

Infrastructure the key to success

BY ELLINA BADRI

Since Malaysia put in place the Islamic Banking Act a quarter of a century ago, the country's Islamic banking and finance sector has been propelled to centre stage, while conventional banking and finance players have been given an opportunity to tap a new avenue of growth.

In a push to make Malaysia a global hub for the sector, the government and regulators developed three 10-year phases, outlining the steps for growth. With 12.8% of total banking assets valued at RM157.13 billion in 2007, the local Islamic banking and finance sector is well on its way to achieving its target of 20% of total banking assets by 2010, as set out by the government. In total, Malaysia's Islamic banking assets have reached US\$65.6 billion (RM229.4 billion), with an average annual growth rate of between 18% and 20%.

The market has also bred 15 full-fledged Islamic banks, out of which nine are local, from just two local players in 1983. Additionally, there are five commercial banks in the country with Islamic banking "window" operations.

The local market can also count on the pioneering of Islamic insurance, or takaful; becoming the world's largest issuer of Islamic bonds, or sukuk; and the launch of the first Islamic real estate investment trust among its accomplishments and contributions towards global industry growth.

Given the size of the global industry, the local market has achieved no easy feat. According to the Malaysia International Islamic Financial Centre (MIIFC), which was established in 2006 to promote the country as a hub for international Islamic finance, global Islamic banking assets and assets under management are expected to hit the US\$1 trillion mark by 2010, from US\$750 billion currently.

A large part of Malaysia's success in putting itself at the forefront of global Islamic banking and finance is attributed to its infrastructure. With sound financial and legal frameworks, the country has built a firm foundation for the domestic sector to prosper and become an international hub.

"Malaysia has, by far, the most comprehensive and developed Islamic banking and finance market due to the solid infrastructure that has been put in place by the regulators. Among the notable infrastructure are a central syariah authority, a deep and liquid ringgit Islamic money market and a comprehensive Islamic regulatory framework," says Shahrizan Sharif, Citibank Bhd's head of regional Islamic structuring, corporate sales and structuring, fixed income, currencies and commodities.

Standard Chartered Malaysia Bhd's head of Islamic banking, Azrulnizam Abd Aziz, adds that the country's long head start in the industry has created a resilient system, while its facilitative business environment receives full support from the government, Bank Ne-



Shahrizan: We see greater sophistication in the offering of Islamic banking products



Musa: The regulators will continue to push Islamic finance, especially in the areas of asset management and private equities



Kamarul Ariffin: Indonesia's huge population also provides many opportunities for Malaysian banks

gara Malaysia, the Securities Commission (SC) and other regulatory bodies.

As the local market has flourished, industry players see many opportunities and numerous trends to keep up with. From meeting customers' needs to tapping new markets, Malaysia's Islamic financial institutions are not running short of things to do.

"The local market is saturated and more banks are sharing the same business pie. Looking at the current market outlook, I believe more players within the Islamic banking industry will go out and seek more international deals," says Jamelah Jamaluddin, managing director of RHB Islamic Bank Bhd. "There are a lot of incentives set aside by the government to support this trend. MIIFC (Malaysia International Islamic Financial Centre) initiative by Bank Negara Malaysia will be the push factor for the local Islamic banks to seek more business abroad.

AmIslamic CEO Ahmad Zaini Othman also reckons local players have evolved to a stage where they are ready to set up shop abroad. He lists Indonesia and Australia as attractive markets to enter, and sees opportunities in the investment banking business in Gulf Cooperation Council (GCC) countries.

"With the establishment of the MIIFC, there will be more Malaysian banks looking across our borders. Gone are the days when Malaysian banks were just domestic players; we are going to be more international players, especially with the support of Bank Negara," he says.

Ahmad Zaini adds that while the ringgit-denominated sukuk market will continue to dominate the Malaysian scene, Islamic banks will also take advantage of the MIIFC framework to look at the international market for the issuance of multi-currency sukuk.

