

# FINANCIAL REGULATORS FORUM IN ISLAMIC FINANCE

## Enhancing the intermediation process in the Islamic Capital market

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# Key Messages

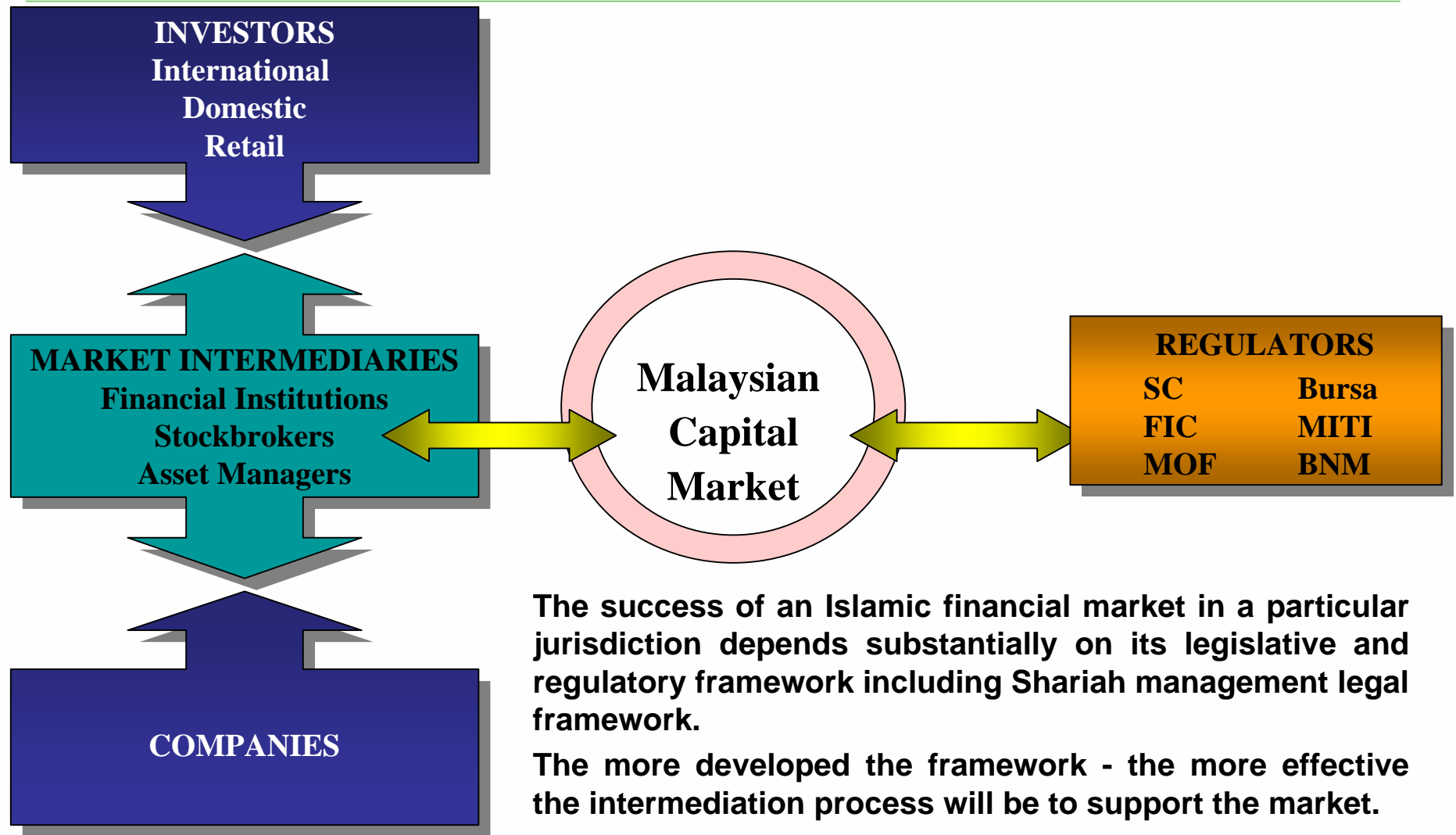
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- Section 1 Malaysian Capital Market : Components, Objectives & Evolution
- Section 2 Islamic Financial Market Components
- Section 3 The Need For Islamic Capital Market
- Section 4 The Need to Enhance Intermediation Process
- Section 5 Islamic Capital Market – Impact from Malaysia’s Government Proactive Approach
- Section 6 Conclusion

## **Important Notice**

# Enhancing the Intermediation Process in Islamic Capital Market Malaysian Capital Market : Components, Objectives & Evolution

# Components of The Malaysian Capital Market



The success of an Islamic financial market in a particular jurisdiction depends substantially on its legislative and regulatory framework including Shariah management legal framework.

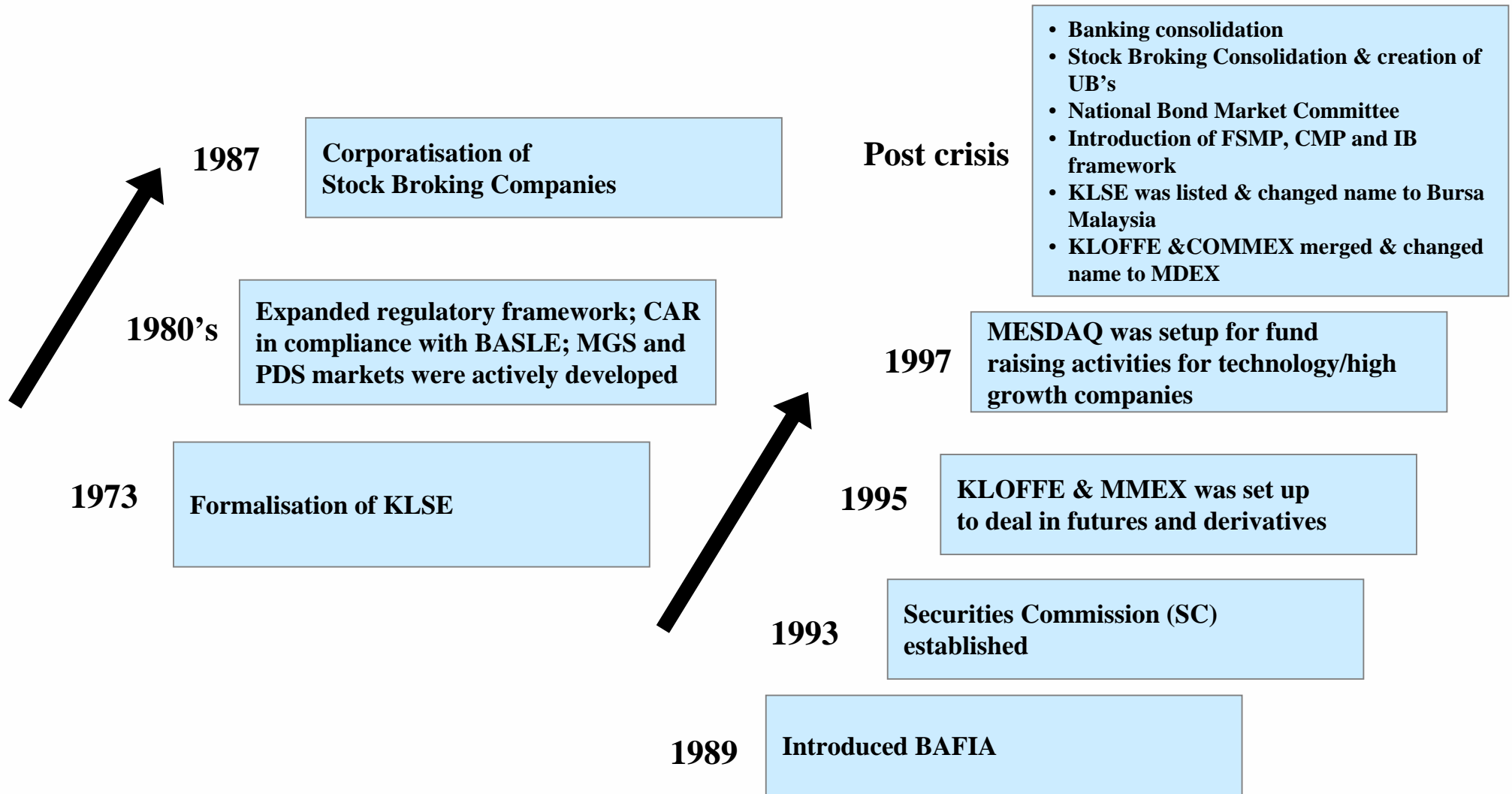
The more developed the framework - the more effective the intermediation process will be to support the market.

