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Contents

Malaysia Leads in Sukuk

The *sukuk* market has been driving the growth of the Malaysian ICM. Many "world-first" issues with sizeable amounts and innovative structures were originated in the past years. Among them were: first *sukuk* issue of RM125 million by Shell MDS; first global sovereign *sukuk* of US$600 million by the Malaysian Government; first *sukuk musharakah* of RM2.5 billion by Musharakah One Capital Bhd; first rated Islamic residential mortgage-backed securities of RM2.05 billion by Cagamas MBS Bhd; and first exchangeable *sukuk musharakah* of US$750 million by Khazanah Nasional Bhd.

In 2007, the robust bond market in Malaysia ended the year with a significant *sukuk* issuance structured under the widely-accepted Shariah principle of *musharakah*. Maxis Communications Bhd (Maxis), the provider of mobile telecommunication services in Malaysia, had through its special purpose company, Binariang GSM Sdn Bhd (Binariang), originated the largest-ever *sukuk* issue in the world on 28 December 2007, with a total of RM15.35 billion (US$4.71 billion) of *sukuk musharakah.*

These *sukuk* issues marked the largest corporate bond issue exercise and one of Asia's largest corporate bond issues ex-Japan. They were the largest hybrid instrument issued by a Malaysian corporation and were subscribed by Saudi Telecom Company and Shield Estate NV. The use of such an innovative instrument, which was granted full equity credit by

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THE MUWA`ADAH PRINCIPLE IN CURRENCY EXCHANGE CONTRACT

Various Shariah principles have been used in developing the Islamic capital market (ICM) in Malaysia. This has contributed to the growth of Malaysian ICM and brought it up to par with the conventional capital market. To further develop the Malaysian ICM, new Shariah principles must be explored and studied, and one such principle is *muwa`adah*.

Muwa`adah* is defined as a mutual promise between two parties with the intention to conclude a contract in the future. Shariah scholars have focused on *muwa`adah principle in their discussions with respect to marriage during *iddah*[1], currency exchange, buy and sell foods before *qabadh* (take possession), buy and sell during *azan* (prayer reminder) of Friday prayer, and buying and selling something which is not owned.

Al-Qurah Daghi, a contemporary Shariah scholar, discussed *muawa`adah* in two aspects:

a. *muwa`adah* in the contract of currency exchange in the future; and

b. *muwa`adah* in the contract of buying and selling in the future.

This article discusses the principle of *muwa`adah* in the contract of currency exchange in the future. The principle of *muwa`adah* in the contract of buying and selling in the future will be discussed in the next issue of the *Malaysian ICM* bulletin.

Shariah scholars have expressed three different views pertaining to *muwa`adah* in the contract of currency exchange in the future, namely:

- absolutely permissible;
- not permissible if it is binding on the parties involved; and
- permissible for import and export purposes.

Absolute permissibility of muwa`adah

Some classical Shariah scholars, such as Imam Shafi`i, as well as some scholars from Mazhab Maliki such as Ibn Nafi` and Ibn Hazm said that *muwa`adah* in this contract is absolutely permissible. They do not consider *muwa`adah* as a contract of sale and there is no clear evidence from *Quran* and *Sunnah* which prevents *muwa`adah*. However, they do not discuss whether *muwa`adah* is binding or otherwise, on the parties involved.

Ibn Hazm has clarified that *muwa`adah* in transactions of gold for gold, gold for silver, silver for silver, as well as *ribawi* items other than gold and silver are permissible regardless of whether the contract is concluded or otherwise. This is premised on the ground that *muwa`adah* is merely a promise and it is not considered as the real contract of buying and selling.

Non-permissibility of muwa`adah if it is binding on parties involved

In the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) resolution, *muwa`adah* is discussed in the topic of trading of currencies, where it is not permissible in trading of

[1] A period of time given to a woman after divorce or death of husband.

currencies if the promise is binding, even for the purpose of hedging against currency devaluation risk. This is because binding *muwa`adah* is considered a contract. If a contract is concluded, the two parties involved are obliged to execute the delivery of the goods and the payment at the time of the contract. However, this situation does not happen at the time the *muwa`adah* is made.

AAOIFI's view is similar to the view of al-Qurah Daghi, Nazih Hammad and Wahbah al-Zuhaili. They are more inclined to the views of classical Shariah scholars i.e. Mazhab Hanafi, Maliki, and Hanbali who view *muwa`adah* in a contract of currency exchange in the future is not permissible if it is binding on the two parties involved.

Al-Qurah Daghi has stated that *muwa`adah* which is binding is not permissible because it could be used to deceive and could lead to a serious conflict and dispute between parties involved, especially in the event of currency fluctuations.

Nazih Hammad also proposed the same view. According to him, a promise will become a contract, if all parties agree to be bound although the contract will be concluded in the future. In this situation, *muwa`adah* is subject to requirements and conditions of a contract, as the expression in a contract viewed from the objectives and meanings of the contract, and is not viewed from the wordings and forms used. This is in line with the methodology of *fiqh* as follows:

العبرة في العقود للمقاصد والمعاني لا للألفاظ والمباني

Meaning: The expression in a contract is viewed from the objectives and real meanings of the contract and not from the wordings and forms of the contract.

Umar Abdullah Kamil, the author of *al-Qawaid al-Fiqhiyyah al-Kubra*, explains that some scholars avoid the use of *muwa`adah* in a contract of currency exchange based on the following reasons:

- *muwa`adah* can lead to *riba* and one of the parties will obtain benefit due to the element of time; and

- the asset does not exist at the time of contract, so in this situation *muwa`adah* will become *bai` al-ma`dum* (sale of something that does not exist) or *bai` al-majhul* (sale of something where its existence cannot be identified) that could lead to a conflict between the contracting parties.

Nevertheless, the two reasons above can be challenged. In the first case, there is a clear rationale that *muwa`adah* will not lead to *riba* as it only involves a promise and that the contract is not concluded yet, thus no delivery of currency. Deferment in delivery of currency at the time of *muwa`adah* is a non-issue, hence it will not lead to *riba*.

