

RAISING THE BAR

A REPORT ON MALAYSIA'S ISLAMIC FINANCE MARKETPLACE

Malaysia's Islamic finance marketplace continues to benefit from global leadership in the development and innovation of a comprehensive and sophisticated, end-to-end community for Islamic finance products and services.

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Malaysia has developed a comprehensive and progressive Islamic finance marketplace that has grown from strength to strength for over 30 years.

Malaysia's marketplace is characterised by a robust regulatory, supervisory, Shariah and legal framework, a deep primary and active secondary sukuk market, a diverse talent base with global capabilities and an efficient system for multi-currency clearing and settlement.

According to KFH Research, Malaysia's holistic approach has allowed the creation of a conducive marketplace for Islamic finance with the following specific attributes:

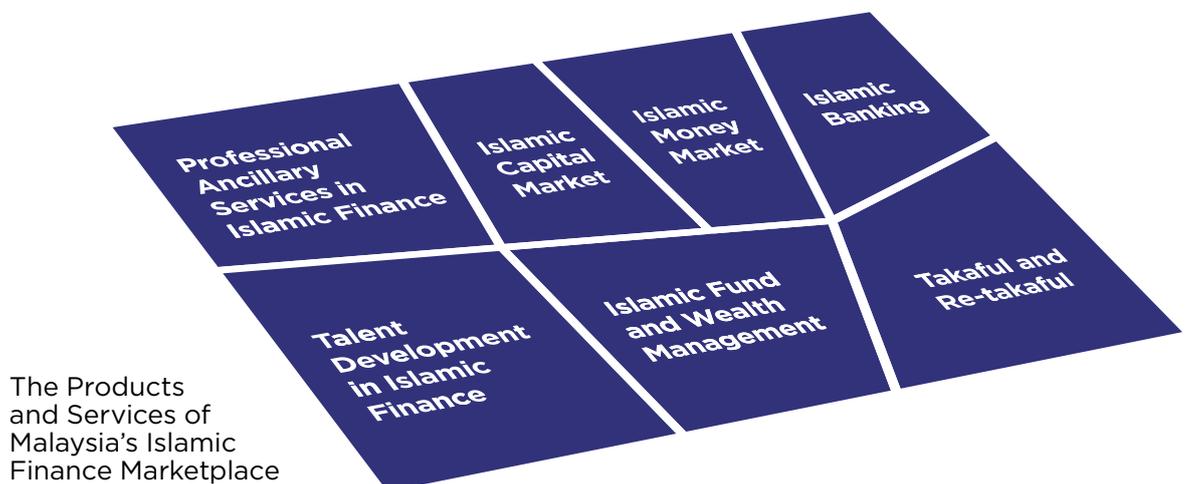
Well-defined Shariah Governance Framework	Competitive Pricing	Innovative Structures and Human Capital Development	Incentives for Investment Activities
Equal Treatment Vis-a-Vis Conventional Institutions	Well Capitalised Institutions	Comprehensive Infrastructure	Facilitative Rules

Source: KFHR

Malaysia's Islamic finance marketplace, being located in ASEAN, one of the world's fastest growing regions has attracted a thriving community of participants in the global Islamic finance industry.

This has resulted in an integrated, end-to-end marketplace that has been recognised as a global destination for expertise, innovation and deal flow.

The complementary components of the marketplace offer both breadth and depth in products and services to the global financial community.



Growing Islamic Banking and Takaful Sectors

The Islamic banking sector in Malaysia has witnessed an increasing market share on the back of growing demand for Islamic financial services. As at the end-1H13, Islamic banking assets totalled RM527.2bln or 24.1% of the banking system's total assets, according to Bank Negara Malaysia. This is compared to a 12.1% market share as at end-2006. Today Malaysia has 20 Islamic financial institutions, ten of which have foreign ownership, while also being home to five international Islamic financial institutions from Europe, the GCC and Asia Pacific.

Similarly, the rate of growth in the takaful industry has been gaining traction to become one of the main segments of the country's insurance sector. According to the latest statistics with Bank Negara Malaysia, takaful operators' net contributions have grown to just under RM6bln as at end-2012, from RM3bln as at end-2008. The country is domicile to 12 takaful operators, three of which are foreign-owned, as well as two local and two foreign retakaful operators. Retakaful operators in Malaysia add an extra layer of depth to the takaful industry through the spreading of risk and added capacity so that more risk can be underwritten.

Malaysia is home to a wide range of investment, wholesale, retail and structured products for a range of purposes and sectors. Islamic financial institutions currently use a wide range of Shariah contracts and innovative instruments such as profit and forex rate swaps that have been accepted globally. Similarly, Bursa Suq Al-Sila' has provided a range of commodity-based products for Islamic financial institutions and market participants to trade, thereby allowing the industry to innovate instruments and financing facilities that add depth and liquidity to the market.