## Key Objectives for Capital Market Regulatory Framework

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- To enable mobilisation and allocation of capital in the most efficient manner
- To provide a high level of market confidence
- To ensure fair markets & protection of investors
- To encourage innovation with minimum compliance cost

# How our Key Market Institutions Have Evolved Since the Formation of KLSE...

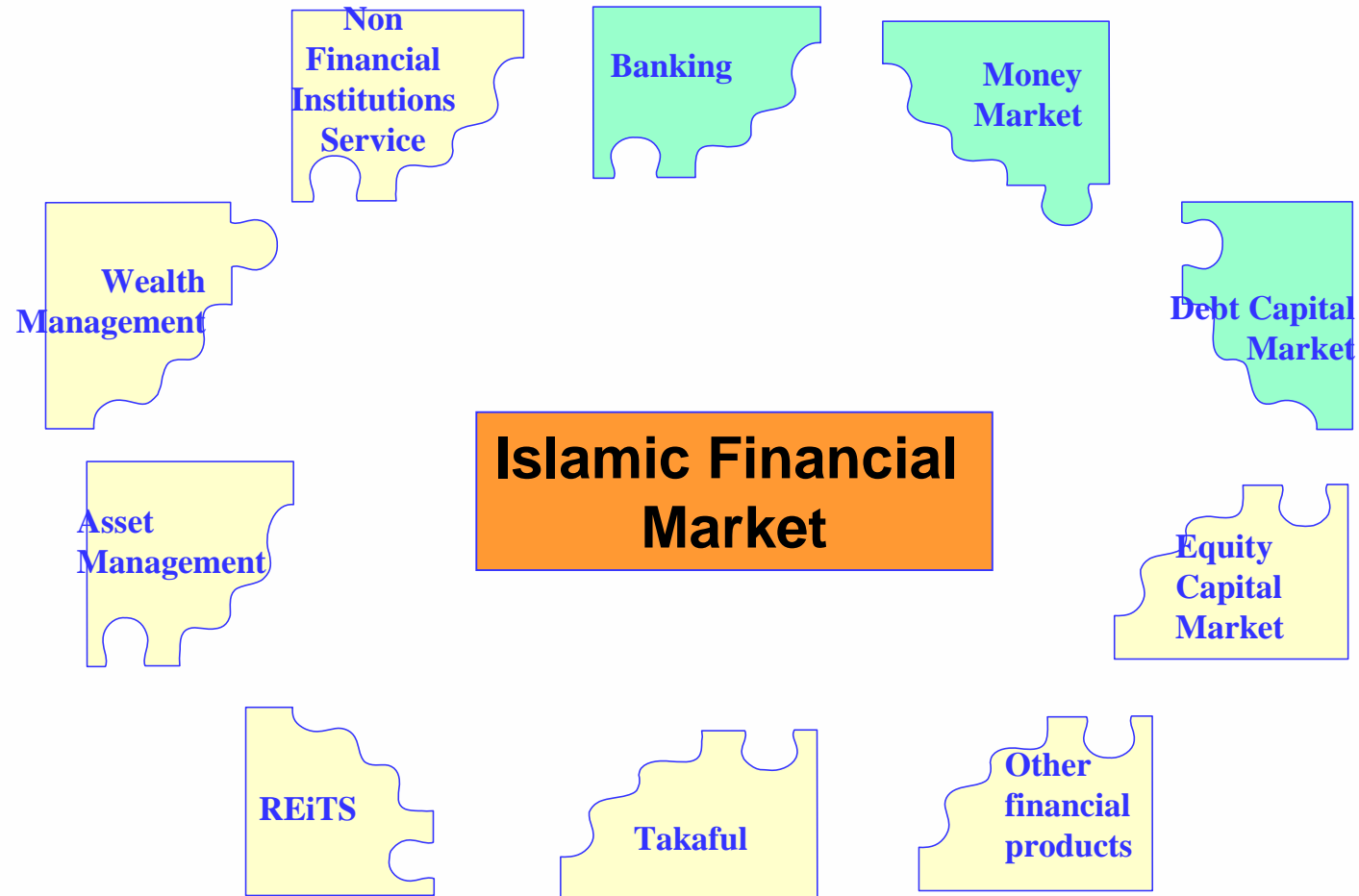


# Enhancing the Intermediation Process in Islamic Capital Market

## Islamic Financial Market Components

# The Industry Components for Effective Islamic Capital Market

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The more developed the components, the more resilient the Islamic financial market will be.

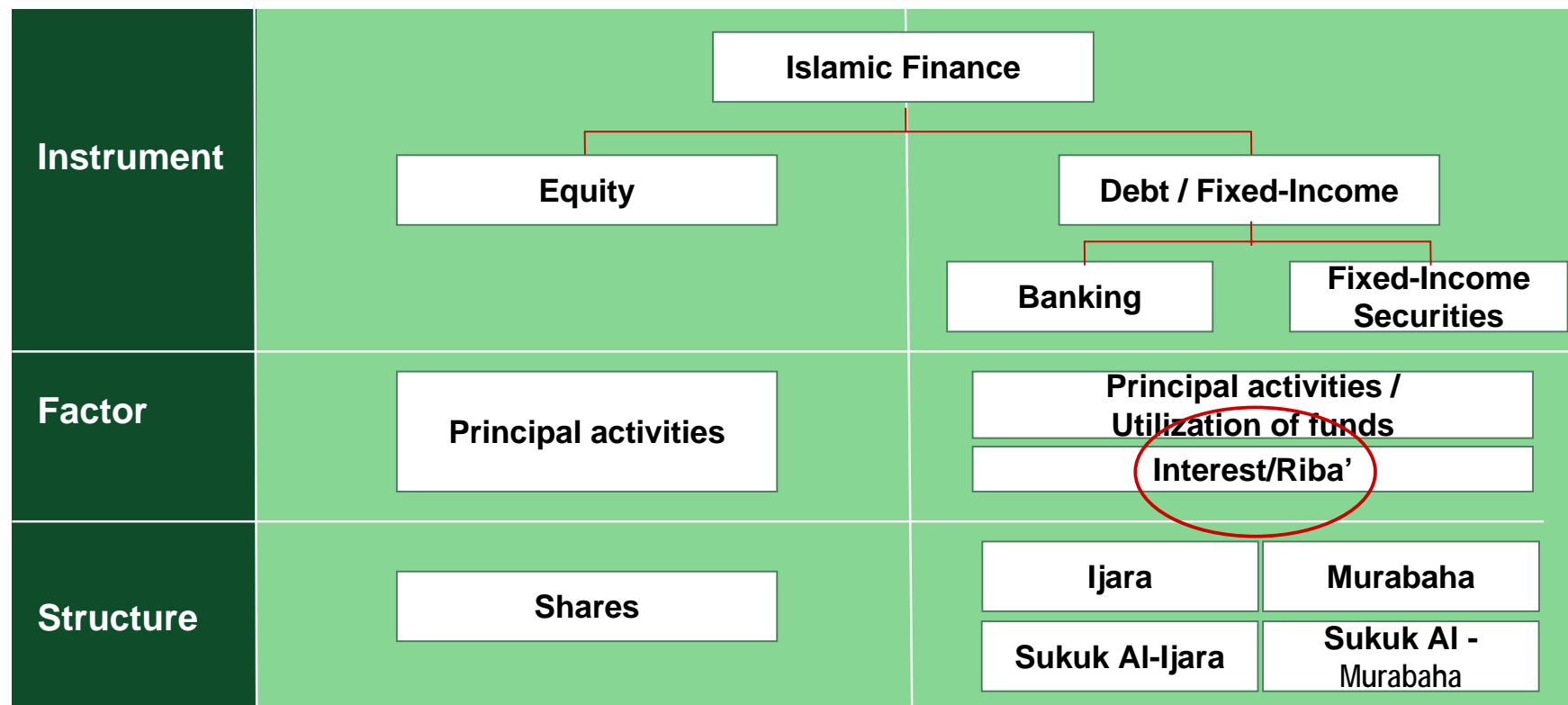
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## Islamic Debt Capital Market : Key Issues

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- Prohibition of Riba' -  
.....That is because they say: Trade is just like usury; whereas ALLAH PERMITS TRADING and FORBIDS USURY.....(Al Quran: Al Baqarah 2:275)
- Islamic debt structures are developed based on the existing laws of a particular jurisdiction. However, the legal relationships are **NOT** about "LENDING" and "BORROWING" but instead about "SALE", "PURCHASE", "LEASE", "CONSTRUCTION" and "INVESTMENT" which are operated under Banking or Debt Securities Laws.
- Therefore, it is extremely important for tax-regime jurisdictions to fine tune tax laws and other laws that govern "SALE", "PURCHASE", "LEASE", "CONSTRUCTION" and "INVESTMENT" while revising banking and Debt securities laws.

