

# **EVOLVING ISLAMIC CAPITAL MARKET IN MALAYSIA**

**By**

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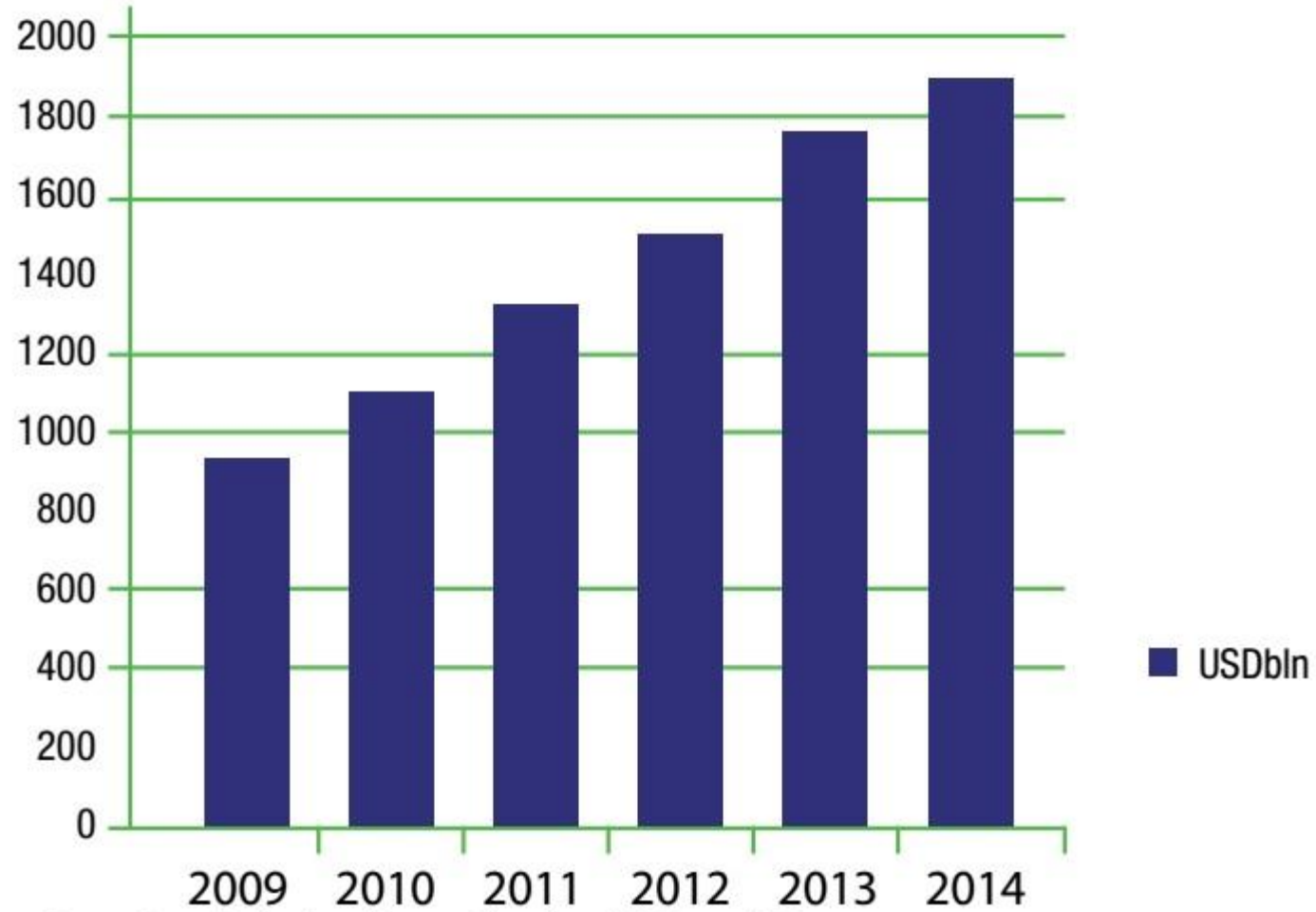
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- Islamic financial products have evolved and developed considerably from simple and straightforward structures to **sophisticated and multifaceted** instruments.
- While Islamic financial products and services offered in the 1980s-90s were **dominated by deposits and savings products, syndicated project financing as well as Shariah-compliant stocks**, the last decade has witnessed the unveiling of more sophisticated structures, including various Islamic investment funds such as **Islamic exchange traded funds, Islamic money market, Islamic real estates, and real estate investment trust, Islamic Hedging etc.**
- This evolution is underpinned by the maturity and complexity of market alongside more sophisticated and demanding investors



# Growth Trends of Global Islamic Finance Assets

USDbln



Source: Central Banks, Annual Reports, Bloomberg, IFIS, Zawya, ISRA

- Thus far, the industry has recorded double-digit growth rates in various segments, and has also further expanded its financing activities to non key Islamic finance jurisdictions.
- More importantly, the recent expansion of the industry in last 5 have further stamped the transformation of Islamic banking and finance into a more competitive and resilient industry.
- Moving forward, the industry's assets are expected to expand further to **USD3.4tn** by end-2018 (Isra estimation)
- The Islamic financial industry has experienced robust expansion in the past five years, recording a **17.3% Compounded Annual Growth Rate (CAGR)** between 2009 and 2014

- In 3Q 2015, the total of global Islamic asset under management (AuM) stood at USD60.2 bln, posting a decrease from the previous year AuM of USD75.8 bln (3Q 2014).<sup>2</sup> The number of Islamic funds declined to 1,030 from 1,161 for the similar period last year.
- This is mainly due to the decline in oil prices and the rapid changes in the global regulatory framework which substantially affect the overall growth of the Islamic finance industry.
- Notwithstanding this, the sector is projected to register an annual growth of 5.05% per annum for the next five years and estimated to reach USD 77 bln by 2019.