Mohd Effendi Abdullah, AmInvestment Bank

Bhd's head of Islamic markets, concurs, saying as the local market has evolved so much since its inception, the time had come for Bank Negara to liberalise the system and encourage local players to venture beyond Malaysian shores.

"Malaysia is already the hub of Islamic finance; for example, we've issued a large number of sukuk, so it's time to go out of Malaysia now. The country has the technology and expertise; we need to bring it to the rest of the world," he says.

Ahmad Zaini and Affin Islamic Bank Bhd CEO Kamarul Ariffin Mohd Jamil agree that Indonesia is a very attractive market for Malaysia's Islamic financial institutions to enter.

Kamarul Ariffin says the penetration rate of Islamic finance in Indonesia is still very low, and the government there has a desire to grow the sector, adding that the country's huge population also provides many opportunities for Malaysian banks. Other attractive markets include India and central Asian countries such as Kazakhstan and Turkmenistan, he adds.

Space for differentiation and diversification

The global market also creates a space for the development of Islamic finance products, says Datuk Mohamed Azahari Kamil, Asian Finance Bank (AFB) CEO.

"There is a lot of growth potential for product differentiation and diversification. There have been a lot of products in the market tailored for local subscriptions, hence, there should be growth in international distribution.

"We should look at the infrastructure of Bursa Malaysia to be able to provide such an opportunity. If you have a trading platform ready, then I'm sure there will be a lot of Islamic products that can go global. Not just in terms of sukuk,



Jamelah: The local market is saturated and more banks are sharing the same business pie

but also more specialised funds."

Meanwhile, industry players agree that as Islamic banking and finance products become more complex, and financial institutions come up with a wider range of products, there is also a large space for Islamic wealth management.

Citibank's Shahrizan says, "We see greater sophistication in the offering of Islamic banking products, especially in the retail market, implying greater use of technology. There will also be growth in the wealth, or asset, management sector, as evidenced by the myriad of syariah compliant investment products being introduced to the retail market. There will be increased innovation in Islamic investment products to meet retail market demand."

Musa Abdul Malek, HSBC Amanah Malay-

CONTINUES ON PAGE 4



ADVERTISING & MARKETING

DIRECTOR
Edward Stanislaus
(02) 9699 8339

GENERAL MANAGER
Chandran Ravi
(012) 267 1000

SENIOR MANAGERS
Alison Lim
(012) 212 3442

John Joseph
(012) 288 3952

SENIOR EXECUTIVES

Heides Dato' Hj Ahmad
(019) 388 1880

Sharon Lee
(017) 873 8139

Geetha Perumal
(016) 250 8640

Helen John Corry
(012) 217 3260

Domino Chong Yee-Li
(012) 399 0468

Yong Wang Ching
(012) 205 7928

Tang Kooi Ching

(019) 331 8181

EXECUTIVES
Azreena Hamzah
(012) 333 6918

Nuraini binti Mohd Ali
(012) 686 3949

COORDINATOR
Azrita Anuar
(603) 7721 8134

ASST COORDINATOR
Norma Jasma binti Norman
(603) 7721 8135

EDITORIAL TEAM

**EDITOR-IN-CHIEF/
MANAGING DIRECTOR**
Ho Kay Tat

PROJECT EDITOR
Tan Su Yin

WRITERS
Gan Yen Kuan
Elina Badri
Sharmila Ganapathy

CHIEF COPY EDITOR
Pushpam Sinnakaundan

ASSISTANT CHIEF COPY EDITOR
Phip Rodrigues

ART DIRECTOR
Sharon Khoo

DESIGN DESK
Raymond Khoo, Boh Jun Kit

We welcome your comments, letters and criticism. Send your letters to The Edge, PO Box 8348, Pejabat Pos Kelana Jaya, 46788 Petaling Jaya, or fax (03) 7721 8018.

Pseudonyms are allowed but please state your full name, address and contact number (tel/fax) for us to verify.

More aggressive marketing needed

FROM PAGE 2

sia Bhd acting CEO, says the authorities also encouraged the growth of Islamic asset management and private equities.

