

MAY 2009

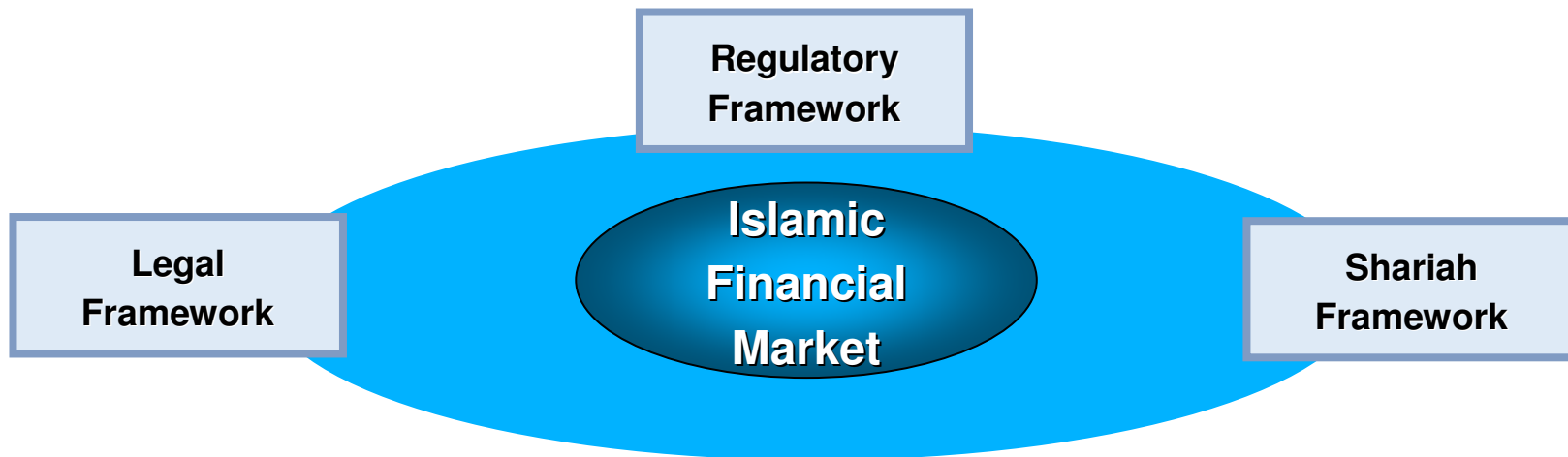
MALAYSIA'S ISLAMIC RETAIL BANKING MARKET

Challenges & Opportunities

Systemic approach to Islamic financial market development..

- Malaysia's first Shariah compliant savings institution was formed in 1963 serving the Malay Muslims outside the conventional market.
- The Islamic Banking Act was enacted in 1983 and the Takaful Act in 1984 and the country's first Islamic Bank and Takaful company was established immediately after that.
- In 1983, the Government Investment Instruments Act was enacted to facilitate the issuance of Islamic securities by the government.
- Ten years later, the Islamic Banking Window Scheme or "Skim Perbankan Tanpa Faedah" was introduced which allowed all conventional banks to offer Islamic financial products and services. Resulting from this initiative the Islamic banking and finance share of market grew from a mere 1% over the last 10 years to about 6% nearly overnight.
- Over the course of the last 8 years, Islamic banking assets in Malaysia has grown by more than 150%.
- Today, Malaysia's Islamic financial market is to a degree complete comprising of the banking sector, the inter-bank money market, the debt and equity market, asset management, takaful, other non-banking financial institutions and the derivatives market.

Regulated Shariah management is crucial..