### Breakdown of Islamic Finance Segments by Region (USD billion, 2015 YTD\*)

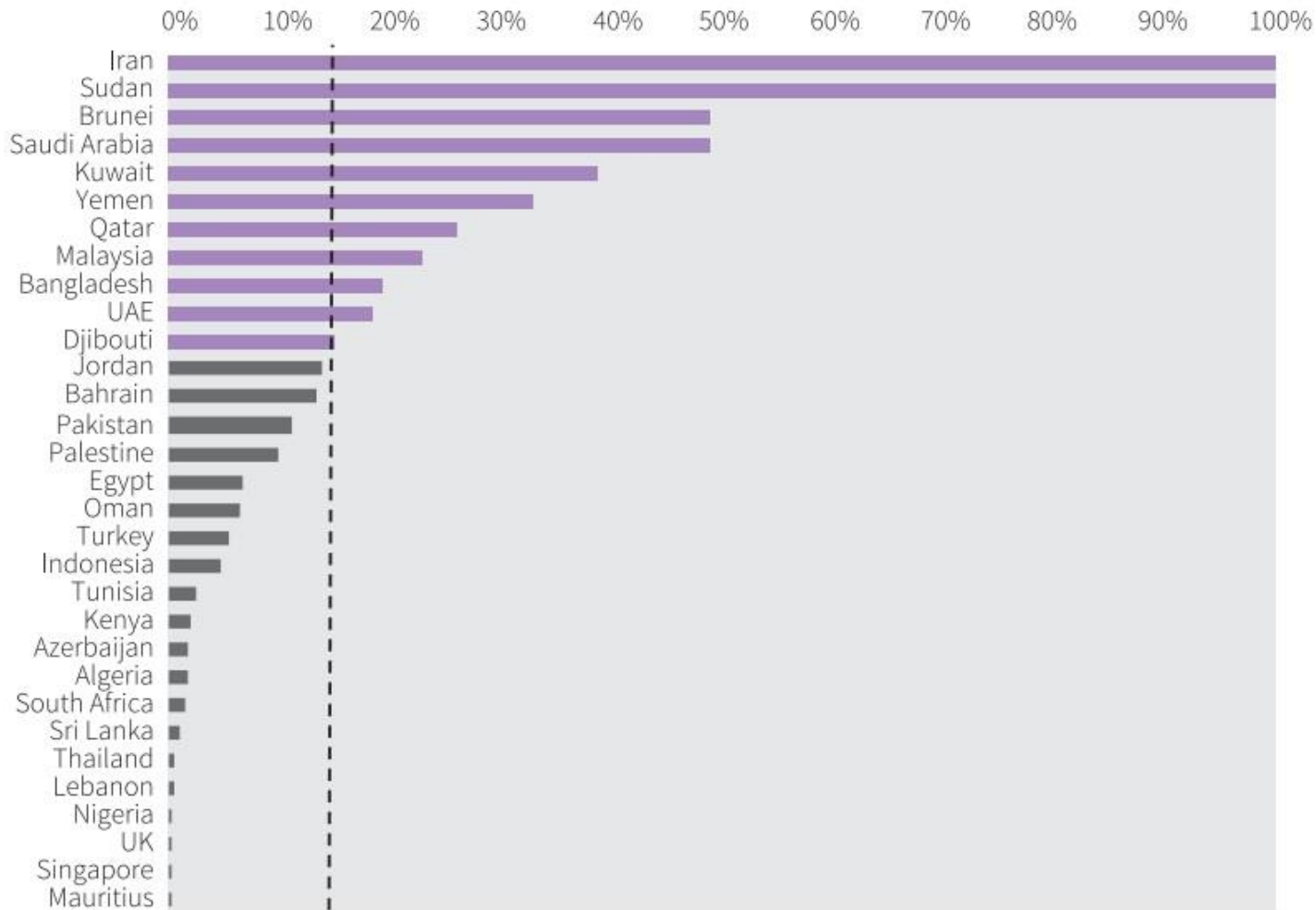
Region	Banking Assets	Sukūk Outstanding	Islamic Funds' Assets	Takāful Contributions
Asia	209.3	174.7	23.2	5.2
GCC	598.8	103.7	31.2	10.4
MENA (exc. GCC)	607.5	9.4	0.3	7.1
Sub-Saharan Africa	24.0	0.7	1.4	0.5
Others	56.9	2.1	15.2	–
<b>Total</b>	<b>1496.5</b>	<b>290.6</b>	<b>71.3</b>	<b>23.2</b>

\*Data for banking and takāful as of 1H2015, while for sukūk and funds as of 11M15.

Source: IFSB Secretariat Workings.

Note: Data are mostly taken from primary sources (regulatory authorities' statistical databases, annual reports and financial stability reports, official press releases and speeches, etc.). Where primary data are unavailable, third-party data providers have been used, including Bloomberg, Zawya, EY and World Islamic Insurance Directory 2015. In only a few instances where there were still information gaps were data estimated based on historical growth trends and country-specific assumptions. Takāful contributions are used as a basis to reflect the growth in the takāful industry. The breakdown of Islamic funds' assets is by domicile of the funds, while for sukūk outstanding it is by domicile of the obligor.

# Islamic Banking Share in Total Banking Assets by Jurisdiction (1H2015)



*\*The countries in purple coloured bars indicate those that satisfy the criteria of having a more than 15% share of Islamic banking assets as a proportion of total domestic banking sector assets and, hence, are categorised as systemically important jurisdictions.*

# ISLAMIC FINANCE IN MALAYSIA

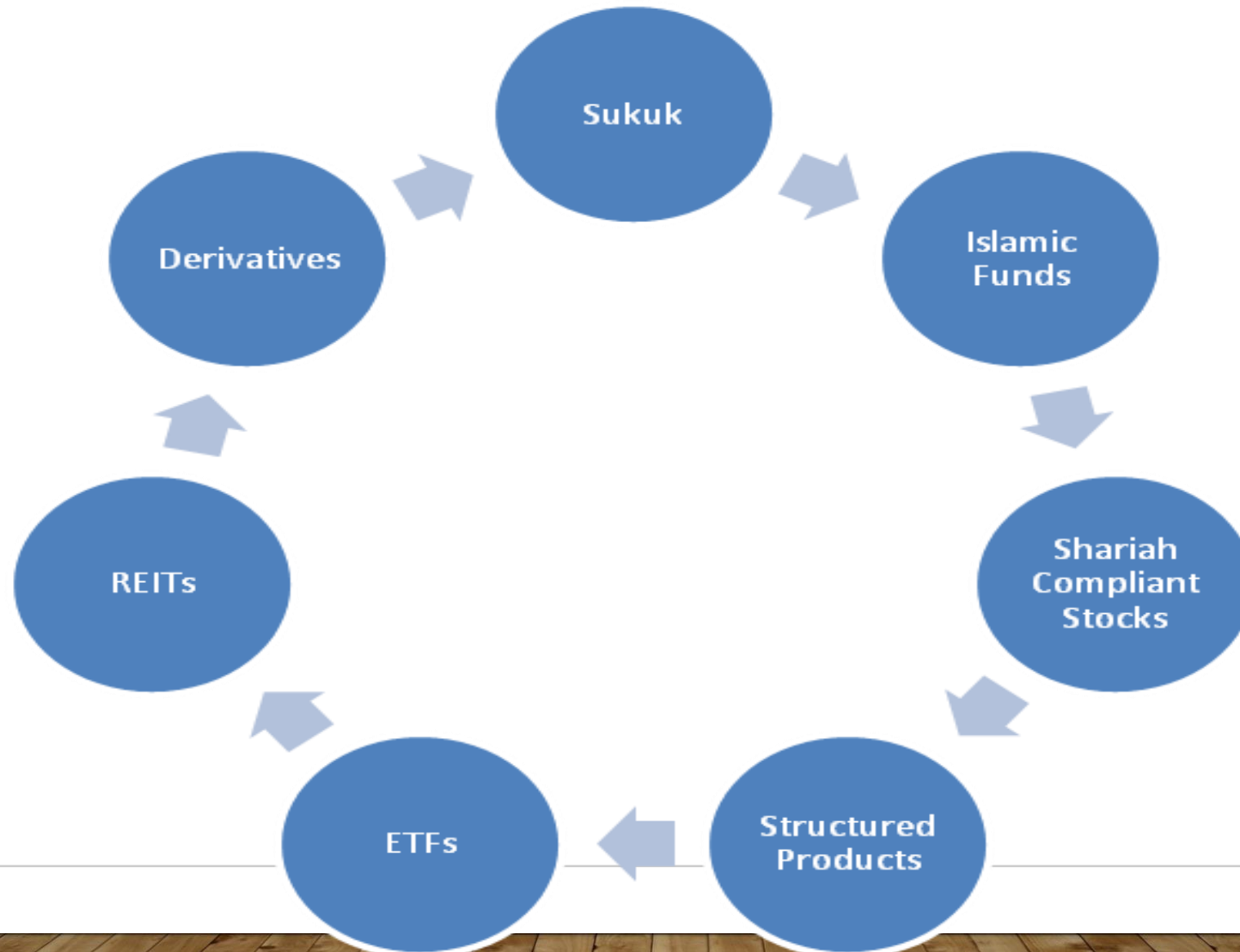
- Fitch Ratings says in a new report. Malaysia's Islamic bank financing reached **MYR390bn** as of end-2015, equal to **27%** of its banking-system loans (2014: 25.0%).
- Islamic financing **expanded 16.2% in 2015 (conventional banking system: 5.2%)**, and has had a **compound annual growth rate (CAGR) of 18.2% since 2011**, against conventional banks' average of 7.0%.
- The Malaysian Islamic banking system's **impaired financing/loan ratio remained stable at 1.2% in 2015** (conventional banking system: 1.7%), while the segment's provision coverage (impairment reserves as a proportion of gross loans) remained lower than that for conventional banks.



