



# malaysian ICM

Quarterly Bulletin of  
Malaysian Islamic Capital Market  
by the Securities Commission

## **Disclaimer**

“The Securities Commission of Malaysia does not represent nor warrant the completeness, accuracy, timeliness or adequacy of this material and it should not be relied on as such. The Securities Commission of Malaysia does not accept nor assumes any responsibility or liability whatsoever for any data, views, errors or omissions that may be contained in this material nor for any consequences or results obtained from the use of this information.”



# malaysian ICM

Quarterly Bulletin of  
Malaysian Islamic Capital Market  
by the Securities Commission

AUGUST 2006 VOL 1 NO 2

## CONTENTS

- 1 Enhancing Market  
Awareness

### SHARIAH SECTION

- 2 Kafalah on Mudharabah  
Capital

### REGULATORY SECTION

- 5 Understanding the Shariah  
Framework for Islamic  
Bonds (Sukuk) in Malaysia

### PRODUCT DEVELOPMENT

- 8 Islamic Real Estate  
Investment Trusts  
8 Single Stock Futures  
9 Shariah-based Unit Trust  
Funds

### FEATURES

- 10 Promoting Disclosure,  
Transparency and Governance  
16 Practical Aspects of Islamic  
Securitisation: A Market Primer  
20 Enhancing Capacity Building

### STATISTICAL UPDATES

- 22 Malaysian ICM – Q2 2006

## ENHANCING MARKET AWARENESS

The availability and accessibility of comprehensive information, such as market statistics, updates on product development and regulatory issues are important for the further development of the Islamic capital market (ICM). International and domestic investors need to be well informed if Malaysia is to become a global Islamic financial hub.

As such, the Securities Commission (SC) has produced this quarterly bulletin, the *Malaysian ICM*, which was launched by the Deputy Prime Minister of Malaysia, Dato' Seri Najib Tun Razak, on 10 May 2006, in conjunction with the Malaysia International Halal Showcase (MIHAS) 2006. MIHAS 2006 was held from 10–14 May in Kuala Lumpur, Malaysia.

Through the bulletin, the SC aims to raise the international profile of the Malaysian ICM and create a greater awareness and understanding of ICM matters among domestic and international market participants. The bulletin features the latest news and covers a range of issues, showcasing innovative ICM products and services, and sets out available opportunities in Malaysia.

▶▶ page 4





## KAFALAH ON MUDHARABAH CAPITAL

The introduction of *kafalah* principles in capital market transactions has raised various Shariah arguments. Among the hotly debated issues was whether the usage of *kafalah* on *mudharabah* capital is permissible.

*Kafalah* literally means guarantee. It is defined as a contract which combines one's *zimmah* (liability) with another person's *zimmah*.

It is a contractual guarantee given by the guarantor to assume the responsibilities and obligations of the party being guaranteed on any claims arising thereof. This principle is also applied in loan guarantees, whereby the guarantor assumes the liability of the debtor when the debtor fails to discharge his obligation. This is also known as *dhaman*.

From a contractual perspective, *kafalah* is included in the category of *uqud tauthiqat* (contractual guarantee). However, from the aspect of *tabadul huquq* (transfer of rights), it conveys the meaning of *tabarru* at the inception of the contract and *mu'wadhat* at the end.

Generally, *kafalah* may be divided into two types:

- *Kafalah bi mal* is a guarantee to return an asset to its owner
- *Kafalah bi nafs* is a guarantee to bring someone to specific authority such as the judiciary.

*Kafalah bi mal* can further be classified into three main categories, as follows:

- *Kafalah bi dayn* is a guarantee for the repayment of another party's loan obligation. It means that when a debtor fails to meet his obligation to repay a loan, then the guarantor will assume this obligation

- *Kafalah bi 'ayn* or *kafalah bi taslim* is a guarantee of payment of an item or a guarantee of delivery in a transaction. For example, in a sale and purchase contract, the guarantor agrees to guarantee the delivery of the item to be sold to the purchaser. In the event the seller fails to honour his obligation according to the agreement, the guarantor will be responsible for the delivery

- *Kafalah bi darak* is a guarantee that an asset is free from any encumbrances. This guarantee is used especially for transactions that involve the transfer of titles or rights to ensure that an asset is free from any encumbrances. For example, if A claims and is able to prove that the item bought by B belongs to A, then it will be the guarantor's responsibility to ensure that B gets back the value of his purchase which has been paid to seller A.

On the other hand, *mudharabah* is a contract which involves an agreement between two parties namely *rabb al-mal* (investor) who provides 100% of the fund, and *mudharib* (entrepreneur) who manages the project in accordance with Shariah principle as per their expertise. Any profit from this investment will be apportioned based on the agreed ratio at the inception of the agreement. However, in the case of losses, it will be wholly borne by the *rabb al-mal*.

### Arguments that support the permissibility of kafalah on mudharabah capital

#### *The original law on guarantees for mudharabah capital*

According to the arguments of past Islamic jurisprudence, the jurists were unanimous in their opinion that when losses occur in a *mudharabah* contract, the loss is to be



borne by the *rabb al-mal* and not the *mudharib*, as the latter's status is only *amin* (trustee). However, if it can be proven that the loss was clearly due to *mudharib's* negligence or intentional act, then the *mudharib* is to make good the capital to the investor.

Past Islamic jurists were unanimous in opinion that in a situation where a loss occurs on a *mudharabah*, a capital guarantee by the *mudharib* is not permissible. However, they had different opinions on the status of the contract. The Hanafi and Hanbali *Mazhab* were of the opinion that the contract is valid and the conditional guarantee is nullified. The Maliki and Syafi'i *Mazhab*, however, were of the opinion that the *mudharabah* contract is immediately nullified if there is such a guarantee.

Contemporary Islamic jurists have made studies on the acceptable level of capital in *mudharabah* contracts that can be guaranteed according to the perspective of Islamic jurisprudence. The main issue of concern in relation to capital guarantee is whether the guarantee given will cause the *mudharabah* contract to be nullified since it violates the *muqtadha`aqd* (the main objective of a contract).

They have submitted several solutions on *mudharabah* capital guarantee, including:

- Third-party guarantee based on *tabarru`* (voluntarily given)
- Third-party guarantee based on *qardh* (debts)
- *Mudharib yudharib* (the entrepreneur channels the investor's capital to investing in a third party)
- Guarantee through special funds.

### Third-party guarantee based on *tabarru`*

The OIC Fiqh Academy discussed on the matter of issuance of *sanadat muqaradhah* and summarised that the *mudharib* guarantee on capital and *mudharabah*

profits are not permissible. However, the guarantee may be issued by a third party who has no connection whatsoever with the *mudharib* if it is done by way of *tabarru`* and is not included as a condition in the actual *mudharabah* contract sealed and signed by both parties.

The Shariah Council for Accounting and Auditing Organization for Islamic Institutions (AAOIFI) allowed for third-party guarantees other than by the *mudharib* or investment agent or business partner towards the liability of investment losses. However, this is on the provision that the guarantee given is not tied to the original *mudharabah* contract. The basis of their decision is *tabarru`* which is allowed by Shariah.

Husain Hamid Hassan summarised the basis of the permissibility of third-party guarantee based on the views of Maliki *Mazhab* which allows *wa`d mulzim* (promise that must be kept). It is further strengthened by *maqasid* Shariah (Shariah's objective) which allows for such action.

### Third-party guarantee based on *qardh*

The Fatwa Council of Jordan legitimised third-party guarantees based on debts. This resolution was the basis for drafting the *Muqaradhah Act*, section 12 pertaining to third-party guarantees.

