

Islamic Financial Industry: The Next Wave

**Organised by
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ISLAMIC FINANCE SUCCESS STORY: THE MALAYSIAN CASE

By

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AGENDA

- Socio-economic development of modern Malaysia
- Some reflections on behaviour of Muslims
- The first idea of Islamic Finance
- Key success factors of Islamic finance
- The step-by-step advancement
- The big leap forward
- The future

Socio-economic development of Modern Malaysia

- Malaysia gained its independence from the British in 1957, after being colonised by them for almost 200 years
- It was mainly agricultural country, producing two main primary commodities namely rubber and tin for exports in return for imports of manufactured products including textiles and food.
- Total GDP was less than USD400 million

Socio-economic development of Modern Malaysia

- The period 1957 – 1970 was marked by activities for economic and human resource development.
- The main emphasis was on the infrastructure development, economic diversification, education, health and order and peace of the country

Socio-economic development of Modern Malaysia

- 1970 – 1990 was marked by affirmative action under the New Economic Policy (NEP) which was mainly intended for nation building.
- Two main missions were
 - the eradication of poverty; and
 - the restructuring of society to eliminate identification of economic functions by race
- This was done by reallocating the increase or newly created wealth to the poorer sections of society

Socio-economic development of Modern Malaysia

- It was also during this second phase that economic restructuring started to manifest itself.
- The economy was no longer considered as agriculture but it was moving rapidly towards becoming an industrial nation.
- This was achieved by the pursuit of import substitution strategies in 1960-70 followed by manufacturing for exports in 1970 - 90

Socio-economic development of Modern Malaysia

- 1990 -2000 witnessed another big change from manufacturing to industrial nation where manufacturing and services sectors dominated the economy by more than 70%
- Malaysia is no longer the world exporter of rubber, tin and palm oil but became world exporter of air-conditioners, important exporter of textiles, microchips, petroleum and gas, etc.
- From 2000 and beyond, Malaysia is one of the leading Muslim countries which provides Islamic financial instruments

Some Reflections on Behaviour of Muslims

- Even up to 1970's a typical Muslim farmer will not go near commercial banks or financial institutions because of riba and prefers to keep cash at home
- Despite being poor, the rice farmers religiously paid their zakat on rice. Zakatul Fitr is widely practised as well.
- Few intermarriages with other races occurred and in every case the non-Muslim will be converted to Islam
- Some Muslims may not be practising but will not tolerate anyone ridiculing him on the basis of faith
- Pilgrimage to Holy land of Makkah is a life time dream of Muslims. They would save almost all their life for Hajj.

The first idea of Islamic Finance

- It was Royal Prof. Ungku Abdul Aziz of the University of Malaya who made various studies on poverty of rural Malays and found the strong will among them to save mainly for hajj. The sad part was that these poor people will be poorer after performing hajj.
- In 1962, the Prof. suggested to the government that a special corporation to assist the Muslims to save for hajj should be established so that they will not be poorer after returning from hajj.

The first idea of Islamic Finance

- The Pilgrims Fund and Management Board was established in 1963 which collects savings from those intending to perform hajj and invested in Shari'ah-compliant investment instruments so that the savings will not only be safe but will also grow over time. Today it is a big corporation with huge investments running into USD billions.

Key Success Factors of Islamic Finance

- Graduates of Middle Eastern universities, particularly from Al-Azhar in Cairo, as well as those from traditional madrasahs had created the need among some Muslims to lead an Islamic life
- The pressure from the Muslims in 1950's to 1970's were not formidable enough for the government to take serious steps towards that direction.
- Islamic resurgent which occurred in late 1960's and early 1970's strengthened the aspiration to introduce Islamic Law and Islamic Economics

Key Success Factors of Islamic Finance

- The Islamic party also played a crucial role in reminding the people to fight for Islamic way of life
- The economic progress achieved by the country especially in late 1970's and early 1980's had benefited the Muslims as well
- The emphasis on education by the government from 1956 (prior to independence in 1957) had also positively contributed towards the betterment of the Muslims

Key Success Factors of Islamic Finance

- The establishment of an International Islamic University, Malaysia in 1983 was very timely in producing graduates in the fields of Islamic Shariah and Economics for the Islamic finance industry
- This was further assisted by the proliferation of Islamic economics courses being offered by various universities in the country
- The establishment of Islamic Consultative Body under the Prime Minister's Department in 1983 which was to advise the PM in efforts towards Islamisation

Key Success Factors of Islamic Finance

- Key success factors can be identified as:
 - The strong awareness among the Muslim masses for the need to lead an Islamic way of life
 - The increase in the wealth of Muslims that was needed to support Islamic finance industry
 - The production of human resource with sufficient knowledge in Islamic finance
 - Government commitment and support through the establishment of the Islamic Consultative Body