## Islamic Debt Capital Market vis-à-vis Equity Capital Market



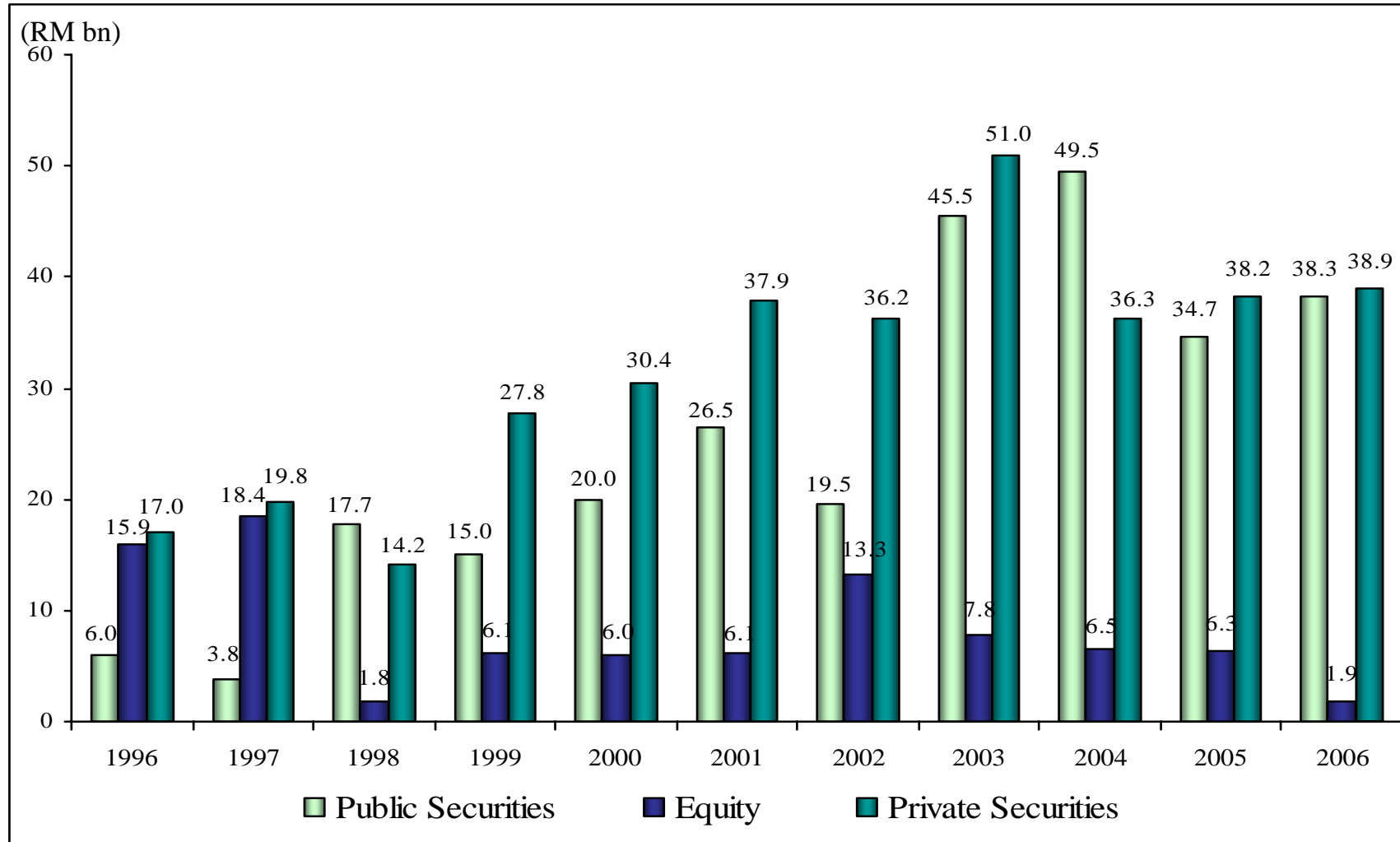
(Source: CIMB Islamic Fixed Income Research)

- Islamic bankers need to focus on “right” legal relationship to reflect Islamic Debt obligation nature which is also senior in claim compared to Equity.
- Also focus on differences in Accounting (Balance Sheet/Profit & Loss) treatment between equity and debt

