The Malaysian Option

A background to Malaysian Islamic Finance Regulation

Over the last decade Malaysia has made significant strides in implementing measures that have made it a leading example for conventional and Islamic finance globally. Malaysia has been at the forefront of facilitating and establishing the necessary legal, supervisory and practical frameworks for an unprecedented drive towards a vibrant and capable SRI industry. Most importantly, Bank Negara Malaysia (BNM), the Securities Commission of Malaysia (SC) and Bursa Malaysia have adopted this approach with a focus both on domestic stability and international reach to all entities that intend sharing in the Malaysian success story.
This story formally began in 1983 with the establishment of legal and regulatory frameworks that resulted in the first SRI-centric financial institution (Bank Islam Bhd) and the first cooperative insurance company in the country. In the period between 1993 and 2001, the number of participants in the industry increased by allowing an additional cooperative insurance company and a new Islamic financial institution while permitting conventional and existing players to participate in the new domain through operational windows. BNM once again played a critical and pivotal role in managing this revolutionary period in a gradual and sound manner, allowing fairness to all stakeholders involved. BNM and Securities Commission Malaysia both established an advisory board (SAC) to promulgate and oversee new guidelines. This board ensures both comprehensive and standardised systems to be applied within strict supervisory criteria that have enhanced the stability and image of the Malaysian dual-banking system.

In 2001, Malaysia announced its 10-year vision for the liberalization of its financial markets and the enhancement of its infrastructures. This included several strategic steps such as the financial sector master plan for the decade ahead, allowing the entry of foreign banks into the financial industry, adding new local players, a tax neutrality policy and the Central Bank of Malaysia Act of 2009. In addition, BNM undertook a bold and visionary move by launching a global university for learning (INCEIF) and the BNP-Paribas sponsored Centre for Wealth Management at INCEIF that is dedicated to applied research in the field of Islamic wealth management and SRI-centric fundamentals.

Since 2010, BNM has been working on expanding the efforts of preceding years while improving existing systems and weeding out inefficiencies and closing loopholes. The results have spoken for themselves in terms of institutions, practitioners, scholars and students from across the world flocking to Malaysia seeking opportunities, growth and knowledge. INCEIF and ISRA have become flagship institutions in their respective rights and have become part and parcel of the industry as incubators and think-tanks. Central banks from Africa and the Middle East have realised the status of Malaysia and the uniqueness of BNM’s role in offering innovative financial solutions such as SRIs and more.
Malaysia as a hub for innovation

Innovative commodity trading platforms, payment and clearing infrastructures as well as partnerships with the leading rating agencies have added to Malaysia’s position and credibility, all within a dual-banking offering. Transparent, efficient dispute resolution systems add confidence to a proven and growing financial sector in Malaysia. At the same time, the finance and investment industry has become diversified as a result of all the initiatives of previous decades, resulting in a number of financial institutions, domestic and international, operating in Malaysia. At this juncture, an array of supporting and complementary industries such as legal firms, trust companies, research companies and financial intermediaries have developed.
Malaysia leads in a recent study by Thomson Reuters\textsuperscript{18} and is considered the most developed Islamic economy ecosystem by a significant margin, topping 4 out of 6 sub-sectors.\textsuperscript{19} Out of a total of 70 countries evaluated using 49 metrics, Malaysia led the study as the most advanced and comprehensively regulated Islamic economy to be considered an example for countries intending to achieve the stability and success in the field.\textsuperscript{20}
Malaysia’s Fund Management Proposition

**ISLAMIC FUND ASSETS BY DOMICILE**

- Malaysia: 25%
- Saudi Arabia: 18%
- Luxembourg: 16%
- Indonesia: 7%
- Pakistan: 6%
- Ireland: 5%
- Jersey: 5%
- South Africa: 4%
- Others: 5%

Source: ISRA and Zawya
Islamic Funds Industry
Assets Under Management

Malaysia has a well-developed Islamic fund industry boasting the highest number of Islamic funds globally. With 299 Islamic funds (30% of global funds)\textsuperscript{21}, Malaysia leads the next most prolific country\textsuperscript{22} by a significant margin (7%). However, Malaysia trails one of the wealthiest countries in the world, Saudi Arabia, to be in second place when considering assets under management by the end of June 2015 with approximately USD27.3 billion under management.

