



# malaysian ICM

Quarterly Bulletin of  
Malaysian Islamic Capital Market  
by the Securities Commission

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## MALAYSIA AS AN INTERNATIONAL ISLAMIC FINANCIAL CENTRE

The government, through financial and market regulators, has embarked on a strategic initiative to strengthen Malaysia's position as an international Islamic financial centre. Launched in August 2006, the Malaysia International Islamic Financial Centre (MIFC) initiatives mark the beginning of a new era to create a vibrant, innovative and competitive international Islamic financial services industry in Malaysia.

The MIFC comprises a wide range of financial institutions in Malaysia, offering Islamic financial products and services, and in any currency. This initiative will position Malaysia as an Islamic financial centre specialising in the origination, distribution and trading of Islamic capital market (ICM) and treasury instruments; Islamic fund and wealth management services; international currency Islamic financial services, and *Takaful* and re-*Takaful* business.

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## COMPENSATION FROM THE SHARIAH PERSPECTIVE<sup>1</sup>

Companies or corporations need working capital to expand their businesses. To a certain extent, they seek financial assistance from lenders or financial institutions. In this case, the creditor expects the debtor to make a prompt settlement of the debt at a given time agreed to by both parties. However, in certain situations or circumstances, the debtor may face problems settling the debt, which results in either a delay or failure in repayment. This raises the question – In Islamic financing, can compensation be imposed as a result of a failure to repay promptly?

According to the Arabic terminology, the imposition of compensation (*ta'widh* or *syart jaza'i*) is a penalty agreed on by the 'aqd parties as compensation that can be rightfully claimed by the creditor when the debtor fails or is late in settling the debt.

In relation to the above, the SC Shariah Advisory Council (SAC) resolved that compensation payment for arrears and failure to pay after the due date, is permissible for Islamic financing formulated based on 'uqud mu'awadhat (exchange contract), including Islamic debt securities.

Compensation can be imposed after it is found that *mumathil* (deliberate delay in payment) is utilised on the part of the debtor to settle the payment of the principal or profit. In this regard, compensation can be imposed as follows:

- For the late payment of profit, the rate of compensation which can be imposed is 1% per year on payment in arrears of profit. However, the sum of compensation cannot be compounded.
- For not settling the payment of the principal sum, the compensation can be imposed at the current rate of Islamic interbank money market.
- The maximum amount of compensation that can be imposed on any unsettled payment of financing cannot exceed the total amount of the remainder of the financing balance.
- Compensation obtained from financing for which payment has not been settled, may be consumed by the creditors involved and distributed according to the bank's prevailing rate of profit distribution ratio.

### Arguments supporting the permissibility of compensation

The imposition of compensation is allowed based on the following:

- **Hadith**  
The Prophet s.a.w. rebuked those who delay the payment of a debt as he says, "The rich who delay the payment of a debt are committing tyranny".
- **Qiyas**  
The delay in paying off a debt can be compared with *ghasb* (usurpation) of valuable property. This is because of the similarity of *'illah* (cause) between the two, that is obstructing the use of property and exploiting it in a tyrannical way. According to the Syafi'i and Hanbali *Mazhab*, in the case of *ghasb*, the usurper has the benefit of using the property that he has seized and, therefore, must pay compensation to the owner. In the case of a delayed payment of debt, the creditor stands to lose because he is deprived of the opportunity of using the funds for other trading purposes, which he could if the debt was settled within the stipulated time. Therefore, this loss should be compensated by the debtor based on *qiyas* (analogy).

<sup>1</sup> Other resolutions pertaining to ICM issues can be found in the book, *Resolutions of the Securities Commission Shariah Advisory Council*.



- **Maxims of Islamic jurisprudence**

There is a maxim of Islamic jurisprudence which can be used in dealing with this matter, that is, "Nothing is a loss or results in a loss (in Islam)".

Based on this principle, the debtor's act of delaying payment is a loss to the creditor. This situation has to be avoided so that businesses are conducted according to the *istiqrar ta'amul* principle, that is the smooth running of the market. It is supported by another maxim of Islamic jurisprudence, "Whatever loss should be removed".

In the context of this discussion, a loss that is borne by a creditor must be removed by the provision of a suitable approach, such as imposing compensation on a delayed payment of debt. This encourages the debtor to settle the debt within the stipulated time.

- **Qadhi Syuraih's resolution**

There is a basis in Islamic jurisprudence to show that compensation can be imposed in a trade. An example is the resolution made by Qadhi Syuraih in a case narrated by Bukhari from Ibnu Sirin: A potential customer said to the owner of

some animals for hire, "Prepare for me one of your animals. Should I not hire it on such a date, I will pay you 100 dirham". Apparently, the customer did not proceed with the deal, and so, according to Qadhi Syuraih, "Whoever imposes a condition upon himself voluntarily, then that condition is binding".

Qadhi Syuraih resolved that the condition stated by the potential customer is binding. Based on this resolution, it can be used as an Islamic jurisprudence principle to permit the imposition of a condition in the form of compensation in a business transaction. The payment is for opportunity loss borne by the creditor. Prof Dr Mustafa al-Zarqa' sums it up by saying, "Compensation is for loss (borne by parties involved in a business transaction) as a result of waiting and disrupting a transaction".

In conclusion, the above arguments demonstrate clearly that compensation can be imposed if there is sufficient evidence of a deliberate delay in payment. This accords fairness and business opportunities to the creditor to finance any other party in need. This also provides a "lesson learnt" for debtors to be more responsible and vigilant in settling their financial obligations.

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To facilitate the MIFC agenda, the MIFC Executive Committee was set up comprising heads of relevant ministries, government departments and agencies, financial and market regulators and industry representatives. The SC is represented by its Chairman, Dato' Zarinah Anwar. The Committee acts to facilitate development of the MIFC.