The Step-By-Step Advancement

YEAR	ACTIVITY
1963	Pilgrims Fund and Management Board
1983	Islamic Banking Act Bank Islam Malaysia Berhad International Islamic University Islamic Consultative Body
1984	Takaful Act
1985	Syarikat Takaful Malaysia
1986	Restructuring of Islamic Economic Development Foundation Malaysia
1987	Islamic Micro Credit Scheme (Amanah Ikhtiar Malaysia)
1993	Interest Free Banking Scheme
1994	Takaful Nasional Sdn Bhd (Etika Takaful Berhad)

The Step-By-Step Advancement

YEAR	ACTIVITY
1993	Bank Rakyat (Cooperative Bank) started to convert to Islamic operations which was completed in 2002
1995	Islamic Pawn Broking in Bank Rakyat
1999	Bank Muamalat as the second full-fledge Islamic bank
2000	Islamic Capital Market Two new takaful licences issued Improvement of Regulatory and Governance by Central Bank Issuance of Global Sukuk
2004	Five new takaful licences issued
2006	Labuan Reinsurance opened first Retakaful window
2007	First licence for Retakaful to Malaysian Nasional Reinsurance Berhad

The Step-By-Step Advancement

YEAR	PHASE
UP TO 1970	Awareness
1970- 1990	Phase I – building institutions and regulatory requirements
1990 – 2000	Phase II – Creating an Islamic financial system by encouraging participation by more players
2000 & beyond	Phase III – Maturing and Globalising

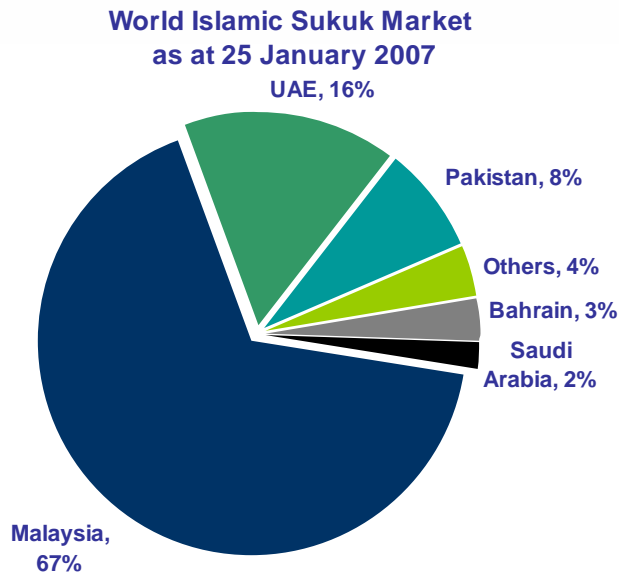
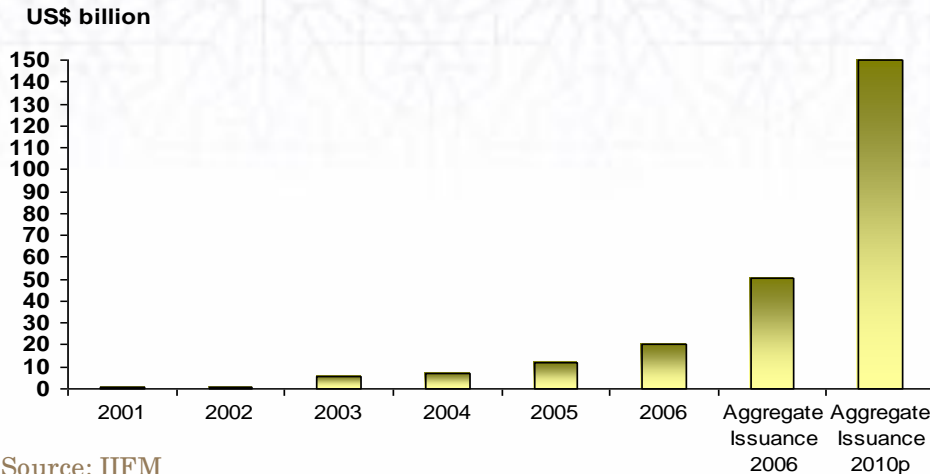
The Big Leap Forward

- Malaysia has emerged as one of the developed Muslim nations of the world
- Evolved a dual Financial System
- Proven the viability of Islamic banking and Takaful
- Issued the most global sukuk
- Created a well regulated environment including the Shariah compliance

ISLAMIC BONDS		OCTOBER 2006 – OCTOBER 2007		
	Manager or Group	Amt US\$ m	Iss.	%
1	HSBC	4,465	31	14.0
2	CIMB	3,709	51	11.6
3	Malaysia Government bond	3,687	4	11.6
4	Barclays Capital	3,353	6	10.5
5	Dubai Islamic Bank	2,271	7	7.1
6	Citigroup	1,668	6	5.2
7	Deutsche Bank	1,393	18	4.4
8	JP Morgan	1,158	2	3.6
9	Riyad Bank	1,066	1	3.3
10	BNP Paribas	845	3	2.6
11	Abu Dhabi Investment	843	1	2.6
12	Credit Suisse	843	1	2.6
13	AmlInvestment	806	48	2.5
14	Standard Chartered	768	22	2.4
15	Goldman Sachs & Co	624	1	2.0
16	Aseambankers Malaysia	527	21	1.7
17	RHB Investment	383	69	1.2
18	Lehman Brothers	299	1	0.9
19	Arab Banking Corp	263	2	0.8
20	Arab National Bank	263	2	0.8
Total		31,913	277	100.0