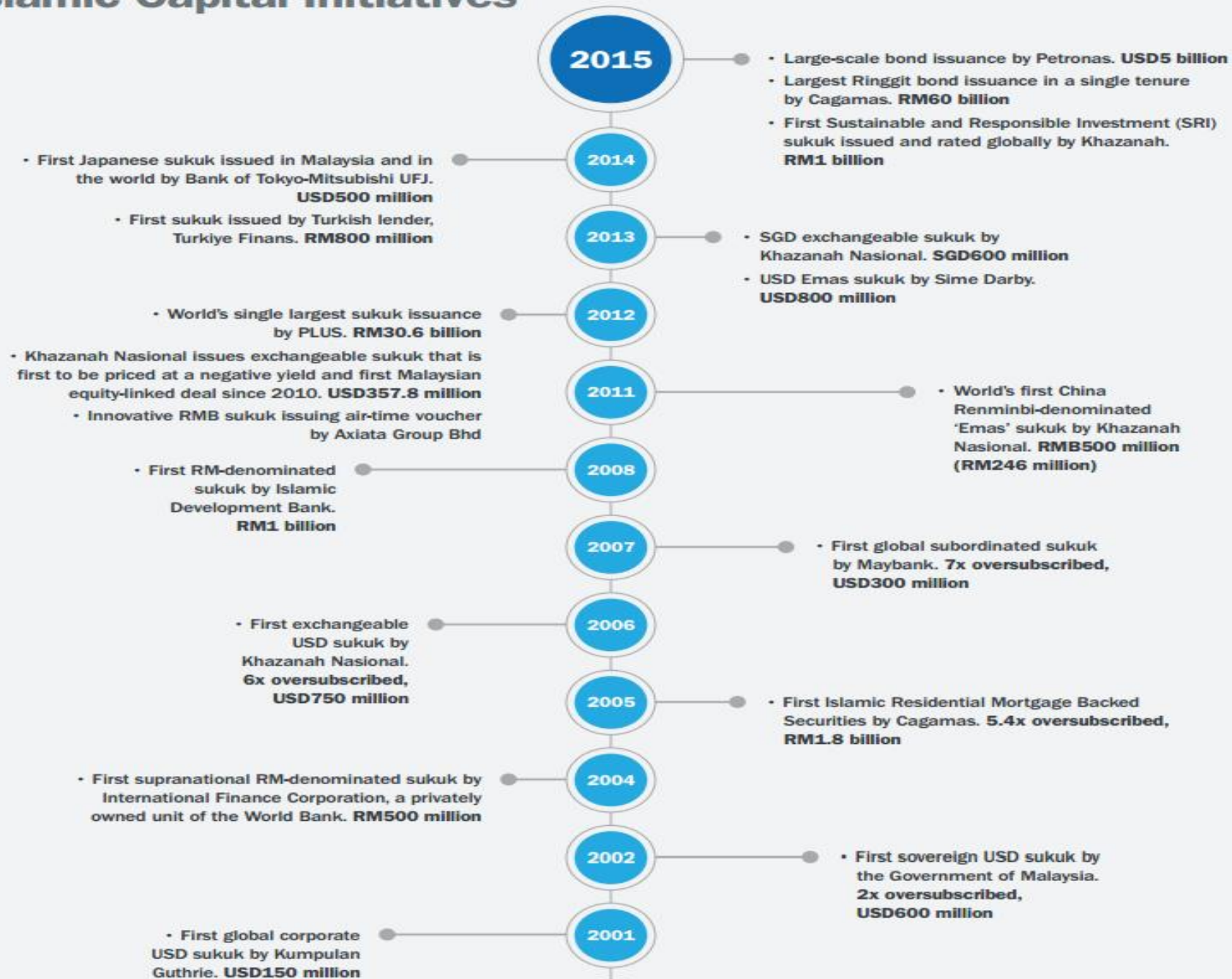
- Sharī'ah-compliant stocks constitute **36% of the assets of Islamic funds**, and **money market instruments 35%**, while sukūk account for only 7%.
- The number of publicly available Islamic funds increased to 1220, but their assets under management (AuM) decreased so that the average size of an Islamic fund is rather small.

- The total value of Islamic AuM in Malaysia as per June 2015 was RM 117.40 bln or approximately USD 27.20 bln, representing 17.9% market share of the total AuM industry in Malaysia.
- In particular, the country has launched 190 Islamic Unit Trust Funds with the total net asset value (NAV) of RM 48.99 bln or USD 11.35 bln, representing 13.8% of the total unit trust fund industry as per June 2015

# Islamic Capital Market



# Malaysia is a Leader in Several Islamic Capital Initiatives





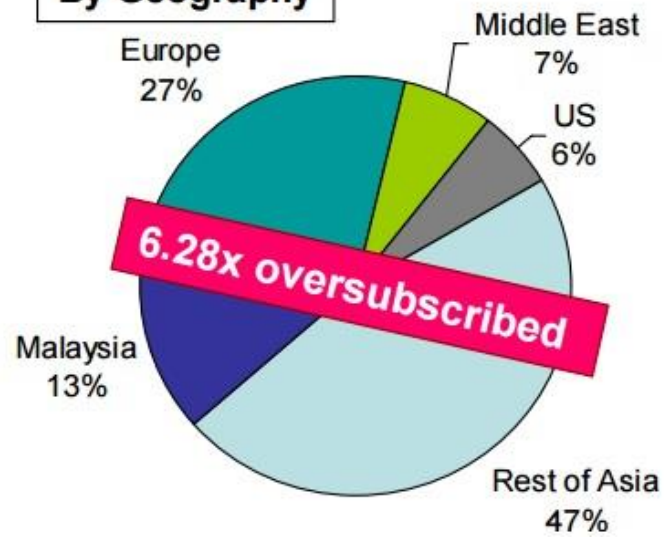
# Highlights - Petronas USD1.5 billion Emas Sukuk



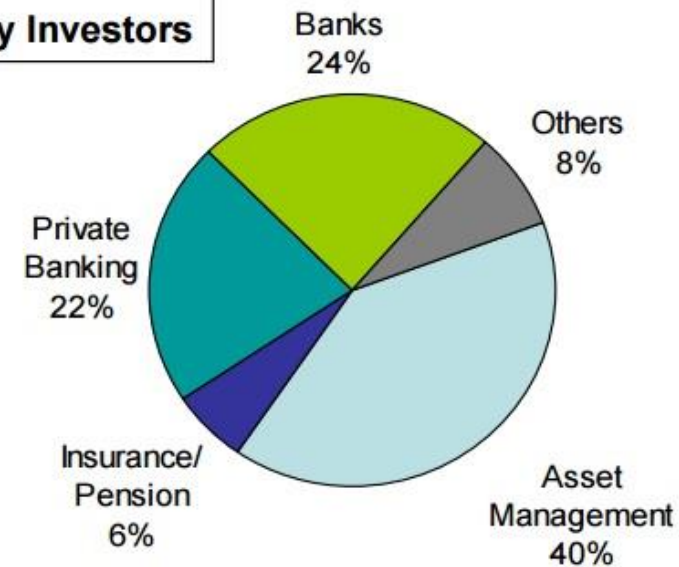
<b>Rating</b>	A1 (S&P) /A- (Moody's)
<b>Issue Size</b>	USD 1.5 billion
<b>Maturity</b>	5 years
<b>Spread to Treasury</b>	1.625 %
<b>Yield</b>	4.279%
<b>Issue Price</b>	99.871
<b>Listing</b>	Bursa Msia, Labuan S.E., Luxembourg S.E.