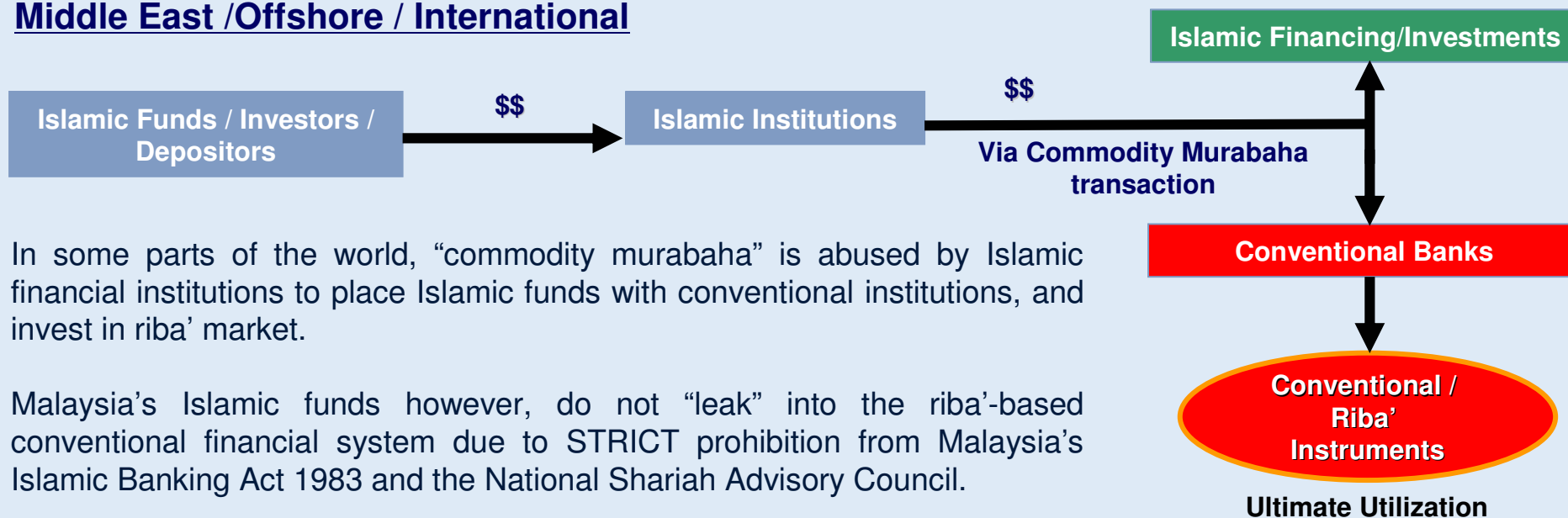
- In Malaysia, Shariah management takes place at **three** levels:-
 - (i) *The regulation of the whole Islamic financial market*
 - ensuring all Islamic banking and finance activities in Malaysia are 100% Shariah compliant
 - (ii) *The management of Shariah committee in financial institutions*
 - all Shariah committee's are subject to the authority of the Shariah Advisory Council (SAC) of the regulators
 - (iii) *The management and monitoring of the activities of the individual financial institutions*
 - financial institutions in Malaysia are required to have an in-house Shariah advisor
 - all new products need to be approved by the regulators and the SAC

The effects of an unregulated Shariah management framework..