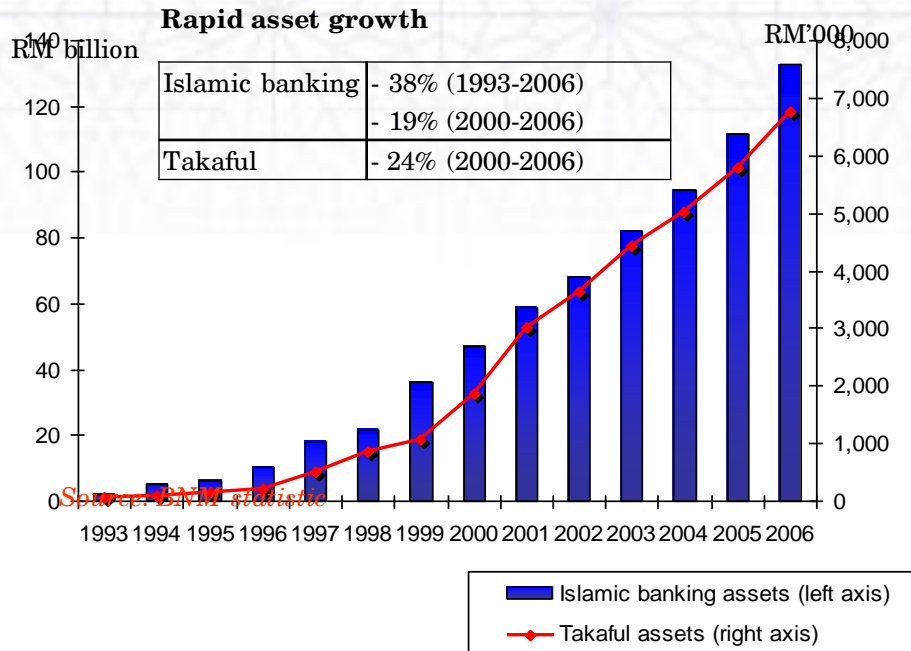
Robust growth in **issuance of *sukuk*** reflecting growing demand around the globe...

Sukuk Issuance Worldwide



- *Sukuk* issuance worldwide increased more than double from USD11.8 billion in 2005 to USD20.6 billion in 2006.
- Aggregate issuance value of *sukuk* market worldwide exceeds USD50 billion as at end-Dec 2006
- Total *sukuk* issuance worldwide projected to surpass USD150 billion before end 2010.
- Market to expand in future with entrance of corporates in GCC region and non-Muslim issuers.
- Malaysia's *sukuk* represented 67% of the total global *sukuk* outstanding valued at USD46.8b

The Malaysian Experience



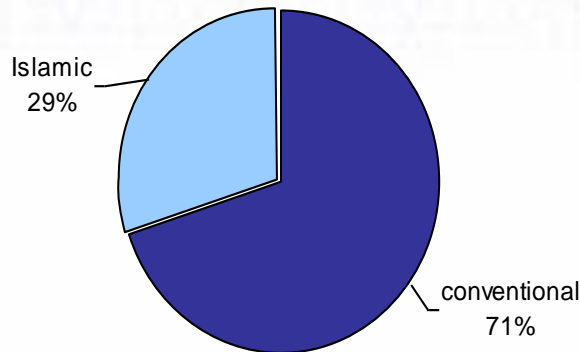
Total size of *Sukuk* as at December 2006

	Islamic PDS	Govt & BNM papers
Size of outstanding <i>sukuk</i>	RM 105bn	RM 42.5bn
% of outstanding <i>sukuk</i> to total outstanding bonds	47.5%	18.3%

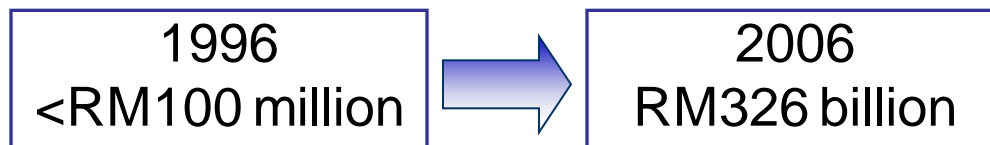
- Wide range of capital market investment avenues
 - Increased issuance of Islamic bonds with diversified *Shariah* contracts
 - Over 85% *Shariah* approved counters on Bursa
 - Over 90 Islamic unit trusts
 - Cheaper issuance cost (stamp-duty exemption for Ijarah, Musharakah & Istisna' contracts)