- Oversubscription rate = 6.28x
- Amount upsized from USD1 billion to USD1.5 billion
- Shariah principle - Ijarah
- World's 1<sup>st</sup> USD corporate sukuk in '09
- Largest USD global sukuk since Dubai Ports issuance in '07
- Largest USD issuance (combined bonds & sukuk) of USD4.5 billion in Asia (ex-Japan) for '09
- 1<sup>st</sup> to be accorded Emas dollar sukuk

### By Geography



### By Investors

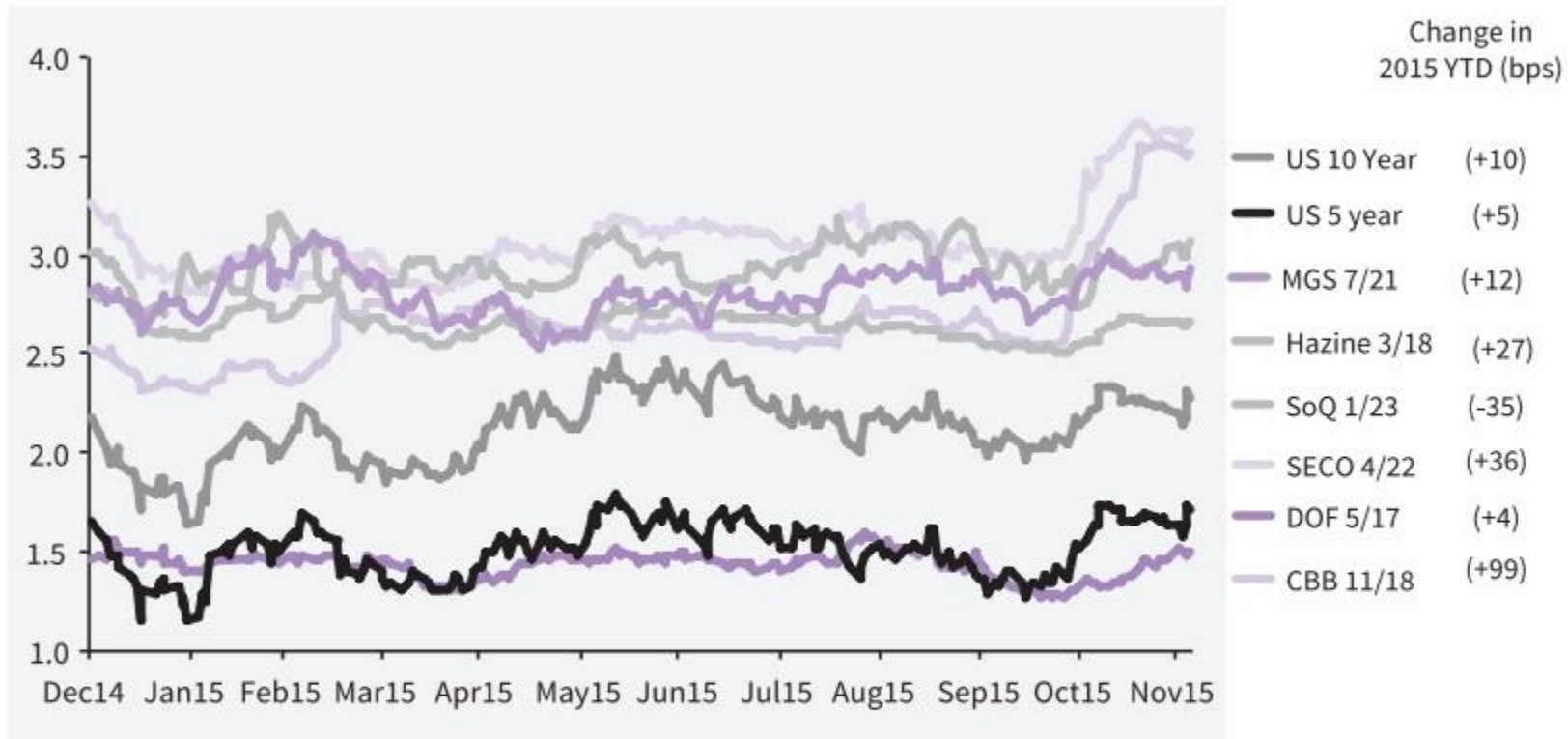




## Selected USD Sukūk Yields vs US Government Securities Yield

In terms of the secondary market returns performances of sukūk instruments, yields have experienced considerable volatility during the course of 2015, on account of a number of global, regional and national factors.

Towards the end of 2015, with increased expectations of a US interest rate increase, yields on US Dollar sukūk instruments have generally increased year-on-year across various jurisdictions