The second reason could also be challenged. If *muwa`adah* is not considered as a contract, there is no requirement for the asset to exist at the time of the contract. Therefore, in this situation, there is no issue of *bai` ma`dum and bai` majhul*.

In addition, the classical Shariah scholars, such as Ibn Qasim and Ibn Basyir from *mazhab* Maliki, do not encourage the usage of the *muwa`adah* principle in the contract of currency exchange in the future even though they do not discuss whether *muwa`adah* is binding or not.

Permissibility of muwa`adah for import and export

According to Umar Abdullah Kamil, in the contract of currency exchange *muwa`adah* is permissible for import-export activities as there is no issue of *riba*. The reason is the concept of selling currency in these activities is not solely for the purpose of exchanging currency but rather buying and selling of goods. In this instance, buying and selling of goods are considered as the primary contract, while contract of currency exchange is subsequent to it. Therefore, if the transaction of buying and selling is valid, the contract of currency exchange is also valid so long as it is free from element of *riba*, *gharar, jahalah* etc.

Moreover, *muwa`adah* is also permissible between the importer and exporter if the selling of currency in the future can be guaranteed through a paper credit/ document credit account (*al-i`timad al-mustanadi*). This is because through the said account, it becomes an alternative for immediate delivery and receipt in cash at the time of the contract (*al-yad bi al-yad*). In this situation, the price of goods that has been determined with the consent of both the importer and exporter during *muwa`adah* will be credited into the credit/document account at the time the real contract is concluded in the future. This becomes an alternative to the issue of mutual receipt of goods and spot price (*al-taqabudh bi al-yad*).

Conclusion

After reviewing the above three different views, the first view which allows *muwa`adah* without any condition is more acceptable. This is based on the reason that there is no clear evidence from the *Quran* and *Sunnah* which prevents *muwa`adah*. Furthermore, *muwa`adah* is not a contract and it is merely a promise to execute a contract at a future date.

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Rating Agency Malaysia Bhd, is reflective of the maturity and sophistication of the country's debt capital market. The issues, made during the global credit market turbulence, were well received by both onshore and offshore financial institutions. It not only exhibited the ability of local financial corporations to raise more than RM15 billion of the refinancing in ringgit, but clearly demonstrated, the strength of the Malaysian debt capital market.

Together with many other sizeable *sukuk* deals launched last year, the Binariang *sukuk musharakah* helped push the total issuance of corporate bonds in Malaysia to a record level of more than RM70 billion in 2007. As at end-December 2007, corporate bonds constituted 52% of the total outstanding bonds in the country. Of the total outstanding corporate bonds, 56% or RM135.8 billion were structured as *sukuk* in accordance with Shariah principles. The depth and sophistication of this market has enabled many corporations, including foreign-owned, to continuously tap the market for long-term funding.

SAC Rulings in 2007

For more than a decade, the Shariah Advisory Council (SAC) of the SC has contributed significantly to the phenomenal growth of the ICM. The members of the SAC have shown exemplary commitment, dedication, and willingness to explore new frontiers for the ICM.

Recognising the importance of in-depth research activities on Shariah issues, the SAC continued to undertake important research to support key resolutions that would later act as a benchmark for industry players. Resolutions made by the SAC continue to provide guidance for the market players in developing the ICM industry.

The key SAC resolutions in 2007 are listed in Table 1.

Kafalah (guarantee) on *musharakah* and *mudharabah* capital	*Kafalah* on *musharakah* and *mudharabah* capital can be in the form of third-party guarantee based on *tabarru`* (voluntarily basis), third-party guarantee with an imposition of fee or guarantee through special funds.
Forward lease	Forward lease is permissible. Lease payments can be fully settled up front upon the contract of *ijarah* or via other agreeable payment arrangements. If the *ijarah* asset does not meet the required specifications by the lessee upon delivery in the future, the lessor is then responsible in replacing the asset.
Consent from chargee or co-owner of asset for securitisation	An encumbered asset (either a charged asset to the bank or an asset that is co-owned with another party) can be used as an underlying asset in structuring *sukuk* provided that the issuer first obtains consent from the chargee or co-owner, as the case may be.
Ta'widh (compensation) on late payments of realised profit under *sukuk musharakah* and *sukuk mudhrabah*	*Ta'widh* is permissible under *sukuk musharakah* and *sukuk mudharabah*. However, *ta'widh* is only applicable when the obligor fails to distribute the capital and realised profit on the stipulated dates in the agreement. *Ta'widh* is not applicable for expected profit.
Revision to terms in *sukuk* documents involving maturity date and profit rate	During the tenure of a *sukuk*, revision to the terms in the *sukuk* document, such as an extension of the maturity date and the revision of the profit rate, will adversely affect the original contract *(`aqd)* of the *sukuk*. Therefore, revisions can only be implemented by first cancelling the initial contract and replacing it with a new contract stating the new maturity date and profit rate.
Convertible/exchangeable *sukuk*	The issuance of convertible/ exchangeable *sukuk* is permissible as long as the *sukuk* is structured based on Shariah principles

Islamic Fund Management Guidelines

The *Guidelines on Islamic Fund Management* issued by the SC on 3 December 2007 are expected to strengthen the Islamic fund management industry and attract greater investments from the Middle East, reinforcing Malaysia's position as the regional gateway for Islamic investments into the Asia Pacific region. Notably, Islamic fund management companies are now allowed to be wholly owned by foreigners and will enjoy tax exemption on all Islamic fund management fees received until assessment year 2016.

Under the new guidelines, an Islamic fund management business can be carried out either as a full-fledge, standalone operation or under an Islamic "window" together with conventional fund management business. The company must appoint an independent Shariah adviser, who can be a non-Malaysian, to oversee all Shariah matters and ensure that its investment activities are limited to Shariah-compliant investments. Furthermore, the company must also ensure the competency of its employees in Islamic fund management, which will promote the development of highly skilled Islamic fund management professionals in Malaysia and internationally.

The new guidelines form part of the SC's pioneering measures to provide greater opportunities for investors from the Middle East to participate in the Malaysian market and vice versa. In March 2007, the SC signed a mutual recognition agreement with the Dubai Financial Services Authority, the first between two Islamic financial centres, to allow the cross-border distribution and marketing of Islamic funds in the two centres.