To promote greater awareness among financial industry players, a half-day dialogue between regulators and industry players was held on 1 November

2006 to discuss implementation issues and to foster greater collaboration in working towards the MIFC's overall success.

As part of government's efforts to facilitate the development of the ICM, Budget 2007 outlined various incentives and opportunities for the ICM industry. These include incentives for managing foreign funds in accordance with Shariah principles, Islamic real estate investment trusts (REITs) and Islamic stockbroking companies.



## BUDGET 2007: MAINTAINING MALAYSIA'S COMPETITIVENESS

Given the challenges and huge potential of the Malaysian Islamic finance, the government has taken additional measures to support the industry and to cater to the growing demand for Islamic-based financing, both from domestic and international issuers and investors. The government has outlined various initiatives to develop Islamic finance in the Ninth Malaysia Plan. Through financial regulators, the government has embarked on a strategic initiative to strengthen Malaysia's position as an international Islamic financial centre. The initiative aims to create a vibrant, innovative and competitive international Islamic financial services industry. In the Budget 2007, incentives were announced for a facilitative tax incentive framework for the ICM. Among the new incentives introduced are:

- To promote Islamic fund and wealth management activities and attract fund managers to set up operations in Malaysia, local and foreign fund managers located in Malaysia are accorded 100% income tax exemption on their management fee earned, for managing foreign funds in accordance with Shariah principles.
- To promote Malaysia as a preferred choice for ICM and a centre for sourcing funds, the government has accorded the following tax incentives in relation to the issuance of *sukuk*:
  - The special purpose vehicle (SPV) set up for Islamic financing is exempted from income tax
  - The company that establishes the SPV is also given a deduction on the cost of issuance of the Islamic bonds incurred by the SPV
  - Extension of deduction on expenses for *sukuk* issued under the Shariah principle of *musarakah*,

*mudharabah*, *ijarah* and *istisna`* for another three years until the year of assessment 2010.

- Expenses incurred prior to the commencement of an Islamic stockbroking business are allowed to be tax deductible, subject to the condition that the company must commence its business within two years.
- To enhance the development of real estate investment trusts (REITs) in Malaysia, including Islamic REITs:
  - Resident and non-resident individual investors and other local entities that receive dividends from REITs listed on Bursa Malaysia are taxed at 15% for five years
  - Foreign institutional investors, particularly pension funds and collective investment funds that receive dividends from REITs listed on Bursa Malaysia are taxed at 20% for five years
  - REITs are also exempted from tax on all income provided that at least 90% of their total income is distributed to the investors.

In summary, the above tax incentive framework further illustrates the government's continued efforts in turning Malaysia into an important international Islamic financial centre. It is hoped that this facilitative tax framework will help market participants promote their businesses and introduce more innovative and high quality products. Such developments will create a more vibrant, liquid and mature ICM, thereby enabling both equity and bond investors to seek out new investment opportunities. More importantly, such a tax incentive framework will help put Malaysia in a better position to compete internationally.



## LIST OF SHARIAH-COMPLIANT SECURITIES BY SHARIAH ADVISORY COUNCIL

One of SAC's efforts to promote the Malaysian ICM is the reviewing of all shares listed on Bursa Malaysia for Shariah compliance. As a result of the review, the SAC has introduced a list of Shariah-compliant securities (SAC List) to facilitate investment in Shariah-compliant securities by equity investors and fund managers. The SAC List is updated twice a year, in April and October, to keep investors informed of the Shariah status of listed securities.

*“ A total of 886 securities or 86% of all listed securities on Bursa Malaysia are currently classified as Shariah compliant.”*

The latest SAC List was released on 27 October 2006. Thirty-three newly classified Shariah-compliant securities were added to the list while six securities were reclassified as Shariah non-compliant. A total of 886 securities or 86% of all listed securities on Bursa Malaysia are currently classified as Shariah compliant. The SAC classifies the Shariah status of these securities based on information and input provided by the SC which focus on the activities of the Bursa Malaysia-listed companies.<sup>1</sup>

The SAC List enables Bursa Malaysia to update the components of the Kuala Lumpur Shariah Index (KLSI) that tracks the performance of listed Shariah-compliant securities. The KLSI components consist of all Shariah-compliant securities on the Main Board of Bursa Malaysia.

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<sup>1</sup> The complete SAC List, together with the SAC's guidance on the disposal of Shariah non-compliant securities, is available at [www.sc.com.my](http://www.sc.com.my).



## SHARIAH-BASED UNIT TRUST FUNDS

The development of ICM products in Malaysia continues to chart its growth in parallel with other capital market products. The Islamic unit trust industry, in particular, has evolved further with the launch of four new Shariah-based unit trust funds to fulfil the increasing demand for new ICM products.

### Shariah-compliant institutional cash management product

In August 2006, Hwang DBS Investment Management Bhd introduced the Shariah-compliant Institutional Cash Management Product or Islamic cash fund which targets corporate and institutional investors. The fund has an initial approved fund size of 100 million units priced at RM1 per unit for corporate and institutional clients and the minimum initial investment is RM1 million. The fund distributes income on a monthly basis in the form of additional units. The fund invests in a diversified portfolio of good quality short-term Islamic securities carrying a minimum credit rating of AA3/P1 by local rating agencies and in various Islamic money market instruments to provide inherent stability to the portfolio.

