is not independent of the financial markets and is, therefore, not totally insulated from any financial crisis – regionally or globally. Thus, the Islamic finance fraternity cannot afford to be complacent. Moving forward, Islamic finance has to truly apply the Shariah spirit not only in form but in substance as well. Hopefully this will make Islamic finance more resilient to economic crises.

Budget 2009: Towards a Vibrant Islamic Capital Market

The Malaysian ICM offers a comprehensive regulatory infrastructure, a range of financial intermediaries and a variety of financial products. A significant development was the innovation of sophisticated Shariah-compliant products which have gained worldwide acceptance and recognition.

Recognising the significance of the ICM, the government offered a range of incentives in Budget 2009 to entice industry players, both local and abroad to join the market:

- Tax exemption accorded for a period of three years for fees and profits earned by institutions undertaking activities on the arranging, underwriting, distributing and trading of non-ringgit *sukuk* issued in Malaysia and distributed outside Malaysia; and profits received by qualified institutions from the trading of non-ringgit *sukuk* issued in Malaysia.

- Double tax deduction for courses conducted by the International Centre for Education in Islamic Finance (INCEIF).

- Tax exemption on fees received by domestic intermediaries which have successfully listed foreign companies and foreign investment products on Bursa Malaysia. This measure will enable domestic investors to acquire shares of foreign companies listed on the local exchange.[1a]

- Tax rate on dividends received by foreign institutional investors from Real Estate Investment Trusts (REITs) was reduced from 20% to 10%. Recognising that REITs is also an attractive investment product for individuals, the government has also allowed a reduction in tax rate from 15% to 10%.[1b]

- A five-year tax exemption for venture capital companies that invest at least 30% of their funds in start-up, early stage financing or seed capital are eligible for[1c].

Special Incentives for Islamic Capital Market

Capital Market Sectors: Products and Services	Recipient	Incentives	Reference Legislation (if any)
Sukuk	Issuer/ SPV	• As the special purpose vehicle (SPV) is established solely to channel funds, the SPV issuing the *sukuk* is exempted from income tax;	i. Income Tax (Exemption) (No.14) Order 2007–3 May 2007 ii. Finance Act 2007 – Amendment to the Income Tax Act 1967 – New Section 60I
	Issuer/ Originator	• The company which establishes the SPV is also given a deduction on the cost of issuance of the *sukuk* incurred by the SPV;	i. Income Tax (Deduction on the Cost of Issuance of The Islamic Securities) Rules 2007–26 April 2007 ii. Finance Act 2007 – Amendment to the Income Tax Act 1967 – New Section 60I

[1a, b, c] These measures are applied to the broad capital market

Special Incentives for Islamic Capital Market (con't)

Capital Market Sectors: Products and Services	Recipient	Incentives	Reference Legislation (if any)
	Issuer	• Extension of deduction on expenses for *sukuk* issued under *Musharakah*, *Mudharabah*, *Ijarah* and *Istisna`* for another three years until the year of assessment 2010;	Income Tax (Deduction for Expenditure on Issuance of Islamic Securities) Rules 2007 – 11 Jan 2007
	Investor	• Profit paid or credited to non-resident companies for ringgit-denominated *sukuk* (exclude convertible loan stock) approved by the SC is exempt from income tax;	Income Tax Act 1967 – Schedule 6: Section 33A
	Investor	• Profit paid or credited to any individual, unit trust and listed closed-end fund in respect of *sukuk* (exclude convertible loan stock) approved by the SC is exempt from income tax;	Income Tax Act 1967 – Schedule 6: Section 35
	Investor	• Profit paid or credited to any person for non-ringgit *sukuk* originating in Malaysia (exclude exchangeable loan stock) and approved by the SC is exempted from income tax; and	Finance Act 2007 – Amendment to the Income Tax Act 1967 – Amendment of Schedule 6: Section 33B
	Issuer	• To ensure tax neutrality with conventional products, any additional tax or duty is exempted or given specific treatment provided that the Islamic capital market products are approved by the SC's SAC.	i. Income Tax Act 1967 – Section 2(8) ii. Stamp Act – Schedule 1 "General Exemptions"
Islamic stockbroking services	Stockbroking company	• Establishment expenditure incurred prior to the commencement of an Islamic stockbroking business is tax deductible, subject to the company commencing its business within a period of two years from the date of approval from the SC. (Effective for applications received by the SC from 2 September 2006 until 31 December 2009).	Income Tax (Deduction on Expenditure for Establishment of an Islamic Stock Broking Business) Rules 2007 – 15 February 2007
Islamic fund management	Fund management company	2008 • Local and foreign-owned companies managing Islamic funds of local and foreign investors to be given income tax exemption on all fees received from managing the funds. To be effective from year of assessment 2008 until year of assessment 2016. The funds must be approved by the SC;	Income Tax (Exemption) (No.6) Order 2008 – 24 July 2008
	Islamic fund management company	• Islamic fund management companies are allowed to have 100% foreign ownership;	–
		• Islamic fund management companies are permitted to invest 100% of assets abroad; and	–
		• A sum of RM7 billion will be channelled by EPF to be managed by Islamic fund management companies.	–
		2007 • Local and foreign-owned companies managing approved Islamic funds of foreign investors are granted income tax exemption on management fees from the year of assessment 2007 until year of assessment 2016. The funds must be approved by the SC.	Income Tax (Exemption) (No.15) Order 2007 – 31 May 2007
Non-resident experts in Islamic finance	Non-resident experts in Islamic finance	• Income tax exemption to be given to income received by non-resident experts in Islamic finance. The experts have to be verified by the MIFC Secretariat.	Income Tax (Exemption) (No.3) Order 2008 – 17 May 2008

SUKUK

In February 2008, the Accounting and Auditing Organisation for the Islamic Financial Institutions (AAOIFI) announced that approximately 85% of the Gulf *sukuk* are not Shariah compliant. This pronouncement had an impact on global *sukuk* issuance especially the issuance of *sukuk musharakah*.