FREQUENTLY-ASKED QUESTIONS

1. An Islamic bank is a registered person and non-CMSL holder under the CMSA. Is an Islamic bank considered an Islamic fund manager if it carries on the Islamic fund management business? Is an Islamic bank governed by the *Guidelines on Islamic Fund Management* (Guidelines)?	No. An Islamic bank is not an Islamic fund manager. An Islamic fund manager refers to an institution (CMSL holder), which carries on a fund management business which complies with Shariah requirements. As a registered person under the CMSA, an Islamic bank is not governed by the Guidelines.
2. We are a fund management company (a CMSL holder) carrying on both Islamic fund management and conventional fund management business. Are we considered an Islamic fund manager?	No, you are not recognised as an Islamic fund manager but instead you are termed an Islamic "window".
3. Is there any tax incentive given to fund management companies carrying on an Islamic fund management business?	Budget 2008 announced that fund management companies will be given income tax exemption on all fees received for Islamic fund management activities, until assessment year 2016.
4. How do I ensure that my employees are well versed in Islamic finance?	The designated fund manager and compliance officer are encouraged to attend at least two Islamic finance courses a year, organised by the Securities Industry Development Corporation (SIDC) or other training providers approved by the SIDC.
5. Can a foreign Shariah adviser be appointed as an independent Shariah adviser to oversee all Shariah matters?	Yes. A foreign Shariah adviser can be appointed provided he is registered with the SC.

World's Largest Sukuk Issue

The SC approved an application from Maxis Communications Bhd (Maxis), the provider of mobile telecommunication services in Malaysia, through its special purpose company i.e. Binariang GSM Sdn Bhd (Binariang), to issue the largest *sukuk* issue in December 2007.

A total of RM15.35 billion (US$4.71 billion) of *sukuk musharakah* comprising RM12.05 billion nominal value of Islamic Medium Term Notes (IMTN), RM300 million nominal value of Islamic Commercial Papers (ICP) (collectively termed as "the Senior *Sukuk*"), and RM3.02 billion (US$900 million) nominal value Cumulative Non-Convertible Islamic Junior *Sukuk* (Junior *Sukuk*) were issued to both domestic and offshore investors.

The *sukuk* issue was two times oversubscribed by investors, a clear indication of its wide acceptance by investors considering the size of the offer. The IMTN were issued in serial basis with the longest tenure for 15 years while the callable Junior *Sukuk* are structured with a 50-year maturity. The long- and short-term ratings of AA3 and P1 have been assigned by Rating Agency Malaysia Bhd (RAM) to the IMTN Programme of up to an aggregate nominal value of RM19.0 billion and ICP programme up to an aggregate nominal value of RM2.0 billion. RAM has also assigned a long-term rating of A2 to the Junior *Sukuk*.

Asia's First Islamic ETF

The region's first Shariah compliant exchange traded fund (ETF) was launched in Malaysia on 22 January 2008. The fund, known as MyETF Dow Jones Islamic Market Malaysia Titan 25 (MyETF-DJIM25) and listed on Bursa Malaysia Securities Bhd ("Bursa Securities") on 31 January 2008. It will have an initial authorised fund size of 10,000,000,000 (10 billion) units, representing a basket of securities designed to track the performance of the benchmark index, namely the Dow Jones Islamic Market Malaysia Titan 25 (DJIM25). The DJIM25 is a market capitalisation weighted and free-float adjusted index consisting of 25 Shariah-compliant securities of companies listed on Bursa Securities. MyETF-DJIM25 will be managed by a government-linked fund management company, *i*-VCAP Management Sdn Bhd.

Generally, ETF is a unit trust fund traded on a stock exchange. The fund consists of securities designed to track the performance of an index. ETFs are open-ended funds with a unique in-kind creation and redemption mechanism supported by a system of participating dealers and liquidity providers. The main difference between ETFs and unit trust funds is in the manner their units are bought and sold. It is designed to be a liquid, low cost financial instrument for investors seeking a performance generally similar to the benchmark index.

The MyETF-DJIM25 among others aims to enable the government-linked investment companies (GLICs) to divest their interests in government-linked companies (GLCs) by selling a portion of their portfolios to the ETF in exchange for units. This also improves the free float in the market and encourages greater retail participation in the equity market. The aggregate market capitalisation of the 25 constituents companies accounted for approximately 30% of the Malaysian stock market.

Currently, there are five Islamic ETFs worldwide – Easy ETF (BNP Paribas), DJIM Turkey ETF (Bizim Menkul Dergler, Turkey) and the three Islamic ETF launched by iShares, the ETF specialist arm of Barclays Global Investors. The uniqueness of MyETF-

DJIM25 however, is the absence of conventional securities borrowing and lending (SBL) mechanism as part of the overall structure, as normal for all ETFs. The need for SBL has been replaced by a Shariah-compliant structure, not adopted by other Islamic ETFs.

The launch of this Malaysian Islamic ETF will boost the country's aspiration to become an Islamic financial hub, attract foreign funds, and broaden the capital market. It will provide added diversity to Bursa Malaysia's offerings and bridge gaps between the exchange and other global Islamic markets.

Structured Islamic Negotiable Instrument of Deposit

Structured products have emerged as a strong new investment alternative, giving investors access to a wider range of markets and payout structures. In January 2008, CIMB Islamic Bank launched its Dynamic Market Rider NID-i, the bank's first structured Islamic negotiable instrument of deposit that allows investors to benefit from both bull and bear markets across different asset classes.

The performance of the Dynamic Market Rider NID-i is tagged to the value of the CIMB Millennium Excess Return Index (CIMB Millennium). The index covers the world's major equity indices in Europe, US, Japan and China and alternative asset classes of currency, commodities and real estate.

CIMB Millennium optimally reallocates investments between the asset classes on a monthly basis by employing a long/short strategy that allows it to allocate a positive (buy) or negative (sell) weighting on an asset class. This investment strategy allows the index, and investors, to gain from either a rise or fall in value of the various asset classes. When applied to historical data, this investment strategy generates an average return of 24.23% per annum over five years. A minimum investment of RM50,000 is required for this product.