However, the OIC Fiqh Academy disagrees with the basis of third-party guarantees that is based on debt and has resolved that third-party guarantees have to be in the form of *tabarru`*. Otherwise, the contract is deemed to be an interest-bearing debt which is not permissible.

### Mudharib yudharib

Past Islamic jurists also discussed on the issue of *mudharabah* capital guarantee in the context of *mudharib yudharib*. The *mudharib* invests the capital



received from *rabb al-mal* to another party. In other words, the *mudharib* acts as an intermediary between the first *rabb al-mal* and the actual entrepreneur.

Wahbah al-Zuhaili summed up the views of past Islamic jurists on the issue of *mudharib yudharib* that all the four *fiqh* sects collectively agreed that the first *mudharib* shall be responsible for the liability of the guarantee (*dhaman*) if the capital is invested or handed over to another *mudharib* (third party).

Generally, *mudharib yudharib* concept is allowable. If it bears any profit, the profit should be distributed between the *rabb al-mal* and the first *mudharib* based on a preagreed rate and the balance is to be distributed between the first *mudharib* and the second *mudharib*.

For financial institutions and companies that issue financial products based on *mudharabah*, the concept of *mudharib yudharib* may be applied if they invest part of the capital to other parties. If this happens, the financial institutions or companies should guarantee

the capital based on the views of majority of Islamic jurists. Hence, in such a situation the interest of investors is guaranteed.

### Guarantee through special funds

Contemporary Islamic jurists also allow the channelling of a portion of *mudharabah* profits to a special fund created for the purpose of insuring against future losses. This may be done with the concurrence of investors.

Based on the above arguments and references, there are many types of *kafalah* that can be applied to *mudharabah* capital. As a conclusion, there is no definitive indication that the *kafalah* (guarantee) on *mudharabah* capital is prohibited. Shariah only prohibits the *mudharib* (entrepreneur) from guaranteeing its *mudharabah* capital. Therefore, a third-party guarantee on the capital invested based on the *mudharabah* principle is permissible.

---

►► *cover page*

With the growth of the Malaysian ICM comes the need for a new breed of innovators, regulators, advisers and market intermediaries. To equip them with a right blend of capital market knowledge and understanding of Shariah principles, the SC organised two training programmes for different groups of market participants, namely, the Islamic Market Programme (IMP) and colloquium on *sukuk musyarakah* and *sukuk mudharabah*, as well as a special

programme for Shariah scholars, entitled "Shariah Advisers Workshop".

The SC has marked these training programmes as an important agenda in its annual training calendar. These programmes will serve as a platform to create awareness among market participants, allowing them to discuss issues and keep abreast with the fast changes occurring in the ICM.



## UNDERSTANDING THE SHARIAH FRAMEWORK FOR ISLAMIC BONDS (SUKUK) IN MALAYSIA

Islamic bonds are structured based on the foundations of Shariah frameworks. In Malaysia, the Shariah Advisory Council (SAC) of the SC holds the responsibility and is given the mandate to approve the Shariah framework, comprising Shariah rulings and principles for the issuance of Islamic bonds.

The SAC's decisions are based on two major sources of Shariah – primary and secondary. Primary sources are the Quran and the Sunnah; whereas, the secondary sources consist of *ijmak* (consensus of opinion), *qiyas* (analogical deduction), *maslahah* (public interest), *`urf* (custom) and other sources that are in line with the Shariah.

### Shariah rulings on Islamic bonds

The Shariah rulings facilitate and provide guidance in the issuance of Islamic bonds, whereby each and every market participant will be able to base his arguments on a well-understood and well-documented standardised framework. From the Malaysian perspective, the rulings should be observed and adopted where applicable in structuring the Islamic bonds.

### Trading

Secondary trading of Islamic bonds which used the principles of *bai` bithaman ajil* (BBA), *murabahah* and *istisna`* is equivalent to the sale of debt – *bai` al-dayn*. Therefore, it must be sold for cash to avoid sale of debt for debt (*bai` al-kali` bi al-kali`*). However, if the Islamic bonds are structured based on the principles of *ijarah*, *musyarakah* or *mudharabah*, the SAC is of the view that the secondary trading of these bonds does not fall within the category of sale of debt.

### Utilisation of the proceeds

The proceeds raised from the issuance of Islamic bonds can be utilised for various purposes including financing, provided that the instruments used and financing objectives are Shariah compliant. The proceeds can also be used for the general business operations of conventional financial institutions as long as the proceeds are not directly used for any activities and instruments which are prohibited by the Shariah.

### Third-party guarantee on the capital

Issuers of Islamic bonds are allowed to apply third-party guarantee on the capital invested under the principles of *muqaradhah/mudharabah*. It was also agreed that a fee (*ujrah*) is allowed to be paid to the guarantor on the condition that the guarantee should not be on a recourse basis, which means the investors cannot go after the issuers in the event of business failure since the guarantee will be provided by the guarantor. The investors are also allowed to ask for collaterals from the issuers in view of possible gross negligence by the issuers.

### Asset pricing

For the purpose of asset pricing in the course of issuance of Islamic bonds, the SAC has issued the guidelines on asset pricing to facilitate the process of determining the selling price of the asset used as an underlying asset for Islamic bonds which are structured under the principles of BBA and *murabahah*. The SAC has resolved that the selling price of the asset, if it is sold at a premium, should not exceed 1.33 times (one and one-third) of the market value. On the other hand, if the



asset is sold at a discount, the selling price should not be less than 0.67 (two-thirds) of the market value.

To further facilitate the asset pricing process, the SAC has resolved that if the market value cannot be identified, then fair value or any other value that is deemed suitable can be used as long as it is based on willing buyer-willing seller and can be evaluated using appropriate valuation methods.

### **Compensation and rebate**

Investors in Islamic bonds are allowed to impose compensation (*ta'widh*) on late and default payment by the issuers. *Ta'widh* can be imposed after it is found that *mumathil* (deliberate delay in payment) is present on the part of the issuer to settle payment of the principal or profit. The rate of *ta'widh* on late payment of profit is 1% per annum of the arrears and it cannot be compounded. While the *ta'widh* rate on failure to settle the payment of the principal is based on the current market rate in the Islamic interbank money market, it too cannot be compounded. In addition, upon request by the issuers of Islamic bonds for an early settlement, a rebate (*ibra'*) was allowed to be given to investors.

*Ibra'* (rebate) clause for an early settlement can be inserted in the primary legal document of an Islamic bond transaction. The resolution is provided on the basis of *`urf* (custom), *maslahah* (public interest) principles and avoidance of *gharar* (uncertainty). The *ibra'* clause in the primary legal document is considered as *syart* (condition) that is complied with *muqtadha`aqd* (purpose of contract). However, the SAC has advised that the *ibra'* clause is to be separated from

the pricing section in the primary document. The *ibra'* clause can be inserted in the payment and settlement section.

### **Islamic asset securitisation**

Asset securitisation is permissible if the underlying asset to the instrument is Shariah compliant. However, an asset which is in the form of debt structure, such as *murabahah* and BBA receivables cannot be securitised for the purpose of issuing Islamic asset-backed securities structured along the debt principles of *murabahah* and BBA respectively.

### **Floating rate mechanism**

A floating rate mechanism can be applied for Islamic bonds based on BBA, *murabahah* and *istisna`*. This is made possible with the application of a rebate (*ibra'*) element in determining the effective profit rate of Islamic bonds. The effective profit rate will be benchmarked against the movement of the market rate.

