

Regulation of Syariah Funds in Malaysia

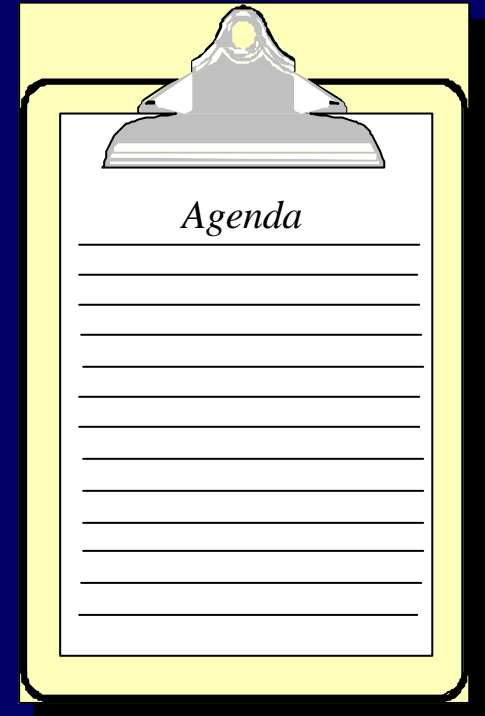
Securities Commission

KL Hilton 27 March 2001



Agenda

- ① **The Malaysian capital markets**
- ② Establishing a new trust fund
- ③ Regulation of Syariah funds
- ③ Developmental issues



Regulation of the financial system

The principles and objectives for regulations include ...

- Create commercial and legal certainty for each person's functions and responsibilities
- Ensure adequate investor protection
- Provide a flexible regulatory framework
- Increase level of professionalism among intermediaries and institutions



... and ...

- Uphold market and financial integrity
- Enhance market transparency
- Promote operational efficiency
- Facilitate innovation
- Ensure systemic stability



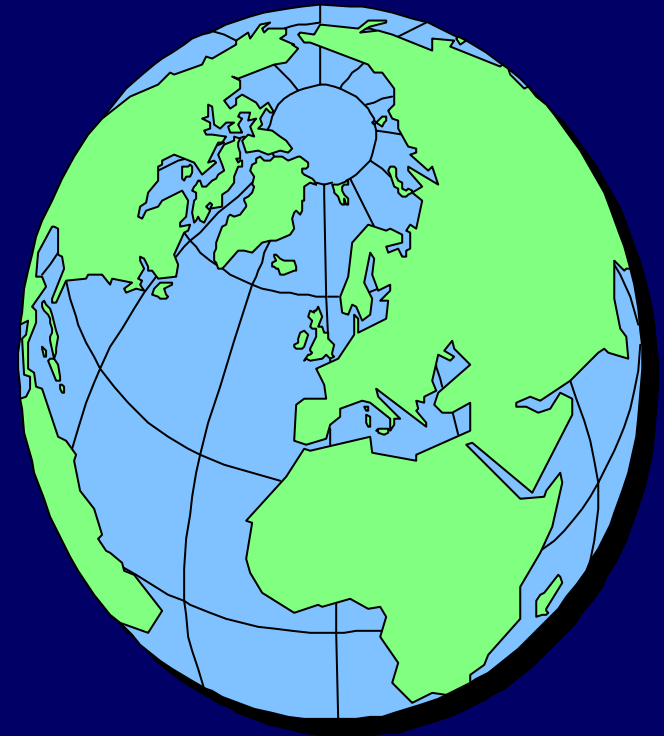
... but most important of all, ...

... all of these principles and objectives of regulation are aimed at re-enforcing and strengthening the most important element in any financial system, that is investors CONFIDENCE.



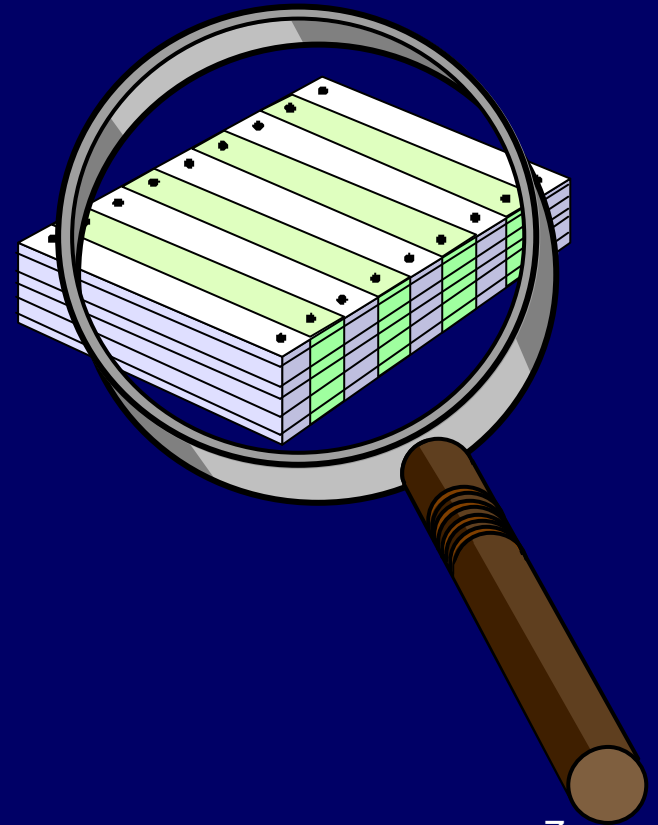
The change in the financial landscape brought about by ...