Global Shariah-Compliant Equities Fund

The SC has approved CIMB Islamic Global Equity Fund, its first global equity fund which complies with Shariah principles. Investors now have access to equities in numerous emerging and developed markets. The fund offers a balanced solution that gives investment access to emerging markets while providing investors with long-term stability arising from the strong fundamentals of developed markets. The fund's broad diversification across Asia-Pacific, Europe, North and Latin America significantly reduces the overall volatility of the portfolio.

The CIMB Islamic Global Equity Fund seeks to provide investors with medium to long-term capital appreciation through investments in global equities which are undervalued and have the potential for significant growth. The fund will invest 70% to 99% of its net asset value in Shariah-compliant equities listed on the stock exchanges in the emerging and developed markets of Asia Pacific, Europe, North and Latin America. The fund will be managed by Principal Global Investors, a diversified asset management organisation and a member of the Principal Financial Group®, with expertise in equity, fixed income and real estate investments.

With a minimum of RM1,000, investors can have investment access to renowned Shariah-compliant equities worldwide. The initial selling price per unit will be RM0.50, and the approved fund size is 300 million units.

Key Trends in Islamic Finance[1]

Islamic finance seems to have developed a gravitational force of sorts recently and is attracting many new players. What was once a sparsely populated landscape is turning into an increasingly visible and flourishing global Islamic market place. As the landscape transforms, Islamic finance is opening up new windows of opportunities to become a driver of economic development for Muslim communities around the world.

Broadening of Islamic financial markets

Malaysia is likely to witness a broadening of many domestic Islamic financial systems from its banking and *takaful* base. It is a natural evolution that growth will, over time, be driven by increasing cross-border investment flows intermediated through the securitisation process and the manufacture of investment products in the ICM. This will see the development of significant equity and bond markets accompanied by a broadening of product offerings.

This has been the Malaysian experience, where a comprehensive ICM has developed alongside the conventional sector. Shariah-compliant products now account for a significant proportion of our overall capital market. For example, Shariah-compliant equities account for 63% of Malaysia's equity market capitalisation of just over RM700 million. Similarly, *sukuk* accounts for 76% of total new bonds approved in 2007.[2]

"...sukuk accounts for 76% of total new bonds approved in 2007."

International participation in domestic markets will also become increasingly evident. Foreign issuers first tapped the Malaysian *sukuk* market in 2005 with the pioneer ringgit *sukuk* issuance by the World Bank amounting to RM760 million or US$224 million. More cross-border issuances will certainly be seen in the future.

Malaysia is also likely to see a broadening of the Islamic wealth management industry and the launch of several potentially high-growth products. The global Shariah-based unit trust industry is still nascent. Malaysia's Shariah-based unit trust industry with a net asset value of RM14.93 billion is the largest – but the growth outlook is promising. Another potential high growth area is the Islamic private equity market. The use of private equity and venture capital in a properly constructed partnership is indeed a natural fit with Shariah principles.

Furthermore, Malaysia will see a strong expansion in product breadth. Over the last few years, intensifying research and development work have resulted in the tremendous growth in the body of knowledge and financial sophistication that has led to the creation and marketing of a proliferation of Shariah-based products, keeping pace with those

1 This article is extracted from the SC Chairman's statement at the Islamic Finance in Southeast Asia: Local Practise, Global Impact Conference, Washington DC in Oct 2007.

2 This figure includes the approval of seven combination issuances (conventional bonds and *sukuk*) with a combined issue size of RM89.5 billion.

available in conventional markets. Malaysia launched the world's first rated Islamic residential mortgage backed securities in 2005 and the first listed Islamic REITs in 2006.

Global sukuk market on verge of take-off

Demand for Islamic products will be turbo-charged by the windfall oil revenues for Muslim nations in East Asia and the Gulf. Just for the Gulf states alone, McKinsey projects US$2 to US$3 trillion revenues over the next decade. These petrodollars need to be recycled and will naturally look for Islamic assets. As evidenced, the equity market capitalisation of the Gulf states is estimated to have risen from US$135 billion in 2001 to US$694 billion in 2006.

On the supply side, not only is Muslim issuance rising sharply, there is increasing interest from non-Muslim countries like China and Japan to issue *sukuk*. These trends confirm the rising popularity of *sukuk* on the world stage and suggest the global *sukuk* market is on the verge of a take-off.

Malaysia, of course, takes considerable pride in pioneering the development of the global *sukuk* market with the launch of the first sovereign five-year global *sukuk* of US$600 million in 2002. The Gulf states are also putting in considerable efforts to develop the global *sukuk* market with issuances totaling more than US$13 billion in 2007. As the largest player with more than 60% of global outstanding *sukuk*, Malaysia intends to continue to be a significant player in the market.

There will also be an increase in the variety of *sukuk* from plain vanilla to exotics. Malaysia's contribution to this was the issuance of the world's first exchangeable *sukuk*, the Khazanah exchangeable *sukuk*, in 2006. Malaysia is likely to see more *sukuk* being offered with features for convertibility and other innovative profit-sharing features attached in the near future.

Markets will increasingly drive convergence of Shariah standards

In earlier days, the development of global Islamic finance was hobbled by variations in standards. The emergence of the global *sukuk* market signifies that Islamic products will increasingly be structured on Islamic principles that are widely accepted in global markets.

> *"The emergence of the global sukuk market signifies that Islamic products will increasingly be structured on Islamic principles that are widely accepted in global markets."*

The first *sukuk* in Malaysia was issued in 1990 when the ICM was in its infancy in Malaysia and almost non-existent elsewhere. *Suku*k issuances then were based on deferred sales or *murabahah* (sale and purchase with cost plus). The breakthrough came in 2004 when Malaysia decoupled the issuance of *sukuk* from the conventional legal concept of debentures, through the introduction of our *Guidelines on Islamic Securities*. This permitted the use of widely accepted structures involving the element of equity participation, such as *musharakah* and *mudharabah*. Latent global demand then took over with the result that international *sukuk* issued out of Malaysia were consistently heavily oversubscribed. The lesson is that issuers will increasingly adopt structures that are widely accepted internationally.