### **Underlying Shariah principles for Islamic bonds**

The acceptable Shariah principles adopted by Malaysian issuers are listed in the table on the following page.

In conclusion, it is very important for issuers to observe the Shariah frameworks to ensure that the Islamic instruments issued to the investors are Shariah compliant. By so doing, issuers can play a role in enhancing market confidence in the ICM.



### **Musarakah**

A partnership agreement between two parties or more to finance a business venture whereby all parties contribute capital either in the form of cash or in kind for the purpose of financing the business venture. Any profit derived from the venture will be distributed based on preagreed profit-sharing ratio but a loss will be shared on the basis of equity participation.

### **Mudharabah**

A contract made between two parties to finance a business venture. The parties are *rabb al-mal* or an investor who solely provides the capital and *mudharib* or an entrepreneur who solely manages the project. If the venture is profitable, the profit will be distributed based on a preagreed ratio. In the event of a business loss, the loss shall be borne solely by the provider of the capital.

### **Ijarah**

A *manfaah* (usufruct) type of contract whereby a lessor (owner) leases out an asset or equipment to his client at an agreed rental fee and predetermined lease period based upon the *'aqd* (contract). The ownership of the leased equipment remains in the hands of a lessor.

### **Istisna`**

A purchase order contract of assets whereby a buyer will place an order to purchase an asset that will be delivered in the future. In other words, a buyer will require a seller or a contractor to deliver or construct the asset that will be completed in the future according to the specifications given in the sale and purchase contract. Both parties to the contract will decide on the sale and purchase prices and the settlement can be delayed or arranged based on the schedule of the work completed.

### **Bai` Bithaman Ajil (BBA)**

A contract that refers to the sale and purchase transaction for the financing of assets on a deferred and instalment basis with a preagreed payment period. The sale price will include a profit margin.

### **Murabahah**

A contract refers to the sale and purchase transaction for the financing of an asset whereby the cost and profit margin (mark-up) are made known and agreed by all parties involved. The settlement for the purchase can be settled either on a deferred lump-sum basis or an instalment basis, and is specified in the agreement.





## ISLAMIC REAL ESTATE INVESTMENT TRUSTS

The issuance of the real estate investment trusts (REITs) guidelines by the SC (to replace the existing property trust fund guidelines) has helped kick-start the now-blooming REITs industry in Malaysia. Subsequently, the SC released the *Guidelines for Islamic Real Estate Investment Trusts* (I-REITs Guidelines) to facilitate the introduction of Shariah-compliant REITs. Malaysia became the first jurisdiction in the global financial sector to issue the I-REITs Guidelines. The I-REITs Guidelines was set as the global benchmark for the development of I-REITs.

This latest achievement further enhances Malaysia's leading role in the development of the ICM among the international financial community. This will further promote and accelerate the growth of a competitive ICM in Malaysia. The thrust of the I-REITs Guidelines is to provide clear guidance on and new investment opportunities in collective real estate investments through a Shariah-compliant capital market instrument.

Following the issuance of I-REITs Guidelines, KPJ Healthcare Bhd has assumed the challenge and became the first Malaysian company to establish and launch I-REITs. Known as Al-'Aqar KPJ REIT, the I-REIT was launched on 24 July 2006 and will be listed on the Main Board of Bursa Malaysia Securities Bhd.

KPJ Healthcare Bhd has identified seven hospitals within the group as its main asset class for the establishment of the I-REITs. Damansara REIT Managers Sdn Bhd was appointed as the management company and Amanah Raya Bhd as the trustee.

With the establishment of this I-REIT, KPJ Healthcare Bhd will be able to unlock the value of its properties, and raise funds to reduce its borrowings and expand its business. A total of 340 million units will be issued and KPJ Healthcare Bhd itself will hold 160 million units or 47%, while 165 million units will be issued to institutional investors and 15 million units to the public.

---

## SINGLE STOCK FUTURES

The Shariah Advisory Council (SAC) of the SC recently approved single stock futures (SSF) as a Shariah-compliant instrument, provided that the underlying stocks of the SSF are Shariah compliant. This latest development provides investors with another Islamic investment alternative, as well as a Shariah-compliant risk management tool in relation to Shariah-compliant stocks.

SSF was introduced by Bursa Malaysia Securities Bhd in April 2006 as a tool for managing share price risk and as a more cost-effective way to gain exposure to the equity market.

SSF was approved by the SAC on the basis that the instruments are free of elements pertaining to *muqamarah* (gambling), *bai` ma'dum* (buying and selling something which does not exist), *jahalalah* (ignorance) and *gharar* (uncertainty). The instrument is traded in clear quantities, and pricing is based on market demand and supply.

Based on the SAC's list of Shariah-compliant securities as at April 2006, five of the 10 SSF currently trading on Bursa Malaysia Derivatives Bhd are Shariah compliant, namely AirAsia, IOI Corporation, Maxis Communications, Scomi Group and Telekom Malaysia.



## SHARIAH-BASED UNIT TRUST FUNDS

The move by the government to liberalise overseas investment has positively provided new momentum for the development of unit trust funds in Malaysia. Since the liberalisation move, we have witnessed a few pioneer global funds being introduced in the first half of year 2006. Since then, Malaysians have invested a total of RM1.5 billion in overseas funds. The relaxed exchange control policy set by the government has become a major factor in boosting the demand for investment in global equity funds. Shariah-based unit trust funds were not excluded from the positive impact arising from the liberalisation policy. Unit trust management companies (UTMCs) were encouraged to introduce new and competitive Shariah-based unit trust funds to provide greater investment opportunities.

### Global Islamic equity fund

The first Malaysian global Islamic equity fund was introduced by AmInvestment Management Sdn Bhd known as AmOasis Global Islamic Equity. It is a capital growth fund established using the recently approved "feeder fund" framework. The fund was successfully launched on 21 April 2006 and targeted to achieve moderate capital and income appreciation in the medium to long term by investing in global Shariah-compliant shares. AmOasis Global Islamic Equity invests in the Dublin-listed Crescent Global Equity Fund, which in turn invests in shares of Shariah-compliant companies across the globe – in the US, Europe and Asia. The fund uses the Dow Jones Islamic Market Index as its investment benchmark.

### High net worth global Islamic portfolio fund

To take advantage of the positive impact of the liberalisation policy, RHB Unit Trust Management Bhd recently introduced the RHB Global Islamic Portfolio

Series 1 (GIPS 1). It is the first wholesale closed-ended global fund for high net worth individuals and corporations looking for capital protection.

GIPS 1 will be investing in the Shariah capital principal-protected notes issued by Deutsche Bank AG of London. The note is made up of 70 global Shariah-compliant stocks with the highest earnings potential selected according to various filters and stringent processes.

### Asia Pacific fund

Apart from global funds, regional funds have also become increasingly popular with investors. In view of this, CIMB-Principal Asset Management Bhd introduced Malaysia's first Asia Pacific Shariah-compliant equity fund known as the Asia Pacific Adil Fund. The fund is managed by CIMB-Principal Asset Management Bhd.

Generally, the fund aims to achieve long-term capital appreciation and income through Shariah-compliant investments, such as Shariah-complaint shares, profit sharing debt instruments, and deposits in emerging and developed Asia Pacific markets. The fund has diversified access to Asia Pacific stock markets with almost 788 Shariah-compliant stocks to choose from. The stock selections are derived from the Dow Jones Islamic Market Asia/Pacific Index.

