THE EVOLUTION OF THE MALAYSIAN ISLAMIC CAPITAL MARKET: TOWARDS A GLOBAL HUB

ABSTRACT

The Malaysian capital market is unique because the Islamic Capital Market (ICM) runs parallel with the conventional capital market. The two main reasons that have been identified to support the emergence of Malaysian ICM are the 1997 Asian Financial Crisis and the liquidity problem resulting from surplus funds from the Islamic finance industry. Following the Asian Financial Crisis, the Malaysian government focused on the development of the Islamic Capital Market especially on the products innovation, infrastructure facilities, policy incentives, human capital development and financial market regulations. This paper summarised the development of the Malaysian Islamic Capital Market including the development stages, regulatory bodies, products and policy initiatives. In addition, this paper also highlights the achievements accomplished by Malaysia in the Islamic Capital Market especially on the pioneered or world first project and products innovation.

Keywords: Islamic Capital Market and Shariah Approved companies.
1.0 Introduction

The Malaysian capital market is unique in that it has two types of capital market; the Islamic and conventional that operate concurrently. The Islamic Capital Market is ideally characterised by the absence of interest based transaction, doubtful transactions and stocks of companies dealing in unlawful activities or items (Alhabshi, 1994). Besides Islamic banking and Takaful, Islamic Capital Market is one of the important and growing segments in Islamic Finance. Currently, these markets are experiencing inflow and innovative financial products and receiving increased investors attention (Syed Ali, 2008). There development of this Islamic Capital Market is remarkable and received attention from all over the world. The two main reasons that have been identified to support the emergence of Malaysian ICM are the 1997 Asian Financial Crisis and the liquidity problem resulting from surplus funds from the Islamic finance industry (IOSCO, 2004).

There are lots of outstanding efforts and achievement has been attained by Malaysia either in term of products innovation or regulatory framework. Therefore, this paper provides information about evolution of the Malaysian Islamic Capital Market, regulatory bodies, competitive value, selection process, products innovation and achievement. To explain Malaysian regulatory environment, the first section provides information regarding the regulatory organizations that govern the conduct of securities dealing in Malaysia. This is followed by a discussion about emergent of the Islamic Capital Market (ICM), regulations, process and achievement towards an international Islamic hub.

2.0 The Regulatory Organization in Malaysia

The main regulatory bodies that govern the Malaysian capital market are the Bursa Malaysia Berhad\(^1\), the Securities Commission and the Labuan Offshore Financial Services Authority.

\(^1\) Previously, the Bursa Malaysia Berhad is known as Kuala Lumpur Stock Exchange (KLSE).
The scope of jurisdiction for these regulating bodies encompasses both Islamic and conventional finance matters. Malaysia’s banking and insurance sectors come under the jurisdiction of the Central Bank, Bank Negara Malaysia (BNM) while the capital market is regulated by the Securities Commission Malaysia (SC). Matters related to offshore finance industry are regulated by the Labuan Offshore Financial Services Authority (LOFSA). The following section provides details of these regulatory bodies.

2.1 Bursa Malaysia Berhad (BMB)

In the Malaysian capital market, the first move towards securities trading was occurred in 1930 when the Singapore Stockbrokers’ Association was established. However, the first formal organization for the public trading of securities only commenced when the Malayan Stock Exchange was established in 1960 (Bursa Malaysia, 2009). On April 14, 2004, the name of Kuala Lumpur Stock Exchange has been changed to Bursa Malaysia Berhad. It operates a fully-integrated exchange, offering the complete range of exchange-related services including trading, clearing, settlement and depository services (Bursa Malaysia, 2009). All listed companies are either on the Main Market or the ACE Market. The main differences between the requirements in order to be listed on Main Market and ACE Market are in term of minimum paid up capital and profit tract record.

Currently, the Malaysian capital market is governed by Capital Markets and Services Act 2007, Securities Industry (Central Depositories Act) 1991, Securities Commission Act 1993, Companies Act 1965, Offshore Companies Act 1990 and Labuan Offshore Securities Industry Act 1995. The following diagram (Figure 1) represents the regulatory structure of Malaysian

\[^2\] Taking over from the Mesdaq Market, the ACE Market – ACE stands for access, certainty and efficiency.
capital market, which governs by the Ministry of Finance.

Figure 1: Regulatory structure of Malaysian capital market
Source: Bursa Malaysia website 2010

2.2 Securities Commission (SC)

The Securities Commission, as the sole authority for the regulating and development of the capital market in Malaysia was set up under the Securities Commission Act 1993 (SCA). It is reporting directly to the Minister of Finance and responsible for the regulation and supervision of the activities of the market institutions (Securities Commission, 2009a). Apart from this role, the SC is also obliged by statute to encourage and promote the development of the securities and futures markets in Malaysia (Securities Commission, 2009a).