The Malaysian Growth in Islamic Securities

Islamic Money Market Funds as % of Total Money Market Funds



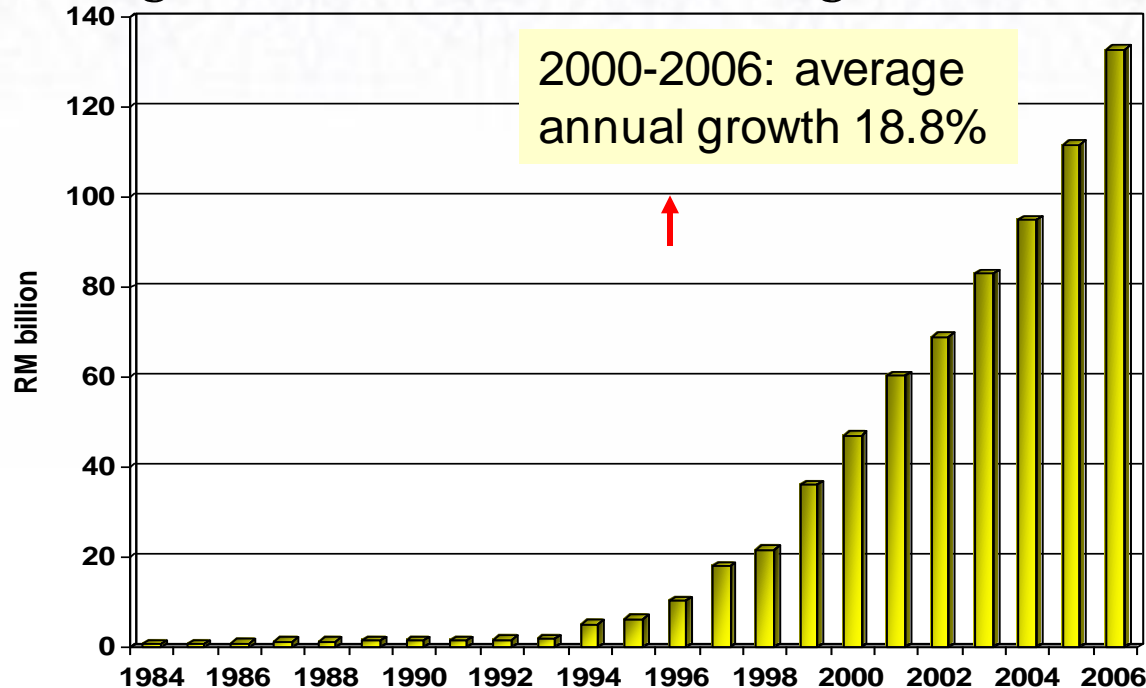
Increasing growth in Islamic securities trading volume...



- The development of Islamic money market made possible with Bank Negara liquidity operation
 - profit sharing facility of mudharabah interbank investment
 - Wadiah acceptance
 - Sale and buy back agreement of Islamic securities for short-term liquidity
 - Commodity Murabahah – short-term financing involving sale and buy back of underlying commodity
- Issuance of various Islamic securities issued by Bank Negara, Government and financial institutions.
 - Malaysia Islamic Treasury Bills
 - Bank Negara Negotiable Notes
 - Islamic Acceptance Bills

The Malaysian Success Story

Strong Growth of Islamic Banking Assets...



Diversified players

- Islamic banks
- Investment banks
- Takaful companies
- DFIs, savings institution
- Fund management companies
- Stock brokers, unit trusts

Comprehensive regulatory, Shariah & legal framework

- Central Shariah advisory council
- Shariah governance framework
- Comprehensive legislation
- Dedicated High Court

Widest repository of products

- More than 100 products

International recognition

- Technical assistance to several member countries

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Building a Comparative Advantage in Islamic Finance

Robust legal, Sharia & regulatory infra

Diversity of players

- Domestic IBs (2 Islamic banks, 8 IS, 1 window)
- Foreign IBs (3 IBs, 5 windows)
- Takaful operators (5 domestic, 4 foreign)
- Retakaful operators (3)
- Financial market players (25 domestic, 3 foreign)
- ICBUs (6)
- Fund managers