### Islamic equity index fund

An Islamic equity index tracking fund is another new Islamic fund introduced in the Malaysian unit trust industry. RHB Unit Trust Management Bhd introduced the Dow Jones-RHB Islamic Malaysia Index Fund (DRIMIF) which tracks the performance of the Dow Jones-RHB Islamic Malaysia Index. The fundamental objectives of the fund include achieving broad-based equity exposure, predictable variance around the benchmark and exposure at the lowest cost.



## PROMOTING DISCLOSURE, TRANSPARENCY AND GOVERNANCE

### Introduction

Islamic financial services and products are increasingly recognised as having the ability to become a viable option in the range of financial services and products available in international markets today. Enhanced efforts at development and promotion internationally have seen the establishment of the Dow Jones Islamic Market Index, the FTSE Global Islamic Index series and the like. This is a clear recognition of the tremendous potential of Islamic services and products by the global community.

Today, there are more than 250 Islamic financial institutions operating in 75 countries with combined assets in excess of US\$230 billion and an annual growth rate of 12–15%.<sup>1</sup> The size of Islamic equity funds globally is approximately US\$5 billion while the size of Islamic bonds globally is said to be over US\$25 billion. Still, this represents a minute portion of the overall market. Thus the potential for the industry to grow is tremendous.

Malaysia has emerged as a significant player in this segment of the market. As at May 2006, there were 89 Islamic unit trust funds in Malaysia, with a total approved fund size of 52.1 billion units and net asset value of RM8.57 billion, constituting 8.1% of the net asset value of the unit trust industry. The size of the Islamic corporate bond market is RM120.9 billion or 55.0% of the total corporate bond market. In the equities market, 85% of Bursa Malaysia's total listed stocks are classified as Shariah-compliant stocks.

In the face of rapid expansion of this market segment, it is important that we spend some time taking stock of the current trends within the industry and deliberate on the necessary regulatory framework for Islamic finance that can help achieve both the broad objectives

of investor protection – fair, efficient and transparent markets; and reduction of systemic risk – as well as compliance with Islamic principles as required by the Shariah.

### Importance of market discipline

The recent wave of corporate failures around the world has renewed interest in market discipline in financial systems. The concept of market discipline incorporates two distinct components: the investor's ability to evaluate a firm's intrinsic value; and the responsiveness of management to investor feedback impounded in security prices or, alternatively, regulatory feedback triggered by changes in security prices. Markets value well-capitalised and well-managed companies as much as regulators do; therefore, they are capable of creating incentives for companies that manage their businesses in a sound and efficient manner, and disincentives for those that do otherwise.

Enhanced market discipline also paves the way for a more liberalised financial system and reduces the need for regulatory intervention. Since a level of discipline is provided by the market, through counterparty evaluation and monitoring, formal regulation by the authorities can be reduced. This will in effect reduce the overall cost of regulation and help promote greater efficiency in the financial market.

### **Three pillars of market discipline: Disclosure, transparency and governance**

In order to ensure effective market discipline, it is necessary for markets to have access to timely, adequate and accurate information. The three pillars of market discipline – disclosure, transparency and governance –

<sup>1</sup> Daud Vicary Abdullah, "Growth and Development of the ICM", *Islamic Markets Programme (IMP)*, Kuala Lumpur, 10–14 July 2006.



are the prerequisites for an effective system of market discipline since they provide the key in guiding the decisions of shareholders, creditors and other stakeholders.

### ***Disclosure***

For disclosure to be effective, financial statements and reports must be timely, comprehensive and relevant. They must reveal the results of the stewardship and accountability for the management of resources. Sound auditing and accounting standards are therefore essential, and audit committees and external auditors must provide honest, independent judgement which will enable investors to make informed decisions.

Similarly, company managers must ensure that public disclosures clearly identify all significant risk exposures and their effect on the firm's performance and potential. In the long run, disclosures will benefit well-managed companies by allowing them access to funds in the market at rates that reflect their sound management.

### ***Transparency***

Disclosure, however, is not necessarily synonymous with transparency. Thus information disclosed must be provided in context – to provide market participants with the ability to accurately assess the firm's performance, values and its risk profile. Transparency allows investors to make more informed decisions on how best to allocate their resources. Because capital is directed to its most productive uses, transparency will result in improved resource allocation and enhanced market efficiency.

### ***Governance***

Effective disclosure and transparency as tools of market discipline are predicated on good governance.

Following the major corporate failures of recent years, the process and quality of governance must be high on the agenda of directors of corporations. Good governance requires focus not only on compliance auditing and oversight, but also on performance of the corporation, i.e. is it doing the right things (investment initiatives) necessary to achieve its strategic objectives and are those initiatives being undertaken satisfactorily in order to ensure that wealth is created. The International Federation of Accountants Committee (IFAC) introduced the concept of enterprise governance which requires corporations to maintain focus both on conformance and performance to ensure that governance addresses adequately the issue of wealth creation. Investors, in turn, must harness their efforts to exert influence on management to ensure appropriate corporate conduct, thus promoting transparency and shareholder value in the long term.

### ***Promoting disclosure, transparency and governance through disclosure-based regulation (DBR)***

It is ironic but true that disclosure, transparency and governance, as tools of market discipline, must be facilitated by an appropriate regulatory framework that imposes certain standards of disclosure, penalises disclosure of false and misleading information, and effectively puts the onus on the investors to make informed decisions about the merits of a particular investment based on the information available.

The guiding principle used in formulating such a disclosure-based framework in Malaysia was that there be sufficient and accurate disclosure of all relevant information pertaining to the company's business, finances, prospects and terms of the securities to allow potential investors to make their own informed investment decisions. The focus will be on whether the applicable standards of disclosure were complied with, and whether sufficient due diligence was performed on the information disclosed.



As a result of the shift to DBR, Malaysia's regulatory framework demands enhanced standards of disclosure and governance which are backed by strong penalties. Companies and their advisers bear a heavier responsibility with regard to the accuracy and completeness of the information disclosed. Investors are also required to assume a higher level of responsibility in evaluating the risks of a particular offering based on the disclosed information before investing.

### Regulatory framework for Islamic capital market

The point has to be made that the same regulatory framework applies across the board regardless of whether it is the conventional or the ICM that is being regulated. ICM products should not be exempted from meeting the set requirements for disclosure, transparency and governance. Consequently, regulators often rely on a two-tier approach to regulate the provision of Islamic financial services and products in order to ensure that the goals and objectives of securities regulation are not compromised. These products and services must comply with both the general conventional requirements (i.e. the first tier) and specific requirements by virtue of being an Islamic service or product (i.e. the second tier).

#### First tier

In Malaysia, pursuant to the first tier, all issuers of Islamic products are obliged to comply with disclosure requirements relating to prospectuses or trust deeds. Similarly, Islamic financial intermediaries are subject to the full range of requirements related to their activities, for example, disclosure of interests in the provision of investment advice and the segregation of client monies in trust accounts. Listed Islamic financial intermediaries are also subjected to the conventional capital market requirements and disclosure standards derived from statutes and the listing requirements.

The Islamic financial system is generally based on four tenets, which are–

- risk sharing – the terms of financial transactions need to reflect a symmetrical risk/return distribution for the respective participants in the transaction
- materiality, in that it must relate to a real economic transaction
- no exploitation – a financial transaction should not lead to the exploitation of any party in the transaction
- no financing of *haram* or sinful activities, for example, gambling.

#### Second tier

ICM products and services are subjected to a second-tier regulation, complying with the Shariah.

