EXCERPT of

Special Address
Facilitating Retail Participation in the Sukuk Market

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

Thus notwithstanding the significant strides that Malaysia has made towards establishing herself as an international Islamic financial centre, in pursuing the development agenda of the Islamic Capital Market, we continue to be guided by asking how the industry can best serve the *ummah*, that is the investing public and the business community as a whole. After all, the first Islamic Principles[1] of Commercial Law asserts that wealth (and property) should be circulated among the general public and actively transferred from one hand to another in the form of investment (and expenditure). It is for this reason that ensuring investment access to the masses has and continues to be a key driver for the development of Islamic markets in

[1] The principle of wide circulation of wealth; The principle of transparency in commercial dealings; The principle of ownership certainty and sanctity of the contract; Justice and fair dealings; and Wealth Acquisition & Investment

Malaysia. It is for this reason too that Malaysia's Islamic capital market has been systematically designed to ensure accessibility and inclusiveness whilst ensuring the protection of investors, efficiency in intermediation, fair and orderly markets and mitigation of risks.

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

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

The Sukuk Market

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

As at 31 December 2012, the size of sukuk outstanding globally was GBP160 Billion[2] with Malaysia making up 68% of the market. This global figure represents a CAGR of almost 35% for the past 5 years[3]. According to a report by KFH-Research, total sukuk issuance reached GBP86.5 billion last year, an increase of 54 percent from 2011 despite the challenging financial and economic conditions in many parts of the world. In the last couple of years, sovereigns and quasi-government institutions from Turkey, Kazakhstan, and Indonesia have all issued sukuk, a clear reflection of the sustained expansion of the global sukuk market.

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

Retail Sukuk in Malaysia

With a view to facilitating greater direct retail participation in the corporate bonds and sukuk market, the Securities Commission Malaysia in 2012 developed the framework for retail bonds and sukuk as envisaged under the Capital Market Masterplan 2, enabling retail investors' access to a wider range of investment products. Under the Exchange Traded Bonds and Sukuk (ETBS) framework, retail investors will have direct access to sukuk thereby broadening the range of low-risk investment products available to them and facilitating diversification for risk management purposes. Under the framework, sukuk issued by a public company guaranteed by the Government, public companies listed on Bursa Securities, Cagamas Berhad and licensed Malaysian

[2] Source IFIS
[3] USD as base

banks can be offered to retail investors. In addition, all sukuk issued to retail investors must be rated although no minimum rating requirement is required.

Pursuant to the release of the framework, Malaysia's first retail (exchange-traded) sukuk was issued by a government-owned entity, Danainfra Nasional Berhad, a company tasked to undertake the development of the country's first mass rapid transit (MRT) project. The retail sukuk tranche was part of a GBP 323 million (RM1.5 billion) government-guaranteed issuance, of which GBP 65 million or 20 per cent was allotted to retail investors and was listed on Bursa Malaysia in February 2013. The project can be expected to make further sukuk issuances in the future and plans to allocate 1/5th of any given issue to the retail investors. Danainfra retail sukuk thus provides not only a new investment product for investors, it allows them to have a direct stake in a massive infrastructure development in Kuala Lumpur.

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

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

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

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

Extending the reach of Islamic finance to the masses through other asset classes

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

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

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

Conclusion

The introduction of retail investment products that seek to widen access of the masses to the capital market requires considerable effort. Often these products may not achieve overnight successes but if we believe in the ultimate goal of widening access to the capital market and ensuring that Islamic finance takes the path of inclusiveness, then we must persevere.

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