2.3 Labuan Offshore Financial Services Authority (LOFSA)

Interesting about the Malaysian capital market, besides the onshore capital market, Malaysia also possess offshore capital market. The Labuan Offshore Financial Services Authority (LOFSA)\(^3\) is the authority to regulate offshore this capital market. The LOFSA is assisted by

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\(^3\) The LOFSA website (http://www.lofsa.gov.my) provides excellent information about this organization.
the Labuan International Financial Exchange Inc (LFX), which is a wholly owned subsidiary of Bursa Malaysia Berhad. The LFX is a web based financial exchange that provides listing and trading facilities for a wide range of financial and non-financial as well as Islamic financial products.

2.4 Shariah Advisory Council (SAC)

The pioneer effort towards creating an organized and efficient Islamic capital market is by the establishment of Islamic Capital Market Department (ICMD) and the Shariah Advisory Council (SAC) in 1996 (Securities Commission, 2007c). Assisted by the ICMD, the scope of jurisdiction of SAC is to advise the Commission on all matters related to the comprehensive development of the Islamic capital market and to function as a reference centre for all Islamic capital market issues (Securities Commission, 2007c). In addition, the SAC is in charge to analyses the Shariah principles which can be used for introducing new Islamic capital market products and services, and also the existing conventional capital market instruments to determine the extent to which these instruments comply with Shariah principles (Securities Commission, 2007c).

2.5 Selection Process for Shariah Approved Companies

The Shariah Advisory Council also responsible for screening, reviewing and indentifying process of listed stock for companies listed and to be listed on Bursa Malaysia for Shariah compliance status. There are two parameters being considered in the selection process; Qualitative parameter and Quantitative parameters.

2.5.1 Qualitative Parameter

Under this stage, focus is placed on the primary activities of a company with regards to good and services offered (Securities Commission, 2007c). As a result, a set of criteria were formulated to be used as basic guidelines for the selection process (Securities Commission,

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4 Further information regarding this exchange can be referred to its website (http://www.lfx.com.my).
5 The primary sources of research and reference are the holy Quran and Sunnah.
Companies that carry out any non-permissible core activities will not qualify as Shariah compliant. Activities are such as; financial services based on riba (interest); gambling; manufacture or sale of non-halal products or related products; conventional insurance; entertainment activities that are non permissible according to Shariah; manufacture or sale tobacco based products or related products, stock broking or share trading in Shariah non-approved securities; and other activities deemed non-permissible according to Shariah are the most important examples.

For companies with activities comprising both permissible and non-permissible elements, the SAC considers two additional criteria; the public perception or image of the company must be good and the core activities of the company are important and considered benefiting in general to the Muslim, nation and the country, and the non-permissible element is very small and involves matters which is common plight and difficult to avoid, custom and the rights of the non-Muslim community which are accepted by Islam.

2.5.2 Quantitative Parameter
The second stage of evaluating the status of Shariah approved requires the assessment from the quantitative parameter. The SAC has established several benchmarks based on reasoning from the source of Shariah by qualified Shariah scholars in order to determine the tolerable level of mixed contributions from permissible and non-permissible activities (Securities Commission, 2007c). The securities of the company will be classified as Shariah compliant if the contributions from non-permissible activities do not exceed the following benchmarks:

a) The 5-percent benchmark for the activities that are clearly prohibited such as interest, gambling, liquor and pork.

b) The 10-percent benchmark for the activities that involve the element which is affecting most people and difficult to avoid such as interest income from fixed deposits in conventional banks and also for tobacco related activities.
c) The 20-percent benchmark for the activities from non Shariah compliant such as rental payment from the premise that involved in gambling, sale of liquor etc.

d) The 25-percent benchmark for activities that may affect the Shariah status such as hotel and resort operations, share trading, stock broking and other Shariah non-permissible.

Subsequently, the Securities Commission compiles the decision of the SAC and publishes the list of Shariah compliant stocks twice a year (April and October\textsuperscript{6}). Definitely the release of the list, will give investors especially Muslims the necessary guidance, opportunities and confidence to select and invest in the listed securities or companies that comply with Shariah principles (Securities Commission, 2007b). The following figure presents the number of Shariah approved companies on Bursa Malaysia from 1997 to 2009.

![Figure 2: Statistics of Shariah Approved Companies on Bursa Malaysia](image)

Source: Securities Commission website 2010

From the figure above, upon the introduction of the list, in 1997, the total numbers companies that comply with the criteria being set up by the SC is 478 companies. Since the introduction, the number of Shariah compliant companies has grown steadily. The number increased remarkably yearly to 846 companies as at 30 November 2009, which represent 88\% of total

\textsuperscript{6} Nonetheless starting from 2007, the SC revised the months of the official release to May and November each year. The change is to streamline the issuance date of the SC list with the FTSE Bursa Malaysia (FBM) EMAS Shariah Index. The FBM EMAS Shariah Index uses the SC’s Shariah compliant list as a basis to construct the index’s constituents.
listed companies on Bursa Malaysia. The list is essential to drive for further growth in the
Islamic capital market, especially in providing reference and guidance to the investing public
and for the development of the Islamic management industry (Securities Commission,
2007b).