Where feasible, the additional requirement for Shariah compliance is added on to the existing first-tier regulations. For instance, the *Guidelines on Unit Trust Funds* applies generally to all unit trust funds but there is an additional section that must be complied with by Islamic unit trust funds. These additional requirements relate to, among other things, the appointment of a Shariah committee or adviser, specific reporting requirements, and the appointment of a designated compliance person.

Where this is not feasible, modifications are made to the first-tier regulation. The regulation of Islamic corporate bonds is a case in point. "Debentures" are defined in section 2 of the *Securities Commission Act 1993* (SCA) in a manner that requires the element of indebtedness of a corporation, and this is reflected in the private debt securities (PDS) guidelines issued by the SC in 2000. Because all Islamic bonds were issued pursuant to the PDS guidelines, such issuance were restricted to those based on the principles of debt



obligation, such as *bai` bithaman ajil*. The PDS guidelines could not be used for the issuance of Islamic bonds structured using principles of *musyarakah* and *mudharabah* which are based on some kind of equity ownership in the asset or business rather than a debt obligation. As a result of the definition in the first-tier regulation, Islamic bond development was impeded.

To remedy this, after extensive consultation with the industry, the SC decoupled Islamic bonds from the definition of debentures and introduced a new term "Islamic securities" to the SCA by way of a prescription order. The *Guidelines on the Offering of Islamic Securities* was also introduced, recognising that certain types of Islamic bonds will have features more akin to equity rather than debt products, and that this would entail the need for additional disclosure requirements through the issuance of an information memorandum to prospective investors to cover relevant disclosures.

### Ensuring effective disclosure without imposing undue regulatory cost

It is trite but true that for ICM products and services to be acceptable to all investors and issuers, it is absolutely vital that they comply with universally accepted principles of securities regulation, i.e. they must provide the same level of protection for investors, be offered within markets that are fair, efficient and transparent, and must not be more susceptible to systemic risks than the conventional products. They must also be offered on terms, which are just as or more attractive and cost-effective than the conventional products in order to be competitive.

However, ICM products have to conform to Shariah principles and Muslims who subscribe to these products and services do so for these reasons. Regulators, therefore, have to ensure that ICM products and services are indeed true to label and

that the trust in the system is safeguarded.

The adoption of the two-tier approach to regulation is to ensure compliance with the Shariah principles. This two-tier approach is not unique to the regulation of Islamic services and products. Similar additional requirements are also imposed on ethical trust funds to ensure that investors obtain what they purchase.

However, the additional tier of requirements often means additional costs. The regulatory cost of prescriptive regulations of this nature may be more significant than mere disclosure requirements. However, it is felt that this is necessary for investor protection and market assurance, given that Islamic finance is still in its early stages of development. The cost to the market in terms of loss of investor confidence and reputation will be far greater should products and services turn out to be not true to label. However, in time to come, the level of regulatory intervention will decrease as the market matures and it is able to self-regulate.

### The correlation between disclosure, transparency and governance in Islamic finance

Market discipline applies across the markets in Malaysia irrespective of whether it is the conventional or the Islamic market. However, the components of market discipline – governance, disclosure and transparency – are even more pertinent in the context of the ICM. The risk sharing principle, which is based on Islamic concepts of partnership and profit sharing, underscores the need for disclosure, transparency and governance. In carrying out any financial transaction, the Shariah requires parties to settle in advance the terms and conditions for redistribution of profits and for there to be proper record keeping.<sup>2</sup> Subsequently, it is the practice for parties to make full disclosures of their value and risks, so these contracts can be drawn in advance.

2 Verses 282–3 Surah Al Baqarah of the Holy Quran.



In addition, because of the Shariah precept that all wealth creation should result from a partnership between the investor and user of capital, the relationship between the parties is always based on trust. Thus, ICM participants are obliged to make known not only their positions and risks in a transparent manner but also how the money or property held in trust by them is managed.

The risk/reward element also means that the returns to capital must be tied to the profits generated from the capital rather than a predetermined interest rate. Subsequently, financial forecasts and year-end results will also have to be reported accurately and in a timely fashion so that the profits can be calculated precisely and distributed fairly based on the capital infused and the contract terms agreed upon earlier.

Recognising that effective disclosure and transparency require proper governance, in Malaysia for example, the SC also requires that all bond and unit trust issuers consult a Shariah adviser to obtain confirmation on the Shariah status of their products. This helps preserve the integrity of the market as any weakness or fault lines here would have the effect of undermining the confidence of the markets in the product and ICM as a whole.

However, it must be emphasised that the Shariah gatekeepers must rely on directors and managers of companies to provide them with the information necessary to make the requisite assessment. If Shariah advisers do not get accurate and comprehensive information from the companies concerned, then their assessment could be inaccurate. For example, in screening listed companies to ensure whether they can be classified as Shariah-compliant stocks, the SC's Shariah Advisory Council examines the financial reports and other information that they require from the companies. If these companies fail to disclose the requisite information or provide information that is

misleading, the screening process becomes inaccurate. The need for directors and managers of companies to act honestly in providing full and accurate information cannot be overemphasised.

### **Addressing the remaining challenges**

Although Islamic finance is growing rapidly, it is nonetheless still undergoing substantial development and innovation; thus challenges remain significant. Among others, the issue of accounting standards and integrated supervision are two critical areas that warrants additional attention.

#### ***Accounting standards***

One of the key tenets to enhancing the overall quality of standards in Islamic finance is to ensure the applicability of internationally acceptable and high quality accounting standards. Application of accounting standards and practices in Islamic finance currently is not uniform, with some countries applying international accounting standards issued by the International Accounting Standards Board (IASB) while some others have chosen to adopt Islamic standards issued by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI). Some other jurisdictions are formulating their own national Islamic accounting standards.

The challenge is to develop a globally acceptable and high quality financial reporting framework for Islamic financial services that will reflect the characteristics of Islamic finance and yet ensure that investors and users of financial statements have access to information of the same level of reliability and quality that they are demanding in the conventional markets. Achieving this objective can go a long way in enhancing the profile and acceptability of Islamic products globally.



### ***Integrated supervision and regulation for Shariah***

On the issue of integrated supervision, while the Islamic financial market has been a growing niche within the modern financial sector, its growth has not been accompanied by the emergence of a coherent body of governing rules and regulations intrinsic to the Islamic perspective. The development of Islamic finance and regulators of Islamic financial markets can certainly benefit from an integrated supervision and regulation of the unique risks associated with Islamic financial products.

The establishment of the Islamic Financial Services Board (IFSB) in 2002 is certainly an important initiative that can contribute towards achieving this objective. The IFSB is currently developing international prudential and supervisory standards, and best practices for Islamic financial institutions.

Similarly, recognising the growing importance of ICMs, and the need to address regulatory issues and challenges, the International Organization for Securities Commissions (IOSCO) established a task force on ICMs, chaired by Malaysia. The task force has recently released a report on the state of development and regulation of the ICM globally.

The task force found that the ICM constitutes a segment of the wider securities market and that the conventional

securities regulation framework and principles apply equally to the ICM with the addition of some form of Shariah approval or certification process. This finding is significant as the task force postulates that ICM products and services may be introduced and developed within any existing well-structured securities market.

The challenge is not only to ensure greater uniformity in regulation and practices to achieve a satisfactory level of protection for investors but also to ensure that these rules accommodate the need for compatibility and acceptability within the international regulatory framework.