"The push to successfully establish Islamic finance in Malaysia has been a concerted effort by the regulators over the last 20 years. Going forward, the regulators will continue to push Islamic finance, especially in the areas of asset management and private equities," says Musa.

Meanwhile, even as Malaysia has established itself as a centre of Islamic finance, with competitors stacking up against each other to attain the status of global industry hotspot, industry players agree the country cannot afford to rest on its laurels. Along with the traditional GCC countries, Singapore, Hong Kong and Indonesia have cropped up as destinations vying for the attention of Islamic investments.

Affin Islamic's Kamarul Ariffin says for the country to remain competitive, players need to develop linkages abroad to gain access and create a presence in the international market.

"If you want to be a centre, by definition, you need to have dependencies. You want to attract businesses to come here. At the moment, activity gravitates towards our domestic market," he says.

The country should also market itself more aggressively as an Islamic banking and finance hub, and make improvements in areas such as transport infrastructure to further attract Islamic money, says Citibank's Shahrman.

"Malaysia should go all out to attract and meet the needs of the members of the international financial community, as they are the sector's most critical asset.

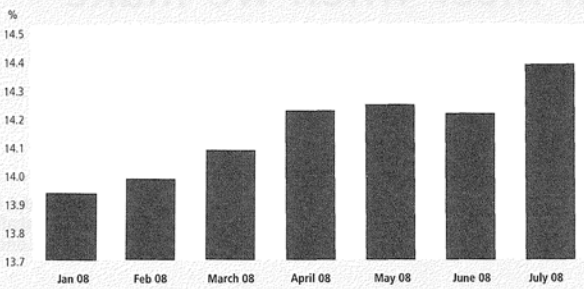
"The approach must be comprehensive and cover a wide range of areas, for example, immigration and transport, with the aim of creating a positive perception of Malaysia through a hassle-free experience when they are doing business in Malaysia," he says.

Meanwhile, Standard Chartered's Azrulnizam says although Malaysia is positioned for greater achievements under the MIFC initiatives, the country should step up R&D, build the pool of human capital in new areas of Islamic finance, and continue to innovate syariah-based products.

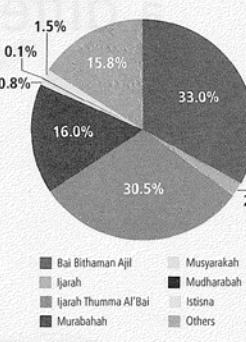
Increasing the country's pool of experts is also deemed crucial by AFB's Mohamed Azahari, who says there is a shortage of syariah scholars. He also envisions Malaysia as an Islamic education hub.

"We need to move forward in this respect. The authorities should look into establish-

Islamic banking loan assets as percentage of total banking system



Percentage breakdown of various Islamic banking loan asset classes



ing Islamic education institutions to equip scholars with syariah expertise. Education is the key to meeting challenges speedily," says Azahari.

Ahmad Zaini of AmlIslamic says the country should take the lead in addressing the varying interpretations of syariah compliance in the global market.

"There's a need to strengthen our syariah framework. The syariah is the most critical component. If we can take charge and give the perception to the world that our syariah is very strong, dynamic and progressive, then we will be able to attract investors into the country. Malaysia should take the lead in terms of becoming a global syariah player," he says.

Room for collaboration

There's room for more collaboration between players in the domestic market — this is all in the spirit of Islamic banking which emphasises great importance on equal and mutual partnership," says Jamelah of RHB Islamic. She adds that she strongly supports collaboration between Malaysia-based banks and their regional counterparts as it will bring a positive outcome and will serve as a catalyst for local players to expand their business portfolios into regional markets. "For instance, through strategic alliances with regional counterparts, local Islamic banks would be able to leverage their partners' network and vice versa, and use it to market their products and services quicker than the organic expansion method.

Industry players agree there is plenty of room for collaboration among domestic Islamic financial institutions, and this could act as a springboard for the country to strengthen its position.