\textsuperscript{21} KFH Research
\textsuperscript{22} KFH Research

Source: ISRA and Zawya
Given Malaysia’s success in Islamic finance at both the global and domestic level, it is well positioned to be the destination for investment opportunities within the region. Many viable economic institutions are driven by profit incentives but in the case of entities engaged in SRI, profitability and bottom lines are not their only priorities. They seek to positively impact the world in a sustainable way. Accordingly, organizations that hold SRI principles high on their agendas can legitimately embrace the SRI initiative by the Securities Commission Malaysia.

The principles and objectives of the SRI initiative by Securities Commission Malaysia\(^2\) embed standards of “substance” where ethical and social values are incorporated in the structuring of products. This ensures an inclusive economy that actively seeks to bring into the economic fold all members of society that would normally have been excluded from any opportunities to succeed and grow. The Securities Commission Malaysia’s SRI initiative thrives in the well-being of society at large as a sacred and ultimate goal. As a consequence, ethical values as defined by the Securities Commission Malaysia standards play a significant role in reducing risk without recourse to costly processes or management.

Islamic funds on an institutional level aims to bring together like-minded investment bodies who share the higher and noble intentions of Bank Negara Malaysia and the Securities Commission Malaysia to offer ethical values in providing financial solutions to support sustainable social changes that benefit communities and societies in a global market generally driven by profit maximization.

The central economic tenet of such ethical social investment is to develop a prosperous and just economic structure in which all members of society irrespective of race, beliefs or religious affiliations could maximise their wealth whilst contributing to the wholesome development of society. It is therefore evident that Islamic funds appeal to investors seeking new and alternative SRI investments.

\(^2\) Securities Commission of Malaysia’s SRI initiatives emphasize the importance of environmental risk, social and corporate governance
Malaysian Institutional Investors
Creating Strong Buy-Side

The Malaysian institutional investors are amongst the largest in the world, with almost a third of their portfolio invested in instruments that comply with Islamic tenets. Malaysian institutional investors such as Employees’ Provident Fund, Retirement Fund Incorporated, Permodalan Nasional Berhad, Hajj Pilgrims Fund Board have invested in Islamic Shariah-compliant funds as demand from contributors are increasing for Shariah compliant investment. Malaysia’s strong buy-side demands are expected to enhance following the new initiative by the ASEAN Economic Community, under the ASEAN Collective Investment Scheme (CIS) Framework launched in 2014.

ASEAN Fund ‘Passportability’

Malaysia has most recently been involved in a framework for the “ASEAN CIS”. The ASEAN CIS Framework was launched on the 25th of August 2014, engaging three initial jurisdictions – Singapore, Thailand and Malaysia –as part of the establishment of the ASEAN Economic Community. The framework creates a harmonious flow of investment funds between the signatories and, through qualifying criteria, makes the ‘passport’ or movement of funds more streamlined. It also brings forth diverse investment opportunities for the signatories and increases their competitive strength in the regional sphere. The new framework also encourages regional economic development through cross-border investments and efficient time-to-market.

ASEAN CIS Qualifying Criteria are as follows:

1. The CIS has been assessed by the relevant local regulator as being suitable as a "Qualifying CIS";
2. Investments may only be made in transferable securities, money market instruments, deposits, units of other CIS and financial derivatives;
3. The CIS may not engage in certain specified activities, such as securities lending or repurchase agreements; and
4. The CIS is operated by a locally licensed CIS operator (that has a minimum five-year track record and at least USD500 million under management globally).