3.0 Emergence of the Islamic Capital Market
The uniqueness about Malaysian capital market is that the Islamic Capital Market is running
concurrently with the conventional capital market. The Islamic capital market refers to the
market where capital market activities are carried out in ways that do not conflict with the
conscience of Muslims and the religion of Islam. Transactions in Islamic Capital Market are
free from the elements such as interest (riba), gambling (maisir) and ambiguity (gharar)
(Securities Commission, 2009b).

The Islamic finance industry in Malaysia has grown tremendously since it first emerged in the
1970’s. The emergent generally can be divided into three phases; Phase 1 (1983-1992) known
as Period of Discovery, Phase 2 (1993-2001) recognized as Period of Acceptance, and Phase
3 (2002 until today) acknowledged as Period of Strategic Development (Yakcop, 2002).
Detail of this evolution is further classified in the following figure;
The Islamic Capital Market played a relatively minor role in the early stages of the development of the Islamic Financial system in Malaysia. Under the Initial set-up in 1980, witnessed the introduction of Islamic Banking Act 1983, Bank Islam Malaysia in 1983 and Takaful Act in 1984. There are two main reasons that have been identified to support the emergence of Malaysian Islamic Capital Market, the 1997 Asian Financial Crisis and the liquidity problem resulting from surplus funds from the Islamic finance industry (IOSCO, 2004).

Apparently, there is a significant development of the Islamic Capital Market in 1990s when more companies and other entities began to source for funds from the capital market to finance their operations (Securities Commission, 2001b). At the same time, in 1996, there is a promulgation of Shariah approved criteria and the introduction of Shariah approved securities by the Securities Commission. Thus, Islamic Capital Market has been increasingly accepted as an alternative market for capital market seekers and providers. Similarly, there was a
growing interest in Islamic debt securities as an alternative instrument for investment and financing.

The richness of Islamic financing principles, provides issuers sufficient flexibility in structuring innovative, competitive and wider range of Islamic securities (Securities Commission, 2003). The market witnessed the development and issuance of variety of Islamic Capital Market products either in term of debt or equities in year 2000 onwards. A notable issuance of first global corporate Islamic bond by Kumpulan Guthrie Bhd in 2002 is a starting point liberalise market access. In 2004, there was another landmark issuance first ringgit denominated Islamic bonds by the International Finance Corporation (IFC), the private arm of World Bank, reflecting the recognition given to Malaysia as an Islamic Capital Market Centre (Securities Commission, 2004).

Towards the Period of Strategic Development or Developed Market, a comprehensive plan that consist vision, strategic initiatives and recommendations was formulated by the Malaysian government. These include among others, the Capital Market Master Plan, the Ninth Malaysian Plan, the yearly Budget from 2007 until 2010.

3.1 Capital Market Master Plan

The Capital Market Master Plan was launched in 2001, with 6 broad objectives, 24 strategic initiatives and 152 recommendations, for the developments of internationally competitive Islamic capital market of Malaysia. Those strategic initiatives that necessary to be undertaken to achieve this objective are; to facilitate the development of various competitive products and services related to the Islamic capital market; to create an independent market to mobilize Islamic funds effectively; to ensure an appropriate and comprehensive accounting, tax and regulatory framework; and to enhance the international recognition of the Malaysian Islamic

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7 Both Capital Market Master Plan and Ninth Malaysia Plan are economic development plan.
capital market (Securities Commission, 2001a). To ensure the objectives will be a reality, the Malaysian government has considered this in their five years economic plan of the country.

3.2 Ninth Malaysian Plan

The Ninth Malaysian Plan, covering year 2006 up to 2010, is a comprehensive blueprint prepared by the Economic Planning Unit (EPU) of the Prime Minister’s Department and the Finance Ministry of Malaysia. This blueprint further reaffirmed the initiative towards the international Islamic capital market. A recommendations to make Malaysia a global hub for Islamic capital market products and services is stated in this plan (Securities Commission, 2001a). An ongoing effort is taken and new incentives are formulated by the Malaysian government to position Malaysia as an international Islamic Capital Market, such as in the budgets bill (2007 to 2010).

3.3 Budget 2007

The Supply Bill in the Budget 2007 is presented as an action plan for the mission set out in the ninth Malaysia Plan. Realizing the huge potential of the Malaysian Islamic finance industry, the government has taken further initiative in order to support its development. Several incentives were announced to facilitative tax incentives framework as presented in Table 1:

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8 The blueprint was announced on 31 March 2006 by the fifth Prime Minister of Malaysia, Datuk Seri Abdullah Ahmad Badawi in Parliament.
Table 1: Tax Incentive Framework in the Malaysian 2007 Budget