- Product and market innovation
- Technological and communication advancement
- Globalisation
- Liberalisation
- Competition
- Increasing investor sophistication and awareness



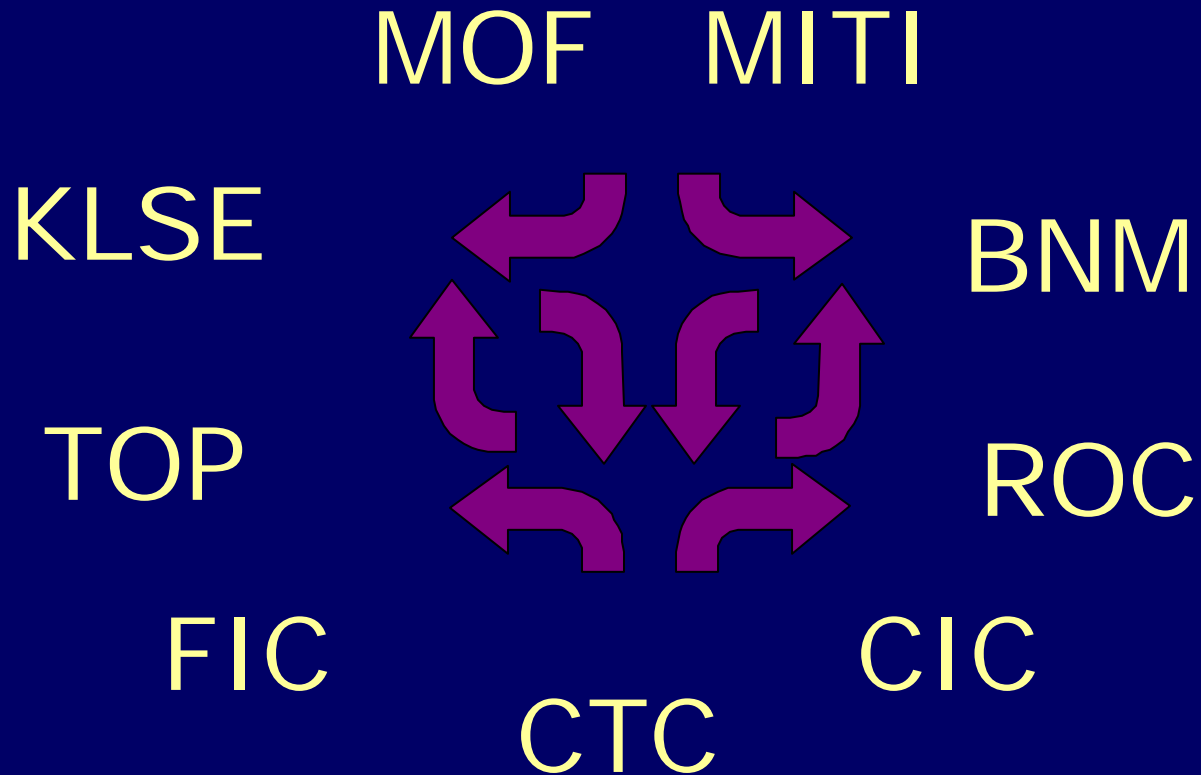
... has compelled regulatory authorities ...

... to continuously review the regulatory framework for the capital market



Prior to 1993 ...

...the regulatory structure was cumbersome and multi-tiered



... but it was streamlined ...

... with the establishment of the Securities
Commission on 1 March 1993



The regulatory framework was streamlined further through ...

- Consolidation of the commodity and financial futures in 1997;
- Rationalisation of fund raising provisions in 2000; and
- Rationalisation of the bond market framework in 2000.



Consistent with its mandate to regulate and develop the capital market, ...

The SC adopted the following Mission Statement -

***To promote and maintain
fair, efficient, secure and transparent
securities and futures markets
and to facilitate the orderly development
of an innovative and competitive capital market***



The Securities Commission's regulatory purview includes ...

- Supervision and licensing of market participants
 - Market intermediaries and market institutions
- Enforcement and compliance
- Regulation of primary market activities
 - Securities issuance, takeovers and mergers
- Regulation of secondary market activities



... and ...

- Regulatory reform
- Market development and education
- International regulatory initiatives
- **Regulation of trusts and investment management**



Some of the key legislations in the capital markets are ...