Talent development

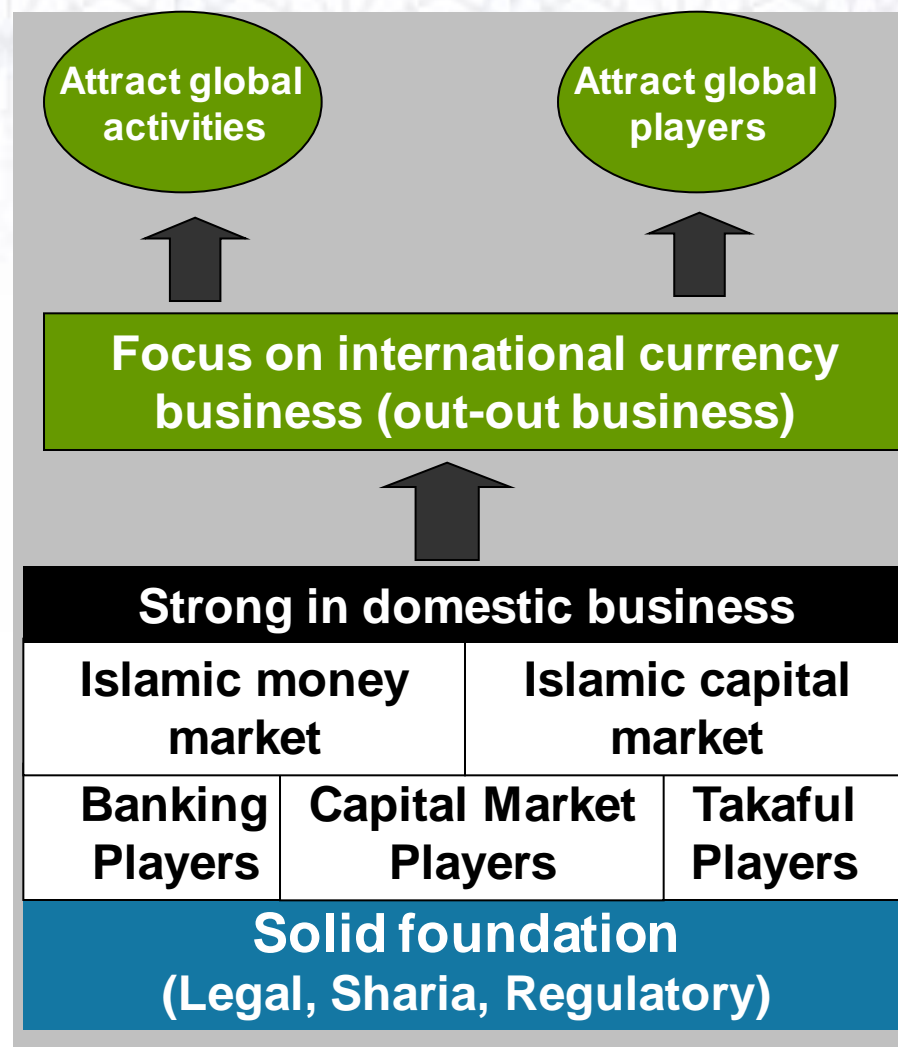
- Experienced talent pool
- Total solution for talent development; technical, professional & leadership, INCEIF, IBFIM, ICLIF, SIDC

Conducive business environment

- Comprehensive infrastructure – vibrant Islamic money and capital markets
- Tax neutrality
- Liberalised foreign exchange rules
- Liberalisation of equity ownership

Strong domestic market

- Islamic banking assets : 12.2% (RM133 b)
- Takaful assets : 6.1% (RM6.9 b)
- Islamic PDS : 49.6% of outstanding PDS (RM144.5b)



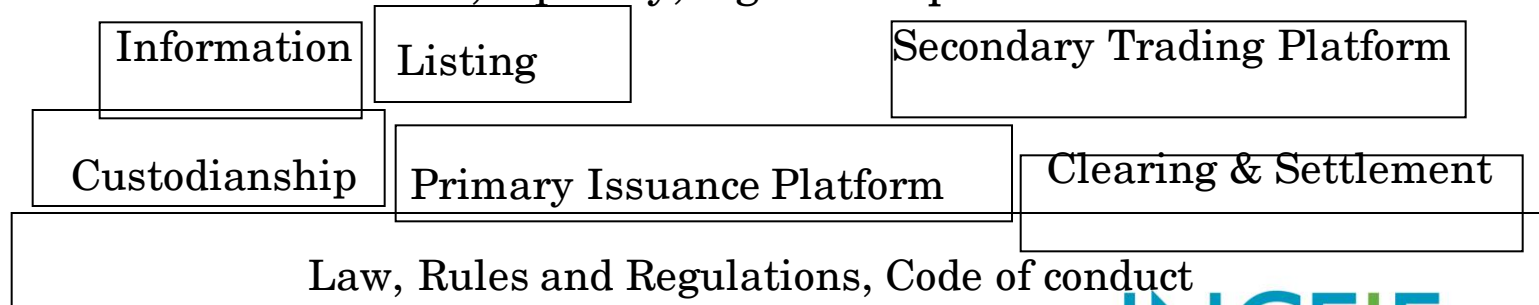
The Malaysian Evolution

Clear legislative mandate & support are pertinent in migration from conventional system