<table>
<thead>
<tr>
<th>No.</th>
<th>Capital Market Sectors</th>
<th>Initiatives</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Islamic Fund and Wealth Management</td>
<td>Local and fund managers located in Malaysia are accorded 100% income tax exemption on their management fee earned for managing foreign funds in accordance with Shariah principles.</td>
</tr>
<tr>
<td>2.</td>
<td>Sukuk (Islamic Bond)</td>
<td>The special purpose vehicle (SPV) set up for Islamic financing is exempted from income tax. The company that establishes the SPV is also given a deduction on the cost of issuance of the Islamic bonds incurred by the SPV. Extension of deduction on expenses for Sukuk until the year of assessment 2010.</td>
</tr>
<tr>
<td>3.</td>
<td>Islamic Stockbroking business</td>
<td>Tax deduction on expenses incurred in establishing an Islamic stockbroking firm.</td>
</tr>
<tr>
<td>4.</td>
<td>Real Estate Investment Trusts (REITs)</td>
<td>Receiver of dividends from REITs listed on Bursa Malaysia are taxed at the following rate:</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Resident and non-resident individual investors and other local entities are taxed at 15% for five years.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Foreign institutional investors are taxed at 20% for five years. REITs are also exempted from tax on all income provided that at least 90% of their total income is distributed to the investors.</td>
</tr>
</tbody>
</table>

Source: The 2007 Budget Bill and Securities Commission website 2010

As can be seen from table 1 above, the Malaysian government is providing focus and incentives in term of tax incentive framework to all capital market sectors including Islamic Fund and Wealth Management, Sukuk (Islamic Bond), Islamic Stockbroking business and Real Estate Investment Trusts (REITs). To ensure the smooth and effective implementation of national development policies and strategies, it is vital to have an efficient system of tax administration (Abdullah, 2006). Besides offering attractive tax incentives, well developed infrastructure, efficiency in services, large size of investments, there is a need to further diversify capital market product to attract local and foreign investors (Abdullah, 2006).

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9 The Islamic Real Estate Investment Trusts (REITs) and the global sukuk supranationals are superb example of the initiative taken to expand the market.
3.4 Budget 2008

Additional incentive has been introduced in the Budget 2008 to strengthen Malaysia’s position as an international Islamic financial centre. The incentives are illustrated in the following table (Table 2):

Table 2: Special Incentives for the Islamic Capital Market in the 2008 Budget

<table>
<thead>
<tr>
<th>No.</th>
<th>Capital Market Sectors and Participants</th>
<th>Initiatives</th>
</tr>
</thead>
</table>
| 1.  | Fund Management Industry               | Foreign ownership on fund management companies and REITs management will be allowed up to 70%.
|     |                                        | Islamic fund management companies are allowed to have 100% foreign ownership & permitted to invest 100% of assets abroad.
|     |                                        | A sum of RM7billion will be channelled by the Employees Provident Fund (EPF) to be managed by Islamic fund management companies.
|     |                                        | Income tax exemption on all fees received in respect of Islamic fund management activities, until assessment year 2016. |
| 2.  | Stockbroking company                    | Tax incentives for existing stockbroking companies from the Middle East to set up Islamic stockbroking subsidiaries. |
|     |                                        | 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. |
| 3.  | Non-resident consultants               | Income tax exemption to non-resident consultants with the required expertise in Islamic finance. |

Source: Securities Commission website 2010

Table 2 above illustrates additional incentives by the Malaysian government towards enhancing emergent of the Islamic Capital Market in Malaysia. Realizing the significant contribution of fund management industry, focus and incentives for the 2008 Budget is more for Fund Management companies, stockbroking companies from the Middle East and followed by international participants. Following the 2008 Budget, additional incentives are

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10 The experts have to be verified by the Malaysian Islamic Financial Centre Secretariat.
11 This will attract greater investments from the Middle East and further encourage greater flows of funds to Malaysia.
being offered in the 2009 Budget, which are evidence that Malaysia is heading towards a
global hub of Islamic capital market.

3.5 Budget 2009

In recognising the significant development of Islamic Capital Market, the Malaysian
government offered a range of incentives in the 2009 Budget:

Table 3: Special Incentives for the Islamic Capital Market in the Malaysian 2009 Budget

<table>
<thead>
<tr>
<th>No.</th>
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<th>Incentives</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Sukuk (Islamic Bond)</td>
<td>Tax exemption for fees and profit earned by institutions undertaking activities(^{12}) non-ringgit sukuk (Islamic bond) issued in Malaysia and distributed outside Malaysia; and profits received by qualified institutions from the trading of non-ringgit sukuk issued in Malaysia.</td>
</tr>
<tr>
<td>2.</td>
<td>International Centre for Education in Islamic Finance (INCEIF)</td>
<td>Double tax deduction for courses conducted by this centre.</td>
</tr>
<tr>
<td>3.</td>
<td>Real Estate Investment Trusts (REITs)</td>
<td>Tax rate on dividends received by foreign institutional investors from Real Estate Investment Trust (REITS) was reduced from 20% to 10%.</td>
</tr>
<tr>
<td>4.</td>
<td>Domestic intermediaries.</td>
<td>Tax exemption on fees received by domestic intermediaries, which have successfully listed foreign companies and foreign investment products on Bursa Malaysia.</td>
</tr>
<tr>
<td>5.</td>
<td>Venture Capital Companies</td>
<td>A five year tax exemption for venture capital companies that invest at least 30% of their funds in start up, early stage financing or seed capital are eligible for.</td>
</tr>
</tbody>
</table>

Source: The Budget Bill 2009 and Securities Commission website 2010

Table 3 present the incentives by the Malaysian government to further reinforce support
towards a vibrant Islamic Capital Market. The incentives in 2009 Budget is quite revealing in
the way that it comprise new participants of the industry players with the objective is to
promote efforts to further diversify and attract more foreign investors to the domestic capital
market (Abdullah, 2008). The tax incentives are offered to entice industry players, both local
and international to join the market (Securities Commission, 2008a). Consequently, all

\(^{12}\) The activities include arranging, underwriting, distributing and trading.
industry players together with the regulatory bodies are responsible for the success to position Malaysia as a global hub for Islamic capital market.