The latest AAOIFI's pronouncement that banned issuers from "purchase undertaking" to purchase the *sukuk* asset back from the *sukuk* holders at a nominal agreed value at the end of the tenure of the *sukuk* or at the point of default has impacted the global *sukuk* industry. The *sukuk* structures directly affected by AAOIFI's pronouncement are *sukuk musharakah*, *sukuk mudharabah* and *sukuk istithmar*. As a result, issuers have opted to issue *sukuk ijarah* which is seen as a viable alternative in the present situation.

This phenomenon can be clearly seen from the statistics of global *sukuk* issuance using *musharakah* and *ijarah* structures at pre and post AAOIFI's pronouncement. From March to June 2007, the issuance of *sukuk ijarah* recorded less than US$1 billion while *sukuk musharakah* recorded more than US$5 billion. This year, for the same period during post AAOIFI's pronouncement i.e. from March to June, the value of *sukuk* issuance using the *ijarah* structures showed an increase to more than US$4 billion while the issuance of *sukuk musharakah* has sharply dropped to around US$1 billon.

The effects of the pronouncement has yet to be felt in Malaysia. However, the global economic downturn due to the global credit crisis has affected the overall value of local *sukuk* issuance.

The following are some selected *sukuk* issuance from August to October this year.

PLSA Group of Companies first foray into the Islamic capital market

In October 2008, Projek Lintasan Shah Alam Sdn Bhd (PLSA) issued a RM330 million *sukuk ijarah* and RM415 million *sukuk mudharabah*. PLSA is a joint venture between Projek Lintasan Kota Holdings Sdn Bhd (Prolintas) and Island & Peninsular Sdn Bhd, which are wholly-owned subsidiaries of Permodalan Nasional Bhd. PLSA has been awarded a 40-year concession to undertake the design, construction, management, operation and maintenance of the 14.7 km Lebuhraya Kemuning-Shah Alam (LKSA).

Under the *mudharabah* structure, investors as *rabb al-mal* contribute financing capital in the toll road business and PLSA as *mudharib* issues *sukuk* to evidence the investors' participation in the venture. PLSA also invites other investors, i.e. the *sukuk ijarah* investors to part finance the project. PLSA will sell the trust asset to be developed to the investors for a purchase price to be paid on a staggered basis. *Sukuk ijarah* investors subsequently entered into a forward lease agreement with PLSA (lessee) to lease the trust asset for an agreed period.

The *sukuk ijarah* and *sukuk mudharabah* were assigned long-term ratings of A1 and A3 respectively by RAM Ratings Services Bhd.

Sukuk Ijarah for shipping company

The SC has approved a RM370 million Islamic medium-term notes (MTN) programme issued by Syarikat Borcos Shipping Sdn Bhd, a local shipping company specialising in the provision of marine transportation and support services for the offshore oil and gas industry. The issuance comprised RM340 million *sukuk ijarah* MTN and RM30 million *bai' bithaman ajil* Islamic securities.

Based on the structure, the issuer enters into an *istisna`* purchase agreement with the investors where the issuer agrees to construct and deliver to the investors the *Ijarah* assets (vessels) in consideration of a purchase price. During the construction of the vessels, the investors enter into a forward lease arrangement with the issuer (lessee) where the issuer agrees to make advance rental payments which will be refunded to the issuer if the vessels cannot be completed and delivered.

The Islamic MTN programme has been accorded an indicative long-term rating of A1 by RAM Ratings Services Bhd. The proceeds from the issuance will be utilised by the issuer to finance the construction of the vessels, refinance existing bridging finance and for working capital requirements which are Shariah compliant.

Ringgit sukuk issuance by foreign entity

The SC has approved up to RM1 billion Islamic trust certificate issuance programme under the principle of *mudharabah* by Tadamun Services Bhd (Tadamun), a special purpose vehicle incorporated in Malaysia under the *Malaysian Companies Act 1965*. On 20 August 2008, Tadamun issued its first tranche of the *sukuk* valued at RM300 million.

Under the programme, Tadamun will purchase a pool of assets from the Islamic Development Bank (IDB) and hold it in a trust capacity for the benefit of *sukuk* holders. The pool may comprise *ijarah* (leasing), *murabahah* and *istisna`* contracts, originated by IDB. The proceeds of the trust certificates issued under the programme will be utilised by the Tadamun to purchase the *sukuk* assets from IDB. IDB will, in turn, use the proceeds from the sale of the *sukuk* assets for its general corporate purposes which include but are not limited to financing projects in Malaysia. Each trust certificate will represent an undivided beneficial interest in the portfolio of assets.

CIMB Investment Bank Bhd and Standard Chartered Bank Malaysia Bhd were the joint lead managers of the *sukuk* issuance which was assigned the AAA rating by Standard & Poor's.

Selected Sukuk Issuance
July – October 2008

- ***Projek Lintasan Shah Alam Sdn Bhd – Ijarah and Mudharabah***
- ***Syarikat Borcos Shipping Sdn Bhd – Ijarah and bai' bithaman ajil***
- ***Tadamun Services Bhd – Ijarah, Istisna` and Murabahah***

Collective Investment Scheme

The Islamic unit trust segment continued to grow with the launch of six new funds to reach 149, while the net asset value (NAV) increased by almost 4% to RM17.5 billion as at end-September from RM16.9 billion as at end-2007.

