Major Milestones and Transformative Trends in the Malaysian Islamic Financial Market: 2025 in Review

By: Islamic Financial Market Sub-Committee (IFMC)

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PART A OVERVIEW

1. Objective

1.1. This article reviews the **major milestones and transformative trends** that influenced Malaysia's Islamic financial market in 2025. It explores key developments in the Islamic repo market, sukuk market, and benchmark transition, while assessing their implications for future growth. By highlighting these achievements, we aim to provide insights into the evolving dynamics of Malaysia's Islamic financial ecosystem.

2. Introduction

2.1. The year 2025 marks a pivotal chapter in Malaysia's Islamic financial market, reinforcing its role as a leading player in global Islamic finance industry. Malaysia retained its top position in the ICD-LSEG Islamic Finance Development Indicator 2025[1], reflecting continued progress in governance, innovation, and market depth.

2.2. Islamic finance remains a key component of Malaysia's financial system, with the Islamic capital markets representing more than 64% of the total Malaysian capital market[2]. The Islamic money market has continued to grow steadily, supporting liquidity needs within the Islamic banking sector, which now accounts for 47% in terms of system financing. Malaysia also continues to hold a prominent position in the global Sukuk market, representing 37% of total global sukuk outstanding[3].

2.3. Over the past five years, the domestic Islamic financial market has continued to grow encouragingly. Malaysian Government Investment Issue (MGII) issuances increased from RM75.8 billion in 2020 to RM86 billion in 2025, marking a 13.4% rise. Similarly, interbank secured expanded more than fourfold, from RM14.2 billion in 2020 to RM62.9 billion in 2025, while interbank unsecured trades nearly doubled, surging from RM475.7 billion in 2020 to RM986.8 billion in 2025[4]. The significant growth in secured transactions relative to unsecured trades underscores the market's increasing emphasis on risk management and stability, reflecting the growing maturity of Islamic finance.

2.4. Malaysia's leadership in Islamic finance is underpinned by a strong regulatory framework, targeted policy measures and a clear development roadmap as highlighted in the Financial Sector Blueprint 2022–2026. These key building blocks have enhanced Malaysia's role as an international

[1] ICD – LSEG Islamic Finance Development Report 2025
[2] Securities Commission as of September 2025
[3] IIFM Sukuk Report 2024
[4] BNM as of 18th December 2025

gateway for Islamic finance and encouraged greater adoption of digital solutions and risk-sharing instruments.

PART B ISLAMIC REPO MARKET

3. Strengthening Liquidity Management Through Islamic Collateralised Funding (ICF) Policy Document

3.1. To support liquidity management and encourage the development of the Islamic repo market, Bank Negara Malaysia (BNM) introduced the Islamic Collateralised Funding (ICF) Policy Document, which came into effect on 30 June 2025. This policy document provides a structured framework and standardised practices for Islamic repo transactions, aimed at improving operational efficiency and enhancing the resilience of the Islamic Interbank Money Market (IIMM).

3.2. Prior to the policy document, the Shariah Advisory Council (SAC) of BNM released the "Ruling on Implementation of New Features of Sell and Buy Back Agreement (SBBA)". This ruling addressed the permissibility of margining, profit disbursement, and substitution of assets.

3.3. The combination of the SAC Ruling and the ICF Policy Document has contributed to higher interbank market activity and facilitated short-term funding and liquidity management among Islamic financial institutions. The volume of Islamic interbank repo transactions grew by 35%, increasing from RM42.6 billion in 2024 to RM62.9 billion in 2025[5], indicating broader market adoption and deeper liquidity.

4. Enhanced SBBA Agreement – Driving Transparency and Global Alignment

4.1. The enhanced Sell and Buy Back Agreement (SBBA) was introduced as part of efforts to improve market practices in Malaysia's Islamic secured interbank market. This enhancement reflects the industry's focus on innovation, standardisation, and alignment with international practices.