3.6 Budget 2010

Realizing the success as an international Islamic financial and capital market centre, the Malaysian government provide additional incentives in the Budget 2010 in order to sustain this position. The incentives offered are summarised in Table 4:

<table>
<thead>
<tr>
<th>No.</th>
<th>Capital Market Sectors and Participants</th>
<th>Incentives</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>International Islamic Financial Centre (MIFC)</td>
<td>The double deduction incentive given on expenses to promote Malaysia as MIFC is extended until the year of assessment 2015.</td>
</tr>
<tr>
<td>2.</td>
<td>Islamic Stock Broking companies</td>
<td>Expenses incurred in the promotion of Malaysia as an International Islamic Financial Centre are given incentive.</td>
</tr>
<tr>
<td>3.</td>
<td>Islamic Securities</td>
<td>Expenditure incurred prior to the commencement of an Islamic stock broking company is given an incentive in the form of deduction for the purpose of income tax computation. The same incentive is extended to Islamic securities approved by LOFSA effective from year assessment 2010 to year of assessment 2015.</td>
</tr>
<tr>
<td>4.</td>
<td>Special Purpose Vehicle (SPV)</td>
<td>The tax treatment of SPV solely to channel funds for the purpose of issuance of Islamic securities is also given to SPV established under the Offshore Companies Act 1990 effective from the year assessment 2010.</td>
</tr>
<tr>
<td>5.</td>
<td>Sukuk (Islamic Bond)</td>
<td>The tax exemption on profits derived from the issuance of sukuk approved by the Securities Commission be extended to the issuance of sukuk approved by Labuan Offshore Financial Services Authority effective from the year assessment 2010.</td>
</tr>
</tbody>
</table>

Source: The 2010 Budget Bill

The incentives proposed in the 2010 Budget are with the aim to ensure that Malaysia advances significantly in the development of Islamic financial services, influence the establishment of stockbroking companies and to persuade the issuance of Islamic securities (Abdul Razak, 2009). As what can be seen in the previous budget, there are lots of initiatives
has been taken by the Malaysian government towards achieving the international Islamic hub. Though lots of achievements so far, such as Malaysia is recognized as the world’s largest sukuk issuer with USD94.7 billion, yet in the Budget 2010 there are initiatives taken to strengthening the developments and achievement in this market.

3.7 Islamic Index

The Malaysian capital market witnessed the introduction of an Islamic index that tracks the performance of the Shariah compliant securities on Bursa Malaysia. The first Islamic equity index was introduced in Malaysia by RHB Unit Trust Management Berhad in May 1996. Consequently, the Dow Jones Islamic Market Index (DJIM) by Dow Jones and Company was launched in February 1999, the Kuala Lumpur Shariah Index (KLSI) by Bursa Malaysia in April 1999 and the FSTE Global Islamic Index Series by the FSTE Group in October 1999.

All these indexes were launched in order to expand participation of investors who are passionate investing in securities approved in accordance to the Islamic law. In addition, this provides the investors a tracking and benchmarking of the performance of Shariah compliant securities towards making better investments decisions. (Securities Commission, 2007d). Besides the Shariah indexes to measure the performance of Islamic equity, in April 2006, the Dow Jones Citigroup Sukuk Index was launched by Dow Jones Indexes and Citigroup Inc. The objectives for the launching of the Sukuk Index are; to educating investors about Sukuk, building awareness of the vehicles, improving market transparency, providing a benchmark and as a basis for investable and tradable products (Siddiqui, 2008).

3.8 Bursa Suq Al-Sila’

Another milestone project to further strengthening Malaysia’s position as an international Islamic financial hub is the launched of the Bursa Suq Al-Sila', a world first commodity trading platform specifically dedicated to facilitate Islamic liquidity management and

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13 RHB Unit Trust Management Berhad is a unit trust company and a subsidiary of RHB Capital Berhad.
14 The KLSI retired on 1 November 2007 and has been replaced by FBM Shariah Index which was launched on 22 January 2007.
financing by Islamic banks (Bursa Malaysia, 2010). One notable features of this market is that, it is a fully electronic web based platform that provides industry players with an avenue to undertake multi commodity and multi currency trades from all around the world. Actually it integrates the global Islamic financial and capital markets together with the commodity market.

4.0 Regulatory Bodies and Regulatory Framework

The development of an Islamic capital market requires an in depth understanding of the operations of the current capital market and contemporary analyses to fulfil the present day needs of investors, especially Muslims who wish to participate in economic activities in accordance to Shariah principles of Islam (S. G. Abdul Rahman, 2007). Therefore the regulatory bodies play a vital role in order to ensure the achievement. The two main regulatory bodies in charge for the accomplishment are the Securities Commission and the Malaysia International Islamic Finance Center (MIFC).