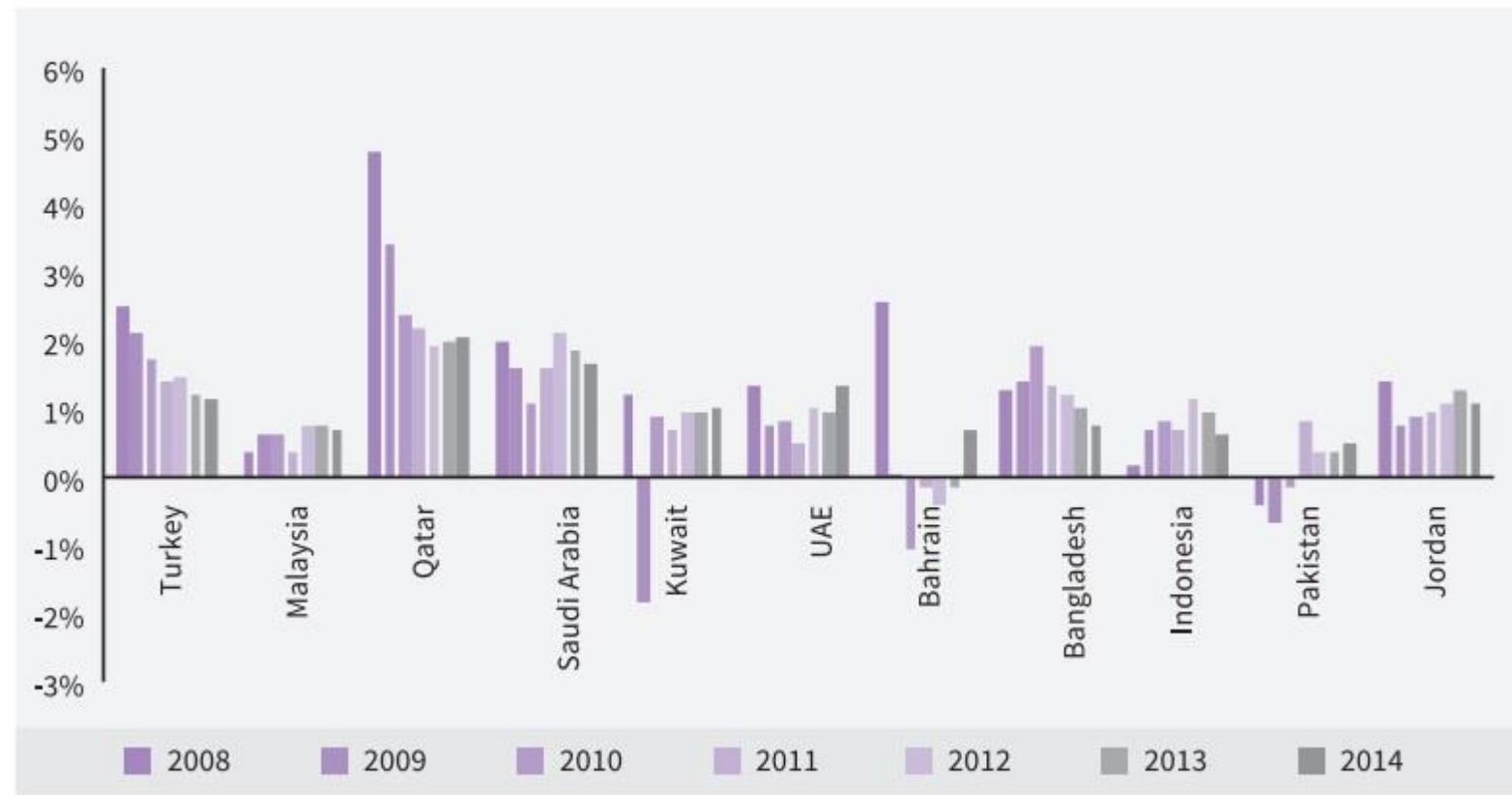


Source: Bloomberg, IFSB.

Note: CBB = Central Bank of Bahrain, DOF = Dubai Department of Finance, SECO = Saudi Electricity Company, SoQ = State of Qatar, Hazine = Hazine Mustesarligi [Turkish Under Secretariat], MGS = Malaysia Global Sukūk Wakālah, US 5Y = US 5-Year Generic Government Yield, US 10Y = US 10-Year Generic Government Yield.

In South-East Asia, profitability levels of Indonesia and Malaysia declined, although Indonesia witnessed the more significant drop. Its ROA and ROE dropped to 0.6% and 5.9%, respectively (2013: 0.9%, 11.6%); Malaysia's returns were 0.7% and 8.8%, respectively (2013: 0.8%, 10.5%)

## Islamic Banking Average Return on Assets by Country



Source: Islamic Banking Sample, IFSB.



# A comprehensive Islamic financial system in Malaysia's financial system

*Diversity of players & wide range of products supported by legal, Shariah & regulatory framework*

## Governance

- **Legal & Regulatory**
  - Islamic Banking Act
  - Takaful Act
  - Government Funding Act
  - Capital Market Services Act
  - New foreign legal firm
- **Shariah Advisory Council**
  - Central Banking Act
- **Dispute Resolution**
  - Judicial system: dedicated high court
  - KL Regional Centre for Arbitration
  - Financial Mediation Bureau

## Financial Markets

- **Money Market**
  - Islamic interbank money market
  - Diverse short-term Islamic money market instruments
- **Capital Market**
  - 58% of outstanding bonds are sukuk
  - 88% Shariah counters
  - 143 Islamic unit trust fund



## Diversified Players

### Banking

- 17 Islamic banks
- 16 Islamic windows
- 3 International Islamic Banks
- 14 International Currency Business Units

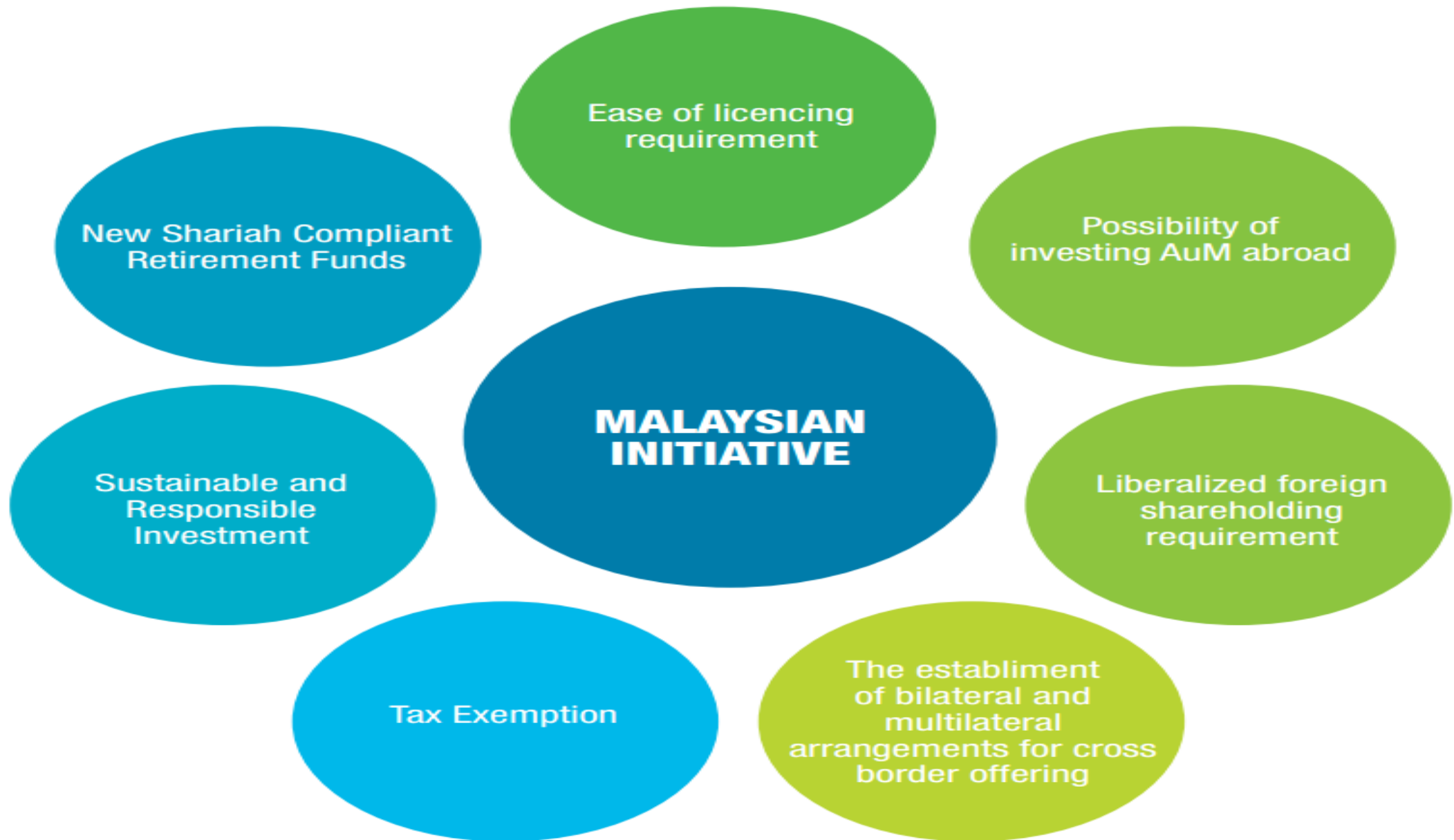
### Takaful

- 8 takaful operators
- 4 retakaful operators
- 1 International Takaful Operator
- 7 International Currency Business Units

### Fund Management

- 9 licensed Islamic fund management companies
- 35 fund management companies with Islamic mandates