The NAV of the overall unit trust industry, however, decreased 12% to RM149 billion, in line with the decline of KLCI and the global equity market.

Unit trust fund managers continued to diversify into foreign markets following the liberalisation of the threshold for investments abroad. During the first half of 2008, 27 new unit trust funds were launched for investment in foreign markets. During the same period, 11 funds had invested RM401 million in foreign assets, bringing the total number of funds invested in foreign markets to 160 with investments totalling RM13.3 billion.

The growth of real estate investment trusts (REITs) has gradually gained momentum. The REIT industry is set to grow further following the recent measures announced in August to enhance Bursa Malaysia as a destination for REIT listings and to promote a vibrant and competitive REIT industry.

The measures include raising foreign equity in REITs to 70% from 49%, providing greater flexibilities for REIT managers to manage their portfolios, and allowing REIT managers to issue units up to 20% of its fund size without having to seek a mandate from unit holders.

Axis REIT Managers Bhd is now targeting to be classified as an Islamic REIT and adding the numbers to three Islamic REIT after Al-Aqar KPJ REIT and Al-Hadharah Bousted REIT.

Below are some Islamic unit trust funds launched from August to October 2008.

Public Islamic Select Enterprises Fund and Public Islamic Income Fund

In August 2008, Public Mutual Bhd launched two new Islamic funds, Public Islamic Select Enterprises Fund (PISEF) and Public Islamic Income Fund (PIIF). PISEF is for investors who wish to participate in the long-term growth potential of Shariah-compliant bell-weather companies in the domestic market while PIIF caters for those seeking a steady stream of annual income. PISEF is actively managed and focuses its investment in the largest 50 bell-weather companies in terms of market capitalisation listed on Bursa Malaysia and complied with Shariah requirements. The fund aims to achieve capital growth over the long-term. It has an approved fund size of 1.5 billion units and is targeted for medium to long-term investors.

At the same time, PIIF seeks to provide annual income over the medium to long-term period by investing in *sukuk* and Islamic money market instruments. The fund, which has 500 million units of approved fund size, will invest up to a maximum of 60% of its NAV in *sukuk* in the domestic market. The balance of the fund's NAV will be invested in Islamic money market instruments. *Sukuk* provides a higher level of security for investors as they are asset-backed securities supported by underlying cash flows. In the event of a higher interest rate environment, investing in *sukuk* allows investors to capitalise on higher yielding *sukuk* with good credit rating.

ING Annual Income Climate Structured

ING Funds Bhd launched its latest innovative product in 10 September 2008, which featured the first close-ended fund that offers a five per cent annual income distribution for three years plus potential capital gain with 100% capital preservation in Australian dollar-denominated underlying assets at maturity in 39 months.

The ING Annual Income Climate Structured (Climate) appointed Citigroup Global Markets Ltd as the guarantor of the 5% income and the capital invested. Its features provide a "safe" solution for investors following their concern over preserving assets under the current high inflation and uncertain market conditions. Climate aimed to capitalise on companies which focus on alternative, efficient and renewable energy, fuel and transport development and technology. This includes nuclear power, battery, solar, biofuel and hybrid vehicles. Climate, which has an approved fund size of 500 million units, is benchmarking the Citi Climate Change Opportunities Index which contains 10 to 30 global stocks selected through stringent criteria.

HLG Shariah Inflation Select Fund

Hong Leong Group Unit Trust Bhd launched its latest Islamic fund, HLG Shariah Inflation Select Fund on 25 September 2008. HLG Shariah Inflation Select Fund is designed for investors who take a defensive approach due to current inflationary concerns. The fund is an 18-month closed-ended Shariah-compliant structured fund which aims to reimburse investors their initial capital upon fund maturity as well as to gain potential returns from an environment of rising inflation. Its strategy is to leverage on potential of inflation hedge sectors such as consumer staples, agriculture, oil and mining.

The fund, which has 600 million units of approved fund size has been structured to seek potential returns benchmarked against the performance reference to companies that might benefit from an environment of rising inflation. As such, the fund's potential returns are benchmarked against three baskets of reference stocks in the agriculture, consumer, and oil and mining sectors.

The fund is for investors who are seeking to preserve the value of their investment capital, and at the same time, wish to benefit from the potential upside from sectors which stand to benefit from rising inflation.

Am-Namaa' Asia-Pacific Equity Growth

Am-Namaa' Asia-Pacific Equity Growth (AM-Namaa') will be the first feeder fund to invest in the Asia-Pacific equities with its investment managed out of Malaysia. The Fund is from AmMutual, the retail brand under Funds Management Division (FMD) of AmInvestment Bank Group and will be exclusively distributed by Al Rajhi Bank (Malaysia).

Launched on 11 August 2008, Am-Namaa' is targeted at investors who seek investment exposure to Asia-Pacific (ex-Japan), with capital appreciation and have a medium-to-long term investment goals. The fund seeks to increase the value of investment in the longer term by investing in listed equities and equities-related investments and other Islamic instruments that conform to the Shariah principles across Asia-Pacific (ex-Japan).

The Am-Namaa' has a maximum approved fund size of 200 million units and is offered at RM0.50 per unit. The minimum initial investment is RM1,000 with subsequent minimum investments of RM500 each.