South East Asia



Middle East /Offshore / International

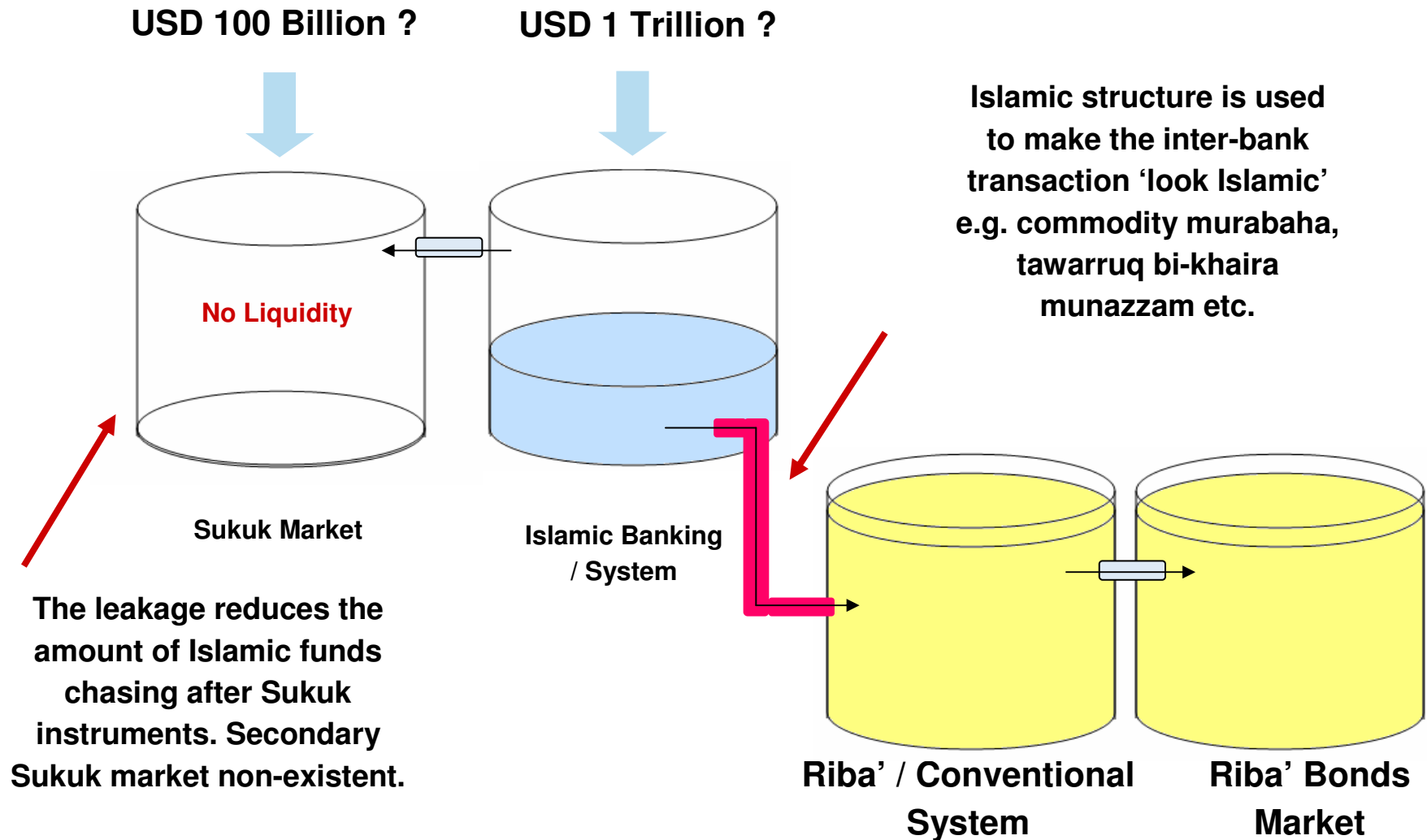


In some parts of the world, “commodity murabaha” is abused by Islamic financial institutions to place Islamic funds with conventional institutions, and invest in riba’ market.

Malaysia’s Islamic funds however, do not “leak” into the riba’-based conventional financial system due to STRICT prohibition from Malaysia’s Islamic Banking Act 1983 and the National Shariah Advisory Council.