### Regional Shariah-based unit trust fund

In August 2006, the SC approved a new Shariah-based unit trust fund managed by Public Mutual Bhd. The Public Asia Ittikal Fund seeks to achieve its goal of capital growth by investing in Shariah-compliant index stocks, blue chips and growth stocks listed on Bursa Malaysia and selected regional markets. The fund may also invest in *sukuk* to generate additional returns. The fund has 1.5 billion units on offer to potential investors with aggressive risk-reward temperament seeking long-term capital growth.

### Shariah bond fund

In September 2006, a new Shariah bond fund known as the Amanah Raya Shariah Trust Fund was introduced. The fund, managed by Amanah Raya JMF Asset Management Sdn Bhd, was introduced by Pos Malaysia Bhd in collaboration with Amanah Raya Bhd. The fund has a maximum approved fund size of 500 million units and its objective is to provide regular income and capital growth over the medium- to long-term, through investment, predominantly in Shariah-compliant instruments. The strategy of the fund is to invest a minimum of 70% of its net asset value (NAV) in *sukuk*, Islamic money-market instruments rated at least "A" or "P2" by local rating agencies. It may also invest up to 30% of its NAV in Amanah Raya Bhd's Common Fund via institutional trust accounts.

### Islamic absolute benchmark Asia ex-Japan fund

In November 2006, the market also witnessed the launch of the country's first Islamic absolute benchmark Asia ex-Japan fund known as the Pheim Asia Ex-Japan (PAXJ) Islamic Fund. The fund, which is managed by Pheim Unit Trusts Bhd, has an approved size of 200 million units of RM1 each. It invests in Shariah-compliant equities in Southeast Asia, Hong Kong, China, Taiwan, South Korea, India, Australia and New Zealand. Pheim Unit Trusts Bhd was optimistic that the fund will attract the interests of both Muslims and non-Muslims, following the success of its first conventional absolute benchmark Asia ex-Japan fund introduced in July 2006.

While 95% of the fund size will be invested in Shariah-compliant equities, a minimum of 5% of the fund will be kept as liquid assets or cash and/or invested in *sukuk*. Similar to its conventional absolute benchmark Asia ex-Japan fund, PAXJ was also benchmarked against an absolute annual return of 7%.



## MALAYSIAN SUKUK ISSUERS BENCHMARK AGAINST INTERNATIONAL STANDARDS

The government's effort in accelerating product development, especially in the issuance of globally accepted *sukuk* through a facilitative tax framework, is beginning to reap rewards. This is reflected in the third-quarter 2006 *sukuk* issue approvals, in which RM9.39 billion or 75% of the *sukuk* approved by the SC are structured using the *musyarakah* principle. The market also witnessed the issuance of the second *sukuk mudharabah* by a local issuer since the first issuance by PG Municipal Assets Bhd last year. Another development is the issuance of the world's first exchangeable *sukuk* by Khazanah Nasional Bhd.

### Sukuk musyarakah by PLUS Expressway Bhd

The SC approved a *sukuk musyarakah* issuance with a total value of RM9.1 billion by Malaysian toll road operator, PLUS Expressways Bhd (PLUS). It will be issued in three series and in each series, the potential investors will form *musyarakah* partnerships among themselves to invest in a venture which includes the residual rights of PLUS under the concession agreement. PLUS and the investors are entitled to the income generated from the venture throughout the tenure of the *musyarakah* in proportion to their interests in the venture.

The objective of the issuance of these *sukuk musyarakah* securities is to convert the bulk of PLUS' existing *sukuk*, such as Bai` Bithaman Ajil Serial Bonds, into *sukuk* that adopt a more globally recognised Shariah principle. This will enable—

- PLUS to be endorsed in relevant global Islamic indices as debt or gearing ratio will be reduced.

- Khazanah Nasional Bhd, as a major shareholder of PLUS, to diversify its investor base by tapping into Middle-Eastern market and increasing its profile among global Islamic investors, especially in the Gulf Co-operation Council (GCC) market.

### Sukuk musyarakah by Sarawak Power Generation Sdn Bhd

Another approved *sukuk musyarakah* was issued by Sarawak Power Generation Sdn Bhd, a wholly-owned subsidiary company of Sarawak Enterprise Sdn Bhd, in the form of medium-term notes up to a nominal amount of RM215 million. Under the structure of this *sukuk*, investors need to form a *musyarakah* venture to participate in existing and future power plant projects, and the proceeds of this issue will be used to finance the Sarawak-based Mukah power plant project.

### Sukuk mudharabah by Mukah Power Generation

The other globally-accepted *sukuk* issued by local companies are the two *sukuk mudharabah* issues by Mukah Power Generation Sdn Bhd (MPG), namely the Serial Senior Sukuk Mudharabah and the Serial Junior Sukuk Mudharabah valued at RM665 million and RM285 million respectively. Similar to Sarawak Power Generation Sdn Bhd, MPG is a wholly-owned subsidiary company of Sarawak Enterprise Sdn Bhd. The *mudharabah* venture is between MPG as a *mudharib* and investors as *rabb al-mal*, and the proceeds from

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## STRENGTHENING MALAYSIA'S POSITION AS A GLOBAL ICM HUB<sup>1</sup>

The Malaysian ICM forms a critical component of the Islamic finance industry, complementing Islamic banking and *Takaful*. It started from a humble beginning, designed to cater to the investment needs of Muslim investors seeking to invest in Shariah-compliant investment instruments. Institutions, such as Tabung Haji, Bank Islam and other Islamic investment institutions were the main stakeholders of Malaysia's ICM way back in the 1980s.

Over the last decade, the Malaysian ICM has witnessed the proliferation of products and services, ranging from equities, bonds, unit trust funds, structured products, derivatives, indices, as well as fund management and stockbroking services. These have contributed significantly to the depth and breadth of the Malaysian capital market. The Malaysian ICM has also been successfully integrated into the domestic mainstream financial system, contributing to the growth and stability of the entire Malaysian financial system. Increasingly, there is international recognition of the efforts put in place and the successes achieved so far.