24 Reported as the 6th largest in the world in 2014 by Reuters Report.
25 Association of Southeast Asian Nations.
Emerging markets have exhibited strong growth and have the potential for further progress and evolution in the near future. Islamic solutions provide innovative products and options to the market that comply with ethical and SRI principles, a trend that has gained significant momentum, especially after the UNPRI initiative, in the formulation of key principles that have encouraged the market to demand ethical investment.

Malaysia’s leading role in the dual-banking approach as well as its global leadership in Islamic finance, banking and capital markets, has made it an amenable environment for secure investment and finance. The formidable regulation for Shariah-compliant investment has made Malaysia a regional hub as it stands strong in its strategy to promote financial inclusion within an ethically bound value system.

Malaysia as a choice for SRI investment makes for the selection of quality-rated instruments within a sound regulatory environment that has the added advantage of fund passportability within the region. Islamic investment funds offered by Malaysian asset managers become an obvious choice for those in search of socially responsible, ethically sound and tailor-made investments promoted within a high level of compliance and governance.

This SRI booklet provides an informative summary of the salient features of SRI’s and other ethically bound investments in the global markets, that not only provide alternatives for investors but also present evidence of at least par performance with conventional investments of equal risks. It helps to explain the commonalities of this niche investment class of assets comprising of SRI investments, ESG investments and Shariah-compliant investments vis-a-vis the conventional investments of equal risks. This booklet provides potential investors interested in this niche class of investments a broad overview and yet an informative introduction to these investments.
About Malaysia’s Islamic Finance Marketplace

Since its introduction more than 30 years ago, Islamic finance in Malaysia has developed into a comprehensive and sophisticated Islamic finance marketplace. The marketplace is characterised by a robust regulatory, supervisory, Shariah and legal framework, a deep primary market and active secondary sukuk market, diverse players and talent base with global capabilities and connectivity for business deals anywhere in the world, product innovation, breadth and depth and an efficient system for multi-currency clearing and settlement. Malaysia’s Islamic finance marketplace is open to global industry players and market participants to collaborate with and mutually benefit from a highly conducive business environment of innovation, expertise and deal flow.

BNP Paribas – INCEIF Centre for Islamic Wealth Management (CIWM)

The Centre for Islamic Wealth Management (CIWM) is a joint initiative between BNP Paribas Malaysia and the International Centre for Education in Islamic Finance (INCEIF) - The Global University of Islamic Finance. It is dedicated to support the growth of the global Islamic wealth management industry with the key objectives of furthering education, industry innovation and policy development.

To achieve its objectives, CIWM conducts workshops, conferences, and public lectures in the areas of Islamic wealth management that covers aspects of wealth generation, accumulation, protection, purification and distribution. CIWM aims to be a catalyst of innovation in the nascent area of Islamic wealth management by sharing and enhancing knowledge and know-how of practitioners, investors, academics and Shari’ah scholars. The Centre also supports applied research initiatives in specialised areas of Islamic wealth management to address operational and strategic challenges in this fast growing global industry.

To encourage and develop interest in Islamic Finance, CIWM offers three (3) PhD scholarships annually for bright and excelling recipients from all over the world.

For INCEIF, this significant collaboration with a bank of global repute in the area of wealth management and a strong local presence augurs well for its quest to be the knowledge leader in Islamic finance and subsequently, contribute towards the development of this niche sector of the economy.

For more information on Malaysia’s Islamic finance marketplace, please visit www.mifc.com, follow us @MalaysiaIF and download MYIF app at Apple Store and Google Play.

Our marketplace is a comprehensive Islamic finance ecosystem and business environment of infrastructure, innovation, expertise and deal flow, served by the Malaysia International Islamic Financial Centre (MIFC) Community, comprising the financial institutions, professional firms, regulators and government agencies.

For more information, go to www.inceif.org → Industry Services → Centre for Islamic Wealth Management