Selected Islamic Unit Trust Funds Launched
August – October 2008

- *Public Islamic Select Enterprises Fund and Public Islamic Income Fund*
- *ING Annual Income Climate Structured*
- *HLG Shariah Inflation Select Fund*
- *Am-Namaa' Asia-Pacific Equity Growth*

Evolving From Meeting the Needs of Muslim Savers to Becoming a Global Hub[1]

The Islamic capital market (ICM) continues to entice interest and enthusiasm from the global financial community. For many, the stage of awareness and understanding is over. They have begun to scan the globe to quickly seize new investment and business opportunities. Malaysia's comprehensive Islamic capital market offers many such opportunities, both to domestic and global investors alike.

Malaysia's success in building a comprehensive ICM can be attributed to the foresight and pioneering efforts of its policy-makers, finance professionals and Shariah scholars who saw a need at the time, to create effective institutions and instruments to mobilise savings to serve the needs of Malaysia's Muslim community and to ensure that these savings could be effectively utilised to promote economic growth.

From humble beginnings with the establishment of Tabung Haji or the Pilgrims' Fund Board in 1969 and the first Islamic bank in 1983, there has been a natural progression in development which has led to the emergence of a distinct and vibrant Islamic financial market and the availability of a full range of Islamic banking, *takaful* and capital market products and services.

Malaysia's ICM has now achieved the necessary critical mass. The leadership and support provided by the government through the facilitation of policies and incentives has ensured the effective translation of vision and aspirations into reality over a relatively short period of time. Its ICM has also thrived to the extent that it now accounts for a highly significant portion of the overall Malaysian capital market.

Islamic equities and sukuk

One of Malaysia's traditional strengths is its diverse range of listed companies – with probably the best offering of small and medium-sized companies in ASEAN and the Middle East. In addition, they operate in diverse industries, with companies which are asset-based such as plantations, resources, properties as well as in a broad range of manufacturing, service industry and technology-based industry. From this large pool of companies trading at attractive valuations, many of them continuously strengthened their corporate governance practices and increasingly focused on managing their capital efficiently to generate greater shareholder value. This has resulted in a steady stream of income flow from dividends and capital repayments as well as in terms of capital appreciation over the past decade.

These features, coupled with the fact that 85% of the listed securities on Bursa Malaysia accounting for 63% of total market capitalisation, are Shariah compliant, implies that Malaysia has an attractive Islamic equity value proposition. This is reaffirmed by the fact that more and more companies going for IPO are voluntarily seeking to have their Shariah-compliant status determined by the SAC. This is a clear recognition of the premium that Shariah-compliant status confers on these companies.

Islamic equities best embodies the Islamic principle of equitable risk-sharing. It is perhaps timely for corporate leaders and fund managers to review the possibilities of maximising the potential brand value of Islamic industries. One possibility may be to shape a value-added definition of an Islamic corporation either as defined by specific aspects of corporate governance, ethical conduct and particularly through their contribution to the development and well-being of society. The creation of valuation premiums through defining a distinctive Islamic approach in generating shareholder value and the eventual ability to trade the shares of these companies across different Islamic stock markets certainly represents an exciting prospect.

[1] This article is based on the keynote address of Dato' Sri Zarinah Anwar, delivered at the Malaysian Islamic Finance (MIF) Issuers & Investors Forum 2008, Kuala Lumpur on 12 August 2008.

Malaysia pioneered the development of the global *sukuk* market with the launch of the first sovereign five-year global *sukuk* in 2002. Since then Malaysia's *sukuk* market has experienced unprecedented growth, and it has been acknowledged as one of the largest issuers of *sukuk* over the years. In 2007, 76% of bonds approved by the SC were *sukuk*. Challenging market conditions this year has naturally had an impact on the issuance of bonds but nonetheless, the first nine months saw the approval of 36 *sukuk* issues totalling RM24.6 billion, accounting for 27.3% of total bonds approved during the period.

There are several reasons why *sukuk* issuances from Malaysia, whether denominated in ringgit or US dollar, will continue to attract international investors and issuers. First, Malaysia has a strong base of domestic investors to anchor the distribution of a major *sukuk* issue. Second, *sukuk* pricing for Malaysian-originated issues are highly competitive and there is also strong availability of expertise as well as an established regulatory framework which meets both Shariah and legal requirements.

Islamic unit trusts and fund management

The investment management industry is the fastest growing segment of Malaysia's capital market with cumulative growth rates of 24% per annum. This growth is expected to strengthen even further on the back of various deregulatory and liberalisation measures. These include the establishment of a more facilitative regime for investment product approvals, the easing of restrictions on investments abroad and liberalised rules for the establishment of foreign fund management companies. A range of tax and other incentives for Islamic fund management companies establishing operations in Malaysia, have already generated strong interest from leading fund management companies and international firms. Recently, Malaysia announced the first batch of Islamic fund management licences to Kuwait Finance House, DBS Bank and CIMB Principal.

> *"… Malaysia has a strong base of domestic investors to anchor the distribution of a major sukuk issue. ….. sukuk pricing for Malaysian-originated issues are highly competitive and there is also strong availability of expertise as well as an established regulatory framework which meets both Shariah and legal requirements."*

The presence of the international Islamic fund management companies together with the five global fund management companies already established under an earlier liberalisation scheme, as well as some of local major firms will help drive the growth and vibrancy of the industry in Malaysia.