Malaysia has a diversified range of ICM products and services with significant size and scale. On Bursa Malaysia, 86% of the listed stocks are Shariah compliant with a market capitalisation of almost RM500 billion. This represents about 65% of the total market capitalisation of the exchange. Similarly, *sukuk* has experienced unprecedented growth and constituted 71% of the bonds approved by the SC in 2005. Up till September 2006, almost 60% of the bonds approved by the SC were *sukuk*.

The *Capital Market Masterplan (CMP)* provides the broad approach and direction for developing the ICM. As a result, the Malaysian ICM has witnessed the

introduction of many new Shariah-compliant instruments on the back of a more facilitative tax and regulatory framework.

*"The 9MP calls for enhancing Malaysia's position as a hub in the provision of ICM products and services."*

The increasing diversity of ICM products is a key strength for Malaysia given that the global demand for ICM products has also experienced unprecedented growth. This is particularly so with respect to more sophisticated products, such as Islamic structured products and convertible and exchangeable *sukuk*. This is because investors are becoming more sophisticated, having distinctive needs and risk appetites. This has led to the phenomenal growth of product innovation and diversification in recent years.

### The government sees tremendous opportunities in ICM

The government sees ICM as a fundamental lever in further developing Malaysia's capital market. Positioning Malaysia as an international ICM centre is one of six key objectives of the CMP. But that is not all. The government has reiterated its commitment to further develop ICM in the Ninth Malaysia Plan (9MP) which was released early this year. It aims to position Malaysia as a global hub for ICM products and services. This is to be achieved by strengthening

<sup>1</sup> This article is extracted from the Deputy Minister of Finance II keynote address at the Malaysian Islamic Finance: Issuers and Investors Forum 2006 on 15 August 2006 and has been edited.



the role of Islamic market intermediaries in the domestic intermediation process and enhancing linkages between domestic institutions and other ICM centres towards a global ICM network. The growth of the Malaysian ICM in terms of size and scale, as well as the country's considerable experience in developing the domestic ICM should provide Malaysia with the necessary impetus towards becoming an ICM hub.

Some industry experts define a financial hub as a place where there is an intrinsic and necessary framework to facilitate an industry's growth and development. Such a framework would require a complementary legal and regulatory environment, a pool of qualified and skilled professionals and a critical mass of products, services and participants.

In this context, Malaysia is geared up to equip itself with the prerequisites for a hub. The building blocks are in place – such as institutional and regulatory framework, market infrastructure, critical mass of participants, wide range of products, facilitative tax framework and long-term policy direction.

With an allocation of RM200 billion for developmental projects and RM20 billion for the private finance initiatives (PFIs) in the 9MP, the domestic intermediation process should leverage on the ICM to mobilise funds between capital seekers and providers. It is therefore critical to ensure that the Malaysian ICM innovates quality, competitive and diversified products and services to enable effective utilisation of funds for 9MP projects.

While domestic players have a key role to play, Malaysia cannot aspire to be a hub by being insular. Malaysia needs to–

- promote greater cross-border trade and investment linkages in order to contribute substantially to the expansion of the Malaysian ICM
- be a centre for originating deals from abroad

- draw funds from abroad that are seeking Shariah-compliant investments
- attract the best global talent to be based in the country.

The government has introduced numerous initiatives and measures, such as allowing the entry of foreign intermediaries, more flexible exchange control policies, facilitative tax regime and immigration policies. These are part of the government's efforts to enhance Malaysia's attractiveness and international connectivity. Since 2003, the country has seen the entry of foreign market intermediaries, such as foreign brokers, foreign fund managers and foreign Islamic banks. These are critical measures towards achieving the broader objective of developing a competitive and efficient ICM, and for Malaysia to remain competitive within the evolving international Islamic financial landscape.

The government has provided the necessary means for foreign market intermediaries to participate in the Malaysian capital market. With reputable and large global players in the market, the Malaysian market will benefit from new and distinctive value propositions that they will bring. Greater participation of foreign market intermediaries will facilitate the import of international skills, enhance cross-border issuance and investment and introduce new knowledge and technological efficiencies, thus creating a more competitive environment and facilitating greater product innovation more rapidly. They are expected to provide access to their global client networks and introduce internationally accepted products based on best practices.

Some international market intermediaries have already chosen Kuala Lumpur as the centre for their regional Islamic financial services. The government would like to see more global market players consider Malaysia as the regional centre for their Islamic financial services. Their participation will contribute significantly to the



government's aspiration to enhance the integration and connectivity of the Malaysian ICM with international markets.

On the other hand, the domestic ICM market intermediaries should consider venturing abroad to offer their services and expertise to countries that are developing their ICM. They are also expected to bring in major deals for cross-border investment and financing activities, and promoting the Malaysian ICM to the rest of the world. For this, the government has provided the appropriate platform for domestic intermediaries to leverage on our leadership and involvement in organisations, such as the OIC, NAM, ASEAN and APEC. The opportunities and linkages established by the government, particularly in financial services, trade and investment, should be effectively capitalised by domestic market intermediaries to create global networks, deals and transactions.

Bursa Malaysia (Bursa) has also played an important role in the promotion of the ICM. Bursa offers a wide range of Shariah-compliant products, such as Shariah-compliant stocks and derivatives. As part of the effort to offer foreign investors greater opportunity to invest in its products, Bursa is currently working with an international index provider to develop and launch a new set of Islamic indices that will give investment access and provide benchmarks for international investors. In addition, it is important to increase promotional programmes to attract global investors, especially high net worth individuals in branding the Malaysian ICM.