By collaborating, HSBC Amanah's Musa says, players could establish a comparative standard for Islamic banking to compete with conventional banking, which also sets a standard for Islamic financial players to come up with a viable proposition in the marketplace.

"Collaboration is crucial to create players that are regional and global in nature, in areas such as human capital development and training, risk management and corporate governance," says Musa.

Cooperation among players could also offset the constraints brought about by the small size of Islamic banks here, Affin Islamic's Kamarul Ariffin says.

"Islamic banks here are smaller than their conventional counterparts. In order to go global, develop new products or enter new markets, collaboration among players could help address this shortcoming," he says.

AFB's Mohamed Azahari agrees that the size of Malaysian Islamic banks should lead to greater collaboration among them, especially since it will be time consuming for the banks to move ahead organically.

An alliance among banks could help them capitalise on their existing pool of expertise, as well as enhance the distribution of Islamic values and products, he says.

Standard Chartered's Azrulnizam says domestic players could work together to increase sophistication and innovation, as well as from growing operating and geographic diversification.

Industry players, both local and foreign, should work together for the benefit of the Islamic community. Key collaboration areas include Islamic hedging or derivative

solutions, and structured investment solutions, he says.

Although the authorities have been instrumental in promoting the growth of the Islamic banking and finance sector, industry players say there are some areas in which regulators could play a bigger role.

"Bank Negara and the SC have done a remarkable job in terms of supporting the whole industry. Nowhere in the world can you see the authorities so tuned into marketing Islamic business. It is a national agenda here," says AmlIslamic's Ahmad Zaini.

The authorities, however, must make an effort to bring in the "big names" of the legal fraternity to Malaysia to help increase the number and size of deals done here, he adds.

"The authorities must work very hard to bring the big names in the legal fraternity to Kuala Lumpur. These legal firms have dedicated Islamic teams. If the government can draw some of the big names to our market, it will be an eye-opener for international issuers, who will look at KL as a very serious player in the Islamic field," says Ahmad Zaini.

Citibank's Shahrman agrees that there is a need for the authorities to consider further liberalisation of the legal industry.

"The legal and accounting infrastructure will need to be looked at so that international legal firms with significant experience in Islamic finance are allowed to set up in KL," says Shahrman.

The authorities may eventually wish to step back and change their role from directing the development of the Islamic finance market, to creating an orderly market environment, he adds.

"This will create a more diverse and resilient Islamic finance industry that is based on sound economic proposition," says Shahrman.

On promoting growth of Islamic finance's talent pool, AFB's Azahari says, "The government should set up scholarships to encourage students to move into Islamic finance in a big way, not only to serve Malaysia, but to export their skills globally."

After being a pioneer of the sector, it appears Malaysia has almost come full circle in promoting the growth of Islamic banking and finance domestically. Authorities and industry players have successfully worked together to put this sector in the limelight. While it continues to satisfy domestic targets, the local market will also increasingly need to look outwards for opportunities it can leverage to cement its leadership position in the global arena. ■



Azahari: There is a lot of growth potential for product differentiation and diversification



Azrulnizam: The country's long head start in the industry has created a resilient system



Ahmad Zaini: Gone are the days when Malaysian banks were just domestic players; we are going to be more international players

Structured products roll out from Islamic banks

BY SHARMILA GANAPATHY

There's no denying that Malaysia has carved a name for itself on the international Islamic banking front. The numbers seem to support it too. Islamic banking assets account for some 13% of total banking assets in the country, the head of a local bank said recently.

Retail banking customers are now reaping the benefits of the country's progress on the Islamic banking front. "Malaysia is home to the largest depository of Islamic financial products in the market. Islamic consumer banking products are fairly established in the Malaysian market. For every conventional product out there, you can find the Islamic equivalent," points out CIMB Islamic Bank Bhd CEO Badlisyah Abdul Ghani.