Islamic finance will shift from adaptation to innovation

The growth momentum will motivate global players to strengthen their capabilities. This is a critical development in that increased R&D budgets are required to attract the best talents to take Islamic finance to the next level. This could be the case of incentivising financial experts who are already well versed with Shariah or Shariah scholars working closely with financial experts to create indigenous Shariah products. The exploration and a deep understanding of the Shariah are the major factors needed to drive the shift from adaptation to innovation.

It should not be overlooked that Shariah Advisory Councils (SAC) can play a critical role in fostering innovation through in-depth research and discussions. In Malaysia, the SAC for the capital market plays a leading role in facilitating product innovation through the issuance of Shariah-specific rules and guidelines which provide market participants clarity and certainty on what is permissible. When they recently published their resolutions, it was extremely well received worldwide. There is certainly room for more of such publications around the world to foster greater sharing of Shariah thinking and to promote greater debate as these will feed into a stronger innovation process.

Expanding role of regulators

The accelerating proliferation and complexity of Islamic products and players and its co-existence with the conventional market are issues which concern regulators. Regulators will increasingly wish to expand their role to ensure the ICM is well regulated and that Islamic investors are protected.

Two important regulatory principles need to be considered. The first is the notion of regulatory parity which requires that all market participants engaged in a particular activity should be regulated in the same manner to promote a level playing field and ensure fair treatment of investors. The IOSCO Task Force, chaired by Malaysia, to review developments in ICM came to the important conclusion that the principles of securities regulation also apply to Shariah-compliant products.

The second principle is that for Islamic products, the market must inspire investor confidence in the Shariah compliance process; that Islamic products are true to label. A key feature of Malaysia's regulatory approach is therefore to ensure a comprehensive Islamic financial system that co-exists with the conventional financial system and which provides all participants the same degree of clarity, certainty and protection.

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Regulators around the world are very interested in enhancing risk management practices for Islamic finance. The Islamic Financial Services Board (IFSB) issued a comprehensive standard on risk management in 2005. The other aspect of risk management is the development of risk products and framework. In this context, the minimisation of risks is certainly in line with Islamic economic objectives but conventional products which do not involve transfer of ownership cannot be used. The challenge for us is to develop hedging instruments which are compliant with Shariah principles.

The role of the regulator is not restricted to regulatory oversight but can also facilitate the development of new products and investor education. For example, product innovation is facilitated by the introduction of guidelines to provide clarity and consistency with respect to the treatment and disclosure of Shariah-related issues. The SC's *Guidelines on Islamic Securities* in 2004 set the stage for the popularisation of the *sukuk* market while the *Islamic REITs Guidelines* facilitated the introduction of the first listed Islamic REITs in Malaysia which was subsequently followed by others around the world.

The SC is quite active in sharing its Islamic regulatory knowledge with other jurisdictions. We have provided advice to developed markets who were interested in promoting Islamic finance in their markets. Our training arm, the Securities Industry Development Corporation, conducts an annual Islamic Markets Programme which attracts regulators and market players from all parts of the world.

Driver of economic development for Islamic communities

Malaysia shares in the satisfaction of seeing its common aspiration of a thriving global Islamic financial market finally taking shape on the back of ceaseless and untiring efforts by the community of dedicated Islamic financial players around the world.

Consistent with the spirit of Islam, we also have a responsibility to ensure that the benefits of Islamic finance are channelled to benefit the *ummah*. In this respect, many Muslim communities around the world still live in poverty without access to basic amenities. Therefore, it is important for us to use our knowledge in Islamic finance to drive economic development and to raise living standards for Muslim communities around the world.

One specific area is the tapping of ICM to finance infrastructure development in poorer countries. The multilateral banks have taken a lead role in this. For example, the World Bank (*bai' bithaman ajil* papers of RM760 million), and the International Finance Corporation (*bai' bithaman ajil* of RM500 million) have all issued *sukuk* in Malaysia for financing infrastructure development.

Malaysia welcomes the opportunity to collaborate with others to recycle global wealth into corporate formation and economic development in Islamic countries through ICM.

Increasing collaboration among Islamic markets

In conclusion, current developments are pointing towards the creation of a deep and broad global ICM. The challenge ahead is for all to build bridges between the currently fragmented pools of Islamic liquidity and to facilitate active trading of Islamic securities across different time zones.

Malaysia is actively looking for international partners to share in efforts to link its markets. Malaysia has launched the Malaysia International Islamic Financial Centre (MIFC) initiative to attract global players to its markets and signed a mutual recognition agreement with the Dubai Financial Services Authority (DFSA) for border distribution and marketing of Islamic funds between the two markets.

With strengths in Islamic regulation, Malaysia's position as a gateway to the Far East, our track record in pioneering and commercialising new products, and with depth and breadth of the markets, Malaysia is capable of offerring many benefits to prospective partners. Malaysia is also investing heavily in developing Islamic intellectual capital and welcomes collaborative efforts with other scholars and Islamic institutions to advance Islamic finance to the frontiers.