Similarly, the role of the Labuan International Financial Exchange (LFX), an offshore outfit of Bursa, can be enhanced further by providing a platform for the trading of global Islamic products, in particular for investors who wish to deal in non-ringgit instruments.

Likewise, LFX can be promoted as an exchange to list non-ringgit Islamic products and to raise global Islamic funds.

The government will continue to facilitate the development of the ICM. Government-linked companies (GLCs) will play a more proactive role in the use of ICM products when going to the capital market to meet their funding requirements. Similarly, as most GLCs are active investors in the capital market, the shift towards investing in ICM products will further support the growth of the Malaysian ICM.

Notwithstanding all of the above, it is absolutely vital for the Malaysian ICM to develop and enlarge the pool of human capital in areas like Islamic finance, Shariah, tax, legal and accounting expertise. Human capital is extremely important in Malaysia's aim to be the global hub for ICM. A knowledgeable and skilled workforce is the key to sustaining a competitive edge.

Organisations like the Securities Industry Development Centre (SIDC) of the SC, International Centre for Education in Islamic Finance (INCEIF) and Islamic Banking and Finance Institute Malaysia (IBFIM) are continuously providing training in ICM for local and foreign market participants.

## Conclusion

Malaysia's well-established building blocks have brought the development of ICM to a higher level. Going forward, given the strong demand for ICM products and services, and the hard work and commitment of all parties, Malaysia will not only be able to maintain its leading position in the ICM but will also achieve the government's aspiration to be a global hub.



## MALAYSIA INTERNATIONAL ISLAMIC FINANCIAL CENTRE: OPPORTUNITIES IN THE ICM<sup>1</sup>

The government, together with the financial and market regulators, have articulated the vision and put in place, facilitative regulatory and tax frameworks to ensure the realisation of the Malaysia International Islamic Financial Centre (MIFC) agenda. The government has provided an overview of the MIFC goals and strategies. This article aims to briefly highlight the government's MIFC goals, strategies and opportunities for growth.

*“Among the activities promoted under the MIFC are the origination, distribution and trading of ICM and treasury instruments, as well as Islamic fund and wealth management. Products and services under the MIFC can be in any currency and can be offered to both residents and non-residents.”*

Due to the strong commitment of the intermediaries, issuers and investors have come to recognise the opportunities and options that the ICM offers to the international market in the form of high quality financial products and services. Recently, the country saw the launch of new *sukuk* by Malaysian companies which are benchmarked against international issues of the highest quality, such as the Khazanah exchangeable *sukuk*, Mukah *mudharabah sukuk* and PLUS *musyarakah sukuk*. This is clear testimony of the ability

of our intermediaries in structuring products and offering services acceptable to the international financial market. The fact that *sukuk*, originating from Malaysia, accounts for over 70% of the total *sukuk* issued in the global *sukuk* market also speaks volumes not only of the capabilities of our intermediaries but also of the opportunities available to them.

Among the activities promoted under the MIFC are the origination, distribution and trading of ICM and treasury instruments, as well as Islamic fund and wealth management. Products and services under the MIFC can be in any currency and can be offered to both residents and non-residents.

These flexibilities offered under the MIFC can be used by the industry to extend its reach to other financial centres through cross-border linkages and strategic alliances which are crucial in building a thriving MIFC.

### Islamic fund management

One aspect of the ICM that offers vast opportunities for intermediaries is fund management. Figures quoted on the size of global Islamic funds vary from one source to another. However, there is general consensus that the amount is huge; it is growing very fast and looking for viable investment products and destinations. It is also true that the huge amounts are being targeted and wooed by many financial centres around the globe.

The SC with the support of the government has introduced several measures to catalyse the development of the fund management industry.

<sup>1</sup> This article is extracted from the SC Chairman's special address at the MIFC Dialogue Session with industry players on 1 November 2006.



*“Global and regional fund managers can now set up operations in Malaysia, and are given the flexibility to source funds from within and outside the country. This is to enhance the diversity of the fund management business and to facilitate the entry of foreign fund management expertise, including foreign Islamic fund management companies.”*

Global and regional fund managers can now set up operations in Malaysia, and are given the flexibility to source funds from within and outside the country. This is to enhance the diversity of the fund management business and to facilitate the entry of foreign fund management expertise, including foreign Islamic fund management companies.

As announced in Budget 2007, local and foreign fund managers managing foreign funds, in accordance with Shariah principles, will be granted income tax exemption on the management fees earned. It is hoped that with this tax incentive, fund managers in Malaysia will intensify efforts to attract more foreign funds to be managed out of Malaysia.

Islamic real estate investment trusts (REITs) is another asset class which has gained acceptance among global Islamic investors. The guidelines on Islamic REITs were introduced to facilitate development, and tax incentives for REITs were announced. The general guidelines on REITs were also liberalised to allow the acquisition of foreign assets which will enable REIT managers to diversify their asset allocation and enhance investment yield. These measures are intended

to put Malaysia in the forefront of REITs, especially Islamic REITs.

### **Origination, distribution and trading of Islamic financial products**

The origination and distribution of Islamic financial products are the other key areas of focus of the MIFC. Malaysia's acknowledged leadership position in the global *sukuk* market can certainly be harnessed by the industry to grow the business of origination, not just for Malaysians but also for foreign issuers.

In this context, it is encouraging to note that several foreign *sukuk* issues were advised and arranged by Malaysian financial institutions. These efforts, if more aggressively pursued, will no doubt entrench Malaysia's leadership in the global Islamic financial market and broaden the business horizon for Malaysian intermediaries.