The Islamic Capital Market

Internationalising Sukuk Market

Malaysia's sukuk market has grown rapidly from only USD1.5bln of global outstanding sukuk as at end-2001 to over USD148bln as at end-1H13, according to KFH Research. Malaysian sukuk accounted for 60.4% of the outstanding amount as at end-1H13, while issuances during the year amounted to USD41.5bln or 67.8% of the total volume. Malaysia has pioneered many of the world's innovative sukuk structures. Among the innovative structures and features that were originated in Malaysia include:

1990	The use of Bai Bithaman Ajil for Islamic debt securities (Shell MDS Sdn. Bhd.)
1994	The use of the Mudharabah principle in a mortgaged-backed securitisation (Cagamas Berhad)
2001 & 2002	Structuring corporate and sovereign sukuk transactions under the Ijarah principle (Kumpulan Guthrie Berhad and the Government of Malaysia, respectively)
2003	Innovated tradable sukuk Istisna' (SKS Power Sdn. Bhd.)
2005	The use of Musharakah principle to create a venture-based securitisation transaction (Musharakah One Capital Berhad)
2006	Innovated exchangeable sukuk (Khazanah Nasional Berhad)
2007	Successfully created a dollar-denominated sukuk with Shariah-compliant subordination features (Malayan Banking Berhad USD300mln)
2009	Established foreign currency sukuk and bond programmes originating in Malaysia while awarded the country's "Emas" status (Petronas)
2010	Innovated a global sovereign US dollar sukuk using the Wakalah principle (Wakala Global Sukuk Berhad)
2010 & 2011	Structured a Singapore dollar-denominated and a renmimbi-denominated sukuk issuance (Khazanah Nasional)
2012	Successfully launched an exchange-traded sukuk with a tranche for retail investors (DanaInfra Nasional Berhad)
2012	Structured a sukuk transaction with a perpetual maturity (Malaysia Airlines System)

Being a conducive environment for sukuk transactions, Malaysia attracts institutions from all regions of the globe aiming to tap Malaysia's Islamic finance marketplace and the pool of liquidity. Starting in 2009, the government of Malaysia awarded "Emas" status to foreign currency issuances in the country for ease of recognition. Since the first Emas sukuk by Petronas worth USD1.5bln, there have been a further 11 milestone Emas issuances to date, as shown in the diagram below. Similarly over the past year, Malaysia has been home to a number of cross-border sukuk transactions such as the National Bank of Abu Dhabi's 15-year, RM500mln (USD164.4mln) sukuk in November 2012, its third issue in that currency, and the Bahraini sovereign wealth fund Mumtalakat's five-year, RM300mln sukuk in September 2012. The Abu Dhabi National Energy Co. also raised funds in Malaysia in 2012 with a RM650mln issuance through a 10 year maturity. Similarly, Malaysia's regional neighbours have sought to raise funds in the country, with Hong Kong's Noble Group successfully raising RM300mln in October 2012, Golden Assets International Finance from Indonesia raising RM1.5bln in November 2012, and Singapore's First Resources Ltd. establishing its RM2bln sukuk programme in July 2012. In addition, Kuwaiti investment firm Gulf Investment Corp. setup a RM3.5bln Islamic medium-term note programme with a 20-year tenure.

Malaysia's Multi-Currency Marketplace: Emas Sukuk

2009	2010	2011	2012	2013
 <p>Petronas USD1.5bln</p>	 <p>Nomura USD100mln</p>	 <p>Govt of Malaysia USD2bln</p>	 <p>Khazanah USD357.8mln Exchangeable</p>	 <p>Sime Darby USD800mln</p>
	 <p>Govt of Malaysia USD1.25bln</p>	 <p>Khazanah RMB500mln</p>	 <p>IDB USD800mln</p>	 <p>IDB USD800mln</p>
	 <p>Khazanah SGD1.5bln</p>		 <p>Axiata RMB1bln</p>	
	 <p>IDB USD500mln</p>			

Price Discovery for Sukuk Issuances

The cross-border deal flows with Malaysia have grown steadily as issuers look to raise funds at affordable rates, in a stable currency, and under a regulatory environment that gives confidence to investors regarding investor protection and contract enforceability. The deal flow in Malaysia's sukuk market is set to continue as demand for Islamic instruments remains unshaken by global bond market volatility, with relatively stable yields within the sukuk market being an encouraging factor for issuers looking to raise funds and generate market growth. The country's sovereign benchmark Islamic issuances have also been able to remain lower than conventional government securities in terms of yield, highlighting the strong demand for Islamic instruments and the ample market liquidity. Overall, the sukuk market benefits from efficient price discovery mechanisms, such as when-issued trading, book building process and other innovative reference pricing services, combined with a liquid secondary market and significant market activity to afford investors transparent and accurate market information that encourages investment.