- Securities Commission Act 1993 (SCA)
- Securities Industry Act 1983 (SIA)
- Securities Industry (Central Depository) Act 1991 (SICDA)
- Futures Industry Act 1993 (FIA)
- Companies Act 1965 (CA)



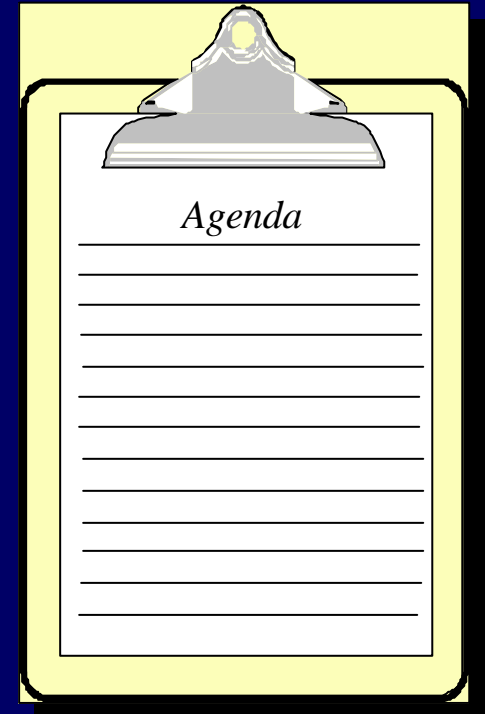
Other than statutes and common law, sources of obligations in the capital markets include -

- Regulations;
- Ministerial orders;
- Orders and directives given by the Securities Commission;
- Guidelines.



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The establishment of new trust funds involves the followings -

- Issuance of securities - must obtain prior approval of the SC (s.32)
- A trustee or a management company in relation to a trust scheme/ fund - must obtain prior approval of the SC to act as a trustee or as a management company (s.98)
- **The SC's Guidelines on Unit Trust Funds** will facilitate the application as well as compliance of the trust fund activities



An application to introduce a new trust fund

...

will be subject to a comprehensive review process by the SC ...

- Entails a qualitative review of the proposed fund
 - investment objective
 - investment strategies
 - product differentiation
- Entails a qualitative and quantitative review of the management company and trustee
 - financial status
 - experience and expertise
 - resources availability



... and ...

- The SC will also conduct site visits to determine the availability of resources at the management company/trustee/delegate or to ascertain adequacy of internal controls
- In the event the company lacks in-house expertise, external parties can be employed
- Post-examination in terms of compliance is conducted to ascertain continuous compliance of the management company / trustee / fund with the regulatory requirements



The Guidelines on Unit Trust Funds require ...

... prior approval of the SC before appointing -

- Members of the Board of Directors of the management company
- Members of the Investment Committee of the fund
- Members of the Syariah Committee (for Syariah funds)
- The Chief Executive Officer of the management company



In terms of deed and prospectus, ...

- Once approval for the establishment of the fund has been obtained, the management company is required to submit a fresh prospectus and deed (taking into account amendments prescribed in the approval letter)
- The management company is required to register and lodge with the SC the amended prospectus and deed before launching the fund
- For more info, refer to PN 11 and 12 Guidelines on Unit Trust



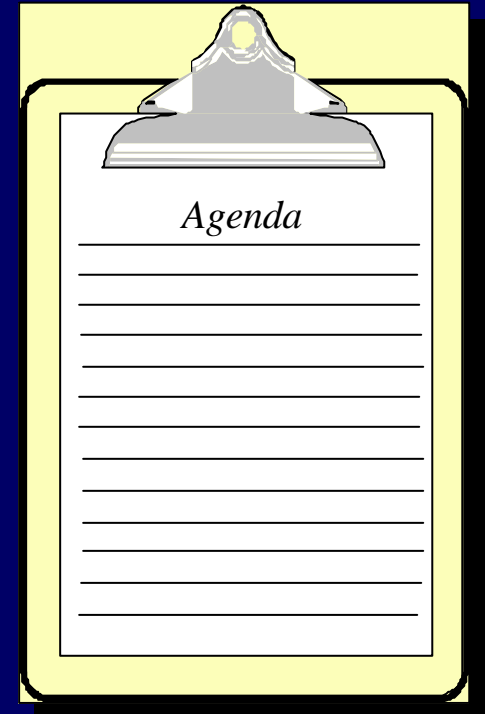
Given the nature of the products and type of participating investors,...