# Malaysian Initiative for Islamic Funds Industry



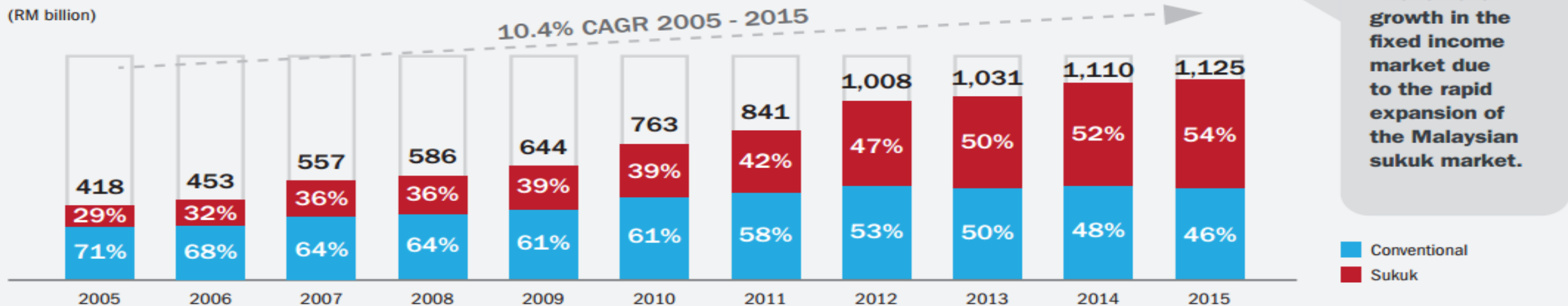
Source: Adapted from various sources

1. The **easing of licensing requirements** for dealing in fund management and giving investment advice.
2. The possibility for Islamic fund managers to **invest their entire AuM abroad**.
3. Liberalised foreign shareholding requirements of unit trust management companies which **opens the door for wholly-owned foreign fund managers to launch and distribute retail funds** in Malaysia.
4. The establishment of bilateral and multilateral arrangements for **cross border offering of Islamic funds** to promote further expansion of markets thus providing new opportunities for Islamic fund and wealth managers to grow their businesses.
5. **Tax exemption until 2020 for all fund management companies on fees** derived from the management of Shariah-compliant investment mandates, including Islamic real estate investment trusts and Islamic business trusts.
6. Guidelines for Sustainable and Responsible Investment.
7. The plan to establish a new Shariah-compliant retirement fund.



# Malaysian Fixed Income Market

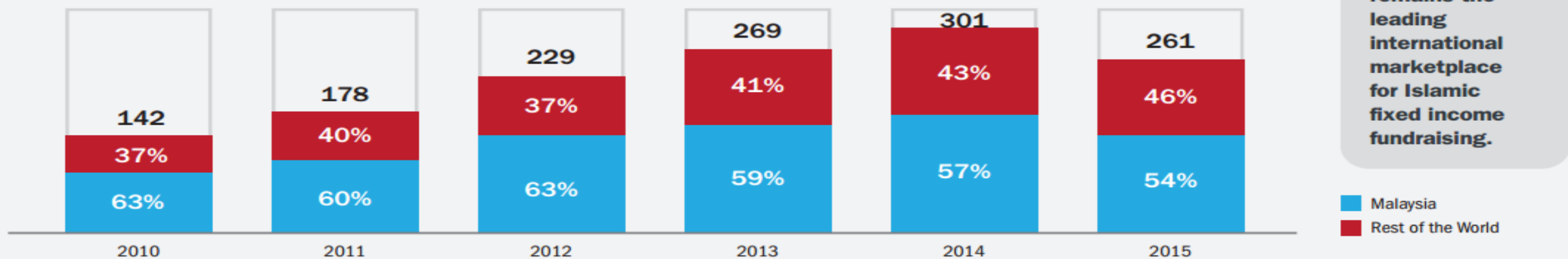
(RM billion)



Phenomenal growth in the fixed income market due to the rapid expansion of the Malaysian sukuk market.

# Global Sukuk Market

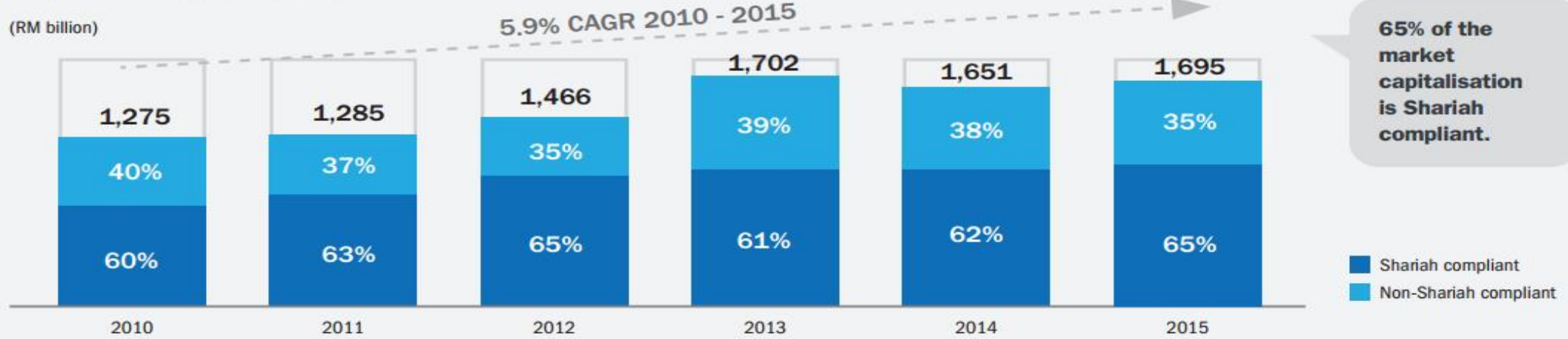
(USD billion)



Malaysia consistently remains the leading international marketplace for Islamic fixed income fundraising.