### **Conclusion**

There are vast opportunities to be tapped globally for Islamic finance, not just by the Muslim investor community, but by all participants in the global financial market. High standards of disclosure, transparency and governance will ensure sufficient levels of investor confidence that can pave the way for the development of a robust and credible market. Indeed the major challenge in the development of Islamic finance is the need for it to be integrated within the global architecture. Thus, the twin approach of ensuring compliance with the Shariah, and developing internationally acceptable standards of conduct and discipline can be the key to success.





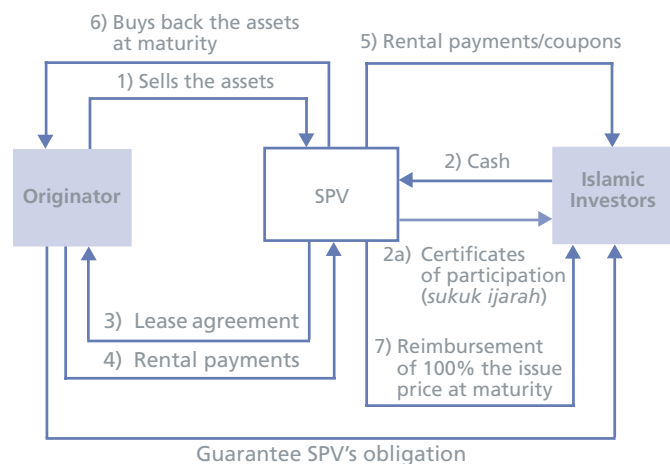
## PRACTICAL ASPECTS OF ISLAMIC SECURITISATION: A MARKET PRIMER<sup>1</sup>

In an internationally globalised and interconnected financial world, Islamic finance has made headway and continues to expand within a global context. Of the array of creative Islamic financing techniques gradually coming of age, one that has emerged as a merit of financial ingenuity is asset securitisation. In order to appreciate the importance of securitisation to Islamic institutions, one must learn the process of securitisation itself, the specific concerns of Islamic institutions in the securitisation process, as well as the restrictions of these institutions when participating in securitisation.

At its core, the technique of asset securitisation involves companies raising funds against their income generating assets or receivables. Assets that can be transformed in this manner include residential mortgages, auto loans, leases and utility payments. Asset securitisation differs from collateralised debt or traditional asset-based lending in that the loans or financial claims are assigned or sold to a third party, typically a special-purpose company or trust. This special purpose vehicle (SPV), in turn, issues one or more debt instruments – asset-backed securities (ABS) – whose interest and principal payments are dependent on the cash flows from the underlying assets.

The crux of asset securitisation is the severance of good assets from a company or financial institution and the use of these assets as backing for high-quality securities that appeal to investors. As securitisation in the Islamic context is more concerned about the Shariah acceptability of the assets in the pool rather than the process of securitisation itself, the said assets are usually of the highest quality. A *sukuk* (i.e. Islamic bond issue) is then issued, providing the investor with ownership in the underlying asset.

### Sukuk al-Ijarah – Asset-based transactions



Source: Aseambankers Malaysia Bhd

Advantages arising from securitisation-type transactions include; the transformation of relatively illiquid financial assets into liquid assets, lower cost of funding to the issuer due to ratings improvement, diversification of funding sources, off-balance sheet treatment of debt resulting in improved gearing, and the more efficient use of regulatory capital. Asset securitisation techniques have been embraced by a number of Islamic countries seeking to promote home ownership to finance infrastructure growth and develop their domestic capital markets.

Nevertheless, the case for securitisation is actually much stronger than this. Asset securitisation, if introduced in a transparent and orderly fashion, offers additional gains from capital market development, as more high-quality securities are added to the fixed-income market. ABS is also a source of funds for rapidly growing, capital-constrained banks, finance and industrial companies whose expansion depends on the extension of credit

<sup>1</sup> Extracted from a presentation given by Baljeet Kaur Grewal of Aseambankers Malaysia Bhd at the Islamic Markets Programme (IMP), which was held at the Securities Commission, Kuala Lumpur from 10–14 July 2006.



**Benefits of securitisation**

Originators	<ul style="list-style-type: none"> <li>• Transforming relatively illiquid assets into liquid and tradable capital market instruments</li> <li>• Cheaper financing costs due to higher rating via credit enhancement</li> <li>• Allows diversification of financing sources</li> <li>• Facilitates removal of assets from the organisation’s balance sheet</li> </ul>
Investors	<ul style="list-style-type: none"> <li>• Provides a variety of product choices at attractive spreads that attract a diversified investor profile</li> <li>• Variety and flexibility of credit, maturity and payment structures and terms via securitisation techniques that allow investment products to be tailored to meet specific investor needs</li> </ul>
Capital Market	<ul style="list-style-type: none"> <li>• The existence of secondary securitisation markets for benchmark purposes</li> <li>• Facilitates and encourages efficient allocation of capital</li> <li>• Reduction of risks within the banking system</li> </ul>

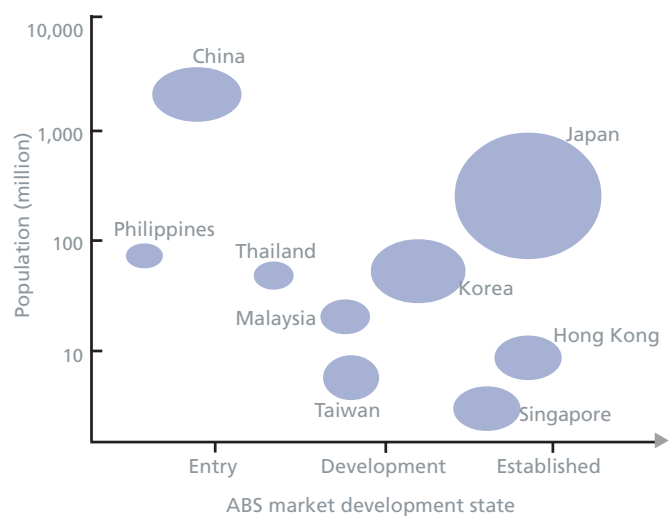
Source: Aseambankers Malaysia Bhd

to their customers. The potential for financing of infrastructure projects, such as toll roads, that produce reliable revenue streams capable of being contractually assigned to a separate legal entity adds to the allure of ABS. In summary, there is a strong argument favouring the growth of asset securitisation in emerging economies with developing capital markets.

For many Islamic financial institutions that face a dearth of risk-management tools, asset securitisation can open up a new avenue of funding that enhances their ability to match the maturities of their assets and liabilities. ABS securities also offer yields exceeding those on comparable corporate bonds while providing an opportunity to diversify a fixed-income portfolio by adding another class of securities.

One very crucial challenge and prerequisite to the growth of the Islamic securitised market has been the inculcation of market awareness and understanding of its varied investment opportunities, contributing to the diverse stages of progression in Islamic finance. Hence, the question of whether or not Islamic banks should participate in this dynamic market remains rhetorical; it is the “how” which intrigues market observers. In the Islamic framework for securitisation, there are three identifiable challenges to Islamic institutions:

**Market potential and readiness for securitisation in Asia**



Sources: GNP and population estimates by World Bank, World Development Indicators

- The type of asset to be securitised
- The structure of securitisation itself
- Credit enhancements must be in its permissible form.