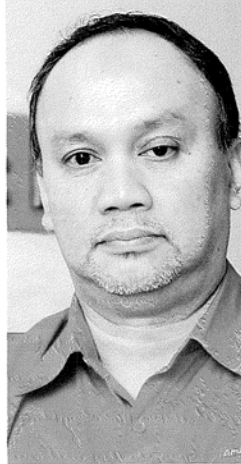
Where once home and automobile financing used to be pretty much the only Islamic financial products to speak of in the market, today's retail customer has access to a wide range of loans, investments and insurance products for various segments.

"We see more structured products being made available to the retail investor now, which used to be

only for corporate and institutional investors," notes Badlisyah. Among the bank's notable products is the Why Wait Fixed Return Investment Account-i, which Badlisyah says is the first Islamic financial product in the country that does not replicate the conventional one. The product invests in syariah-compliant activities and offers returns upfront to customers when they deposit their money.

The bank also launched the first Islamic equity-linked structured product in the country last year — the Islamic All Stars Global Restricted Mudharabah Structured Investment-I, which offers capital protection and is tied to a basket of 20 multinational corporations which include Procter and Gamble, Samsung Electronics and Nestlé.

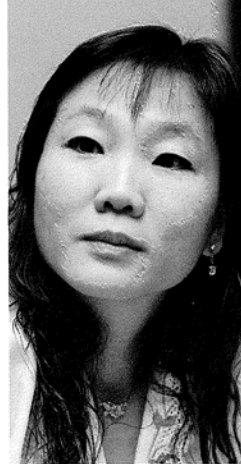
Inflation and uncertain economic conditions have cast certain types of Islamic financial products into the limelight, bankers say. "Inflation leads to people trying to stretch their ringgit and beat the inflationary trend, and that's where investment-linked products come into the picture as most customers want their principle protected. We see many investors moving towards commodities-linked investment products," says Amslamic Bank Bhd CEO Ahmad



Ahmad Zaini: We see many investors moving towards commodities-linked investment products

mad Zaini Othman.

The bank's own such product is its Active Commodities NID-i (negotiable instruments of deposit), which offers capital protection on a portfolio linked to agriculture, energy and metals commodities.



Lam: Islamic fixed deposit (FD) accounts are as competitive as conventional FDs

ING Funds Bhd's ING Annual Income Climate Structured Fund, which was launched on Sept 10, is a close-ended fund that invests in global alternative technology and renewable energy companies tracked by five indexes, including The Citi

Climate Change Opportunities Index monitored by Citigroup's Citi Investment Research.

"There is a tendency for investors to hold more cash in deposits and use their liquid assets to capitalise on viable opportunities that may arise during uncertain local and global economic conditions. Investors are cautious and want the best returns for their money. Therefore, they are constantly looking out for the best investment options available," points out Aisyah Lam, Citibank Bhd's head of wealth management products.

In times of volatility, there is little difference from conventional investing, she adds. Investors still seek minimal correlation to traditional assets, and commodities present such an asset class for them.

Lam also likes Islamic fixed deposit (FD) accounts, which she says are as competitive as conventional FDs. "At certain tenures in given market conditions, the Islamic fixed deposits could potentially outperform that of a fixed rate of conventional deposits," she says.

Citibank, she says, offers the Islamic Time Deposit-i account based on the Al-Mudharabah (profit-sharing) concept. The product allows

CONTINUES ON PAGE 10

What's in the market

Home financing from RHB Islamic

For customers seeking to acquire residential property, RHB Islamic Bank has an innovative product which is an alternative to a widely offered BBA home financing. Equity Home Financing-i is based on the concept of musharakah mutanaqisah or diminishing partnership.

The musharakah mutanaqisah is a form of partnership whereby the bank and the customer co-own the property in which one of the partners promises to buy the equity share of the other partner gradually until the title to the equity is completely transferred to him. This product is a hybrid composed of different contracts, namely musharakah (partnership) and ijarah (leasing), which come into operation at different stages. "The agreement of the musharakah contract between the bank and the customer should be independent of the ijarah and should not be tied together in one single contract. This is because it is a well-established rule of Islamic jurisprudence that one transaction cannot be made a condition for another," says Zulkhairi Zabiri, head, asset based finance group, RHB Islamic Bank.