Year in Review: 2007

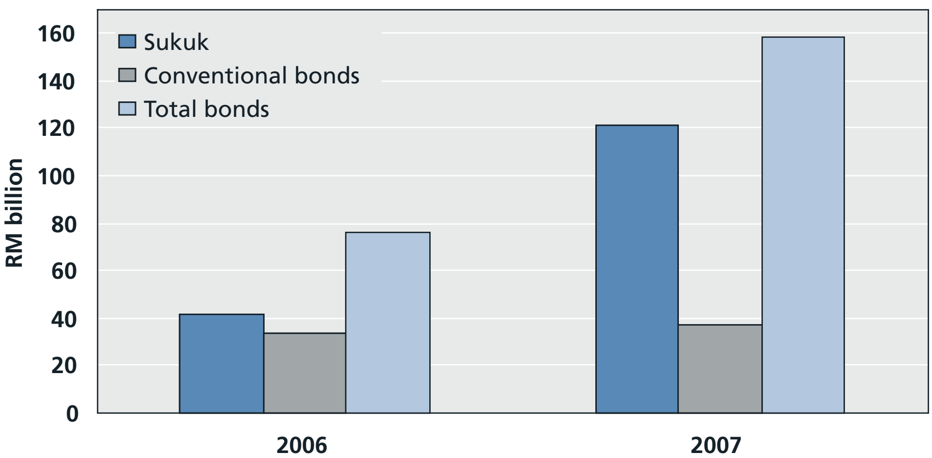
Sukuk

The Malaysian *sukuk* market continued to experience unprecedented growth, where 76% of all bonds approved by the SC were *sukuk* – with a total value of RM121.3 billion (Chart 1)[1]. The positioning of Malaysia's ICM as a centre of innovation was further reinforced with landmark issuances, such as the largest *sukuk* (combination issuance with conventional bonds) funding programme of RM60 billion by Cagamas Bhd; the *sukuk* programme of RM19 billion by Binariang GSM Sdn Bhd; the largest exchangeable *sukuk* of USD850 million by Khazanah Nasional Bhd; and the RM3 billion TM Islamic Stapled Income Securities by Telekom Malaysia and Hijrah Pertama Bhd (Table 2).

Sukuk musharakah, *sukuk ijarah,* and *sukuk istisna`* dominated the Malaysian *sukuk* market in terms of approval size in 2007. The combination of these innovative structures represented RM47.5 billion or 78% of the total size of *sukuk* approved.[2] The remaining 22% or RM13.8 billion of *sukuk* approved were structured using *mudharabah*, *murabahah* and *bai` bithaman ajil* principles.

To promote Malaysia as a centre of origination, distribution, and trading of *sukuk*, the SC introduced a facilitative framework for the issuance of foreign currency denominated *sukuk*. Qualified issuers are multilateral development banks, multilateral financial institutions, sovereigns and quasi-sovereigns, and local or foreign multinational corporations. A non-ringgit *sukuk* issued by any of these entities, which is rated at least a single A, will be deemed approved under the practice note 1A in accordance with the Islamic securities guidelines.

Chart 1: Sukuk Approved by the SC



1 This figure includes the approval of seven combination issuances (conventional bonds and *sukuk*) with combined issue size of RM89.5 billion.

2 The combination issuance of RM60 billion by Cagamas Bhd was not included for the purpose of this calculation due to uncertainty of the amount per multiple Shariah principles to be used.

The *sukuk* approved under this framework may be offered offshore and to sophisticated investors onshore. Additionally, the liberalised framework allows the use of international documentation, based on the UK or US laws, and credit ratings by international credit rating agencies are also acceptable. These flexibilities introduce international standards and practices as benchmarks in the *sukuk* issuance process, while saving costs for international issuers.

Table 2: Notable Sukuk Issues in 2007

Issuer	Shariah Principle	Amount (RM million)
Cagamas Berhad	Multiple Shariah principles	60,000+
Binariang GSM Sdn Bhd	*Musharakah*	19,000
Telekom Malaysia Bhd & Hijrah Pertama Bhd	*Ijarah*	2,997
Khazanah Nasional Bhd	*Musharakah*	2,890++
MISC Bhd	*Murabahah*	2,500
Cagamas MBS Bhd	*Musharakah*	2,300
Putrajaya Holdings Bhd	*Musharakah*	1,500
Lebuhraya Kajang-Seremban Sdn Bhd (two issues)	*Istisna'*	1,453
Menara ABS Bhd	*Ijarah*	1,100
United Growth Bhd	*Musharakah*	800

\+ *A combination of a few Islamic principles and conventional bond*
++ *Issued out of Labuan amounting to US$850 million*

Islamic Fund Management and Equities

In line with the MIFC's objectives, the SC facilitated several measures announced in Budget 2008 to encourage the development of the fund management industry. The new measures are:

- Foreign ownership on fund management companies and real estate investment trusts (REITs) management companies are allowed up to 70%. The minimum Bumiputera ownership requirement will remain at 30%;
- The SC will facilitate the licensing process and all dealings with other government agencies to expedite the approval process for the establishment of fund management businesses in Malaysia;
- To attract greater investments from the Middle East, three new stockbroking licences will be issued to leading stockbroking companies which are able to source and intermediate businesses and order flows from the Middle East;
- For the Islamic fund management:
  - Islamic fund management companies are allowed to be wholly owned by foreigners;
  - A sum of RM7 billion will be channelled by the Employees Provident Fund to be managed by Islamic fund management companies;
  - Islamic fund management companies are allowed to invest all their assets abroad; and
  - Fund management companies are given income tax exemption on all fees received in respect of Islamic fund management activities, until assessment year 2016.

Several guidelines were introduced:

- The SC issued *The Guidelines on Islamic Fund Management* which set out the requirements to be followed by an Islamic fund manager that carries on Islamic fund management and the requirements for carrying on an Islamic fund management business under an Islamic window; and

- Bursa Malaysia Berhad released the *Best Practices Guidelines in Islamic Stockbroking for Stockbroking Companies Offering Islamic Stockbroking Business or Services* which outline key areas for operations and compliance aspects of an Islamic stocbroking business.

Shariah-based Unit Trust Funds

In 2007, the SC approved 34 new Shariah-based unit trust funds. This brought the total of Shariah-based unit trust funds to 134 or 25.7% of the total of 521 approved funds. Of the Shariah-based unit trust funds, 62 were equity funds, 21 were balanced funds, 19 were *sukuk* funds while the remainder were money market funds, structured products, feeder funds, fixed income funds and mixed asset funds.

The increase in Shariah-compliant investment products mainly contributed to the growth of Shariah-based unit trust funds in Malaysia. The NAV of Shariah-based unit trust funds for the last 10 years grew at a compounded annual growth rate of 39.6% while the total industry recorded a growth rate of 17.8% in the same period.

On the real estate investment trusts (REITs), a second Islamic REIT, Al-Hadharah Boustead REIT made a commendable debut on Bursa Malaysia in February 2007. The Al-Hadharah Boustead REIT, the first REIT to be backed by plantation assets offers investors an attractive alternative to plantation stocks, with a profit sharing of at least 98% of its distributable earnings to be paid to unit holders for the first three financial years.