Bank Negara Malaysia has allowed non-ringgit *sukuk* to be issued in Malaysia. The SC will be introducing a facilitative framework for the issuance of foreign currency-denominated *sukuk* by multilateral

*“The SC will be introducing a facilitative framework for the issuance of foreign currency-denominated sukuk by multilateral development banks, multilateral financial institutions, sovereigns and quasi-sovereigns, as well as local or foreign multinational corporations.”*



development banks, multilateral financial institutions, sovereigns and quasi-sovereigns, as well as local or foreign multinational corporations.

A non-ringgit *sukuk* issued by any of these entities, which is rated at least a single A, will be deemed to be approved under a new and forthcoming practice note pursuant to the Islamic securities guidelines. The *sukuk* approved under this framework may be offered offshore and to sophisticated investors onshore. Additionally, the new liberalised framework will allow the use of international documentation, based on the laws of England or the US. Credit ratings by international credit rating agencies will also be acceptable. These flexibilities will introduce international standards and practices as benchmarks in the *sukuk* issuance process, while saving costs for international issuers.

The recent incentive in the form of tax exemption on income received by Malaysian financial institutions from their overseas branches and subsidiaries should provide the impetus for Malaysian intermediaries to market their expertise in the structuring of Islamic products by having a presence in appropriate foreign markets. Similarly, the extension of tax incentives for expenses incurred in issuing *sukuk* based on *musyarakah*, *mudharabah*, *ijarah* and *istisna`* should increase the issuance of *sukuk* based on these internationally-accepted structures.

The SC will also introduce a new Capital Market Services Act which will consolidate the present securities and futures laws into a single Act. The proposed legislation will give due recognition to the important role that Islamic banks play in the development of the ICM. Hence, to allow more intermediaries to participate in the origination of ICM products, the proposed legislation will recognise, as registered entities, Islamic banks licensed by Bank Negara Malaysia. This will enable them to broaden the scope of their activities and to carry out additional ICM activities, such as fund management, initial public offering (IPO) submission

and private placement, without further need for licensing by the SC.

While origination is important, it must be supported by appropriate and effective distribution and trading infrastructures. In this regard, tax incentives announced in Budget 2007 which allow deduction on expenses incurred in setting up Islamic stockbroking businesses should encourage stockbroking companies to distribute ICM products.

*“The SC will also introduce a new Capital Market Services Act which will consolidate the present securities and futures laws into a single Act. The proposed legislation will give due recognition to the important role that Islamic banks play in the development of the ICM.”*

### **Exploring other Islamic financing and investment opportunities**

There is a need to continuously explore new Shariah-compliant financing and investment avenues. The success of the Malaysian ICM has been largely due to the pioneering spirit of the industry and intensive efforts to explore new financing and investment opportunities, and to keep pushing the boundaries in terms of product innovation. Without doubt, these efforts must continue with even greater vigour and urgency under the MIFC.

Venture capital is an area that can benefit from enhanced focus considering the consistency of its



structure and the fact that the application of the *musyarakah* concept makes venture capital an appropriate Islamic financing and investment option.

To promote the venture capital industry, the government has set up the Malaysian Venture Capital Development Council which provides strategic direction and co-ordination in implementing policies to develop the industry. The government has allocated RM1.6 billion under the Ninth Malaysia Plan (9MP) for the venture capital industry. To accelerate the development of this industry, the government also allows a venture capital company, which invests at least 50% of its fund in the form of seed capital, a tax exemption of 10 years.

Despite these efforts, the Islamic venture capital industry is still relatively small. Market intermediaries should, therefore, take advantage of the incentives provided to grow this industry segment and to attract more global Islamic funds into Malaysia.

## Conclusion

The MIFC is a national agenda and various building blocks are already in place, including facilitative legal, regulatory and tax frameworks. But these alone cannot create an international financial centre, as other conditions must also be satisfied. Malaysian intermediaries must be willing to venture abroad and foreign intermediaries must be welcomed to our

*“Despite these efforts, the Islamic venture capital industry is still relatively small. Market intermediaries should, therefore, take advantage of the incentives provided to grow this industry segment and to attract more global Islamic funds into Malaysia.”*

shores. Liberalisation of the intermediation services is crucial, and indeed inevitable, if Malaysia intends to quickly seize the opportunities offered in the area of Islamic financial services, as well as to maintain its leading position.

Another crucial building block for the success of the MIFC is the willingness of intermediaries to invest in human capital. The importance of ensuring the availability of appropriate talent cannot be over emphasised. The government through the MIFC Executive Committee is determined to ensure that any difficulties faced by intermediaries in acquiring talent are minimised, if not eliminated. It must be recognised that in order to tap the global market we need global talent; hence, there is a need to invest in such talent.



## NEWS ROUNDUP

### MIFC dialogue with finance industry

To create a greater awareness of the Malaysian International Islamic Financial Centre (MIFC) initiatives, the SC, Bank Negara Malaysia and the Labuan Offshore Financial Services Authority, held a half-day dialogue with the finance industry.

Urging the industry's support and commitment, the SC Chairman, Dato' Zarinah Anwar highlighted various opportunities offered by the MIFC initiatives and the recent tax incentives accorded by the government. She also announced that the SC was working on a facilitative framework for the issuance of foreign currency *sukuk* by eligible issuers. During the session, industry players and regulators also exchanged views and deliberated on issues and opportunities related to the MIFC initiatives.

The half-day dialogue held on 1 November 2005 was attended by chairmen and CEOs of onshore and



offshore financial institutions, including commercial banks, Islamic banks, merchant banks, investment banks, discount houses, *Takaful* operators, insurance companies, development financial institutions, fund managers, venture capital companies and stockbroking companies.