Malaysia's expertise in manufacturing Islamic funds lends itself to providing a strong complement to the development of the Islamic fund management industry. The industry is still growing at a considerable pace and demand for unit trust products continue to be strong. Shariah-compliant unit trust funds chalked up sales totalling RM2.96 billion this year, a growth of 84% compared to last year. The robust growth in this market segment is really significant when compared to the 11% growth in net sales for conventional products over the same period.

The strong growth is a reflection of the increasing innovation capabilities in the Malaysian industry. There have been many recent product offerings providing features of capital protection, with only a portion invested in structured products like swaps, options and hedging instruments for a wide range of underlying assets including currencies and commodities. This development suggests that irrespective of overall market conditions, there are opportunities for market intermediaries to innovate and cater for investors' appetite for products with sufficient risk mitigation features. Malaysia has also approved products for offering in other regional markets; indicating new areas of growth to increase market share. Therefore, the challenge is for intermediaries to be innovative in their Shariah product offerings with more structured features capturing the entire horizon of investibles in line with changing appetites of investors. The exploration of new greenfield markets capitalising on Malaysia's lead position in product development would certainly be another area of growth.

Shariah governance and investor protection

To meet the topmost requirement of investors seeking Shariah-compliant products, Malaysia offers a consistent, reliable and robust Shariah-compliance framework. The thinking and opinions of Malaysia's Shariah scholars are well researched and relatively well documented.

Certainty, consistency and clarity of the rulings are facilitated through the establishment of a single forum, a national Shariah Advisory Council (SAC) for the Islamic capital market which was established by the SC since 1996. Membership of this council comprises highly qualified Malaysian individuals with wide international exposure and international scholars within the region. The SAC was established under the *Securities Commission Act 1993*, and serves as the sole authority for the issuance of rulings and guidelines on the Islamic capital market.

A key aspect of Malaysia's regulatory approach is to ensure that investors in Malaysia's Islamic capital market receive the same degree of clarity, certainty and protection as an investor in the conventional market. Malaysia emphasises a common regulatory approach based on IOSCO's objectives and principles of regulation. The requirements for disclosure, transparency and governance apply equally to both Islamic and conventional products, thus ensuring that an investor in an Islamic product receives the same legal and regulatory protection and recourse that would be available to the investor of a conventional product.

Conclusion

The Islamic capital market provides us the most potential for a sustainable competitive advantage. It is the most liberalised sector of the Malaysian capital market; has been a trailblazer in innovation, recording numerous world firsts in regulatory and product development since 2002; achieved tremendous growth and has propelled the country to the global stage.

But there is still so much more that Malaysia can do to enhance the value proposition of its Islamic capital market to both domestic and global investors. Energy and resources need to be continuously invested to enhance capabilities and competitiveness to attract more players and to strengthen its distribution capabilities by addressing bottlenecks and inefficiencies in the intermediation process, while at the same time, pursuing linkages with other markets to enable greater cross border flows. Although Malaysia has the products, the delivery channels particularly in reaching investors across its borders are still not fully developed. Similarly, Malaysia would benefit from the listing of international Islamic products ranging from equities, *sukuk* as well as the increased availability of fund products from other Islamic centres.

Therefore, even as Malaysia pursues developmental initiatives to widen access of its markets to regional and global issuers and investors, it is equally important for its domestic intermediaries to increase their visibility abroad and to enhance their focus on regional and global expansion. In this regard, a number of Malaysian intermediaries have already taken steps to forge strategic alliances with intermediaries in other jurisdictions and are venturing into regional markets, enabling them to acquire skills and expertise on new products and overseas investments. Their ability to partner with other players and leverage off each other's strengths in product manufacturing and distribution will inevitably expedite the growth of Islamic markets and intermediaries.

Financial Contagion and its Impact on Private Equity[2]

The financial crisis in developed countries in the West is already affecting Asia. While Asian institutions generally have a relatively low direct exposure to the "high-risk" structured products, the shockwaves radiating from the financial distress of global investment banks and other financial intermediaries have led to increased risk aversion among lenders and investors.

Inevitably, private equity investors are also exposed to the effects of the contagion. Regional stock markets have fallen sharply making it difficult for companies to finance deals and for buyers and sellers to agree on a price. Buyers are demanding cheaper bargains to take into context the current valuations while sellers are reluctant to sell at a price influenced by the distressed financial conditions. Financing for transactions comes at much higher costs while long-term return estimates need to be trimmed to take into account the more somber economic environment. Languishing stock markets do not create an appealing exit mechanism for the venture capitalist. In Silicon Valley, there is a dearth of successful public offerings where only six venture-backed technology and healthcare start-ups have gone public this year (as opposed to 86 such companies last year) and only two are trading above their offering price.[3]

On the other hand, distressed financial conditions also mean that there are more "cheap" assets to buy. Investor like Warren Buffet has made bold investments at this time, and it appears the upheaval in global financial markets has created opportunities for the private equity investor that is long on cash and long on time. In fact, private equity/venture capital (PE/VC) funds have been reported to be discreetly buying blocks of companies that just went public or undertaking Private Investments in Public Stocks (PIPEs)[4] specifically capitalising on the consolidation of cash-rich but fragmented industries.

The current financial environment has transformed stock markets from being exit mechanisms into hunting grounds for private equity investors. It is certainly a reasonably easy task for the PE and VC investors highly-skilled in nurturing start-ups to shift towards deploying these skills on growing more matured companies and franchises and to steer them safely through the current difficult environment.

Certainly, the emergence of PE and VC investors as major and active shareholders can bring immense benefits to most companies in terms of their business knowledge and in terms of strengthening corporate governance and organisational capabilities, to unearth greater efficiencies in management and to leverage on their wider knowledge base and global relationships. Their strengths are evident in adding to a company's appeal especially in penetrating new markets or in attracting talent.