# Enhancing the Intermediation Process in Islamic Capital Market

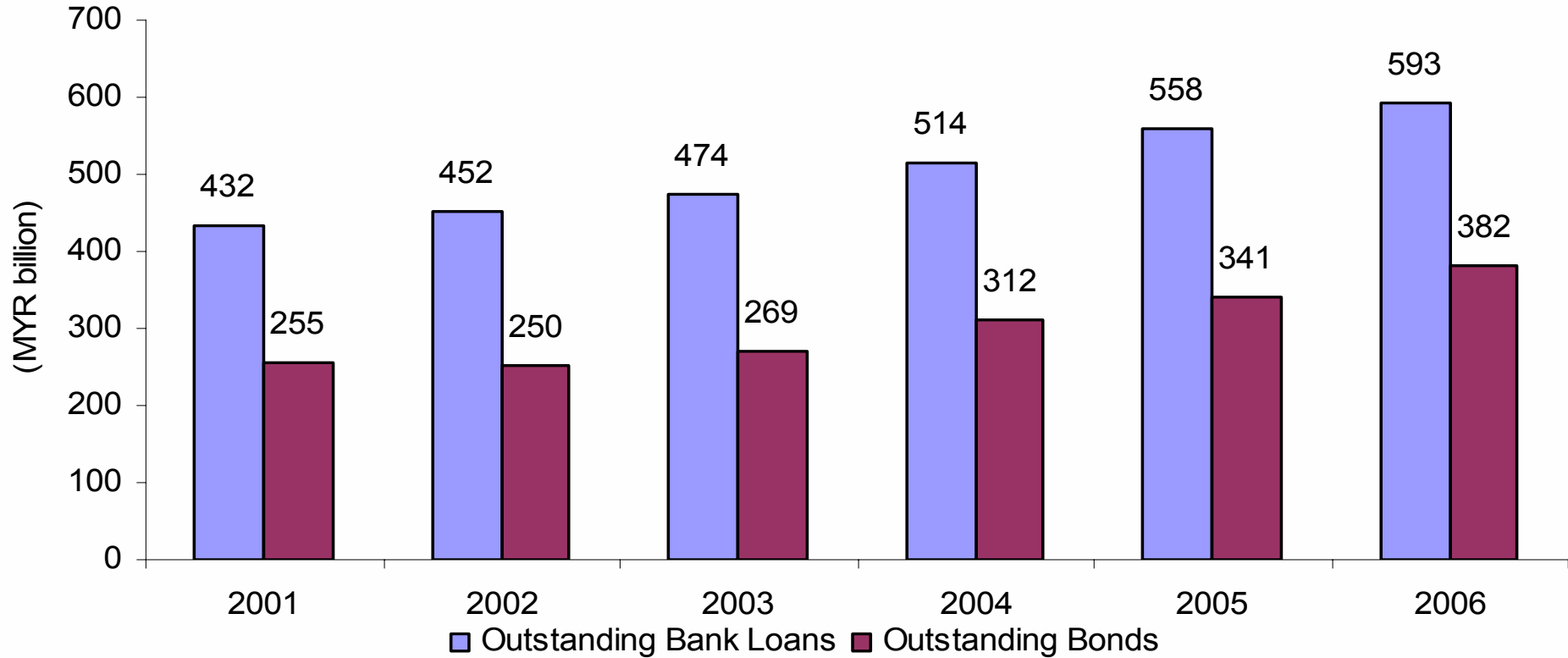
## The Need For Islamic Capital Market

## Our Capital Market Provides Funding For Both Public and Private Sectors

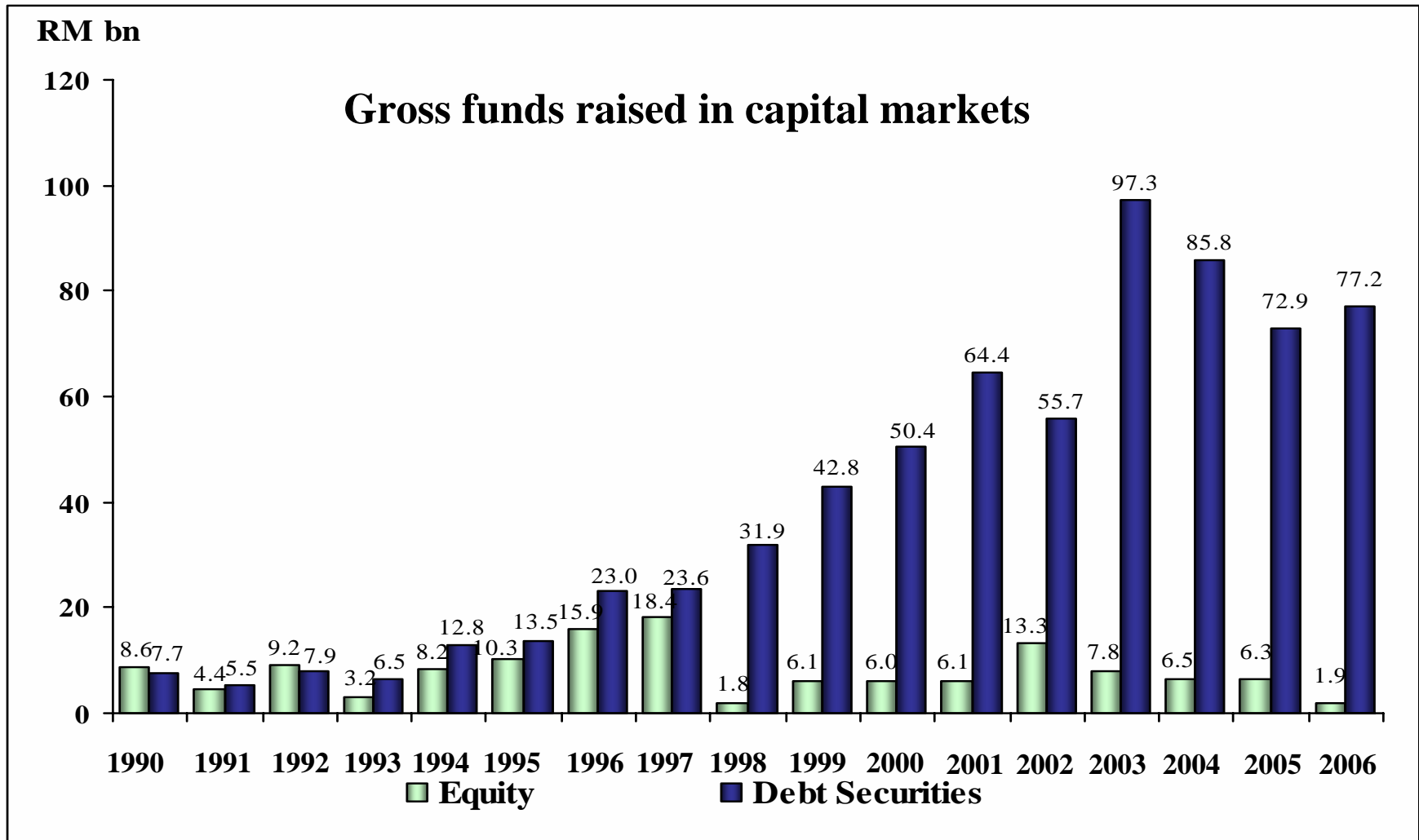


## Banking System Dominance...

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## To Further Promote Our Capital Market Growth



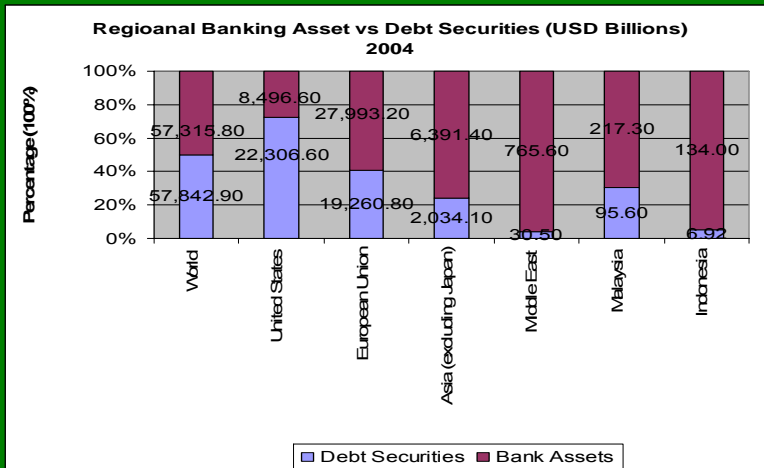
# The Need to Grow Islamic Capital Market

Why have Islamic capital market or more particularly why a sukuk market? The reason is Islamic banking industry on its own is inadequate to sustain a robust economy ...

- Banking assets are not as liquid as capital market instruments. In most Islamic countries it is an inefficient market; therefore the creation of a functioning Islamic Capital Market is key.
- This is largely a process of disintermediation of the banking sector.

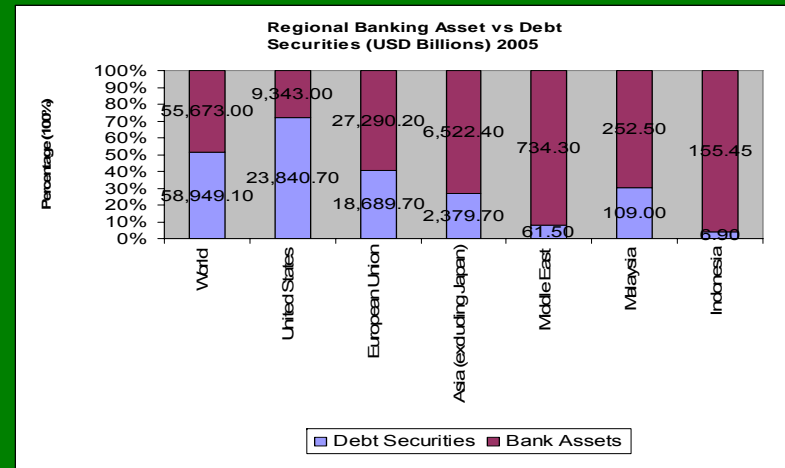
## Regional Banking Assets vs. Debt Securities 2004

Source: International Monetary Fund, Bank Negara Malaysia, Bank Indonesia



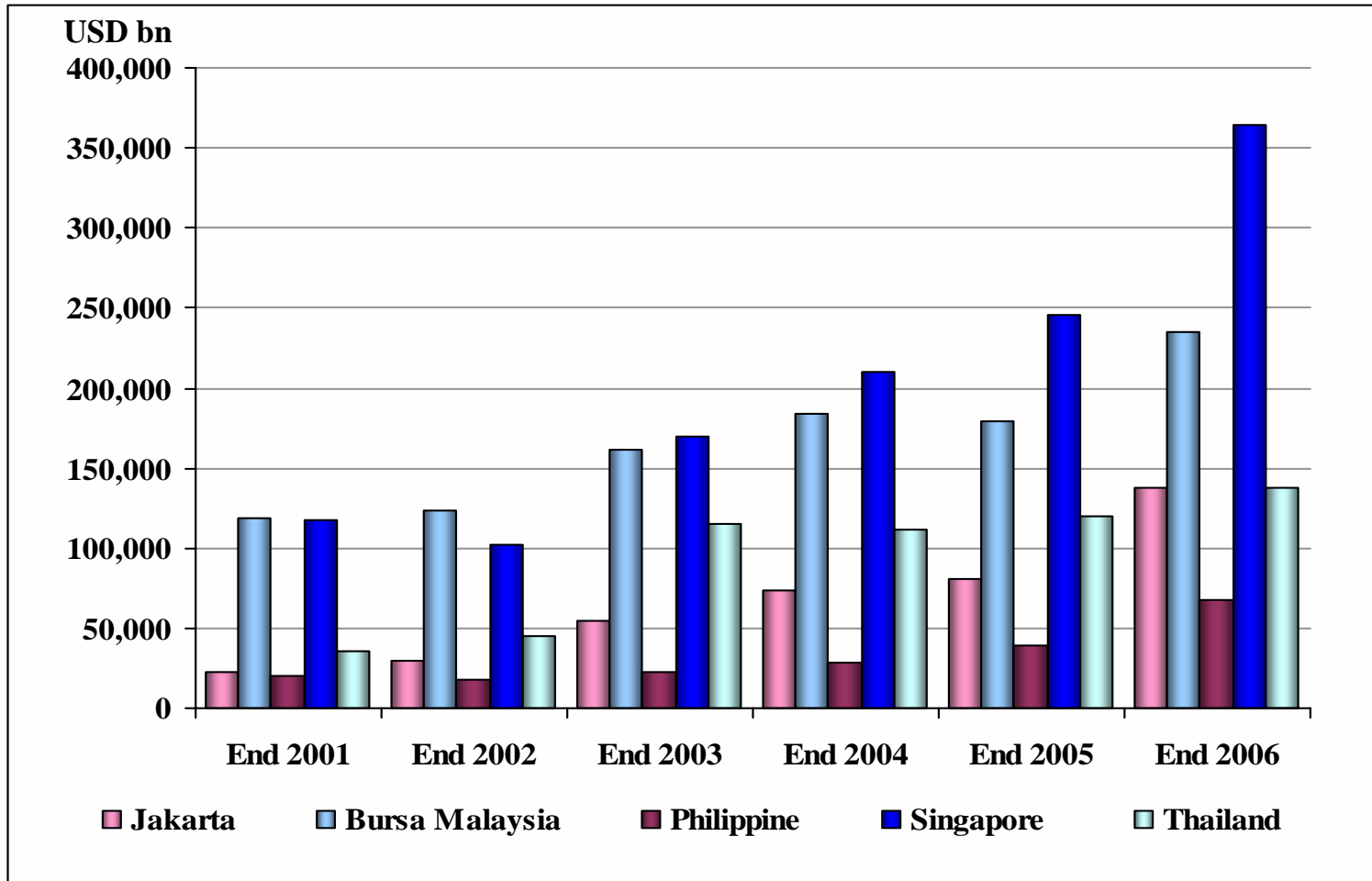
## Regional Banking Assets vs. Debt Securities 2005