4.1 Malaysia International Islamic Finance Center (MIFC)

In order to promote Malaysia as a major hub for International Islamic Finance, the country’s financial and market regulators, including the Central Bank of Malaysia, Securities Commission Malaysia (SC), Labuan Offshore Financial Services Authority (LOFSA) and Bursa Malaysia, together with industry participation from the banking, takaful (Islamic insurance) and capital market sectors in Malaysia have launched the Malaysia International Islamic Financial Centre (MIFC) in August 2006. The focus of this centre is on the areas such as; Sukuk origination, Islamic Fund and Wealth management, International Islamic Banking, International Takaful- Takaful (Islamic insurance) and Human Capital development. Apart from this, Securities Commission with collaboration of other regulatory bodies, has played an important role in formulating a facilitative regulatory framework to strengthening and sustaining Malaysia as an international hub for Islamic Capital Market.
4.2 Regulatory Framework

In line with its vigorous effort to provide facilitative regulatory environment for the development of the Islamic Capital Market, the Securities Commission introduced the following regulatory framework:

i) Guidelines on the Offering of Islamic Securities in July 2004:
These guidelines aimed to facilitate the development of more innovative and sophisticated Islamic instruments that meet the requirements of both local and global investors.

ii) Guidelines for Islamic Real Estate Investment Trusts in November 2005:
These guidelines were introduced to facilitate the creation of new asset class and further development of new Islamic Capital Market products. This effort is another notable effort, making Malaysia the first jurisdiction in the global Islamic financial sector to issue such guidelines (Securities Commission, 2005).

iii) Guidelines and Best Practices on Islamic Venture Capital in May 2008:
The new guidelines stipulate the minimum requirements for the establishment on an Islamic venture capital and Islamic venture capital management company. In addition, it includes a set of best practices to promote appropriate Islamic standards in the industry.

iv) Guidelines on Unit Trust Funds in March 2008
These guidelines set out requirements to be complied with by any person intending to establish a unit trust fund in Malaysia and were revised to set out additional requirements for the appointment of Shariah advisers and define the roles of the Shariah adviser and compliance officer. On top of a robust and effective regulatory framework, a fine balance between enhancing the growth of the industry and ensuring safeguards to protect investor interest needs to be top priority when designing regulatory framework for the market (A. Abdul Rahman, 2007).
5.0 Islamic Capital Market Products

The modern Islamic financial products and services are developed using two different approaches. The first is identifying and modifying existing conventional products and services to comply with Shariah principles. The second approach is the innovation of new products and services that involves the application of various Shariah principles (Securities Commission, 2007c). Figure 4 illustrates variety of financial products that being offered in the Malaysian Islamic Capital Market:

![Figure 4: Malaysian Islamic Capital Market Products](Source: Securities Commission website 2010)

As can be seen from Figure 4, the Malaysian Islamic capital market products are mainly divided into five categories of; Shariah compliant securities, Shariah-based Unit Trust Fund, Islamic Exchanged Traded Funds (ETF), Islamic Real Estate Investment Trusts and Sukuk (Islamic Bond). There is a significant product innovation and sophistication all over the world and Shariah compliant products have proven to be attractive also to non-Muslim investors and offer many opportunities, even to non-Islamic institutions (Mahlknecht, 2010).

5.1 Shariah Compliant Securities

The most popular product is the securities issued by listed companies on Bursa Malaysia, which comply with the Islamic criteria promulgated by the Securities Commission. Shariah compliant securities include those ordinary shares, warrants and transferable subscription rights issued by companies that comply with the Islamic criteria promulgated by the
Securities Commission. Those companies are known as Shariah approved companies or Shariah compliant companies. There are a lot of choices available at Bursa Malaysia on the selection of Shariah-compliant stocks across diversified industries for broader and deeper investment portfolios.

5.2 Shariah Based Unit Trust Fund
The Shariah based unit trust funds are collective investment funds that offer investors the opportunity to invest in a diversified portfolio of Shariah compliant securities and managed by professional managers in accordance with the Shariah principles. As at September 2009, the net asset value (NAV) of Shariah based unit trusts funds is RM21.18 billion, which is 11.3% to total industry. There are three main categories of Shariah-based Unit Trust Funds; Balance, Sukuk, Equity\textsuperscript{15}. The following figure 5 provides the category and Net Assets Value of Shariah-based Unit Trust Funds as at September 2009.

![Figure 5: Category of Shariah-based Unit Trust Funds as at September 2009](Source: Securities Commission website 2009)

As shown in Figure 5 above, the Equity funds is the largest Shariah-based unit trust fund being issued in the market as compared to the other funds.