Opportunities in Southeast Asia

In the current market environment, it is hard to predict with any degree of certainty where the best or value for money opportunities will emerge. But certainly Southeast Asia with its potential growth prospects and strong economic resilience will command a premium over other geographical regions.

The Southeast Asia market is big. With a population of 600 million, Southeast Asia houses nearly 9% of the global population. While this is less than half of India and China, nonetheless, it represents a large consumer

---

2 This article is extracted from the keynote address delivered by the SC Managing Director, Dato Dr Nik Ramlah Mahmood at the AVCJ Private Equity and Venture Forum, Kuala Lumpur on 15 October 2008.

3 *International Herald Tribune* "Credit crisis spreads a pall over Silicon Valley" October 3, 2008 and NVCA website.

4 PIPE refers to the purchase of stock in a company at a discount to the current market value per share for the purpose of raising capital. There are two main types of PIPEs – traditional and structured. A traditional PIPE is one in which stock, either common or preferred, is issued at a set price to raise capital for the issuer. A structured PIPE on the other hand, issues convertible debt (common or preferred shares). E.g. of a VC undertaking PIPE is Battery Ventures.

market. Collectively, with a combined GDP of over US$1.2 trillion (in 2007)[5], Southeast Asia is comparable with India which has a GDP of US$1 trillion.

Southeast Asia also offers diversity in terms of economic structures, dynamics and competitive advantages. Some countries have a strong agriculture sector, others are not only rich in resources but also have a highly competitive global manufacturing export base and outsourcing centre. The region's diversity makes it an interesting playing field for PE firms which appreciate the variety for asset diversification, and who believe that growth opportunities can be found in different markets within the region, even at a time when all the economies are likely to be affected by the overall downturn in the global financial market.

In addition, this is the time where the old adage "small is beautiful" has greater appeal than "big is best". While the deal flow for large transactions may have dwindled, there are ample opportunities in the small and mid-market range in Asia. Many companies in Southeast Asia are family-owned; hence deal sizes may be smaller than those of China and India and therefore, easier to finance.

Certainly, regulators in the Southeast Asia region have taken measures to attract more PE and venture capitalists to participate in its markets by creating a more facilitative framework that provides greater avenue for financing private equity entrepreneurs. The Singapore Exchange in July 2008, announced that it will consider allowing private equity and "blind pool" funds and life-science companies with no financial track record to list.[6] Similarly in Malaysia, the SC together with Bursa Malaysia has embarked on transforming the MESDAQ Market into a sponsor-driven market and to facilitate the listing of both technology and non-technology emerging companies.[7]

There have also been collaborative efforts by the ASEAN securities regulators operating through the ASEAN Capital Markets Forum to facilitate cross-border offers in ASEAN. As a start, the working group on the harmonisation of distribution rules for IPOs looked at developing similar offering processes and a single offering timeline.[8] In fact, the ASEAN Finance Ministers have announced the released of ASEAN + Plus standard schemes to facilitate cross-boarder offering of securities. The scheme aims to promote the integration of the region's capital market and will facilitate greater efficiency in cross-border capital raising and provide cost savings to issuer making multi jurisdiction offerings within ASEAN. These efforts towards harmonisation will augur well for the PE players in realising the fruits of their labour and will be a plus point in attracting PE investment flows into the region.

With all these positive attributes that Southeast Asia offers PE and VC investors, it would be interesting to find out where the investment opportunities are. There are several industries in Southeast Asia which are as competitive as their counterparts in China and India in the areas of auto and automotive-related sectors, tourism, agribusiness and food processing and business process outsourcing. Views have also been expressed that there are strong growth prospects in retailing and housing given the increase in disposable income and growing middle class. Additionally, some countries such as Indonesia, the Philippines and Vietnam are rich in commodities, mining and natural resources. Given these opportunities, PEs with established local presence and networks have the sourcing and execution capabilities to exploit these opportunities.

Strong recognition in Malaysia for the important role of the VC industry

The Malaysian venture capital industry has enjoyed strong growth albeit from a small base. The total investments by the VC industry grew by 54% from RM1.1 billion in 2006 to RM1.8 billion in 2007. Malaysia has long recognised the value that a thriving VC industry will bring to its capital market – particularly in terms of promoting new sources of growth and transforming SMEs into PLCs. Under the Capital Market Masterplan (CMP), the VC developmental agenda was to adopt a light touch regulatory approach which generally

[5] Source: IMF Global Economic Outlook Database, April 2008. Also cited in the SC Chairman's speech on 26 June 2008 entitled "Accelerating ASEAN Integration and Strengthening Capital Markets".
[6] Starbiz Friday 11 July 2008 "SGX may allow private equity and blind pools list".
[7] SC Press Release "Further details on capital market initiatives" – 25 March 2008.
[8] SC Chairman's speech on 26 June 2008 entitled "Accelerating ASEAN Integration and Strengthening Capital markets".

aimed at providing substantial support to nurture the growth of the industry and to strengthen its capacity. Given the VC's business philosophy, its contribution to the economy and recognising the fact that it is very much an industry that seeks its funding from agencies, institutional investors and sophisticated high net-worth investors; Malaysia's regulatory approach is to exempt the VC companies and the VC management companies from licensing requirements and to put in place a registration requirement with light reporting requirements for the purpose of compiling data on industry development as well as to facilitate them to enjoy tax incentives.