Source: International Monetary Fund, Bank Negara Malaysia, Bank Indonesia



# Bursa Malaysia Is One of SEA's Largest Exchanges...

## Market Capitalisation



# Enhancing the Intermediation Process in Islamic Capital Market

## The Need to Enhance Intermediation Process

# Enhancing the Intermediation Process

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## To enhance the competitive position and efficiency of market Institutions

- ability to adapt promptly and appropriately to external competitive pressures
- to tap economies of scale, strengthening the integrity of the market

## To develop a strong and competitive environment for intermediation services

- ability to respond effectively to the impact of changing consumer demands, technological developments and the increasing integration of financial services
- more cost effective and comprehensive range of services and products to be offered by capital market intermediaries

## To ensure a stronger and more facilitative regulatory regime

- adoption of a market-based system of regulation represents the greater use of competitive market disciplines and processes, with minimum direct regulatory intervention, to achieve regulatory objectives

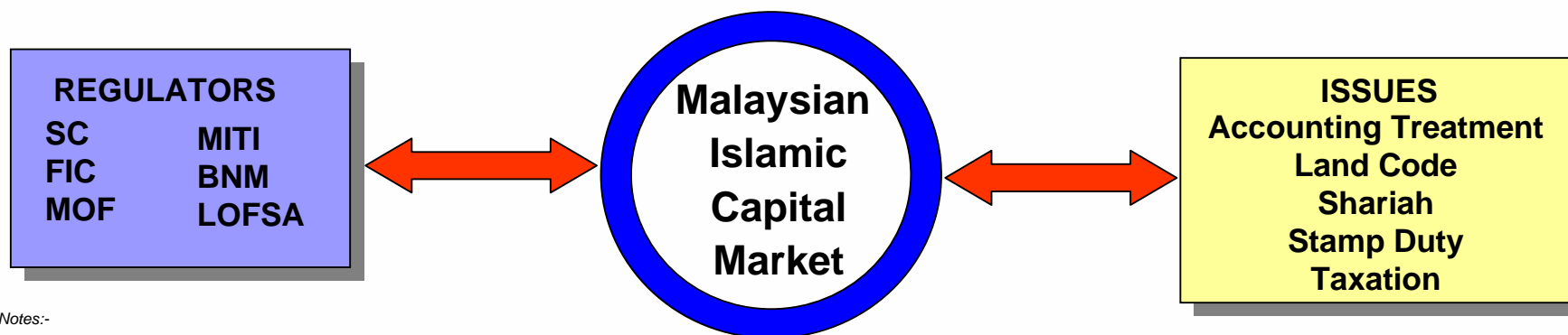
Source: Capital Market Masterplan, SC

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# Enhancing the Intermediation Process in Islamic Capital Market

## Islamic Capital Market – Impact from Malaysia's Government Proactive Approach

# Malaysia's Government Proactive Approach



Notes:-

BNM: Bank Negara Malaysia  
FIC: Foreign Investment Committee  
LOFSA: Labuan Offshore Financial Service Authority  
MITI: Ministry of International Trade and Industry  
MOF: Ministry of Finance  
SC: Securities Commission

## Key Governing Laws

- Banking Laws (Islamic Banking Act 1983 ("IBA"))
- Securities Laws (Guidelines on the Offering of Islamic Securities 2004 ("IS"))
- Shariah requirements (incorporated in IBA and IS)

## "Accidental" Governing Laws

- Land Laws
- Securities Laws i.e. merger/ takeover, beneficial ownership
- Lease Laws (Ijara transaction)
- Tax/Stamp Duty legislation
- Others

# Making Islamic Transaction Competitive

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## *Provision of Automatic Tax Neutrality*

To facilitate the issuance of more Sukuk, the Government has amended the tax legislation to provide automatic tax neutrality. This makes Sukuk issues at parity with conventional in terms of cost.

## *Effective Regulation for Shariah Advisory*

Shariah Advisory Council acts as the sole authoritative body to advise SC on Islamic Capital Market issues

All appointments of Shariah Advisors on committees of licensed Islamic financial institutions is subject to stringent due diligence and approval by BNM

## *Introduction of Tax Incentives*

The Government has taken a bold step to incentivise issuers to issue Sukuk through tax deductibility of expenses incurred in raising the Sukuk (Ijarah, Istisna', Mudharabah and Musharakah)

# Effective Regulatory Framework Promotes Innovation

**Pre – 2001**

## Ijara

- Competing against conventional lease market – Malaysia’s tax structure

## Bai’ Bithaman Ajil

- Most popular in Malaysia – 70% Islamic banks portfolio due to tax

## Murabaha

- Popular for corporate trade financings in Malaysia. Popular for Islamic financial institutions as “Commodity Murabaha” in the GCC/ME for Treasury Placements

## Syndicated Ijarah Muntahiyah Bit-Tamlik

- Kumpulan Guthrie Berhad – Education process again to get prepared for global Sukuk Al-Ijarah issuance