The client approaches the bank, that is, RHB Islamic Bank, which, upon application, agrees to participate with him to purchase the leased house. The client will pay 10% of the price while the bank will pay the remaining 90%. Thus, the bank owns 90% of the house while the client owns only 10%. After jointly purchasing the house, the client is free to use

the house as his residence while paying rental fee to the bank for using its share of the property. The customer will also, in a period specified in their agreement, purchase units of the bank's ownership. Thus, monthly rental fee includes two elements — a rent portion and a purchase of the bank's share of the house. When the bank's share has been purchased by the customer, the bank will transfer ownership of the house to the customer by way of a notice of fulfillment.

As stated, musharakah mutanaqisah consists of two globally accepted contracts — musharakah (partnership) and ijarah (leasing). Zulkhairi says this is more acceptable, compared to the BBA, which involves the bay' al 'inah, which is disallowed by the majority of jurists except for the Shafie school of jurisprudence. "The syariah scholars unanimously agree that rental fees as practised under musharakah mutanaqisah could reflect the market price, that is, Libor, Klibor, BLR and so on. Moreover, the rental rate can be revised periodically to reflect prevailing market condition. The floating BBA, on the other hand, is a debatable issue among Muslim jurists locally and internationally," he says.

Under this product, the bank and the customer become co-owners of the house and risks are borne by both. "This is unlike the BBA, in which the relationship between the customer and the bank is that of buyer and seller. For example, if the construction of the house purchased is prematurely concluded, the customer is not obligated to pay any com-

pensation fees to the bank as the bank is the co-owner of the house," she adds.

Affin Islamic and Mutiara Goodyear embark on hybrid musharakah financing arrangement

Affin Islamic Bank Bhd and Mutiara Goodyear Development Bhd have announced that both parties have entered into musharakah (joint venture) financing arrangement for a land development project. The arrangement is the first in the country to feature a combination of hybrid Islamic financing products based on the concepts of musharakah, murabahah (sale-based financing), istisna' (bridging financing) and musharakah mutanaqisah (diminishing partnership).

The musharakah is established via a registered special purpose vehicle called Affin-i Goodyear Sdn Bhd in which Affin Islamic and Jurus Positif Sdn Bhd, a wholly-owned subsidiary of Mutiara Goodyear, are joint partners. Musyarakah is a partnership agreement between two or more individuals or corporations where each party contributes the capital and shares the profit of the venture or project based on the agreed profit-sharing ratio.

For the first project, Affin-i Goodyear will undertake the development of high-end residential project on an 8.8-acre land in Bukit Gambir, Penang. Says Kamarul Ariffin Mohd Jamil, the bank's CEO, "We are indeed ecstatic to be the first bank in Malaysia to introduce this unique financing ar-

angement despite being just two years in operation. This is the first of many innovative structures we plan to develop. It is also in line with the government's aspiration to meet the increasingly diversified and sophisticated market demand and transform the country into an international hub for Islamic finance."

Hamidon Abdullah, executive chairman of Mutiara Goodyear, adds, "This is our first joint venture with Affin Islamic and the combination of both parties' resources and expertise will bring tremendous synergistic benefits. Under this joint venture, Mutiara Goodyear will be responsible for the construction and sales of the development while Affin Islamic will provide the facilities required to finance the development."

"This high-end residential project is targeted at the affluent market and we expect it to be fully completed within three years. We are confident it will enjoy a high take-up rate, based on the vibrant Penang property market and the influx of foreigners who come to reside on the island under the Malaysia My Second Home Programme," he says.

Affin Islamic Bank will focus on offering equity-based structured products as part of its core expansion plans, says Kamarul. "We will focus on developing new innovative structures, with special emphasis on equity-based structures, such as musyarakah and mudharabah," he says. He adds that the bank has several such products in the pipeline and expects to launch them next year. ■