

IT'S ALL ABOUT THE SUKUK

Malaysia continues to assert its position as a world leader in Islamic finance. Accounting for around 67% of global sukuk issuances, Malaysia is the largest sukuk issuer in the world. It is a pioneer in the Islamic finance industry, as the first country to issue sovereign sukuk in 2002 and to list an Islamic real estate trust (REIT) on its Stock Exchange in 2006.

ISLAMIC FINANCING in Malaysia was kick-started in 1983 when the Islamic Banking Act 1983, the country's first law for Islamic banking, was passed. Islamic banking in Malaysia was introduced via "windows," which allowed conventional financial institutions to offer Shariah-compliant banking products and services. Unlike countries such as Qatar, where legislation now requires Islamic banks to be standalone, maintaining this policy supported the creation of a dynamic and competitive Islamic industry. The same year, a Sharia-compliant government Investment Act was introduced to allow the government to issue Sharia-compliant investment certificates, or sukuk, to facilitate the liquidity management of Islamic banks. Progressive liberalization, which allowed foreign institutions to obtain Islamic banking licenses, saw an increase of players in the industry; Malaysia now has 16 licenced Islamic banks, of which 6 are subsidiaries of foreign institutions. Today, Malaysia's Islamic banking assets amount to \$65.6 billion and the industry sees a robust average growth rate of around 18-20% annually.

The role of Bank Negara Malaysia (BNM), the country's central bank, has been crucial in establishing the right regulatory framework and creating an environment where the Islamic financial industry continues to flourish more than 30 years since its inception. In 1994, BNM introduced an Islamic Interbank Money Market (IIMM), which remains unique to Malaysia. "Malaysia has been distinct from the very beginning by having a strong public policy stance, and a mix of experimentation and development of a vision," explained Jaseem Ahmed, Secretary-General of the Islamic Financial Services Board (IFSB), a Kuala Lumpur-based organization set up to issue global standards to promote stability in the Islamic financial services industry.

Malaysia has also been particularly successful in other countries at addressing the challenges that prevent Islamic finance from competing with its conventional counterpart. One of the often-cited problems is a shortage of talent in the industry. To address this, in 2005, BNM set up the International Centre for Edu-

cation in Islamic Finance (INCEIF), the world's first international university dedicated solely to Islamic Finance. According to independent reports, 11% of the world's accredited and referenced output on Islamic Finance comes from INCEIF and its related organization, the International Shari'ah Research Academy for Islamic Finance (ISRA).

Another global issue is the negative perception that surrounds Islamic finance. Unlike Turkey, which despite its dominant Muslim community refers to Islamic banking as participation banking, Malaysia has been able to market it as an alternative business model rather than a product targeted at Muslim consumers. According to Raja Teh, CEO of Chinese Malaysian-owned Hong Leong Islamic Banks (HLIB), half of HLIB's customers are non-Muslims. "This clearly illustrates that the service is meant for everyone."

Alongside a robust Islamic banking sector is a well-developed takaful industry in Malaysia. Its risk-sharing model is seen as an alternative to conventional insurance and hence appealing to non-Muslim Malaysian customers. A low penetration rate of around 14%, coupled with a large protection and savings gap, "shows that there is so much potential for the Takaful business," says Elmie Aman Najas, CEO, AIA Public Takaful.

Malaysia's success in Islamic finance has made Malaysia the case study for those countries wishing to tap its growing potential. "Malaysia is clearly becoming the Islamic finance capital of the world," says Daud Vicary Abdullah, CEO of INCEIF. As countries increasingly turn to Malaysia to learn from its experience, the country assumes a growing role in exporting Islamic finance to the rest of the world. The UK, for example, has set up an advisory board on Islamic finance on which the IFSB sits, and organizations such as INCEIF are responsible for supplying a large pool of talent to the global Islamic finance industry each year. Sukuk issued both by the Malaysian government and Malaysian multinational firms is increasingly denominated in foreign currency, contributing to the internationalization of Islamic finance and creating liquidity in the global Islamic finance market. ✖

SUKUK

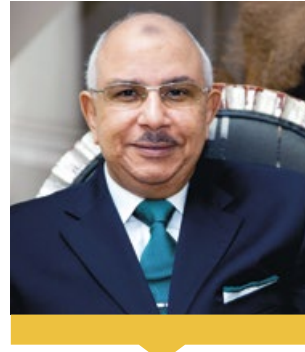
The emergence of sukuk, or Islamic bonds, as a method for funding infrastructure projects is a visible trend in Malaysia's economy.