As securitisation is developed primarily in non-Islamic financial markets, the assets typically included in securitised pools do not necessarily conform to Islamic principles. The assets in conventional structures are



typically interest-bearing debt instruments, such as credit card receivables, conventional mortgages, etc. which are not permissible under Shariah law. Therefore, it is essential for Islamic banks to originate their own Islamic-acceptable assets within the pool of Shariah-compliant assets. According to this prescribed guidance, the assets to be securitised might include leasing contracts across different business lines, for instance, equity ownership/participation certificates (i.e. *musyarakah*), *murabahah* contracts and tangible assets (i.e. mixed asset *sukuk*), Islamic mortgages and short-term money market instruments (i.e. *sukuk al-salam*).

Sound titling of the assets securitised also contributes to the success of the transaction. In terms of ownership of these assets, there is currently a great diversity of laws relating to foreign ownership of assets within Islamic countries, such that it may not be possible for a foreign-incorporated issuance vehicle to own the underlying assets. On the contrary, local laws may inadvertently disallow foreigners to own the *sukuk* (which limits the investor base/target market), or may not even provide for the issuance of *sukuk* as a valid corporate financing instrument.

In studying the structure of securitisation under Islamic philosophy, in essence, its features do not differ greatly from those of conventional type securitisation structures. The major players comprise the originator, trustee, servicer, SPV, investment bankers, credit enhancer and rating agencies. Devoid of examining in great detail the specific roles and functions in the securitisation process, the differences in responsibilities under Islamic philosophy are as follows:

- The securities issued by the SPV are claims on assets held by the issuer SPV. These claims are closely attached to the ownership of such assets
- When assets are not sold to an incorporated SPV, they are sold to a trust which takes the form of either a guarantor trust or an owner trust. Trusts are created

and managed by trustees for the benefit of beneficial owners

- Accordingly, ABS does not guarantee a predetermined rate of return but a variable one depending on the performance of the assets under securitisation
- Investment bankers underwrite the securities for public offering or place them privately to institutional or wealthy investors, while rating agencies provide the necessary rating, based on certain recommended level of credit enhancement
- The credit enhancer provides the required credit as part of the fund generated from asset cash flows, collateral pledged to support assets, or guarantee in order to obtain sound credit rating
- The pass-through securitisation structure (a pass-through represents direct ownership in a portfolio of assets that are usually similar in terms of maturity, yield, and quality) can be visualised as the closest arrangement that satisfies Islamic principles.

The use of credit enhancements in a transaction should not change the character of the structure, but merely “augment” the credit of the debt within. There are various types of credit enhancements; for example, overcollateralisation, ownership rights to assets, creation of spread/reserve accounts, bank letters of credit, retainer on purchase, liquidity facilities or straight subordination.

Given the above, what are the over-riding challenges posed by Islamic securitisation structures? Securitisation within the realms of acceptable Shariah laws is still a fairly pristine concept. As in all financial structures in their formative stages of development, untested market processes pose numerous challenges to market participants. Among the more glaring issues include the legal and tax implications of an ABS transaction (i.e. specific tax legislation to deal with asset securitisation, each transaction tends to be on a case-by-case basis),

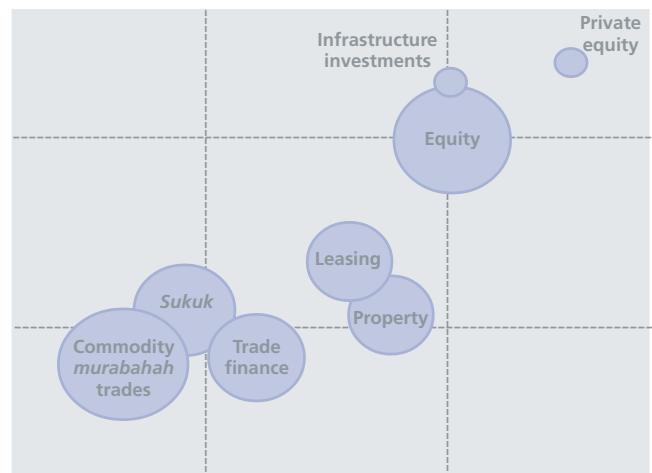


as well as clarity on accounting issues. Augmenting market knowledge among issuers and investors is also key in enhancing capital market development – a number of securitisation deals have been stalled due to the market’s reluctance in accepting papers rated lower than AA.

Moving forward, corporate needs will drive the evolutionary development of the Islamic securitised market. Securitisation for small and medium enterprises, for instance, provides an avenue for small enterprises to tap the benefits of debt markets, and the off-balance sheet treatment of asset securitisation allows smaller entities to leverage beyond their balance sheet limitation, and scale up to a greater capacity of business activity to enhance returns. The dynamics of an ABS transaction itself will also propel this market forward, in that securitised transactions are asset-backed, and hence, the regulatory environment needed to operate is less restrictive, i.e. because the transaction structure is transparent and provides the investor with direct recourse to the assets, the transaction is enabled even without a fully mature regulatory environment.

Overall, most Islamic institutions have long endured the need to transact with financial intermediaries whose vast interest-based products are not acceptable

**Potential for Islamic securitisation**



**The Islamic wealth management landscape by asset value depicts potential growth for securitisation and sukuk**

Source: Failaka International, Islamic Banker

according to Islam. Securitisation enables Islamic institutions to bypass these shortcomings and unequivocally engage with the assets to be financed, and with investors in the pools of these assets. It also enables Islamic institutions to progressively partake in financial engineering and product innovation, while preserving the uniqueness of Islamic finance. The key challenge in moving forward will be to ensure the sustainability of the Islamic securitisation market in contributing to the resilience of the overall financial architecture.



## ENHANCING CAPACITY BUILDING

The development of human capital is absolutely crucial for the growth of the ICM. With market changes occurring at breakneck speed, coupled with the advent of technology, the ICM industry must ensure that it has the capacity and the capability to deliver effectively to meet the needs of market participants. In this regard, having a large pool of Shariah experts and professionals of high calibre is vital as they are required to undertake increasingly challenging roles and responsibilities.

### Islamic Markets Programme

Understanding this importance, the SC through the Securities Industry Development Centre (SIDC), organised an inaugural Islamic Markets Programme (IMP) from 10–14 July 2006. The main objective of this annual high-level workshop was to share and communicate the current issues in product development, as well as to build and enhance the manpower and technical capacities in the ICM. The workshop was also designed to provide a comprehensive training platform for promoting the sharing and transfer of knowledge in the ICM among market intermediaries, consultants, issuers, investment strategists, stock market professionals, senior finance executives, institutional investors, corporations, securities market regulators, government representatives and academicians.

Dr Mohd Daud Bakar, Malaysia's international figure in Islamic finance and also a member of Shariah Advisory Council (SAC) of the SC, was the principal of the workshop. This five-day workshop covered important aspects of Islamic finance, which included topics on developments in the global ICM, Islamic bond structures, Islamic real estate investment trusts (REITs) and issues on regulation. These topics were presented during the workshop by reputable speakers from various financial institutions, including the SC.

The workshop attracted a total of 31 participants. Apart from Malaysian participants, there were also participants from Brunei, Indonesia, Japan and Qatar. This workshop enabled them to exchange ideas, keep abreast with emerging trends and developments, and enhance their knowledge on new ICM products and services.

The SC also organised various special sessions as part of its capacity building initiative. The special sessions included the following:

### Colloquium on sukuk musyarakah and sukuk mudharabah

The SC organised a colloquium on *sukuk musyarakah* and *sukuk mudharabah* on 3 May 2006. It was part of an ongoing effort to enhance awareness and educate market players on various *sukuk* structures that were developed and used in Malaysia and other parts of the world.

This colloquium was attended by members of the SAC, registered Shariah advisers, members of the SC's Islamic Capital Working Group, and heads of investment banks and rating agencies. Altogether, 53 participants attended the event.