### Shariah Advisers Workshop

Shariah advisers need to have a deeper understanding of the *sukuk*. On 4 September 2006, the SC organised a second Shariah Advisers Workshop, entitled "*Meningkatkan Kefahaman dan Penglibatan Penasihat Syariah Dalam Industri Sekuriti Islam (Siri 2)*".

This one-day workshop was designed to educate on the issues relating to the importance of *sukuk*, the SAC's resolutions on *sukuk*, the various structures and

framework of *sukuk*, based on the concepts of *musyarakah*, *mudharabah*, *istina`* and *ijarah*. It was also to encourage Shariah advisers to be more effective in providing their advisory services to the industry.

Thirty-six Shariah advisers registered with the SC and Bank Negara Malaysia, and members of SC Shariah Advisory Council (SAC), attended this workshop.



## SAC's 10th anniversary

The SC celebrated the SAC's 10th anniversary in September 2006. The SAC was the first advisory body to be established at the regulatory level and led the way in setting precedents and achievements that were instrumental in developing Malaysia as a global ICM hub. Over the past decade, the SC has tapped on the vast experience of the distinguished members of the SAC in applying Shariah principles, particularly in the areas of Islamic

economics, finance and all issues relating to the ICM.

The SAC's contributions and noteworthy initiatives in the rapidly developing ICM landscape are reflected in the continued rapid growth of Shariah-based unit trust funds, issuance of innovative *sukuk* structures and in efforts to set global benchmarks by introducing new ICM products, such as Islamic REITs.

## Latest book on SAC resolutions

In conjunction with the SAC's 10th anniversary celebration, the Minister of Finance II, Tan Sri Nor Mohamed Yakcop, launched the second edition of the SAC resolutions book. Entitled *Resolutions of the Securities Commission Shariah Advisory Council*, the book is a compilation of all SAC decisions on ICM-related issues since 1996. Published in both English and Bahasa Melayu, it is an essential reference for domestic and international market participants on the application of Shariah principles for the ICM.



## Major initiative with Dubai Financial Services Authority

On 15 August 2006, the SC announced the commencement of a joint initiative with the Dubai Financial Services Authority (DFSA) on regulatory alignment designed to facilitate Islamic finance transactions between the Dubai International Financial Centre (DIFC) and Malaysia.

This initiative was announced during the signing of a memorandum of understanding (MoU) between the SC and DFSA. The MoU will facilitate inter-jurisdiction co-operation on enforcement; strengthen channels for information exchange, co-operation and consultation; and promote development and training initiatives.

SC Chairman, Dato' Zarinah Anwar and DFSA Chief Executive David Knott signed the MoU at a ceremony in Putrajaya, witnessed by the Minister of Finance II, Tan Sri Nor Mohamed Yakcop.

The joint initiative seeks to promote optimal implementation and cost effectiveness of cross-border transactions, requiring a streamlining of regulatory standards between Malaysia and the DIFC. In addition, the DFSA will also consider the eligibility of Malaysia as a "recognised jurisdiction" under its fund management laws, which will allow Malaysian unit trust funds to be marketed and distributed in Dubai. To date, the SC has signed 24 MoUs with its foreign counterparts.



## Malaysian Islamic Finance: Issuers and Investors Forum 2006

The inaugural Malaysian Islamic Finance: Issuers and Investors Forum 2006 (MIF) was held on 14–15 August 2006 in Kuala Lumpur and hosted by four major regulators, namely the SC, Bank Negara Malaysia, Bursa Malaysia and the Labuan Offshore Financial Services Authority (LOFSA). The event attracted over 1,000 senior participants from over 30 countries from the Middle East, Asia Europe and the Americas, and 65 of the industry's leading practitioners appeared as panellists.

During the forum, the SC, Bank Negara Malaysia, Bursa Malaysia and LOFSA together with the industry representing the banking, *Takaful* and capital market industry in Malaysia agreed to undertake a set of new initiatives known as the Malaysia International Islamic



Financial Centre (MIFC). The objectives of the MIFC are to provide a catalyst for Malaysia to become a centre of origination, issuance and trading of ICM and treasury instruments, Islamic fund and wealth management services, and international currency Islamic financial and *Takaful* services.

►► page 7

these issuances will be used to finance the Sarawak-based Mukah power plant project.

### Exchangeable sukuk musyarakah by Khazanah Nasional Bhd

In October 2006, Khazanah Nasional Bhd, via a special purpose company – Rafflesia Capital Ltd, launched and priced the world's first issuance of Shariah-compliant exchangeable *sukuk musyarakah*. The *sukuk* is listed on Labuan International Financial Exchange Inc and the Stock Exchange of Hong Kong Ltd, which is a milestone considering that it is the first *sukuk* to be listed on the latter.

The issuance created an exchangeable *sukuk* benchmark for Islamic investors with an innovative structure that is widely accepted by international investors. This is the first *sukuk* issue which incorporates full convertibility features usually seen in conventional equity-linked transactions.

The *sukuk* comprises US\$750 million (RM2.75 billion) 5-year certificates due in 2011 and is exchangeable into ordinary shares of RM1 each of Telekom Malaysia Bhd which are currently held by Khazanah Nasional Bhd. At the end of the offer period, the *sukuk* was oversubscribed by six times, with about 27% subscribed by Middle East investors.



# MALAYSIAN ICM – Q3 2006

## Shariah-based unit trust funds\*

Number of approved funds	
Shariah-based	94
Total industry	392
Net asset value (NAV) of approved funds	
Shariah-based	RM8.91 billion
Total industry	RM108.90 billion
% of Shariah-based to total industry	8.18%

\*As at end-August 2006.