## Ijara Muntahiyah Bit-Tamlik

- Education process for legal, tax, accounting, credit and Shariah

## Bai’ Bithaman Ajil

- Kuala Lumpur International Airport Berhad

## Bai’ Bithaman Ajil

- Notes/Sukuk issuance – First issuance by Shell MDS Sdn Bhd

1990

1995

1996

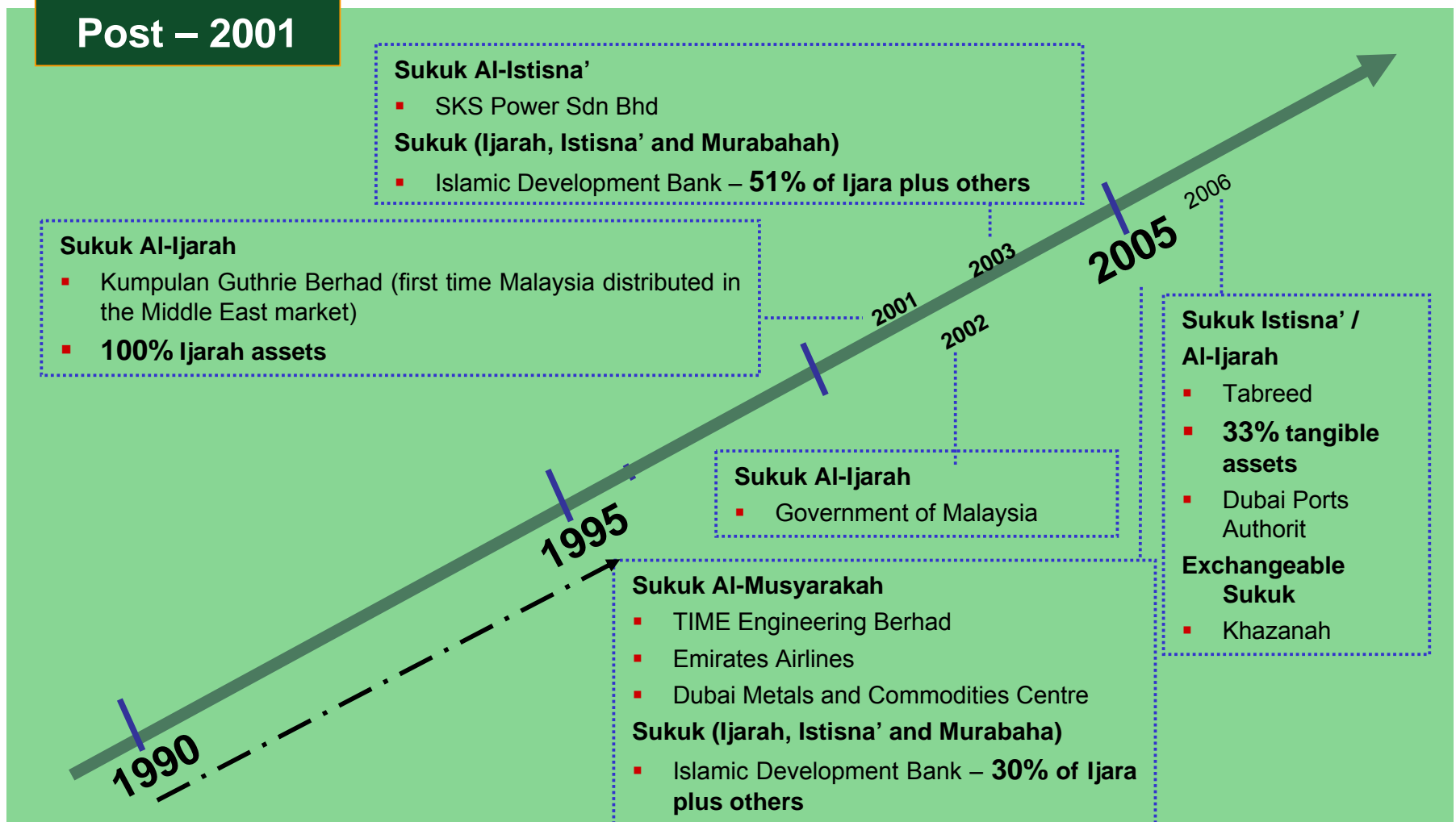
1997

1998

2000

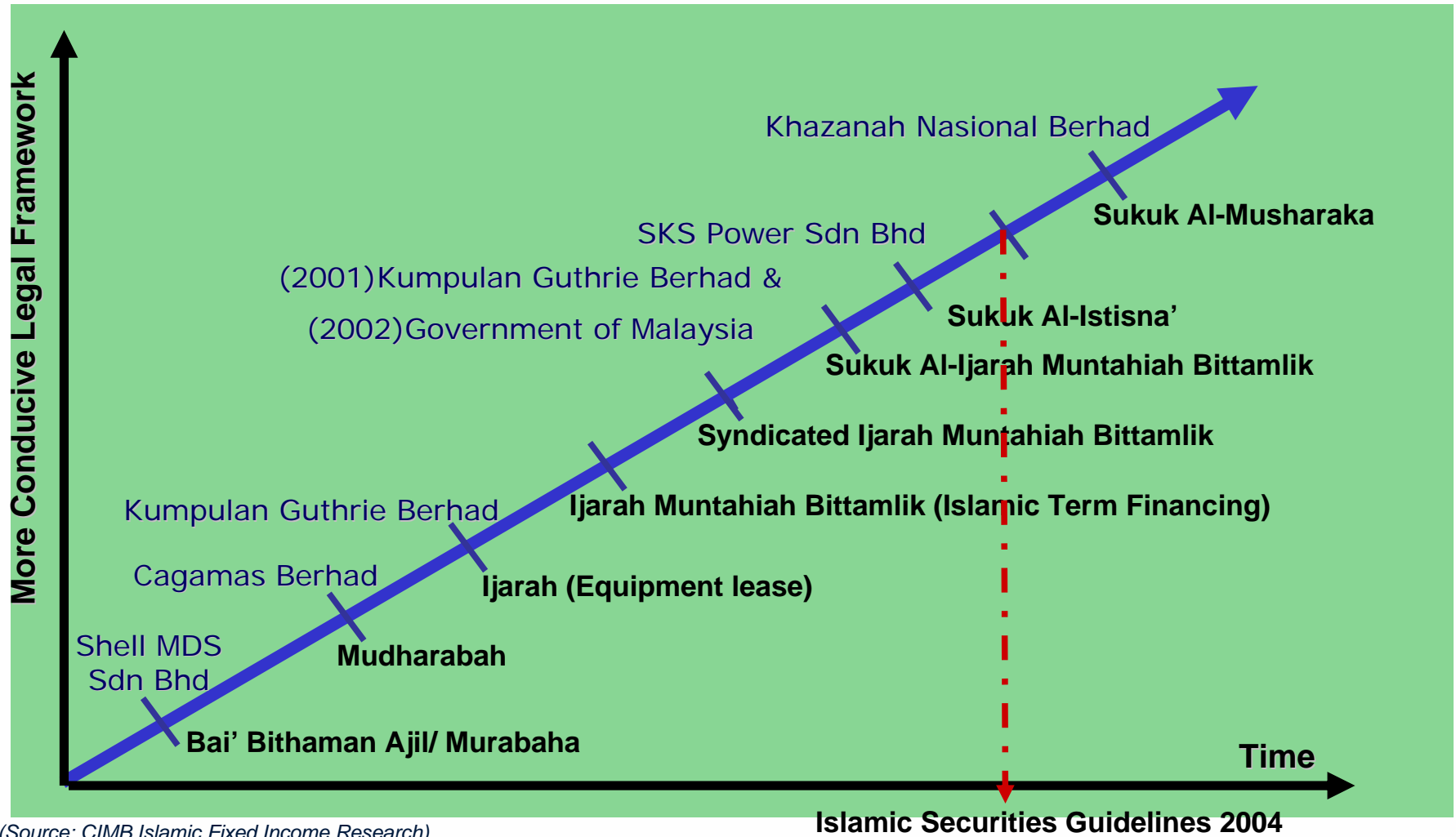
(Source: CIMB Islamic Fixed Income Research)

# Education Process Promotes Innovation of Islamic Debt Markets



(Source: CIMB Islamic Fixed Income Research)

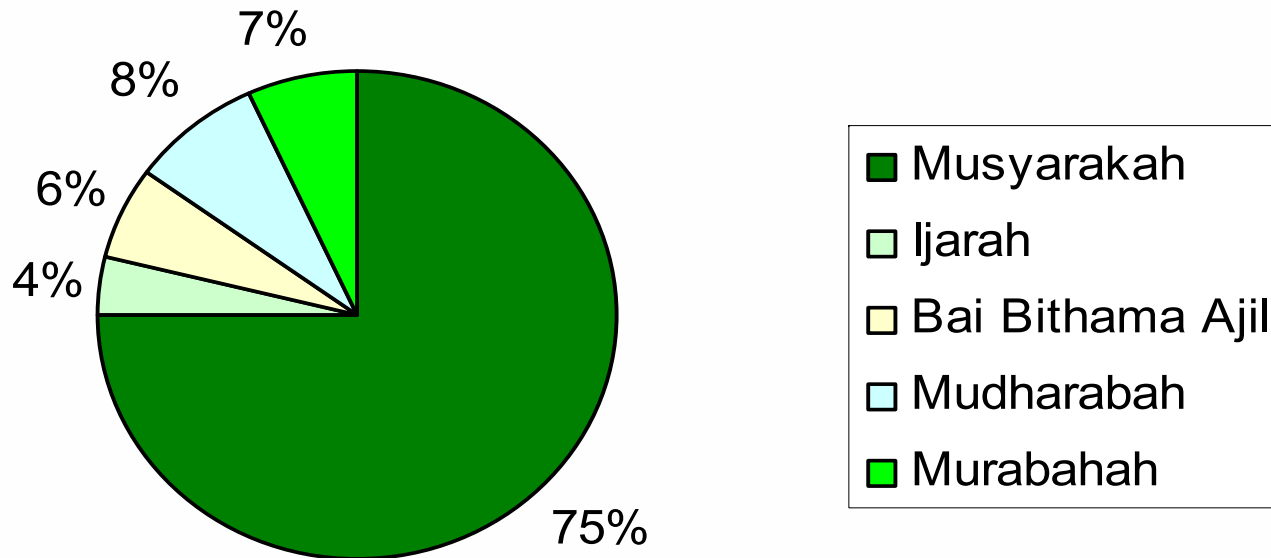
# Evolution of Sukuk Structures in Malaysia