# Bursa Malaysia Profile

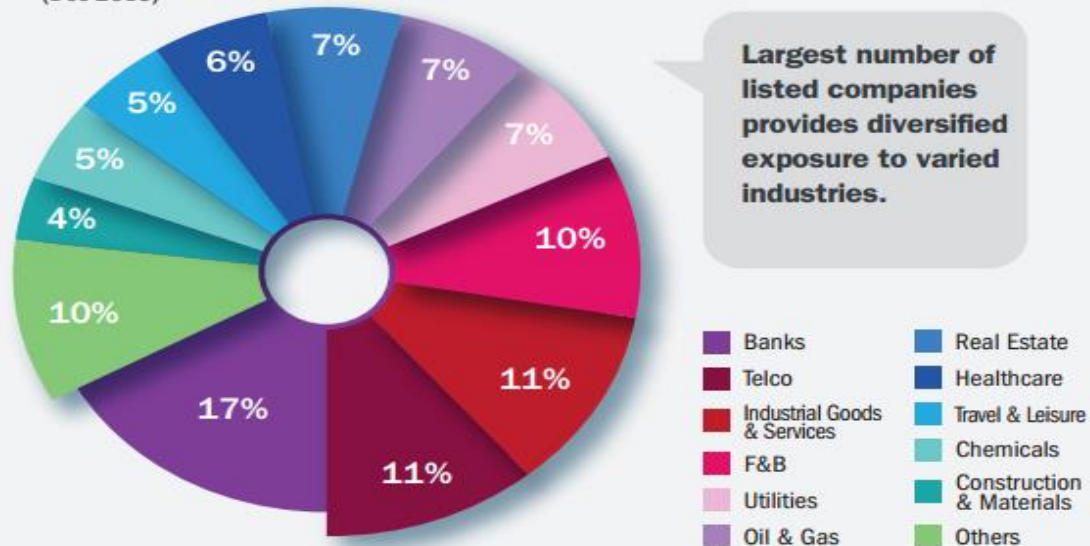
## Market Capitalisation



## Sectors Listed by Market Cap

USD383 billion, 903 PLCs

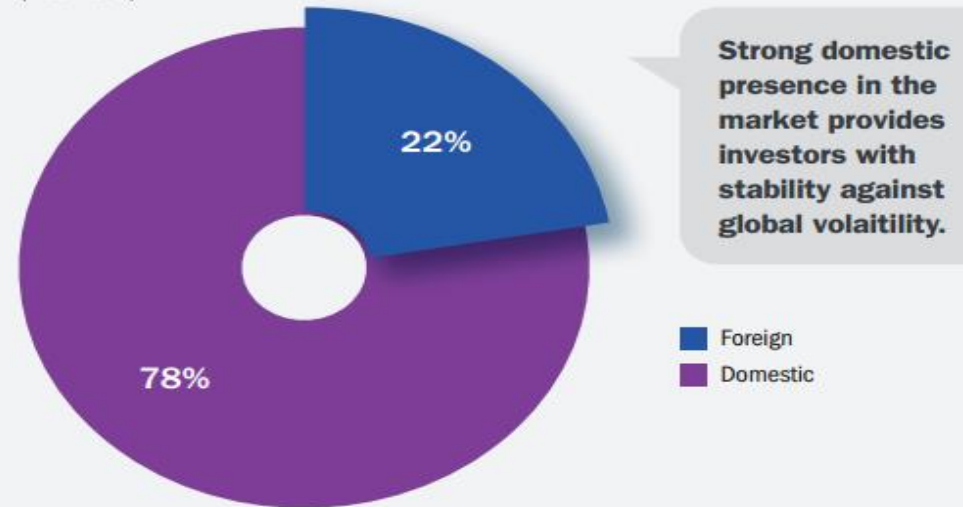
(Dec 2015)



## Domestic/Foreign Ownership by Market Cap

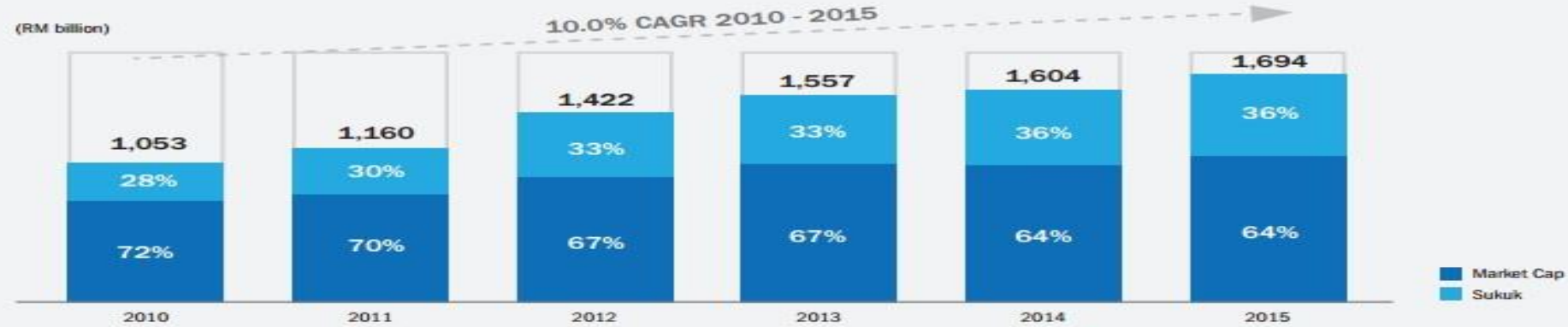
USD383 billion

(Dec 2015)

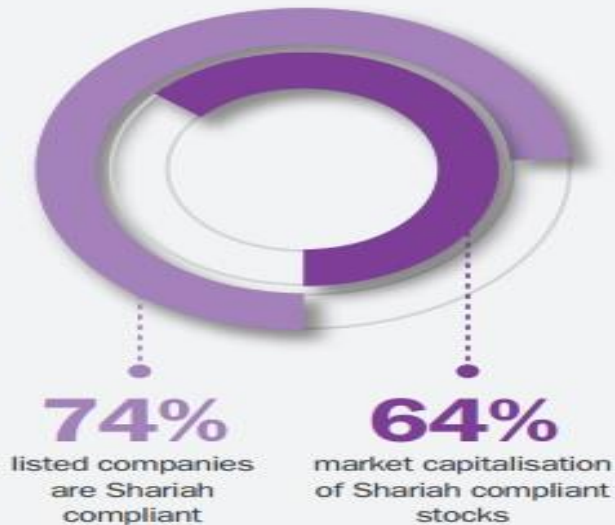


# ISLAMIC CAPITAL MARKET

## Total Islamic Assets

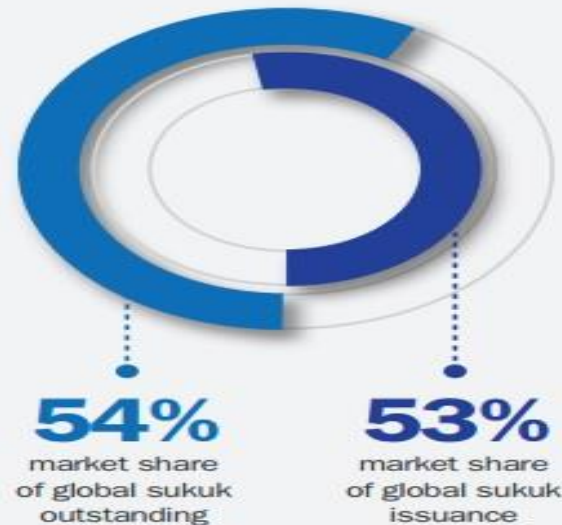


## Islamic Equity



The leading exchange in ASEAN for Shariah compliant investment

## Sukuk



## Islamic Unit Trust



Global leader in Shariah compliant unit trust

# Sukuk Features

- Underlying asset
- True sale
- Sell to third party = Debt trading (Malaysian only)
- 'Inah sale (Malaysian)
- Collateral.
- Fixed return

## Debt Based Sukuk

## Equity Based Sukuk

- Mudarabah / Musharakah contract
- No capital guarantee
- No Profit Guarantee
- Purchase Undertaking at a fixed formula
- Collateral.
- May sell to third party

- Sale contract
- Leasing
- Fixed or variable rental
- Collateral
- Frequent rate of return.
- May sell to third party