4.2. The enhanced SBBA model addresses existing challenges by incorporating advanced features such as margining, asset substitution mechanisms, profit distribution mechanism and refined Shariah applications, positioning SBBA on par with global standards like the GMRA in conventional banking. Supported by Malaysia's Netting Act and endorsed by BNM's Shariah Advisory Council, the model is legally sound, operationally efficient, and

[5] BNM as of 18th December 2025

fully Shariah-compliant. This alignment with international best practices is expected to strengthen Malaysia's role in Islamic liquidity management.

4.3. The enhanced SBBA also creates opportunities for non-interbank players to participate in Islamic Repo transactions. The overall structure of the enhanced SBBA is well-suited for non-banking financial institutions, asset management companies and even statutory bodies, particularly those with sizable sukuk portfolios.

5. Sustainable SBBA – Integrating ESG Principles

5.1. The enhanced SBBA now provides an opportunity to incorporate sustainability features. By embedding Environmental, Social, and Governance (ESG) principles into its model, Islamic financial institutions can align short and medium-term funding solutions with global sustainability objectives. This innovation supports market liquidity, diversifies financing avenues beyond sukuk and bonds, and facilitates funding for green and socially responsible initiatives.

5.2. A notable development in this model is the Sustainable Use of Proceeds Annex, which provides a clear framework for applying sustainability criteria across eligible SBBA transactions providing for scalability in its application. This annex simplifies approval processes, reduces operational complexity, and encourages wider participation by institutions seeking to meet sustainability standards**.**

6. Practice Note for SBBA – Deepening the Interbank Repo Market

6.1. Introduction of ICF Policy Document and the enhanced SBBA Agreement has also paved the way for the issuance of the SBBA Practice Note, an industry-led initiative driven by the Association of Islamic Banking and Financial Institutions Malaysia (AIBIM). Issued on 13 June 2025, the Practice Note provides a simplified operational process flow and reduced documentation for inter-bank SBBA transactions, whilst also implementing margining and asset substitution mechanisms.

6.2. The SBBA Practice Note is an initiative that represents strong collaboration, technical work, and alignment among interbank players, BNM and Shariah experts. As this was an industry-led initiative, it also reflects the industry's commitment to enhance transparency, operational efficiency and Shariah compliance in Islamic treasury transactions.

PART C SUKUK MARKET

7. Broadening the Investor Base through Continuous Innovation.

7.1. To support the continued development of Malaysia's Islamic financial market, the Government of Malaysia explored the variant of the Wakalah concept which is Wakalah bi al-Khadamat (agency contract for services) as an underlying asset in its sukuk structure as an alternative to the existing Murabahah framework. This innovative structure is designed to address any concerns related to the tradability of debt-based sukuk in the secondary market and to meet the requirements of both domestic and international Shariah authorities.

7.2. By incorporating services-based underlying assets, the Wakalah bi al-Khadamat structure enhances Shariah compliance and improves market flexibility. Its design is intended to attract a broader investor base, including global investors seeking Shariah-compliant instruments, and supports potential future public and private sector issuances.

8. Driving Confidence: Industry Endorses MGII for Corporate Sukuk Pricing

8.1. The use of MGII as a benchmark for corporate sukuk pricing has received positive industry support, contributing to improved market confidence and transparency. Aligning sukuk pricing with MGII yields offers issuers and investors a more consistent reference point, helping to reduce pricing variations and improve comparability across Islamic instruments. This approach is expected to strengthen price discovery and support liquidity in the Islamic capital market.

9. Efforts to Market MGII to Foreign Investors

9.1. Malaysia has continued its efforts to position MGII for potential inclusion in the FTSE World Government Bond Index (WGBI), which would enhance MGII's visibility among global investors. BNM has engaged with key stakeholders, including FTSE's Index Policy team and major WGBI trackers, to share information, address queries, and gather feedback on MGII.