Islamic Banks	Islamic Windows	Islamic Money Market
<ul style="list-style-type: none">▪ Enactment of Islamic Banking Act 1983 (IBA)▪ Confers power to BNM to regulate and supervise Islamic banks▪ Granted a universal banking licence▪ Accords flexibility to Islamic banks to undertake broad range of Shariah-compliant banking business	<ul style="list-style-type: none">▪ Provision under Banking and Financial institution (BAFIA) 1989▪ S. 32 and S. 124 of BAFIA; ~ Permitted banking institutions to conduct Islamic banking business	<ul style="list-style-type: none">▪ Enactment of Government Funding Act (GFA) 2005<ul style="list-style-type: none">– GFA provide powers to the Government of Malaysia to issue government bonds based on Islamic principles– Enable Islamic banks to manage liquidity requirements and surplus funds

Supportive Capital Market Development

- Underpinned by an effective set of laws, rules and regulations, and market code of conduct
- Involves multi set of institutional players in a jurisdiction and/or across global markets
 - Settlement banks (including central banks), stock exchanges that provide trading, listing, clearing and settlement mechanism
 - Information providers publishing investment information and pricing tools
 - Financial institutions providing accounts services and custodianship facilities
- Operates in automated systems to realise
 - Speed, reliability and consistency
 - Reduction of credit, liquidity, legal and operational risks



The Malaysian Approach

Continuous enhancement of number of IF experts & level of expertise in Islamic banking and finance to meet growing demand

Having competitive edge over other Islamic financial centres

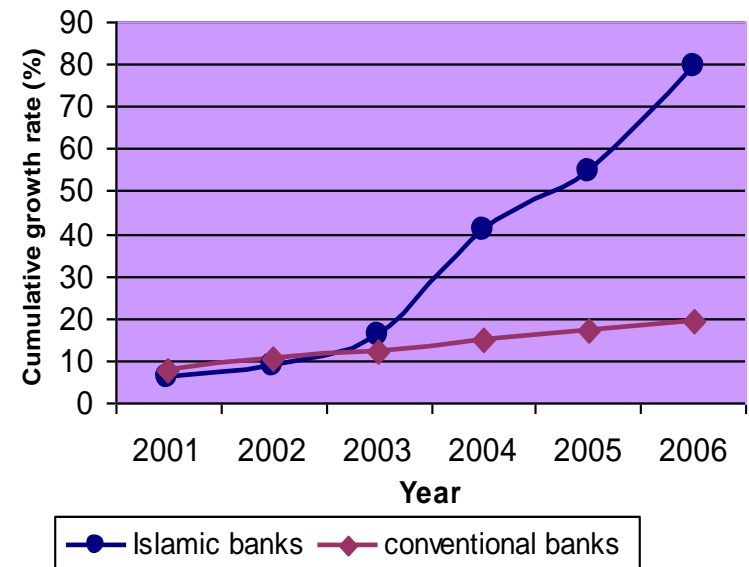
- Niche areas of focus
- Efficient & effective infrastructure and delivery system

Maintaining robust regulatory & supervisory framework to ensure soundness & stability of IF system that is able to withstand changing needs and practices

Ensuring dynamism, innovativeness and contemporary development of Islamic financial products and services

- Constant product innovation, mutual respect of Shariah views, continuous enhancement of research capability