... in the unit trust industry, these measures have been put in place to ensure investor protection and to maintain market integrity



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Syariah Compliance and Approval

- The development of Islamic capital market can be traced back to the establishment of Tabung Haji in 1960s
- As well as the establishment of Islamic financial system in early 80s i.e. Islamic bank and takaful
- There was no Syariah authority to vet and approve various capital market instruments and products



(cont'd)

- The **Islamic Instrument Study Group (IISG)** was set up by SC in 1995 to assist and advise SC in undertaking the study of various conventional instruments
- Comprised of experts, both in fiqh muamalat and financial system
- IISG was replaced with a more formal body called SAC



SC's Syariah Advisory Council (SAC)

- Established in 1996
- Act as the sole authoritative body to advise SC on Islamic capital market operations
- Standardise and harmonise the application of Syariah principles and concepts
- Review Syariah compatibility of conventional instruments and new Islamic instruments
- Endorse the list of Syariah approved securities
- Members comprise of prominent Syariah scholars, academicians and Islamic finance experts

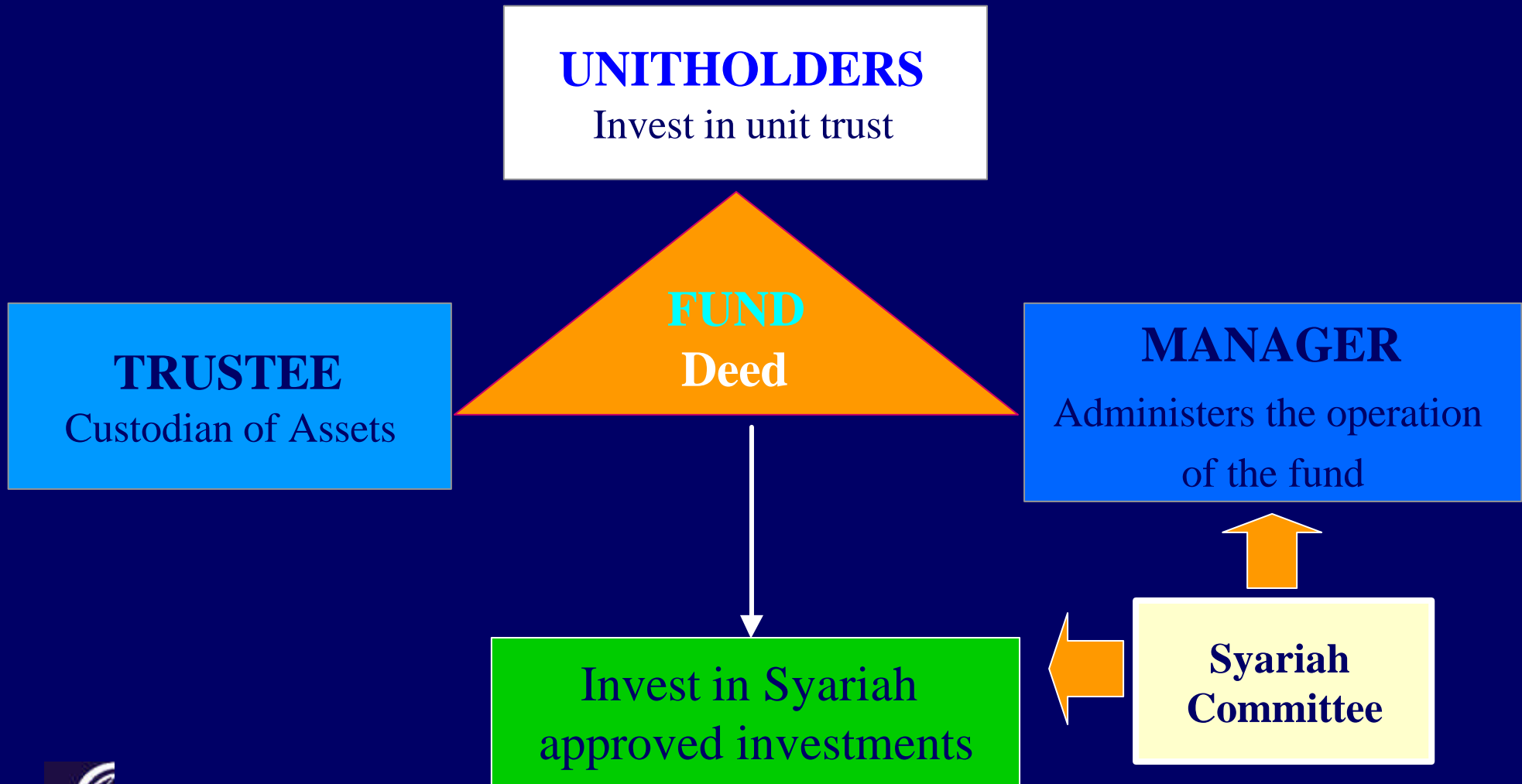


Syariah Funds are ...

A group of specialised collective investment funds which offer investors the opportunity to invest their surplus cash in a diversified portfolio of securities that are managed and selected by professional portfolio managers in accordance to Syariah principles



Structure of a typical Syariah Fund



A Syariah fund is allowed to invest in ...

.... (with investment spread restrictions) -

- *listed securities*
- *foreign securities*
- *futures contracts*
- *unlisted securities*
- *other collective investment schemes*
- *liquid assets*

provided the above are approved by its Syariah committee or SC's SAC.