Shariah-compliant Equities

Bursa Malaysia has introduced two new equity index series for Shariah-compliant equities in Malaysia. The two new Shariah indexes are subjected to international indexing features, such as free float and liquidity, and the Shariah-compliance filter by the SC's SAC. The FBM EMAS Shariah Index was designed to replace the old benchmark index for Shariah-compliant equities, the Kuala Lumpur Shariah Index (KLSI). The second index, FBM Hijrah Shariah Index, is a tradeable index with a fixed number of 30 constituents.

The new index creates further opportunities for investors seeking Shariah-compliant investments to benchmark their investments, and for asset managers to create new products serving the investment community. It provides opportunities for capital market intermediaries to work with Bursa Malaysia to package a broad range of attractive products to widen the choice of investments in the Malaysian capital market, such as Islamic exchange-traded funds (ETFs) and structured products.

For Shariah-compliant equities, two reviews were conducted on all listed companies and the results were published on 25 May 2007 and 30 November 2007 respectively. Throughout the year, 35 equities were added to the list of Shariah-compliant equities by the SAC while 21 were removed. In total, there were 853 Shariah-compliant equities or 86% of the total listed equities on Bursa Malaysia.[3] As at end-2007, the market capitalisation of Shariah-compliant equities stood at RM705.1 billion or 63.7% of total market capitalisation.

[3] Throughout 2007, 46 Shariah-compliant equities were excluded from the list as their shares were delisted from Bursa Malaysia.

News Roundup

SC is Best Regulator for Islamic Funds

The SC emerged as the "Best Regulator for Islamic Funds" at the inaugural Master of Islamic Funds Awards held in Dubai. The award acknowledges the SC's pioneering efforts and leadership in the development and promotion of a comprehensive ICM capital market. The Master of Islamic Funds Awards confers international recognition for outstanding achievement in the global Islamic funds industry.

This international acknowledgement is also an endorsement of the government's efforts to position Malaysia as a global Islamic financial hub that specialises in, among others, the origination, distribution, and trading of Islamic funds and wealth management.

The co-winner of the award is the Dubai Financial Services Authority (DFSA). The SC and the DFSA signed a mutual recognition agreement in March 2007, opening the gateway for cross-border distribution and marketing of Islamic funds between Malaysia and the Dubai International Financial Centre. This arrangement between regulators was the first of its kind between two Islamic markets.

SC Director Awarded Most Outstanding Person for Contribution to Islamic Finance

The SC's Senior Executive Director, Dato' Dr Nik Ramlah Mahmood was named the "Most Outstanding Person for Contribution to Islamic Finance" by the Kuala Lumpur Islamic Finance Forum 2007 (KLIFF). Dato Dr Nik Ramlah received the award from Second Finance Minister of Malaysia, Tan Sri Nor Mohamed Yakcop. Dato' Dr Nik Ramlah, who has been at the forefront of ICM development for over a decade, was selected from among other leading players in the Islamic finance circle based on her significant role in developing the Malaysian ICM, outstanding leadership qualities, professional achievements and contribution to Islamic finance activities. She was also selected for the award based on her significant presence in the local and international market platform as a highly-respected and much sought-after speaker, moderator and innovator in the Islamic finance circuit.

Her appointment as the SC's Director of Policy and Development in 1998 marked her foray into the ICM arena, which was at its nascent stages in Malaysia at that time. Currently, she leads the ICM Department in pursuing the Capital Market Masterplan (CMP) recommendations and the Malaysia International Islamic Finance Centre (MIFC) initiatives, relating to the Islamic capital market. Dato Dr Nik Ramlah and her team, guided by the visionary leadership of the SC chairmen throughout the years, have made a mark for Malaysia on the ICM map with the introduction of the world's first guidelines for Islamic securities and REITs. These guidelines paved the way among others for the phenomenal development of the *sukuk* market and world's first listed Islamic REITs.

Picture courtesy of CERT Sdn Bhd

4th Kuala Lumpur Islamic Finance Forum 2007

The 4th Kuala Lumpur Islamic Finance Forum (KLIFF 2007) was held from 19 to 22 November 2007 under the theme of "Towards Innovation and Sustainable Growth". The event, organised by CERT Sdn Bhd, in collaboration with Dow Jones Islamic Market (DJIM), International Institute of Islamic Finance (IIIF), and Halal Industry Development Corp (HDC), was officiated by Dato' Sri Mohd Effendi Norwawi, Minister in Prime Minister's Department. Encik Wan Abdul Rahim, ICM Consultant, represented the SC as a moderator in a panel session entitled "Global *Sukuk*: Market Growth and Future Trends".

MATRADE Inaugural Malaysia Services Exhibition

The Malaysia External Trade Development Corporation (MATRADE) Inaugural Malaysia Services Exhibition (MSE2008) was held from 13 – 15 January 2008 at Sharjah Expo Centre, United Arab Emirates. It was the first-ever Malaysia Services Exhibition in West Asia. The exhibition was jointly officiated by His Highness Sheikh Sultan bin Mohamed bin Sultan Al Qassimi, Crown Prince and Deputy Ruler of Sharjah, and Dato' Seri Rafidah Aziz, the Minister of International Trade and Industry, Malaysia.

A total of 168 Malaysian companies and associations participated, aimed at showcasing the strengths and expertise of the Malaysian services industry to the GCC markets and the surrounding regions. The SC was part of the MIFC delegation presenting Malaysia's Financial Services at the Exhibition. The SC also hosted a special forum on "Opportunities in the Malaysian Capital Market".

IFSB Seminar in Hong Kong

A seminar on Islamic Finance, the first of its kind in Hong Kong was held on 15 and 16 January 2008. The seminar brought together experts from regulators, market players, and international financial institutions to discuss interesting topics on Islamic financial services industry, including Shariah, legal, and rating issues.