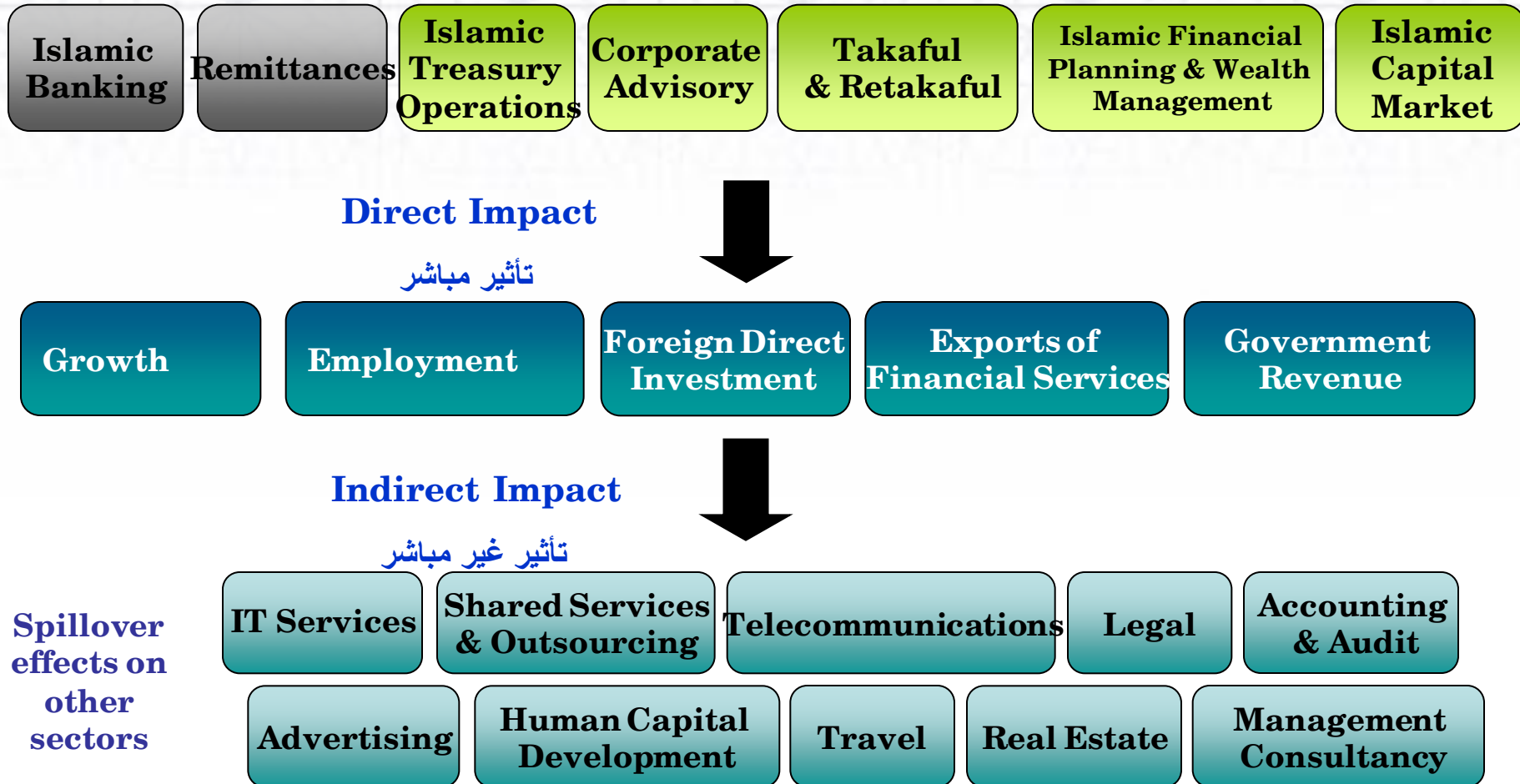
Employment in Banking Industry



Number of employees of Islamic banks increased by 80% from 2,869 (2001) to 5,151 (2006)

Multiplier impact on the economy

التأثير المضاعف على الاقتصاد



The Flow of Human Capital to Islamic Finance

تدفق رأس المال البشري للمالية الإسلامية

Regulators المنظمين

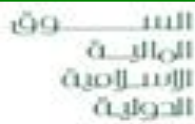
Central banks, Monetary Agencies, Securities Commissions etc. البنوك المركزية، الهيئات النقدية، مفوضيات الأسهم



مركز إدارة السيولة المالية ب.س.ك.م
Liquidity Management Centre B.S.C. (K)

Liquidity Management Centre

Market maker for Islamic secondary market



International Islamic Financial Market
IIFM

International Islamic Financial Market

Establish, develop and promote Islamic Financial Market



الوكالة الإسلامية الدولية للتصنيف
Islamic International Rating Agency

International Islamic Rating Agency

Rating of Islamic FI's & Islamic finance instruments



Islamic Research and Training Institute

Promote Islamic research and training



Islamic Development Bank بنك التنمية الإسلامي

Foster the economic development and social progress of member countries and Muslim communities



International Financial Services Board

Governance regulatory standards

General Council for Islamic Banks and Financial Institutions



General Council for Islamic Banks and Financial Institutions

Enhance market understanding of Islamic finance

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KNOWLEDGE LEADER
IN ISLAMIC FINANCE

International Centre for Education in Islamic Finance الجامعة العالمية للمالية الإسلامية

Develop human capital تنمية رأس المال البشري

ARCIFI

Arbitration and Reconciliation Centre for Islamic Financial Industry

Dispute resolution services for members



Accounting and Auditing Organisation for Islamic Financial Institutions

Accounting and auditing standards

INCEIF

MIFC Gateway for Islamic finance between regions

Conducive environment

Tax incentives

- 10 years exemption - management fees received by fund managers managing Islamic funds of foreign investors
- 5 years tax exemption on profit of newly Malaysian banks going abroad
- Tax exemption on SPV
- Tax deduction - expenses in establishing Islamic stock broking firm
- Full stamp duty exemption for 10 years
- Withholding tax exemption on profit from holding RM & non-RM Islamic securities

Offers flexible opportunities

Flexible structure:

- IIB, ITO & enjoy 10-year tax exemption
- ICBU - to conduct the full range of Islamic banking services in international currencies with non-residents and residents
- Flexibility to Labuan offshore Islamic institutions to open offices anywhere in Malaysia

No limit on number of licences to be issued for international currencies business