Approval of Syariah fund

- The establishment of a Syariah trust fund require similar approval process and compliance as outlined in **The Guidelines on Unit Trust Funds**
- The investments of the fund must be adequately disclosed in the prospectus and annual report of the fund / scheme



Additional requirements for Islamic Unit Trust

- **The Guidelines on Unit Trust Funds** require that any fund, expressed to be managed in accordance with the Syariah principles, to appoint a **Syariah committee**
- Consisting of not less than three members who are individuals
- The appointment of a member of the Syariah committee must be approved by the SC
- Subject to the SC's approval, the fund may alternatively appoint a Syariah consultant



Criteria imposed on members of Syariah Committee

Members of the Syariah committee of the fund must

- Be of a good repute and character; and
- Possess the necessary qualifications, expertise and experience (particularly in fiqh muamalah) to perform their duties and responsibilities in a fit and proper manner



Role, power and duties of Syariah committee / Syariah consultant include ...

- Ensuring the fund is managed and administered in accordance with Syariah principles
- Providing expertise and guidance for the fund in all matters relating to Syariah, including on the fund's trust deed and prospectus, its structure and investment, and other operational and administrative matters
- Consulting the SC's SAC in cases of ambiguity or uncertainty as to investment, instrument, system, procedure and/or processes.



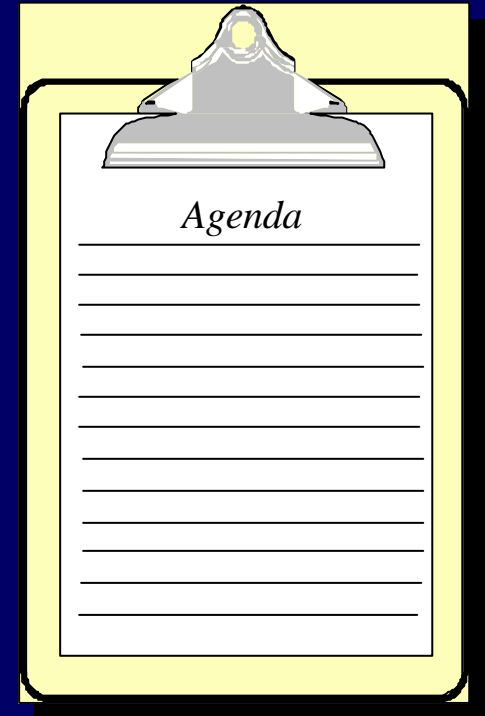
... and ...

- Ensuring compliance with any guidelines, ruling or decision made by SC or SC's SAC
- Carrying out duties and responsibilities with due care, skill and diligence



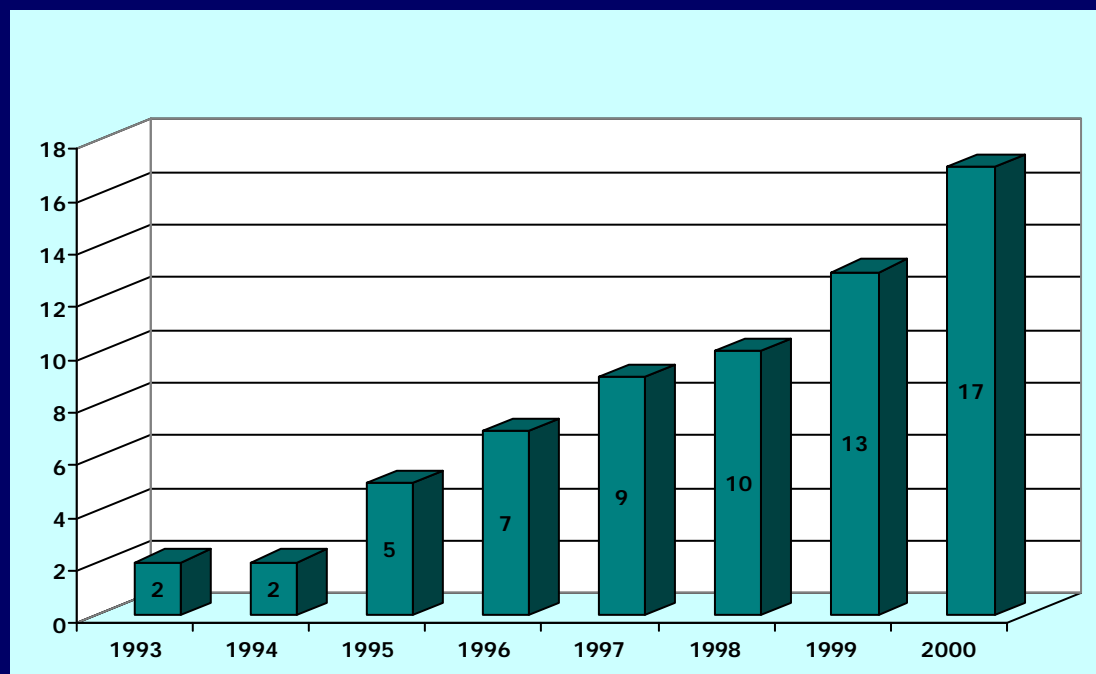
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Development of Syariah Funds