This was complemented by initiatives to create a more conducive investment environment for the VC. In this instance, the SC allowed the listing of technology incubators, allowed funds[9] to invest in VC and continually strengthened MESDAQ as an exit mechanism.

The VC industry is also a fully liberalised industry which recognises that foreign venture capitalists will bring benefits to the development of the industry and expedite the development of the talent pool through the transfer of their expertise and experience. Indeed, the agglomeration of foreign talent with the knowledge of local players will not only strengthen overall skill sets but also provide opportunities for local players to form strategic alliances or to network with foreign partners.

In September 2008, Malaysia witnessed the participation of Japan Asia Investment Co Ltd (JAIC) as the first registered foreign venture capital corporation in Malaysia. JAIC's entry adds greater depth and breadth to the pool of players within the industry and increasing the pool of private equity funding in Malaysia.

Taking cognisance that issues affecting the VC industry spans across various ministries and government agencies, one of the recommendations under the CMP was to establish a one-stop agency to co-ordinate and spearhead the development and promotion of the industry. This led to the setting up of Malaysian Venture Capital Development Council (MVCDC) in January 2005 under the chairmanship of the SC.

In 2007, the MVCDC was requested to lead a project steering committee tasked to oversee and monitor a study on venture capital industry with special focus on funding.[10] This is a significant milestone as findings and recommendations from the study forms part of the government's National Innovation Model, or Malaysia's roadmap towards an innovation economy.

The government has been consistent in providing extensive support not only in the form of facilitative policies but also in terms of funding and tax incentives. Under the Ninth Malaysian Plan, RM1.6 billion was allocated to the VC industry to bridge the crucial financing gap at the early stages of enterprise development. This represents more than a two-fold increase from the amount allocated in the previous plan.[11] Tax incentives for the industry were announced in various budgets[12] and most recently, under Budget 2009, the incentives were further boosted with the announcement that VC companies investing at least 30%[13] of their funds in start-up, early stage financing or seed capital would be eligible for a 5-year tax exemption.

Conclusion

While Southeast Asia may not be insulated from the effects of global financial turbulence, opportunities abound within the region for the PE and VC investors. Being the regulator, the SC has a responsibility to nurture the growth of this industry. Therefore, the support from industry players both domestic and global are most welcomed in order to create a more conducive environment that is attractive and profitable.

---

9 Private funds (RIS and Wholesale) are not restricted to invest while public/retail funds can only invest up to 10% of the NAV in unlisted securities.

10 The study identified current challenges in the industry and proposed strategic initiatives to enhance the industry's effectiveness as well as to improve the dependability of venture capital as a source of financing.

11 8th Malaysian Plan allocated RM690 million.

12 Budget 2000, 2004 and 2007.

13 This is in addition to previous tax incentives–tax exemption for 10 years for investing 70% of investment fund in seed, start up or early stage or if 50% of investment fund is invested in the form of seed capital.

News Round-up

Islamic fund co-operation between Malaysia and the Middle East

Prudential Fund Management Bhd (PFMB) in Malaysia and Prudential Asset Management Limited in the Dubai International Financial Centre signed an MoU to expand marketing co-operation and distribution of Islamic funds in Malaysia and the Middle East on 20 August 2008. In Asia, Prudential's asset management business is one of the region's largest. Based in Kuala Lumpur, PFMB manages six Shariah funds and Prudential BSN Takaful funds valued at RM629 million. PFMB also manages offshore Shariah assets worth RM294 million.

The MoU signing ceremony was witnessed by the SC Chairman, Dato' Sri Zarinah Anwar and Prudential Corporation Asia, Chief Executive of Fund Management, Arne Lindman

Road show to Taiwan, Australia and Middle East

The Malaysian International Islamic Centre (MIFC) organised a country road show to Perth and Sydney, Australia from 20–26 August 2008. Several meetings were held with Australian regulators and corporations to strengthen Malaysia's position as an investment gateway to the region for the origination, issuance and trading of Islamic capital market and treasury instruments.

Bursa Malaysia organised a showcase in Taipei, Taiwan from 27–29 August 2008. The objectives were:

- to promote Malaysia as an Islamic funds/investment destination;
- to profile Islamic exchange-traded fund (ETF); and
- to evaluate Taiwanese investors' interest in Islamic financial markets.

The MIFC conducted its first road show to Kuwait and Saudi Arabia to meet potential investors and promote Malaysia as the international hub for Islamic finance from 22–27 October 2008. The delegation which was headed by the MIFC Ambassador, the Regent of Perak Raja Nazrin Shah, included representatives from regulatory bodies and industry participants.

Shariah Advisers' Workshop

On 15 October 2008, the SC organised the Shariah Advisers' Workshop on Derivative Products. As new Islamic products are continuously introduced all over the world, the SC realises that it is pertinent for Shariah advisers to equip themselves with the concepts and trading activities involved.

More than 70 participants comprising Shariah advisers registered with the SC and Bank Negara Malaysia, members of the SC's SAC and Shariah officers of Islamic financial institutions attended the workshop.