## Innovation in Islamic Capital Market Products.....

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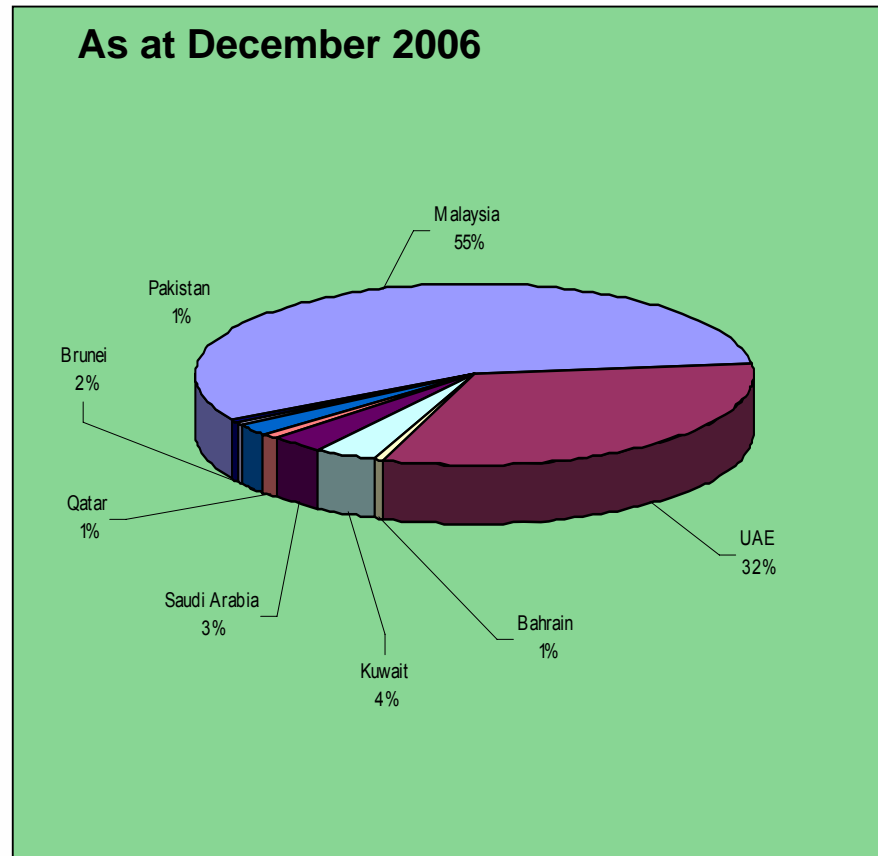
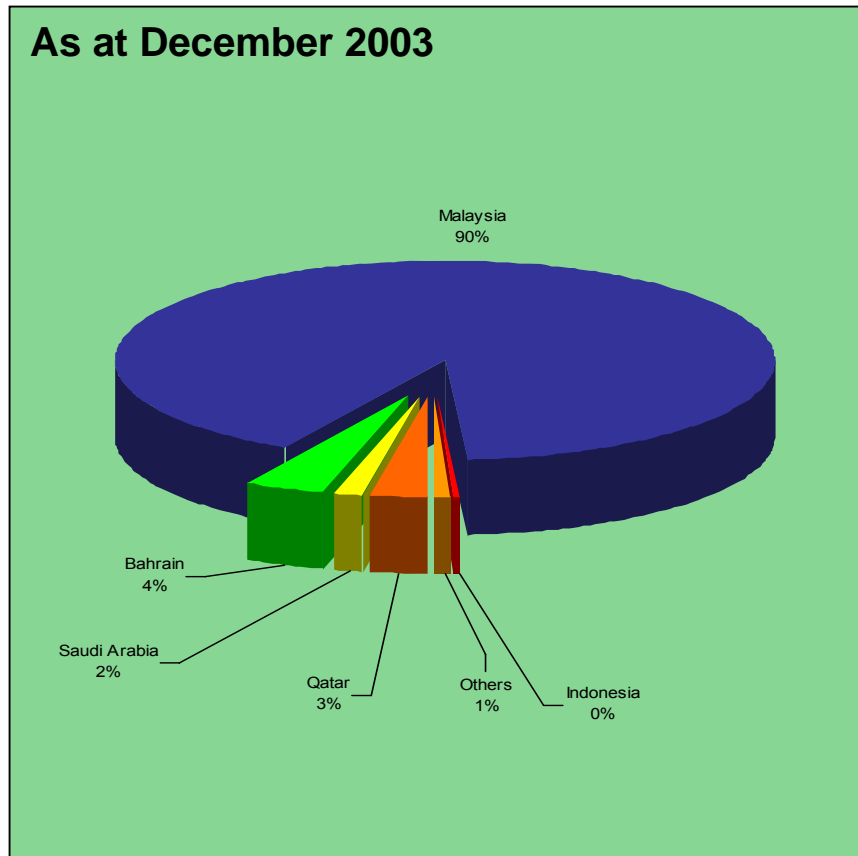
Sukuk approved based on Syariah principle in Malaysia – Q3 2006. Note That 75% of the Sukuk approved are Musyarakah Principle as Compared to 6% the Traditional BBA principle.



Source : SC website

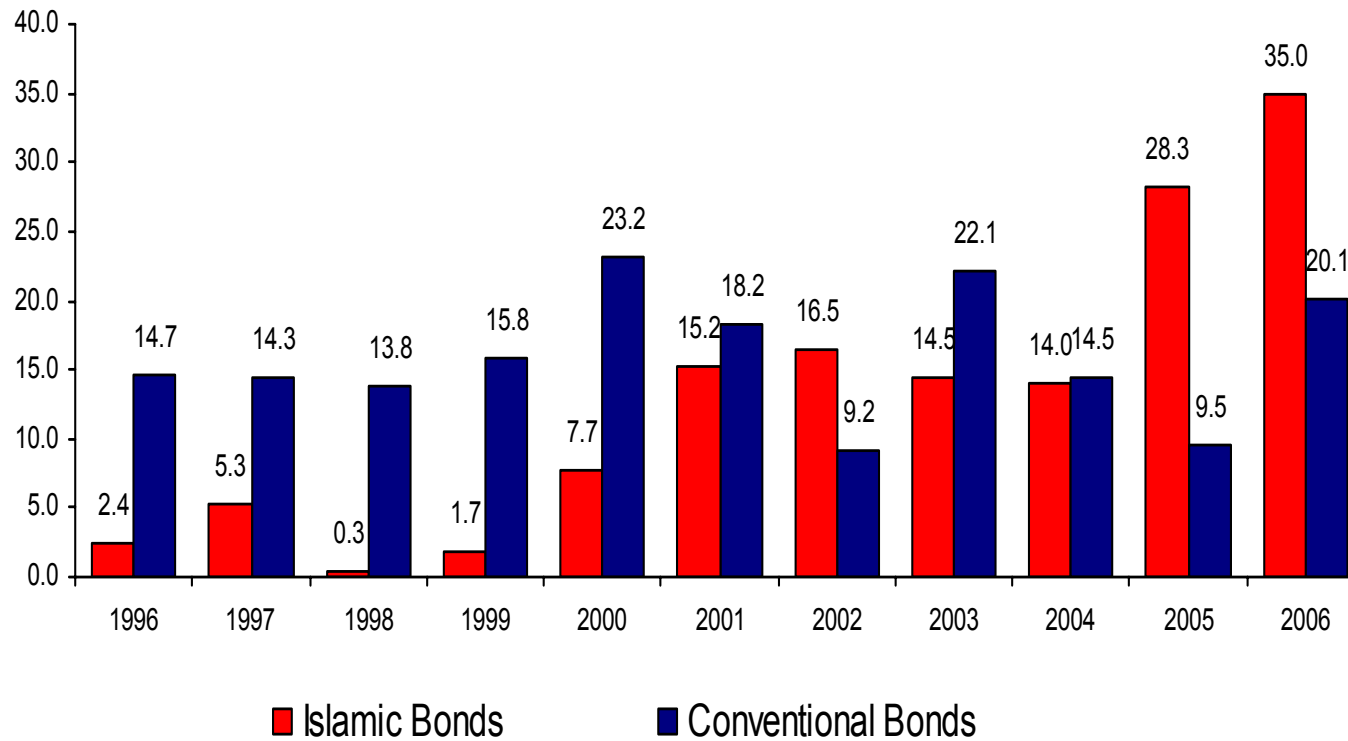
# Efficient Regulatory Framework Stimulate Growth of Sukuk Issuance

As of December 2006, approximately 56% of new Islamic fixed income securities globally were issued in Malaysia. The remaining global issues are from the Middle East / GCC



(Source: The Islamic Capital Market Task Force (IOSCO) Report and ISI Emerging Markets)

## Growth of Islamic Capital Market in Malaysia (RM Bil)

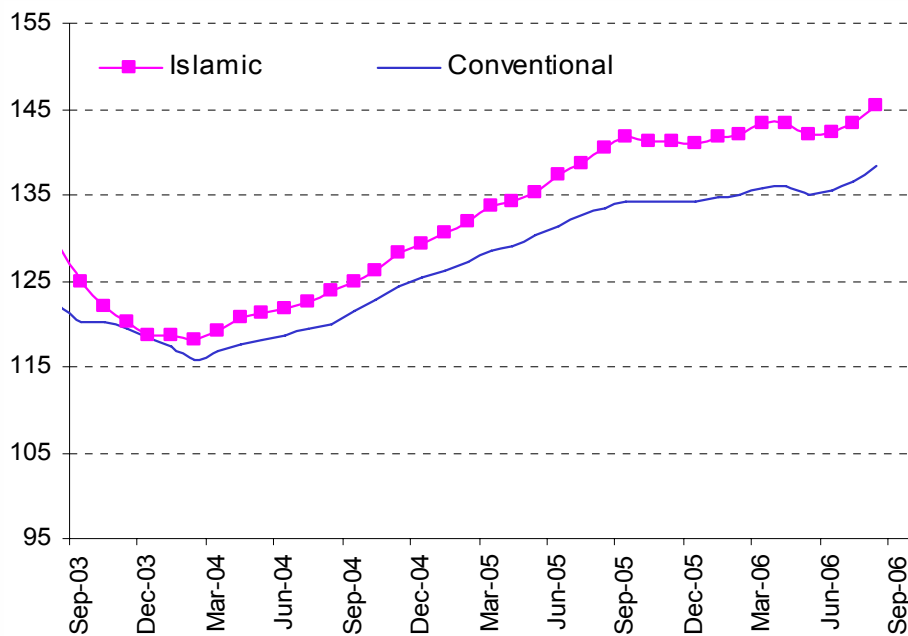


(Source: CIMB Fixed Income Research)