## Shariah-compliant securities on Bursa Malaysia

Number of Shariah-compliant securities – Oct 2006*	886 securities		
% of Shariah-compliant securities to total listed securities	86%		
Market capitalisation (October 2006)			
Shariah-compliant securities	RM494.24 billion		
Total market capitalisation	RM769.08 billion		
% of Shariah-compliant securities to total market capitalisation	64.26%		
Equity market indices			
	30 Jun 06	30 Sep 06	% change
Kuala Lumpur Composite Index	926.63	914.69	(-1.89)
Kuala Lumpur Shariah Index	132.34	132.27	(-0.05)
Dow Jones-RHB Islamic	939.12	957.50	(+1.96)

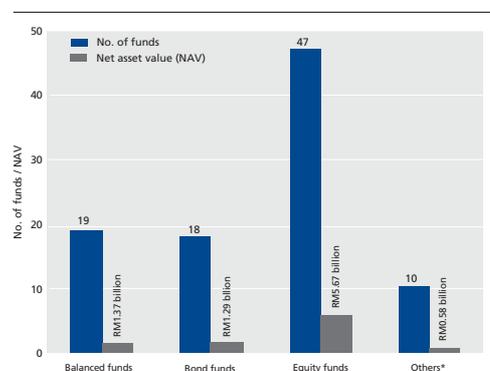
\*The SAC releases the updated Shariah-compliant securities list twice a year in April and October.

## Sukuk

Size of outstanding <i>sukuk</i> * (excluding government <i>sukuk</i> )	RM102.85 billion
% of outstanding <i>sukuk</i> to total outstanding bonds	46.76%
Sukuk approved by the SC in Q3 2006	
Number of <i>sukuk</i>	16 issues
Size of <i>sukuk</i>	RM12.39 billion
Size of total bonds approved	RM20.69 billion
% of size of <i>sukuk</i> to total bonds approved	28.8%

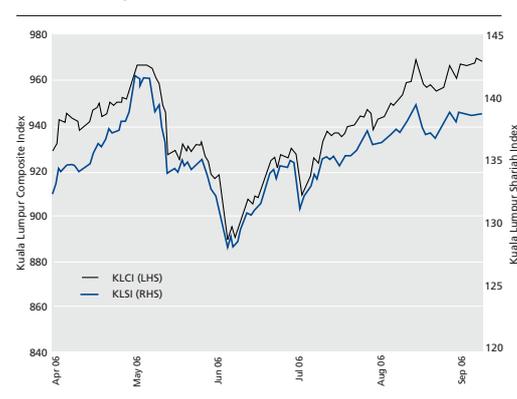
\*As at end-September 2006.

## Shariah-based unit trust funds by category

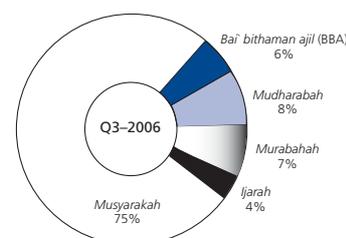


\* Including feeder funds, fixed income funds, money market funds and structured products.

## KLCI vs KLSI performance



## Sukuk approved based on various Shariah principles





**Sukuk approved by the SC in Q3 2006**

Issuer	Shariah principle	Facility	Size of issues (RM million)	Date of issuance	Rating
1 ABS Logistics Bhd	Ijarah	Sukuk	300	n/a	AAA <sub>ID</sub> AA <sub>ID</sub> , A- <sub>ID</sub>
2 Bank Muamalat Malaysia Bhd	BBA	Islamic Subordinated Bonds	250	5 Sep 06	A3
3 EP Manufacturing Bhd	Murabahah	MUNIF/IMTN	120	n/a	MARC-2 <sub>ID</sub> A <sub>ID</sub>
4 Glomac Regal Sdn Bhd	Murabahah	MUNIF/MMTN	175	20 Oct 06	A1 (s) P1 (s)
5 Kinsteel Bhd	Murabahah	CP/MTN	100	28 Aug 06	A <sub>ID</sub> MARC-2 <sub>ID</sub>
6 Kinsteel Bhd	Murabahah	MTN	100	7 Sep 06	A <sub>ID</sub>
7 KNM Capital Bhd	Murabahah	ICP/IMTN	300	18 Oct 06	MARC-1 <sub>ID</sub>
8 Minetech Resources Bhd	Murabahah	MUNIF/IMTN	100	5 Oct 06	A2 P2
9 Mukah Power Generation Sdn Bhd	Mudharabah	Junior Sukuk	285	n/a	A2
10 Mukah Power Generation Sdn Bhd	Mudharabah	Senior Sukuk	665	n/a	AA3
11 Nepline SPV Sdn Bhd	Ijarah	Sukuk	170	n/a	A <sub>ID</sub>
12 Projek Lebuhraya Utara-Selatan Bhd	Musarakah	Zero Coupon Sukuk Series 1	2,260	n/a	AAA
13 Projek Lebuhraya Utara-Selatan Bhd	Musarakah	Zero Coupon Sukuk Series 2	2,410	n/a	AAA
14 Projek Lebuhraya Utara-Selatan Bhd	Musarakah	Sukuk Series 3 MTN	4,500	10 Oct 06	AAA
15 Sarawak Power Generation Sdn Bhd	Musarakah	Sukuk	215	n/a	AA1 P1
16 Syarikat Pengeluar Air Sungai Selangor Sdn Bhd	BBA	Islamic Notes Issuance Master Programme	435	n/a	MARC-1 <sub>ID</sub> AA <sub>ID</sub>
17 NICBM Sukuk Limited*	Musarakah	Sukuk	US\$100 million	n/a	n/a
	<b>Total</b>		<b>RM12,385</b>		

\* Foreign currency-denominated *sukuk* issued by a foreign corporation. The amount is not calculated for the total figure.

n/a: not applicable.



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:

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