\textsuperscript{15} The reminder are money market, structured, feeder, fixed income, mixed and structured funds
5.3 Islamic Exchanged Traded Fund

Islamic Exchanged Traded Fund are funds traded on Bursa Malaysia which track indices based on stocks that have been classified as Shariah compliant listed equities. Among the benefits of investing in ETF are; diversification as ETF invests in a portfolio of securities, low minimum investment as ETF is traded in board lot and liquidity as ETF is continuously traded on Bursa Malaysia. It can be seen from the data in Figure 7 that, as at September 2009, the net asset value (NAV) of Islamic ETF is RM638 billion, representing 55% to total industry.

5.4 Islamic Real Estate Investment Trusts

Islamic Real Estate Investment Trust is defined as a collective investment vehicles that pool money from investors and use this fund to buy, manage and sell real estate (Securities Commission, 2006). At present, there are 13 REIT being offered in Malaysia inclusive of two Islamic REITs. From Figure 7, it is clear that, the total market capitalisation on Islamic REITs as at September 2009 is RM1,748.65 billion or 33.6% of total industry.

5.5 Sukuk (Islamic Bond)

Sukuk is a form of financial note, which represent value of asset. The issuance of Islamic bonds require an exchange of a Shariah-compliant underlying asset for a financial consideration through the application of various Shariah principles such as *ijarah*, *mudharabah*, *murabahah*, *mushakarah*, *bai’ bithaman ajil* and *istikna*\(^\text{17}\) (IOSCO, 2004). Sukuk are being issued in Malaysia in both Malaysian Ringgit and foreign currencies. Therefore, this offers variety investment opportunities to all investors, either local or foreign investors and also for local and international entities that seek for listing on Bursa Malaysia.

\(^{16}\) The structure of Islamic ETFs similar like a unit trust but it is entirely a different product as it is tradable instantaneously on the Bursa Malaysia like equity during the usual trading hours.

\(^{17}\) *Ijarah* (leasing contract), *mudharabah* (business venture contract: profit sharing), *murabahah* (business venture partnership: profit and loss sharing), *bai’ bithaman ajil* (assets financing contract: deferred payment sale), *istikna* (progressive sale) are the Islamic principle used for a similar transaction in conventional market.
Among the five major Islamic Capital Market products, Sukuk is the most preferable choice for corporations to raise fund due to several factors. The key factor is due to strong demand from fixed income investors and it offers a competitive pricing and more cost effective to be issued (Securities Commission, 2007a). As shown in Figure 6, the size of outstanding Sukuk in September 2009, is RM168 billion, which represent 57.7% of total outstanding bonds issued in Malaysia.

![Figure 6: Statistics of Islamic Capital Market Products as at September 2009](source: Securities Commission website 2010)

### 7.0 Value Proposition

Malaysian becomes a destination of choice because of the competitive advantage or value propositions in a number of fundamental areas needed for an International Islamic centre. Figure 7 demonstrates 10 value propositions poses by Malaysian Islamic financial market.
As identified by Malaysia International Islamic Finance Centre (MFIC) in figure 7, currently Malaysia is considered a strategic location as an Islamic hub due to the following values:

i) Well Developed market:
Malaysia has placed strong emphasis on the development and expansion of Islamic finance including Islamic Banking, Takaful (insurance), Islamic capital market and Islamic money market for more than 30 years. Thus, resulted in the development of a comprehensive Islamic finance environment that rich in diversity of financial institutions, vibrant with continuous product innovation, market activity, and embedded maturity that adds stability and robustness to the whole system (MIFC, 2009b).

ii) Diversity of International and Domestic Financial Institutions:
A well diverse and growing community of domestic and international financial institutions and fund managers in Malaysia is undeniable. Lots of Malaysia’s notable achievement such as record setting Islamic bond issuance and other industry ‘first’ are due to the participation of these intermediaries. Their in depth experience and innovative capability and credibility in producing new Islamic products and issuances are internationally recognized (MIFC, 2009b).
Figure 8 presents the Islamic Capital Market Product Innovation and World First achievement since year 1990.

- **1990**: First Bait'ibithaman Ajil debt securities by Shell MDS Sdn Bhd, RM125 million (USD33 million)
- **1994**: First Sukuk Mudarabah by Cagamas Bhd, RM30 million (USD8 million)
- **2001**: First Global Corporate Sukuk Ijarah by Kumpulan Guthrie Bhd, USD150 million
- **2002**: First Global Sovereign Sukuk Ijarah by Government of Malaysia, USD600 million
- **2003**: First Tradable Sukuk Ijarah by SKS Sdn Bhd, RM5.6 billion (USD1.5 billion)
- **2004**: First Ringgit Denominated Sukuk by International Finance Corporation, RM500 million (USD130 million)
- **2005**: First Sukuk Musyarakah by Musyarakah One Capital Bhd, RM2.5 million (USD894 million)
- **2006**: First Exchangeable Sukuk by Khazanah National Bhd, USD750 million
- **2006**: First Global Sukuk Index by Dow Jones Citigroup Sukuk Index
iii) Liberal Foreign Exchange Administration (FEA) Rules:

The main objective for Malaysia to adopt a liberalized foreign exchange administration rules is to enhance its competitiveness and business efficiency while promoting financial and economic stability. This also enabled greater trade in foreign currencies whereby foreign Islamic fund management companies are allowed to invest all their assets abroad and to swap domestic currency funding into other currencies (MIFC, 2009b).