9.2. As part of these efforts, FTSE launched the FTSE MGII Bond Index on 31 January 2025, providing a dedicated benchmark to track Malaysia's government sukuk market. This was followed by a feature article published

by FTSE[6] on 24 February 2025, which helped raise awareness among international investors.

9.3. To further improve accessibility, BNM collaborated with Bloomberg to enhance MGII's visibility on its platform, enabling global investors to access relevant data and analytics more easily. This initiative supports transparency and informed decision-making.

9.4. Non-Resident (NR) participation in MGII has grown significantly over the past five years, from RM24.8 billion in 2020 to RM51.3 billion in 2025 while total MGII outstanding has also expanded substantially from RM374.6 billion to RM619.8 billion. Despite the growth in absolute terms, NR participation has only risen from 6.6% to 8.3%. In terms of composition, NR holdings are largely concentrated among investors from Singapore (24.3%), the United Kingdom (17.0%) and the United States (12.1%). By investor profile, banks and financial institutions account for the largest share at 33%, followed by asset managers at 29% and central banks or government institutions at 22%.[7]

9.5. Moving forward, continued engagement with international investors will be the primary focus. Broader measures will focus on improving MGII's visibility by strengthening market accessibility, enhancing settlement efficiency, and aligning with international best practices. While index inclusion is a longer-term objective, these initiatives reflect Malaysia's ongoing commitment to promoting MGII in the global markets.

PART D KLIBOR TRANSITION TO MYOR-i

10. Transitioning to MYOR-i: Establishing a Shariah-Compliant Benchmark for Islamic Finance

10.1. As part of ongoing efforts to strengthen Malaysia's Islamic financial market, BNM is facilitating the transition from the Kuala Lumpur Interbank Offered Rate (KLIBOR) to the Malaysian Islamic Overnight Rate (MYOR-i), the world's first transaction-based Islamic benchmark rate.

10.2. In support of this transition, the Governor of BNM highlighted during his keynote address at the Global Islamic Finance Forum (GIFF) that MYOR-i will serve as the mandatory reference rate for all new Islamic financial products starting 1 July 2027, coinciding with the planned cessation of KLIBOR.

10.3. To ensure a smooth and orderly transition, BNM is working closely with industry stakeholders through a series of coordinated initiatives. These efforts are overseen by the KLIBOR Transition Coordination Subcommittee,

[6] Malaysian Government Investment Issues (MGII) attract growing foreign interest | LSEG
[7] BNM as of 18th December 2025

supported by four dedicated Working Groups established under the Financial Market Committee (FMC):

- **Derivatives Working Group** – Develops best practices for using MYOR/MYOR-i in derivatives products, manages legacy contracts with active transition and fallback provisions, and addresses related accounting, legal, and tax matters.
- **Cash Products Working Group** – Supports the transition in the domestic cash market, ensuring product alignment and operational readiness.
- **Shariah Working Group** – Reviews and resolves Shariah-related matters, obtains necessary approvals from BNM's Shariah Advisory Council (SAC), and promotes industry understanding through engagement and educational initiatives.
- **Communications Working Group** – Oversees effective communication across all market participants throughout the transition period.

10.4. The Shariah Advisory Council (SAC) of BNM has expressed its support for the transition to MYOR-i and related market initiatives. This may include providing updated Shariah guidance, clarifying permissibility for market-making activities, and addressing any Shariah considerations to facilitate smooth implementation across the industry.

10.5. Industry engagement and public awareness on MYOR-i adoption are critical components in ensuring success of benchmark rate implementation. Following the announcement by the Governor at GIFF in October 2025, an article on transition roadmap was published in the Financial Stability Review (FSR). Going forward, building on the market engagement and public outreach initiatives conducted throughout 2025, these efforts will be ramped up in 2026 to further enhance understanding among stakeholders. In parallel, efforts are also underway to enhance operational readiness among banks, including increasing the number of SBBA and TMA agreements signed between institutions, expanding credit limits and upgrading internal systems to support smoother market functioning.