Vibrant and Innovative Islamic Equity Market

The Malaysian Islamic capital market has experienced phenomenal growth and raised the bar globally in product innovation and financial intermediation. Islamic equity market products in Malaysia include Shariah-compliant equities, equity indices, unit trust funds and asset management, structured products, i-REITs, i-ETFs, Islamic venture capital and private equity.

The Islamic equities market started screening in 1995, making visible the vast investment universe for Shariah-compliant investments. As at June 2013, there were 800 Islamic securities listed on Bursa Malaysia with a market capitalisation of RM1.6trn or 63% of the total market capitalisation of the bourse, according to the Securities Commission Malaysia (SC). The Malaysian equity market

witnessed the largest Islamic initial public offering (IPO) to date and the second largest IPO of the year after Facebook Inc., with the USD3.1bn Felda Global Ventures Holding offering in 2012. The transaction was also the largest in Asia and was bolstered by cornerstone investors from the region who bought nearly 20% of the IPO. The FTSE Bursa Malaysia Hijrah Shariah Index and the FTSE Bursa Malaysia EMAS Shariah Index were launched in 2007 in response to increasing interest in Shariah-compliant investments. According to data from Bloomberg, the FTSE Bursa Malaysia EMAS Shariah Index has gained 9.48% this year as compared to the FTSE

**The FTSE Bursa
Malaysia EMAS Shariah
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this year as compared
to 7.17% in the KLCI
benchmark index**

Bursa Malaysia KLCI Index which gained 7.17%.

The Securities Commission Malaysia released the guidelines for Islamic Real Estate Trusts (Islamic REITs Guidelines) in November 2005, making the country the first jurisdiction to introduce such guidelines in the global Islamic finance sector and setting a global benchmark for the development of Islamic Real Estate Investment Trusts (Islamic REITs). The first Islamic REIT was introduced in 2006 and has now grown to three as at June 2013 with a market capitalisation RM16.1bn, up from RM2.9bn as at end-2011. Malaysia launched the region's first Shariah-compliant Exchange Traded Fund (ETF) in January 2008, the MyETF Dow Jones Islamic Market Malaysia Titan 25 which tracks the performance of the benchmark Dow Jones Islamic Market Malaysia Titan 25 Index. As at June 2013, the Islamic ETF had a net asset value of RM0.3bn or 28.4% of the total ETF industry, according to the Securities Commission Malaysia.

Talent Development & Research

Given that the unprecedented growth in Islamic finance has put increasing pressure on the supply of high quality human capital, the Malaysian central bank established the International Centre for Education in Islamic Finance (INCEIF) in December 2005, aimed at producing a new class of Islamic finance professionals. The need for more highly skilled individuals will continue to grow in the future as Islamic finance expands and develops throughout the world; to which Malaysia can contribute by supporting and enhancing the human capital development programmes as well as supporting other institutions and initiatives. Similarly, the central bank set up the International Shariah Research Academy for Islamic Finance (ISRA) in 2008, aimed to promote applied research in the area of Shariah and Islamic finance. It also acts as a repository of knowledge for Shariah views or fatwas and undertakes studies on contemporary issues in the Islamic financial industry.

Taking Islamic Finance to the Next Stage

In order to further develop the Islamic finance industry, the Malaysian government has introduced the Islamic Financial Services Act 2013 (IFSA) which came into force on 30 June 2013. The act replaces the Islamic Banking Act 1983 and Takaful Act 1984 while incorporating elements from Payment System Act 2003 and Exchange Control Act 1953. The new law provides for greater clarity on the legal and prudential requirements underpinned by Shariah principles which enable Islamic financial industry players to align their practices and expertise accordingly when undertaking Islamic financial business and transactions.

Similarly, the central bank has introduced the Financial Sector Blueprint which runs up until 2020, by which time it envisions greater participation from the Malaysian financial sector to further expand the internationalisation of Islamic finance. As such, the central bank has undertaken efforts that will continue to be made to enhance Malaysia's Islamic finance marketplace through the development of a more conducive environment for the mobilisation of higher volumes of international Islamic financial flows, from a diverse range of players, to be channelled through innovative Islamic financial instruments.

The new laws and Blueprint will place Malaysia's financial sector on a platform for advancing forward as a sound, responsible and progressive financial system. This is especially important to enable the financial system to meet the new demands for financing associated with Malaysia's economic transformation programme both during and beyond the next decade, the changing demographics of the population, and the increasing integration of the Malaysian economy with the region and the world.

On the support side, there are over 31 law firms that offer Islamic finance related services, two rating agencies, three accounting and auditing firms, three research houses and nine training providers in the country. Such institutions and services serve to build a holistic system, support innovation and develop upon existing expertise in the area of global Islamic finance.

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