The SC Senior Executive Director, Dato' Dr Nik Ramlah Mahmood presented a paper entitled "Overview of the Islamic Financial Services Industry (IFIS): Perspectives of Regulators and Market Players (Capital Market)". The seminar, jointly hosted by the Islamic Financial Services Board (IFSB) and the Hong Kong Monetary Authority (HKMA), aimed to create awareness of Islamic finance and to highlight opportunities in Hong Kong.

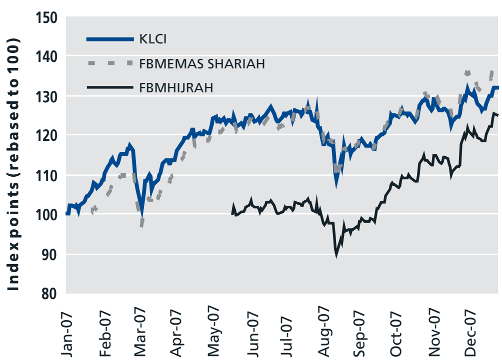
MALAYSIAN ICM – FACTS & FIGURES

Shariah-compliant securities on Bursa Malaysia

Number of Shariah-compliant securities - Nov 2007+			853 securities
% to total listed securities			86 %
Latest market capitalisation – Dec 2007			**(RM billion)**
Shariah-compliant			705.05
Total market			1,106.15
% of Shariah-compliant securities to total market			63.74%
Equity market indices	**30 Nov 07**	**31 Dec 07**	**% change**
KL Composite Index (KLCI)	1,396.98	1,445.03	3.4%
FBM EMAS Shariah	10,038.5	10,533.10	4.9%
FBM Hijrah Shariah@	10,974.37	11,660.06	6.3%

\+ *The SAC of SC releases the updated Shariah-compliant securities list twice a year in May and November.*
@ *Launched on 21 May 2007*

KLCI and Shariah Index Performance

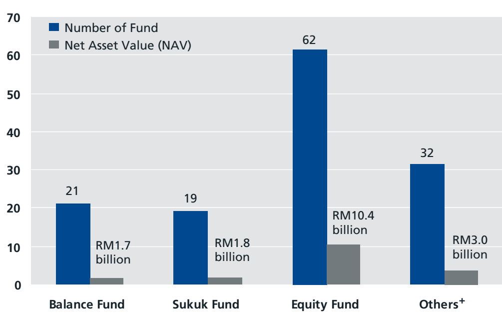


Shariah-based unit trust funds

Number of approved funds	**2006**	**2007**
Shariah-based	100	134
Total industry	416	521
Net asset value (NAV) of approved funds	**2006**	**2007**
Shariah-based	RM 9.20 bln	RM 16.90 bln
Total industry	RM121.8 bln	RM 169.40 bln
% to total industry	7.6%	10.0%

\+ *Including feeder funds, fixed income funds, money market funds and structured products*

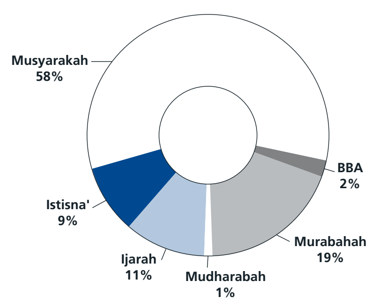
Shariah-based unit trust funds by catergory



Sukuk

	2006	**2007**
Size of outstanding sukuk (exclusive of Government sukuk)	RM 105.2 bln	RM 135.8 bln
% of outstanding sukuk to total outstanding bonds	47.75 %	56.0 %
Sukuk approved by the SC	**2006**	**2007+**
Number of sukuk	64	59
Size of sukuk	RM 42.02 bln	RM 121.30 bln
Size of total bonds approved	RM 75.83 bln	RM158.80 bln
% of size of sukuk to total bonds approved	55.41 %	76.4 %

Sukuk approved based on various Shariah principles++



\+ *The sukuk figure includes the approval of seven combination issuances (conventional bonds and sukuk) with a combined issue size of RM89.5 billion.*
++ *The combination issuance of RM60 billion by Cagamas Bhd was not included for the purpose of this calculation due to uncertainty of the amount per multiple Shariah principles to be used.*

Sukuk approved by the SC in Q4-2007

	Issuer	Shariah Principle	Size of Issues (RM milion)	Date of approval	Initial Rating
1	Naim Cendera Holdings Bhd	*Musharakah Murabahah*	500	1 Oct 07	AA3 P1
2	Cerah Sama Sdn Bhd	*Musharakah*	600	5 Nov 07	AA3
3	Nilai Terbilang Sdn Bhd	*Istisna`*	3,000	5 Nov 07	AA-
4	Projek Lebuhraya Utara-Selatan Bhd	*Musharakah*	3,550	26 Nov 07	AAA
5	Binariang GSM Sdn Bhd	*Musharakah*	19,000	3 Dec 07	AA3 P1
6	Tradewinds Plantation Capital Sdn Bhd	*Ijarah*	210	4 Dec 07	AAA & AA+
7	Tradewinds Plantation Capital Sdn Bhd	*Murabahah*	190	4- Dec 07	MARC-1/AA+
8	Tanjung Offshore Bhd	*Murabahah & Istisna`*	400	10 Dec 07	AA3
9	Perisai Petroleum Teknologi Bhd	*Murabahah*	150	10 Dec 07	A
10	Syarikat Pengeluar Air Sungai Selangor Sdn Bhd (SPLASH)	*Murabahah*	600	10 Dec 07	AA2
11	DRIR Management Sdn Bhd	*Ijarah*	850	14 Dec 07	AA & AA-
12	Binariang GSM Sdn Bhd	*Musharakah*	3,150	17 Dec 07	A2
13	Sunrise Bhd	*Murabahah*	400	18 Dec 07	A
14	Pendidikan Industri YS Sdn Bhd	BBA	150	18 Dec 07	AA
15	MRCB Southern Link Bhd	*Istisna`*	230	27 Dec 07	A2
16	MRCB Southern Link Bhd	*Istisna`*	900	27 Dec 07	AA3
17	Manfaat Tetap Sdn Bhd	*Mudharabah*	752.24	27 Dec-07	Not rated

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