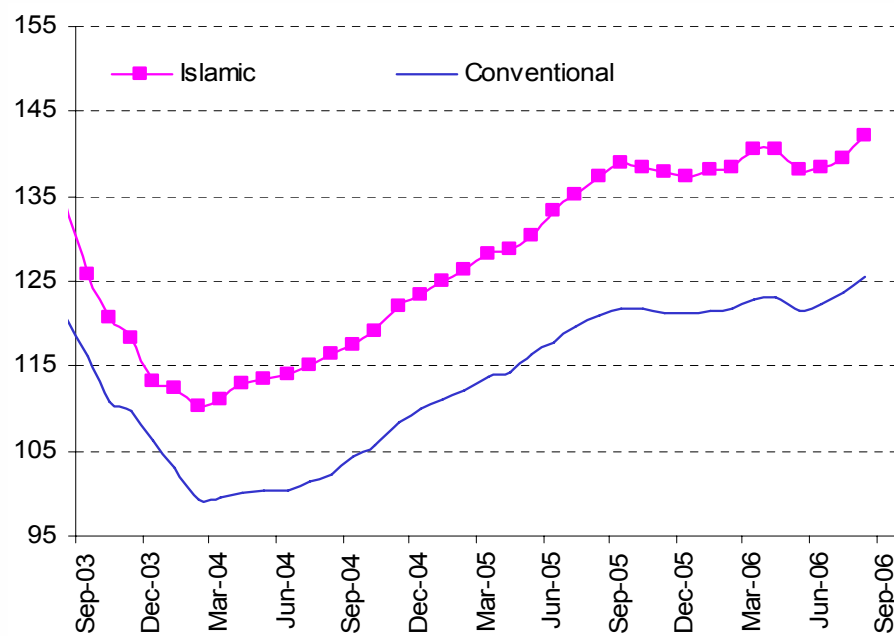
# As a Result.....

## Islamic Papers have always Outperformed Conventional Papers in Malaysia

Ringgit Bonds with maturities of 1-year and above



Ringgit Bonds with maturities of 5-years and above

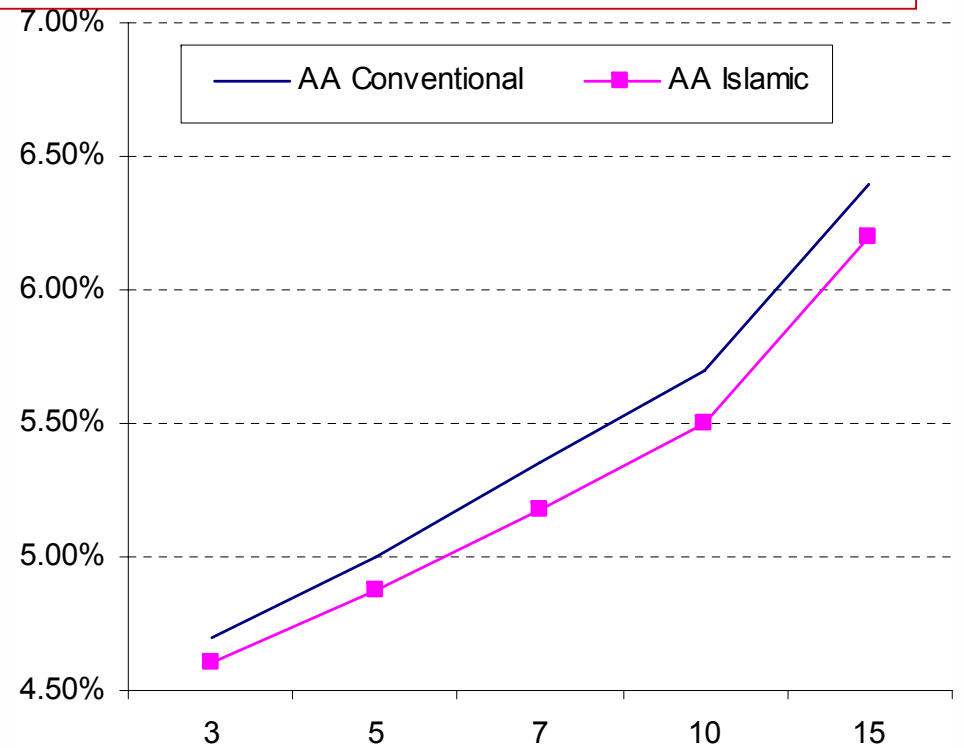
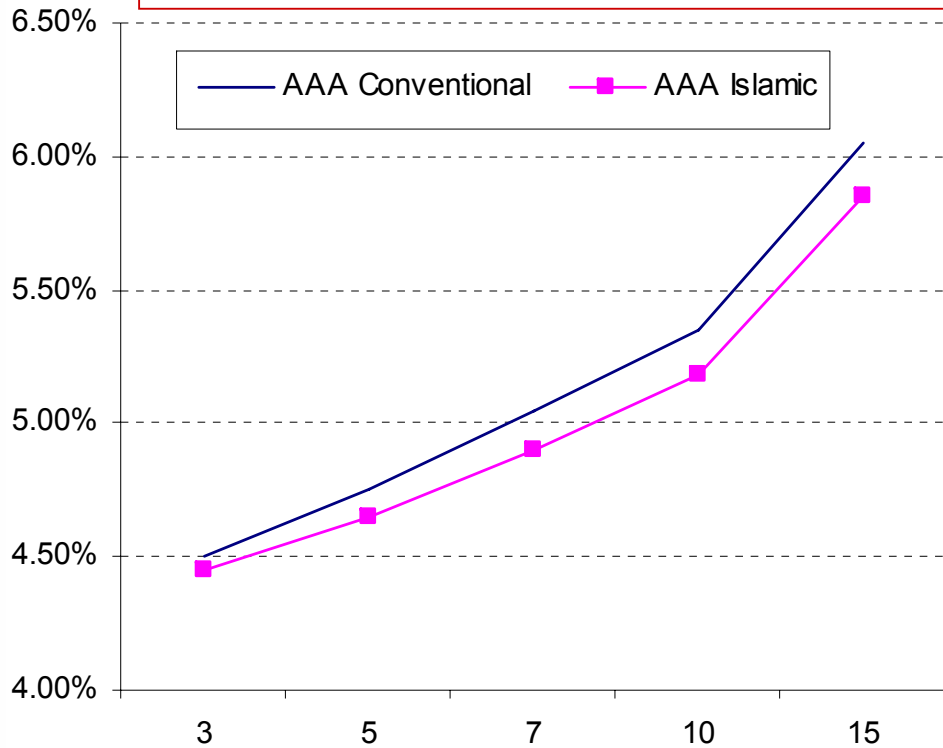


	Index reading		Av. Annualized Returns		Average Duration	
	Islamic	Conventional	Islamic	Conventional	Islamic	Conventional
1-year and above	145.47	138.35	7.64%	6.27%	4.73	3.98
5-years and above	142.07	125.43	7.57%	4.39%	6.32	6.11

(Source: CIMB Fixed Income Research)

# As a Result.....

## Islamic Papers are More Tightly Priced



- Yield differential between Islamic and Conventional papers are in the regions of 4 to 20 bps for tenures 2- to 15-years.

(Source: CIMB Fixed Income Research)

## Some Critical Key Milestones

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- Shariah Advisory Council identified by Islamic Banking Act 1983.
  - Originally domiciled at Bank Islam Malaysia Berhad, now at BNM and SC
- Introduction of Scripless Security Trading Systems and Authorised Depository function at BNM
- Requirement of Ratings for Bond Issuances creates a very strong comfort to investors when dealing with new shariah compliant structures.

# Enhancing the Intermediation Process in Islamic Capital Market

## Conclusion

# Conclusion

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- Malaysia Shariah management regulatory framework has translated the demand for Islamic investment instruments real. The Islamic funds is channelled to Islamic financings or Islamic investments; making Malaysia Islamic bonds / Sukuk biggest in the world.
- Enhancing intermediation process is integral in developing Islamic Capital Market.
- Products can come and go. The system must sustain through a well regulated intermediation process.

## Contact Details

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