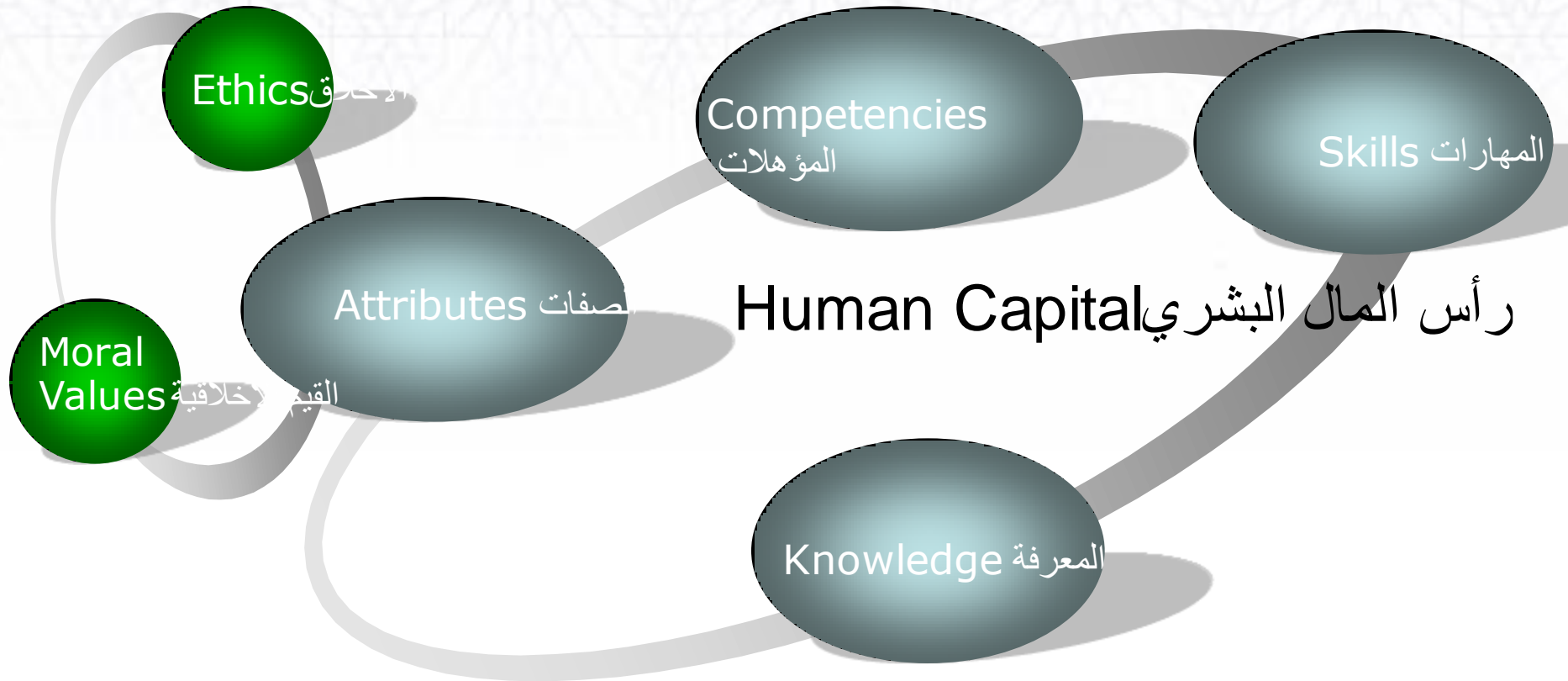
Flexible regulatory & forex policy

- Flexible shareholding structure and relaxed policy on property ownership
- Enabling platform in the origination, issuance and trading of sukuk
- Liberalised forex rules- allow issuance of RM & non-RM sukuk
 - Pre approved rating for issuer: 'AAA' for RM-deno and 'A-' for non-RM deno instruments

Global Integration

- Expand opportunities to build linkages on Islamic finance - MOUs –JBIC, DFSA, QFRA
- Foreign equity participation – relaxed FIC Rules
- Strategic alliances in human capital development – INCEIF signed MOUs - few strategic partners
- Cross border product development e.g. the first IDMA and Commodity Murabahah House
- Engagement in adopting international standards and best practices
- Progressive R&D activities – joint research

تعريف رأس المال البشري Human Capital defined





Knowledge
(معرفة)

Acquired
Knowledge
معرفة مكتسبة

Revealed
Knowledge
معرفة الوحي

**Knowledge of Worldly
Sciences fard kifayah (فرض
كفاية):**
•Economics الاقتصاد
•Finance المالية
•Law القانون
•Engineering الهندسة , etc

**Fundamental Knowledge
(Fard 'Ain عين فرض):**
•Tawhid توحيد
•Islam الإسلام
•Iman الإيمان
•Ihsan الإحسان
•Ethics الأخلاق

Well-
Balanced
Knowledge
Workers
عاملين ذو معرفة
متوازنة

Government,
NGOs,
Foreign, etc.

Islamic
Finance
Industry
صناعة المالية
الإسلامية

Private
Sectors القطاع
الخاص, etc.

Increase Job
Satisfaction
زيادة رغبة
الوظيفة

Increase the
Value of the
Firm زيادة قيمة
المؤسسة

Increase Job
Satisfaction
زيادة رغبة
الوظيفة

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THANK YOU