Distinguished speakers from various financial institutions were invited to present their papers on various topics during the event. Among the topics discussed in the one-day programme were as follows:

- Overview on the development of *sukuk musyarakah* and *sukuk mudharabah* in the global ICM
- *Sukuk musyarakah* and *sukuk mudharabah* – Malaysian structure



- Global structure of Islamic securitisation – *Sukuk musyarakah* and *sukuk mudharabah*
- Issues in Islamic securitisation adopting profit sharing, or profit and loss sharing
- Assessing risk profile in *sukuk musyarakah* and *sukuk mudharabah*

The colloquium concluded with a panel discussion on “the future for *sukuk musyarakah* and *sukuk mudharabah* towards enhancing international connectivity”. Following the success of the colloquium, another was planned for next year.

### Shariah Advisers Workshop

On 21 June 2006, the SC organised a Shariah Advisers Workshop entitled “Enhancing Understanding and

Participation of Shariah Advisers in the Islamic Capital Market”.

The main objective of the workshop was to educate, expose and enhance the understanding of Shariah advisers on issues pertaining to Shariah-compliant securities, Shariah-based unit trust funds and Islamic REITs. In addition, this workshop could encourage the Shariah advisers to be more effectively involved in the ICM industry, as well as to increase their capability and professionalism.

A total of 52 Shariah scholars registered with the SC and Bank Negara Malaysia, as well as the members of SAC attended this workshop. Speakers from the SC presented papers on Shariah-compliant securities, Shariah-based unit trust funds and Islamic REITs.

The SC plans to organise the 2nd Shariah Advisers Workshop in September 2006 on Islamic bonds.



# MALAYSIAN ICM – Q2 2006

## Shariah-based unit trust funds\*

Number of approved funds	
Shariah-based	89
Total industry	364
Net asset value (NAV) of approved funds	
Shariah-based	RM8.57 billion
Total industry	RM105.38 billion
% of Shariah-based to total industry	8.13%

\*As at end-May 2006.

## Shariah-compliant securities/shares

Number of Shariah-compliant securities – Apr 2006*	871 securities		
% of Shariah-compliant securities to total listed securities	85%		
Market capitalisation (June 2006)			
Shariah-compliant securities	RM459.06 billion		
Total market	RM721.79 billion		
% of Shariah-compliant securities to total market	63.6%		
Equity market indices	30 Mar 06	30 Jun 06	% change
KL Composite Index (KLCI)	926.63	914.69	(-1.89)
KL Shariah Index (KLSI)	132.34	132.27	(-0.05)
Dow Jones-RHB Islamic	939.12	957.50	(+1.96)

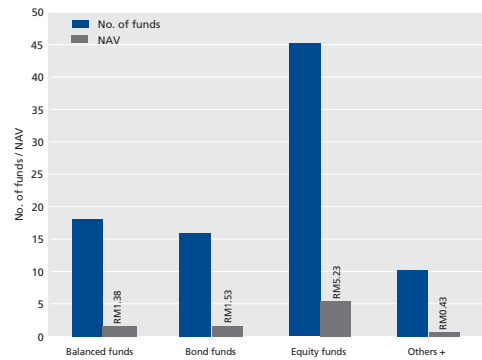
\*The SAC of the SC releases the updated Shariah-compliant securities list twice a year in April and October.

## Islamic bonds (IBs)

Size of outstanding IBs* (excluding government bonds)	RM120.94 billion
% of outstanding IBs to total outstanding bonds	55.0%
IBs approved by the SC in Q2 2006	
Number of IBs	15 issues
Size of IBs	RM4.31 billion
Size of total bonds approved	RM14.98 billion
% of size of IBs to size of total bonds approved	28.8%

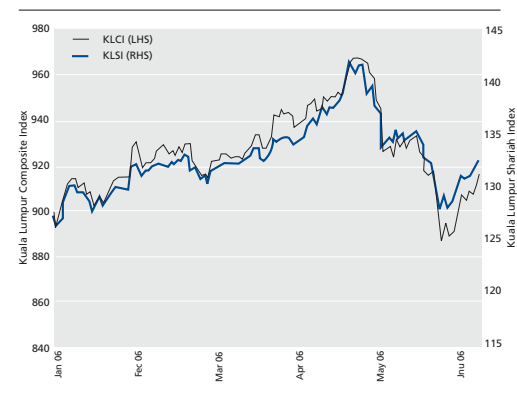
\*As at end-June 2006.

## Shariah-based unit trust funds by category

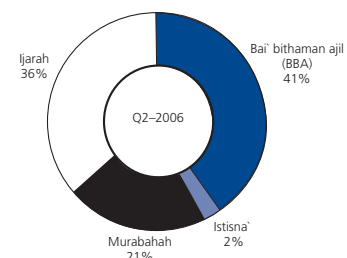


+ Including feeder funds, fixed income funds, money market funds and structured products.

## KLCI vs KLSI performance



## IBs approved based on various Shariah principles





## Islamic bonds approved by the SC in Q2 2006

Issuer	Shariah principle	Size of issues (RM million)	Date of issuance	Rating
1. England Optical Group (M) Sdn Bhd	Murabahah	60	n/a	P2
2. Symphony House Bhd	ICP/MTN	100	n/a	A <sub>ID</sub> MARC-2 <sub>ID</sub>
3. Segari Energy Ventures Sdn Bhd	Ijarah	930	11 May 06	AA1
4. Malayan Banking Bhd	BBA	1,500	15 May 06	AA1
5. Kwantas SPV Sdn Bhd	Ijarah	155	19 May 06	AAA <sub>ID</sub> AA <sub>ID</sub> A+ <sub>ID</sub>
6. Zecon Toll Concessionaire Sdn Bhd	BBA	60	14 Jul 06	A+ <sub>ID</sub>
7. RE Power SPV Sdn Bhd	Istisna`	88	n/a	AA- <sub>ID</sub> A+ <sub>ID</sub>
8. FEC Cables (M) Sdn Bhd	Murabahah	130	14 Jun 06	AA2 (s)
9. FEC Cables (M) Sdn Bhd	Murabahah	20	14 Jun 06	P1 (s)
10. Poh Kong Holdings Bhd	Murabahah	200	n/a	A2 P1
11. Dura Palms Sdn Bhd	Ijarah	284	28 Jun 06	AAA <sub>IS</sub> AA <sub>IS</sub> A <sub>IS</sub>
12. Viable Chip (M) Sdn Bhd	BBA	135	n/a	A+
13. Viable Chip (M) Sdn Bhd	BBA	50	n/a	AAA
14. Perwaja Steel Sdn Bhd	Murabahah	400	n/a	A
15. Diversified Venue Sdn Bhd	Ijarah	200	n/a	AA <sub>ID</sub>
	<b>Total</b>	<b>4,312</b>		

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:

Mr Nik Ruslin Nik Jaafar  
**Islamic Capital Market Department**  
Tel: 03–6204 8000 ext 8589  
E-mail: [ruslin@seccom.com.my](mailto:ruslin@seccom.com.my)

Dr Md Nurdin Ngadimon  
**Islamic Capital Market Department**  
Tel: 03–6204 8000 ext 8105  
E-mail: [nurdin@seccom.com.my](mailto:nurdin@seccom.com.my)

Mr Zainol Ali  
**Islamic Capital Market Department**  
Tel: 03–6204 8000 ext 8666  
E-mail: [zainol@seccom.com.my](mailto:zainol@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](http://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