- ◆ Arab-Malaysian Tabung Ittikal is the first Syariah trust fund in Malaysia launched in 1993

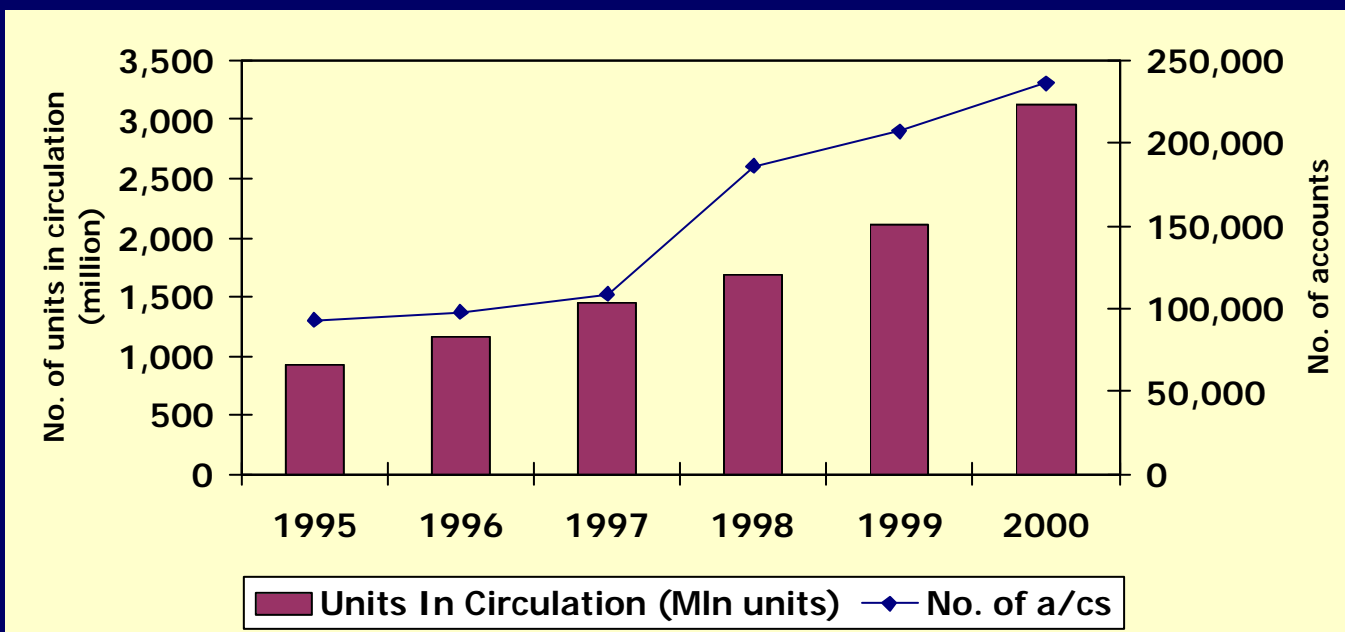


- ◆ As at 31 Dec 2000, there were 17 Syariah funds approved by the SC
- ◆ There were 127 approved funds
- ◆ Potential growth opportunity