iv) Facilitative Business Environment:

A great facilitative business environment and framework has been provided in Malaysia especially to enable an efficient delivery channels for the proliferation of foreign Islamic institutions as well as Islamic products and services. This includes a reliable infrastructure platform of the Electronic Trading Platform (ETP) and the Real-time Electronic Transfer of Funds and Securities (RENTAS) System which enable an efficient trading. Besides, the existence of an active secondary market generates a greater trading activity and grow the depth and liquidity of Islamic products especially the Islamic bond (MIFC, 2009b).

v) Strategic Location:

Geographically, Malaysia is located at the most strategic position in order to function as a link between the East and West. This ideal location is an advantage to serve and facilitate the cross
flow of funds and greater global economic linkages especially between South East Asia and the Middle East (MIFC, 2009b).

vi) Adopt Global Legal and Regulatory Best Practice:

The legal framework in Malaysia caters the specific regulation of Islamic Finance. It is being governed by dedicated legislation; the Islamic Banking Act 1983, the Takaful Act 1984 and the Capital Market Services (CMSA) Act 2007. With the rapid growing of Islamic finance industry, the legal and regulatory framework is continuously updated in order to ensure laws are refined to best practices.

vii) Well Developed Shariah Governance Framework:

Malaysia posses two dedicated Shariah Advisory Council (SAC) in order to govern any matters pertaining to Islamic market. (MIFC, 2009b). The SAC of the Central Bank of Malaysia advises on issues related to Shariah compliance related to the Islamic banking and takaful industry. Meanwhile the SAC of the Securities Commission Malaysia advice on issues related to the operations of the ICM while provide guidance and advise to investors, the government and the industry. The establishment of these two SAC is a world first at the level of regulator (Anwar, 2007).

viii) Wide range of Innovative Islamic Investment Products:

Malaysia has taken an initiative to cultivate the growth of various innovative Islamic finance products either under banking sector or Islamic Capital Market to ensure participations from local or foreign market players (MIFC, 2009b). At present, a holistic range of innovative Islamic capital market products from equities to debt securities across all sectors and industries are being offered by Bursa Malaysia. Strategic differentiation in identifying, designing to produce products and services that customers perceive as being different in ways, that are important to them is the key to sustainability in this market (Anwar, 2008).

ix) Tax Neutrality:
Malaysia has introduced a very conducive tax environment for Islamic Capital Market similarly as being offered to conventional market. The introduction is to provide a competitive advantage and spurs the development of Islamic Finance. In addition, Anwar (2007) claimed that a tax neutral environment is considered as vital tool in facilitating innovation and product promotion, if not, Islamic transactions, which involves execution of numerous underlying contracts will be very costly and the development of new products will be slow down.

x) Comprehensive Human Capital:
Equally important to facilitative environment is human capital, which is vital element to ensure an excellent expansion of Islamic Capital Market. It is a primary challenge for Malaysia to build an adequate new generation of innovators, regulators, intermediaries and risk manager with a right blend of financial and Shariah knowledge and expertise in capital market (MIFC, 2009a). Complete infrastructure for intellectual capital development is an essential towards meeting the education needs of all level of Islamic finance practitioners. In addition to higher learning institutions available currently, Malaysia has established; Islamic Banking and Finance Institute Malaysia (IBFIM), International Centre for Leadership in Finance (ICIF), and International Centre for Education in Islamic Finance (INCEIF), which offering short term training courses together with long term certification and post graduates programmes in the Islamic finance. The latest initiative to create a pool of human capital to facilitate the development of Islamic capital market is the Islamic Capital Market Graduate Training Scheme (ICMGTS) which is jointly developed and introduced by the Securities Industry Development Corporation (SIDC) and Securities Commission Malaysia in March 2009 (SIDC, 2010).
6.0 Conclusion

The Malaysian Islamic Capital Market is growing rapidly and vibrantly. At present, Malaysia faraway exceed other Muslim countries in term of capital market infrastructure with persistent support by the government providing impulsion for the growth of Malaysian Islamic Capital Market. The leadership and support provided by the government through the facilitation of policies and incentives has ensured the success of Islamic Capital Market development. Moreover, in recognizing the significance of the Islamic Capital Market, the government offered a range of incentives in their Budget starting from the Budget 2007 to 2010 to attract industry player either locally or abroad to participate in the market. A number of initiatives and measures to further open the markets, including supporting the entry of foreign intermediaries and a facilitative tax regime.

Initiatives taken by the Malaysian government towards a global hub are substantial. Every perspective, such as product innovation, infrastructure facilities, policy incentives, human capital development, liberalisation and regulatory framework are being well focused. All parties either the regulatory bodies or the market players are involved to ensure the achievement of an international hub for an Islamic Capital Market. In addition, it is a continuous effort whereby all aspect is being reviewed by the respective bodies. It is responsibility of all to support and ensure the success of Malaysia as a global hub for Islamic Capital Market.
References