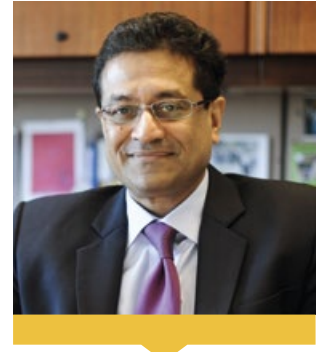
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Initially, we did not have much flexibility, and simply relied on two instruments. The project was kicked off very quickly and we had to raise the funding equally quickly. Issuing sukuk was a conscious decision to support the Malaysian Islamic Financial Center (MIFC) initiative in Kuala Lumpur, but it was also our belief that the sukuk structure makes it easier for the Treasury to manage its liability moving forward as a fixed instrument, rather than a floating one. Our second instrument is an Islamic revolving credit, which is arranged through a group of banks. Besides that, we have also tapped the retail market by issuing Bursa Malaysia's first Exchange Traded Sukuks. We are trying to tap the retail sukuk market as well, to see that more is issued, and to attract more retail investors. It is all part of our strategy to broaden our investor base. The debt market as a whole grew faster than the sukuk submarket. But there is an overall slowdown as well. In the capital markets, over 60% of the equities side is now Islamic.

We received approval for the foreign currency denominated program in November 2014. When we purchase Islamic Home Financing, we will explore the possibility of funding that either through sukuk in ringgit or in a foreign currency. Cagamas buys loans from the financial institutions, and we issue bonds and sukuk to fund it. It is always done simultaneously. Moving forward, Cagamas is looking at how we can replicate what we have done in the mortgage market and how we can help in the development of infrastructure, particularly in the health and education sector. We are also looking at how we can support the SME sector so we could potentially purchase SME loans on a "with recourse" basis. Furthermore, we are also exploring ways in which we can complement our Malaysian banks which are operating in the region. Over the last 28 years, Cagamas has emerged as the single largest private debt securities (PDS) issuer in Malaysia, cumulatively issuing a total of approximately \$78 billion of bonds and sukuk.

The aim is to create awareness about the IILM Sukuk, since the IILM was the first organization in the Islamic financial services industry to issue short-term, tradable US dollars denominated, 'A-1' rated Sukuk. In Mauritius, the Program was hosted by Bank of Mauritius. In Jordan, it was the first time that the IILM conducted awareness program with the private sector to create awareness among them and it was hosted by Jordan Islamic Bank. So far, the IILM has done outstandingly well with a total issuance of \$1.85 billion. If the IILM takes into accounts the issuances and reissuances, the total comes to \$8.63 billion until February 2015. In 2014, the IILM received seven awards. Other financial institutions have nominated the IILM because we never nominated ourselves to any of them. The IILM Sukuk are really unique with real innovation. The fact that the IILM Sukuk provide Islamic banks with such a product has really addressed the non-level playing field between them and their conventional counterparts.

There are two factors—one is comparability across countries in which Islamic finance participates, which is important as Islamic finance expands. We are also trying to provide comparability with global conventional financial standards to the best extent possible. The global standards that we are advocating are important towards facilitating integration of Islamic finance across borders in a consistent way. They are also important to facilitate the integration of Islamic finance into the global economy. When we look at the progress of Islamic finance in the last ten years, it is not just the growth rate that is impressive, but also the geographical expansion. Indonesia and Malaysia regularly use sukuk to fund their public expenditures; this has been the case in Malaysia since 1983 and in Indonesia for the past few years. Any time there is a financial or economic crisis, corporates no longer have the same access to bank financing or syndicated loans. As a result, they begin to issue securities directly.