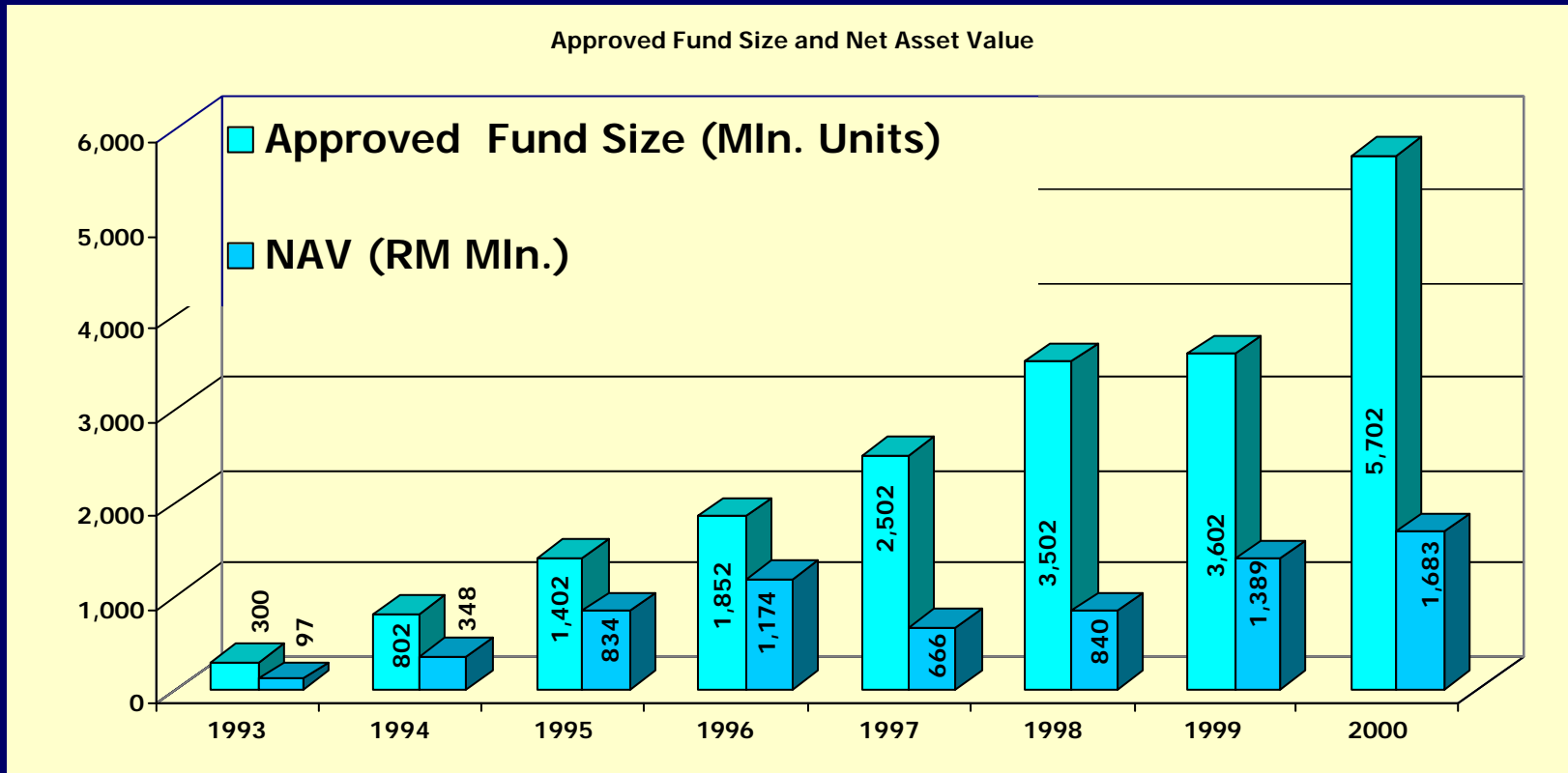
Growth of Syariah Funds in Malaysia

- ◆ The total no. of accounts grew at a compounded annual growth rate (CAGR) of approx. 25% from 1995 to 1999



- ◆ Whilst the growth of accounts for the overall industry only grew at 7 % for the same period

Approved Fund Size & Net Asset Value

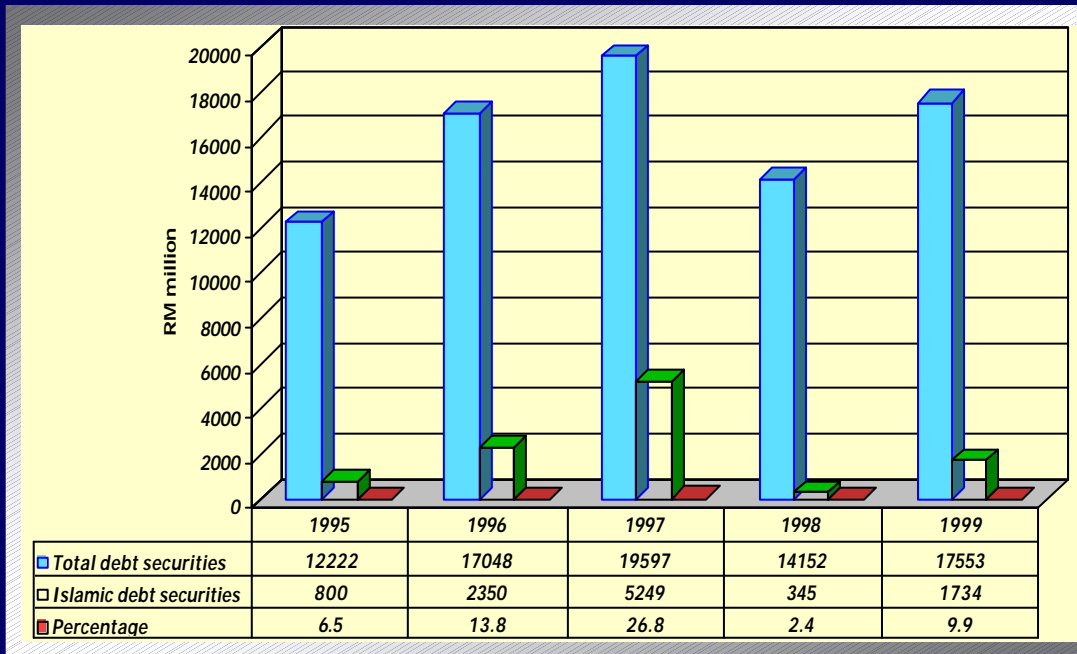


Need for product diversifications

- Most Syariah funds in the market are equity funds
- The development of the Syariah funds industry should not rely solely on the equity market
- Islamic bond market is one of the potential growth sector - Since July 2000, SC acts as the single regulatory authority for the issuance and development of corporate bond market
- Specific requirements on the issuance of Islamic debt securities are provided in the Guidelines on the Offering of PDS in Malaysia