PART E IFMC ROUNDTABLE

11. Driving Collaboration and Innovation in Islamic Finance: Highlights from IFMC Roundtable & MOU Signing Ceremony

11.1. On 15 October 2025, BNM hosted the IFMC Roundtable in conjunction with the Global Islamic Finance Forum (GIFF) 2025. The event brought together industry leaders from Islamic banking and investment institutions to discuss key initiatives for market development.

11.2. The industry-led roundtable facilitated constructive discussions on strategies to strengthen Malaysia's Islamic finance ecosystem, with focus on two key areas: enhancing investors' experience in relation to MGII and strategizing the transition to MYOR-i as the Shariah-compliant benchmark. A notable proposal from market participants was to price corporate sukuk over MGII rather than MGS, to ensure better alignment with Islamic benchmarks and reinforce the integrity of Islamic financial instruments. The industry also suggested that issuers consider offering government-guaranteed corporate sukuk through the Fully Automated System for Issuing/Tendering (FAST) to encourage transparency in the bidding and allocation process.

11.3. In conjunction with the roundtable, a number of Islamic banks signed two Memoranda of Understanding (MOUs): one on the enhanced SBBA and the other on the Tahawwut Master Agreement (TMA) with 15 and 16 signatories respectively. These MOUs signify the industry's commitment to executing the agreements and aim to strengthen operational readiness and risk management practices among Islamic banks. This will facilitate more efficient liquidity management and hedging capabilities in line with global standards. Additionally, as a strong sign of intent by industry players, an industry first Cross Currency ESG SBBA was signed between RHB Bank Berhad, HSBC Amanah, Standard Chartered Saadiq and UOB Malaysia Berhad. These signing ceremonies reflect the industry's collaborative approach to deepening interbank trading activity and supporting the ongoing development of Malaysia's Islamic financial market.



Picture 1: Cross Currency ESG SBBA signing involving Standard Chartered Saadiq, RHB Islamic Bank, HSBC Amanah and UOB Bank. The ceremony was witnessed by DG Adnan Zaylani and AG Mohamad Iqbal.

PART F OUTLOOK FOR 2026

12. Malaysia's Islamic Financial Market Outlook for 2026: Innovation, Benchmark Transition, and Islamic Market Deepening

12.1. Looking ahead, 2026 is poised to build on the continued progress of 2025 through structural enhancements, benchmark transition efforts, and initiatives aimed at deepening market activity.

12.2. In the Islamic repo segment, the ICF Policy Document is anticipated to further strengthen liquidity management and promote standardisation in Islamic repo transactions, building on the positive adoption observed in previous years. Greater clarity from the SBBA Practice Note is also expected to enhance transparency and compliance, contributing to more efficient interbank operations.

12.3. Preparations for the transition from KLIBOR to MYOR-i will gain momentum throughout 2026, with efforts focused on system readiness, product alignment, and liquidity support for Islamic hedging instruments. These initiatives will be complemented by engagement and educational programs to facilitate a smooth transition ahead of the mandatory adoption in 2027.

12.4. The year marked a significant milestone with the execution of Sustainable SBBA deals totalling over RM400 million, underscoring the industry's growing commitment to responsible finance. Looking ahead, more ESG-linked Islamic financial products are expected to emerge, reflecting the industry's growing emphasis on responsible and inclusive finance.

12.5. Another area of focus will be the feasibility study on Islamic derivatives with active market-making capabilities. This initiative aims to strengthen risk management tools for Islamic financial institutions and improve liquidity in hedging instruments. The study will explore Shariah-compliant structures, operational frameworks, and regulatory considerations, potentially paving the way for pilot programs in the coming years.

12.6. Collectively, these initiatives are expected to support the continued development of Malaysia's Islamic financial ecosystem and reinforce its role as a key international player—anchored on innovation, inclusivity, and market resilience.