## Lease-Based

# Characteristic & Features

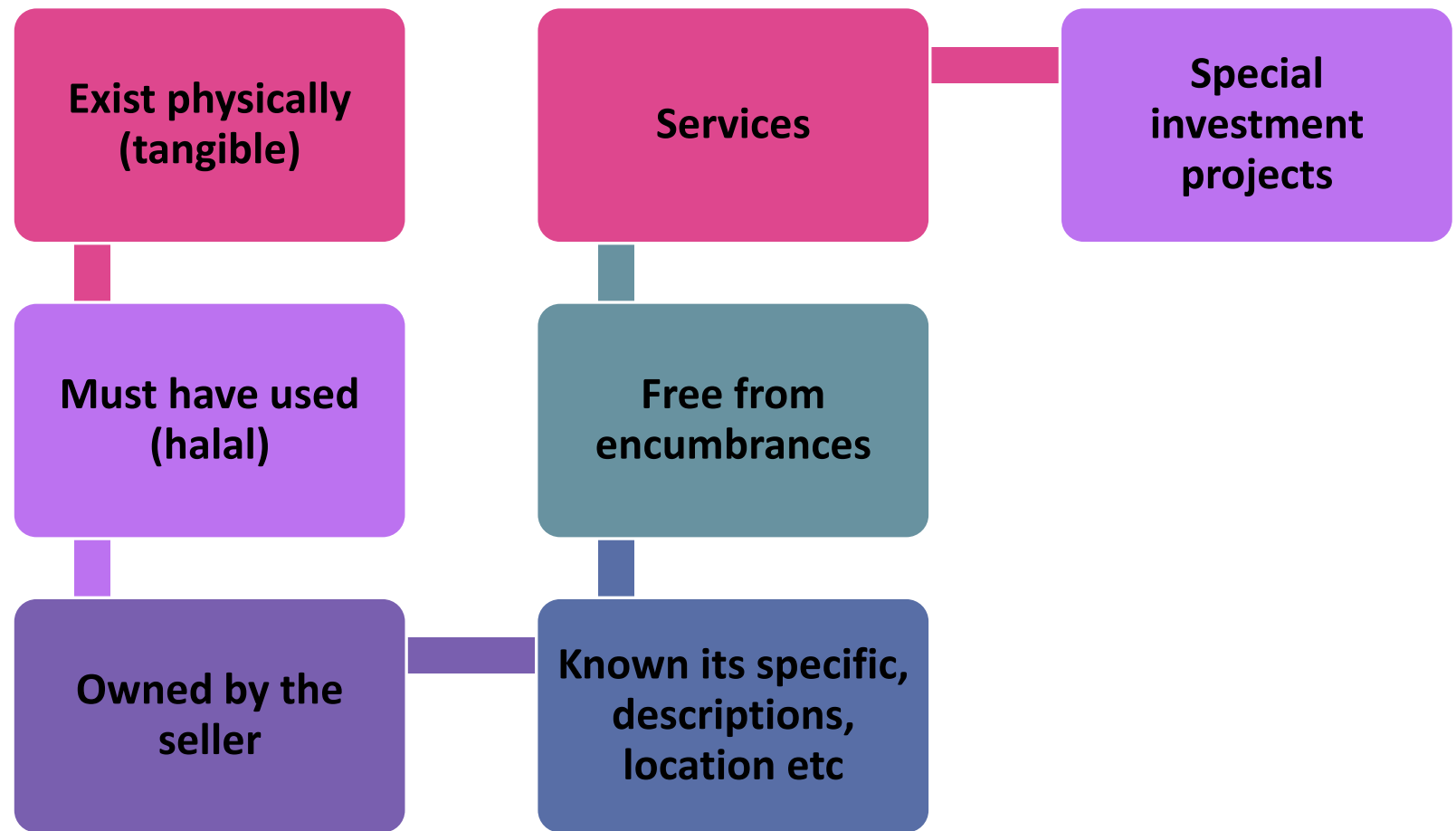
Issuance of Sukuk must be supported by underlying asset.

Must not only be a debt or cash. Trading of indebtedness is prohibited by quite a number of contemporary Shariah scholars.

What is asset?

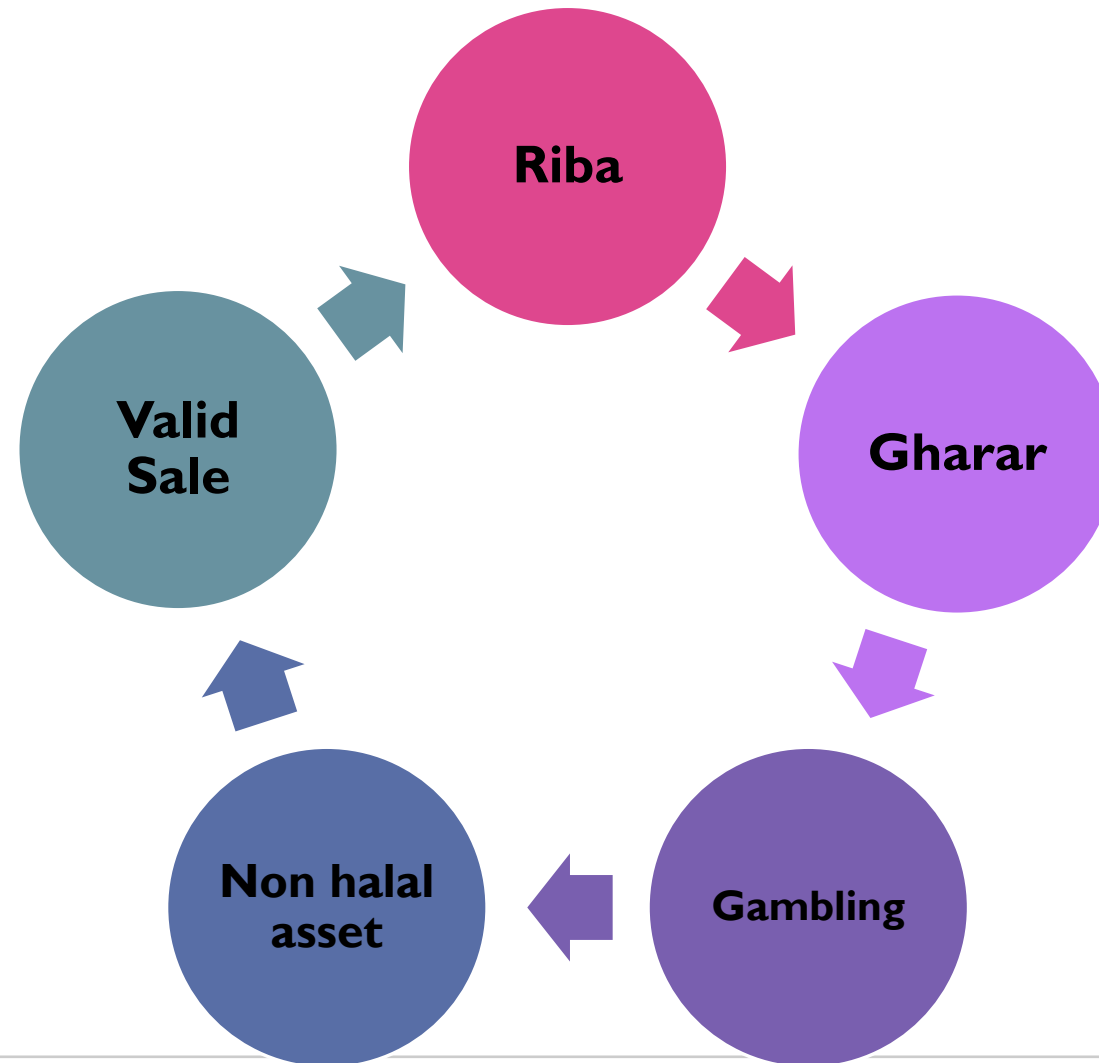






**By SC definition, the asset may include financial assets such as receivables and debts, as well as non-financial assets in the like of tangible assets, usufructs and services**

# NO PROHIBITED ELEMENTS



# Bases For Sukuk Classification

## Underlying Contracts

- Sales-based
- Lease-based
- Partnership-based
- Agency-based

## Technical Commercial Features of Sukuk

- Asset-based (normal)
- Asset-Backed (ABS)
- Hybrid Structure (Convertible & Exchangible)

## The nature & type of Asset represented by the Sukuk

- Debt-based
- Tangible Assets
- Usufruct
- Rights in investment projects
- Special Investment Activities

# WHAT AN ORIGINATOR LOOKS FOR?

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- Capital relief
- Managing Assets liability
- Off balance sheet funding
- Reducing concentration risk
- Direct access to capital Markets
- Improved RoA / RoE



**ELZAR SHARIAH**  
SOLUTIONS & ADVISORY

- Shari'ah Compliance for Financial Contracts
- Shari'ah Compliance for Investment funds
- Shari'ah Compliance for Equity Funds
- Product Innovation & Development
- Shari'ah Reviews & Audit
- Research & Development
- Shari'ah & Islamic Advisory
- Shariah Training
- Islamic Content Provider
- Curriculum & Syllabus Provider

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