New funds raised via IPDS (1995-1999)



- ◆ By-product of Islamic financial system
- ◆ Establishment of Islamic banks, Islamic banking scheme and takaful operators
- ◆ Demand from Islamic based institutional investors for fixed income products

- ◆ Growth of Islamic unit trusts, fund management and takaful business
- ◆ Greater awareness and acceptance among issuers and investors



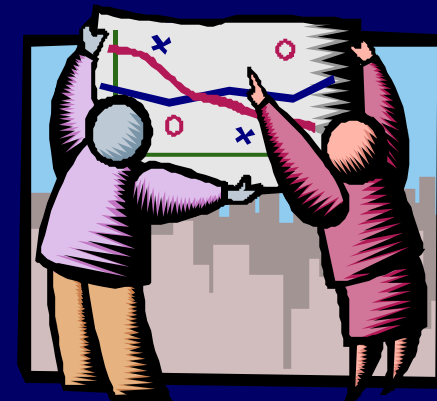
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- More **Islamic bond funds** can be introduced
- Provides alternative investment avenue for retail investors to invest in Islamic bonds
- **Islamic Index funds** may also be offered to investors who wish to diversify their investment portfolio
- **KLSE Syariah Index** was introduced in early 1999
- There are conventional index funds in the market today



Future development of Malaysia's ICM

- **Capital**MARKETMASTERPLAN
- ICM and investment management represent two of the six strategic objectives in CMP
 - *To establish Malaysia as an international Islamic Capital Market Centre*
 - *To promote an effective investment management industry and a more conducive environment for investors*



To support the implementation of the CMP objectives,...

The following were recommended for ICM

- Efforts to introduce more competitive and innovative Islamic financial products and services will be actively pursued
- Efforts to introduce and promote a wider range of Islamic collective investment schemes will be facilitated
- Investment restrictions for the Takaful industry should be further liberalised to facilitate greater mobilisation of Takaful funds into the Islamic capital market
- Efforts to mobilise untapped Islamic assets through securitisation should be pursued



...and...

- Efforts to increase the pool of Islamic capital market expertise through training and education will be enhanced
- A single Syariah Advisory Council should be established for the Islamic financial sector
- A facilitative tax and legal framework should be established for the Islamic capital market
- Efforts to develop and appropriate financial reporting framework for the Islamic capital market in collaboration with MASB will be pursued
- Increased efforts to enhance the awareness of Malaysia's Islamic capital market at the domestic and international levels will be pursued



...and ...

- Strategic alliances between Malaysia and other Islamic capital markets should be established
- The government and government-related entities should consider issuing Islamic debt securities in the global market
- The listing of Malaysian Islamic equity funds in international markets should be pursued
- Incentives to encourage the entry of foreign intermediaries and professionals with expertise in Islamic capital market-related businesses should be provided



For investments management, ...

The CMP recommendations include -

- A more market-based approach to regulation will be applied to the investment management industry
- The process for introducing new investment management products will be streamlined
- A uniform regulatory framework streamlining the licensing rules for the investment management industry will be introduced



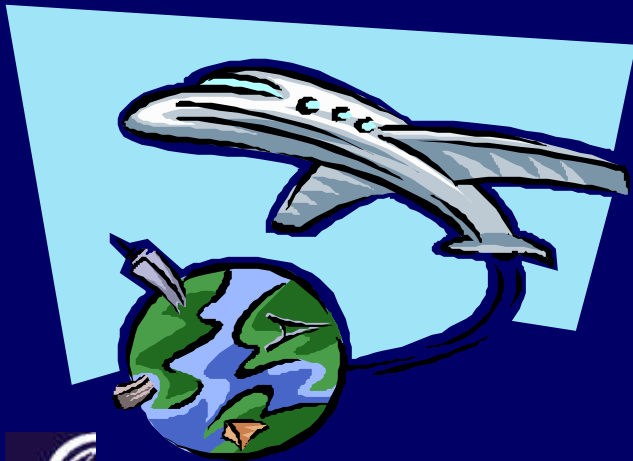
Positive contributing factors for development of ICM

- Strong government backing for developmental efforts
- Relatively well developed domestic Islamic financial sector
- Increased investor and issuer awareness and sophistication
- Our strength in research capabilities



(cont'd)

- Growth of the international Islamic financial services
- Estimated growth rate of 12% - 15% p.a.
- Muslims private assets in the Middle-East estimated worth of USD 800 bil



- Consolidation and harmonisation of Syariah interpretations **
- International Islamic accounting standards



** Bai` Dayn / trading of debts and Bai` Inah

Thank you