Malaysian Islamic Finance: Issuers and Investors Forum 2008

The Malaysian Islamic Finance Issuers and Investors Forum 2008, organised by RedMoney Sdn Bhd was held from 11–13 August 2008 in Kuala Lumpur. The SC Chairman delivered a keynote address while Dato Dr Nik Ramlah, the SC Managing Director moderated one of the sessions at the forum.

malaysian ICM

Malaysian ICM – Facts And Figures

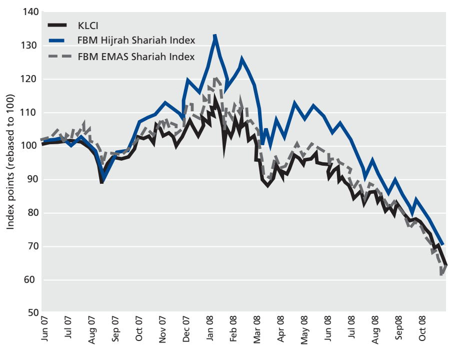
Shariah-compliant securities on Bursa Malaysia

Number of Shariah-compliant securities – May 2008+	843 securities
% to total listed securities	85 %
Latest Market capitalisation – Oct 2008	(RM billion)
Shariah-compliant	416.5
Total market	655.3
% of Shariah-compliant securities to total market	63.6%

Equity market indices	30 Sep 08	31 Oct 08	% change
KL Composite Index (KLCI)	1,018.68	863.61	-15.2%
FBM EMAS Shariah	6,913.91	5,853.46	-15.3%
FBM Hijrah Shariah	7,680.41	6,565.9	-14.5%

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

Chart 1
Performance of KLCI vs Shariah Indices

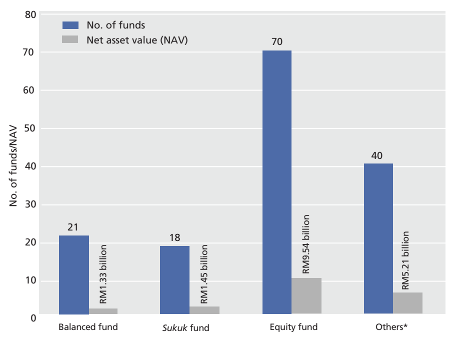


Shariah-based unit trust funds

Number of approved funds	2007	2008*
Shariah-based	134	149
Total industry	521	582
Net asset value (NAV) of approved funds		
Shariah-based (RM billion)	16.90	17.54
Total industry (RM billion)	169.40	148.81
% of Shariah-based to total industry	10.0%	11.8%

* *As at September 2008.*

Chart 2
Shariah-based unit trust funds by category



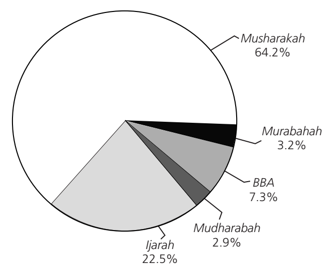
**Including feeder funds, fixed income funds, money market funds and structured products.*

Sukuk

Sukuk approved	2007+	Q2-2008++
Number of *sukuk*	59	36
Size of *sukuk* (RM billion)	121.30	24.6
Size of total bonds approved (RM billion)	158.80	90.03
% of size of *sukuk* to total bonds approved	76.4%	27.3%
Sukuk issued	2007	Sep-2008++
Size of *sukuk* issued (RM billion)	72.9	37.66
% of *sukuk* issued to total bonds issued	57.2%	44.9%
Sukuk outstanding	2007	Sep-2008
Size of outstanding *sukuk* (RM billion)	135.8	146
% of outstanding *sukuk* to total outstanding bonds	56%	56%

+ *The sukuk figure includes the approval of seven combination issuances (conventional bonds and sukuk).*
++ *Figures from January–September 2008.*

Chart 3
Size of sukuk approved based on various Shariah principles in Q3 2008



RM-denominated Sukuk approved by the SC in Q3-2008

Issuer	Shariah principle	Size of issue (RM million)	Date of approval	Rating
1. Cosy Bonanza Sdn Bhd	*Murabahah*	570	03 Jul 08	Not Rated
2. Tadamun Services Bhd	*Ijarah, Istisna`* & *Murabahah*	1,000	18 Jul 08	AAA
3. Sepangar Bay Power Corporation Sdn Bhd	*Ijarah*	450	22 Jul 08	AA
4. Syarikat Borcos Shipping Sdn Bhd	*Ijarah* & BBA	370	25 Jul 08	A1
5. Dawama Sdn Bhd	*Musharakah*	140	25 Aug 08	A+, A
6. TSH Sukuk Ijarah Sdn Bhd	*Ijarah*	400	29 Aug 08	AA–, MARC-1
7. Seafield Capital Bhd	*Musharakah*	1,500	05 Sep 08	AA2
8. Rim City Sdn Bhd	BBA	1,000	15 Sep 08	Not Rated
9. Chemical Company Of Malaysia Bhd	*Musharakah*	500	16 Sep 08	AA3, P1
10. Projek Lintasan Shah Alam Sdn Bhd	*Ijarah, Mudharabah*	745	16 Sep 08	A1, A3
11. Bank Muamalat Malaysia Berhad	BBA	200	18 Sep 08	Not Rated

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, please contact:

Badlishah Bashah
Islamic Capital Market Department
Tel: 03–6204 8000 ext 8373
E-mail: badlisha@seccom.com.my

Zainol Ali
Islamic Capital Market Department
Tel: 03–6204 8000 ext 8666
E-mail: zainol@seccom.com.my

Azmaniza Bidin
Islamic Capital Market Department
Tel: 03–6204 8000 ext 8280
E-mail: azmaniza@seccom.com.my

Securities Commission
3 Persiaran Bukit Kiara Bukit Kiara
50490 Kuala Lumpur Malaysia
Tel: 03–6204 8000 Fax: 603–6201 5082
Website: www.sc.com.my

Printed by:
Good News Resources Sdn Bhd
6-1-8 Meadow Park Jalan 1/130 Off Jalan Klang Lama
58200 Kuala Lumpur Malaysia