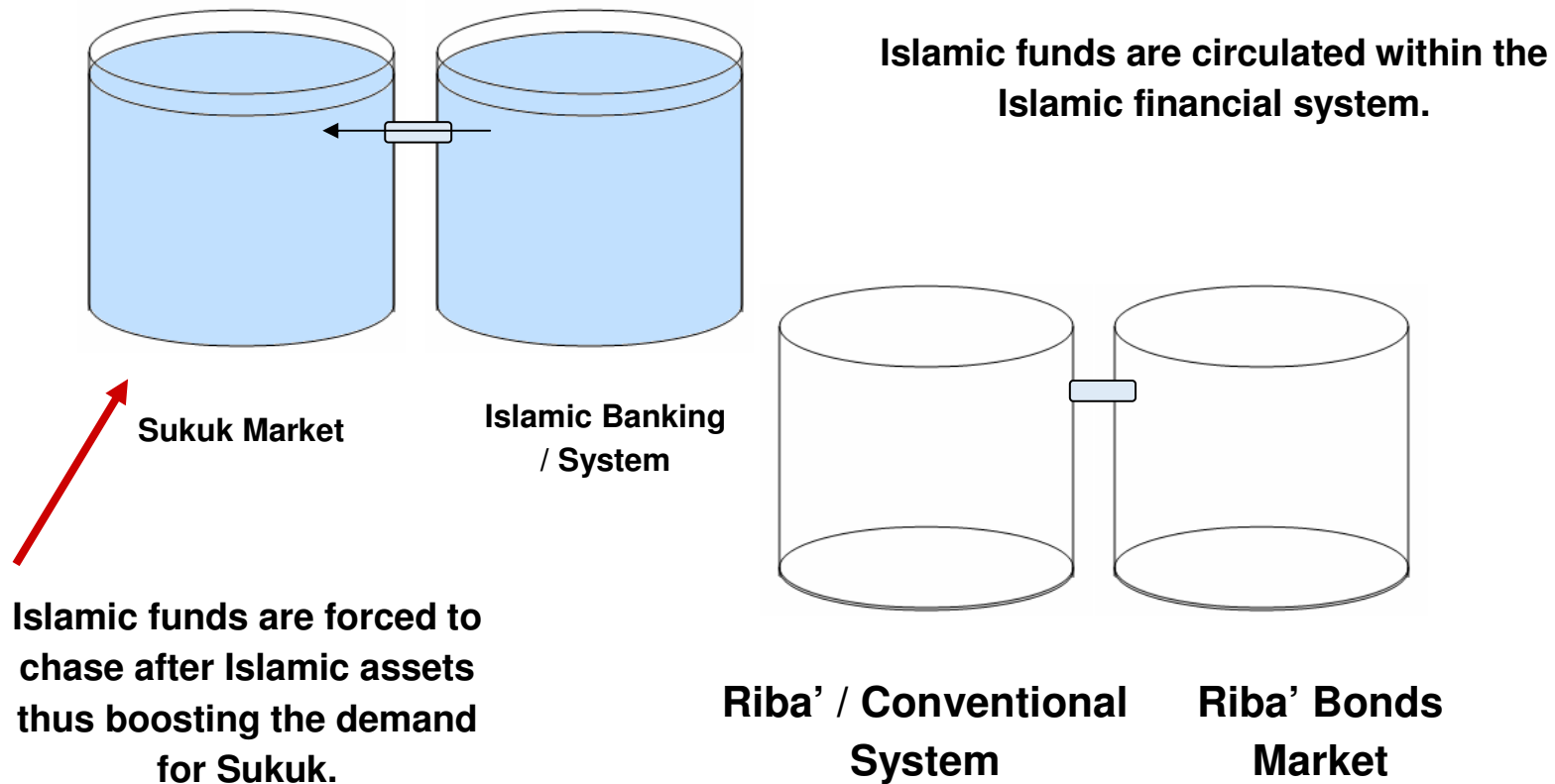
(Source: CIMB Islamic Fixed Income Research)

Leakage of Islamic funds to the conventional system..



No leakage of Islamic funds in Malaysia..

- Islamic financial institutions (IFI's) in Malaysia are bound by the Islamic banking act 1983 which requires all Islamic finance transactions to be fully Shariah compliant from start to finish. IFI's will have their licenses revoked if they fail to do so.



Shariah management insufficient if legal constraints exist..



Notes:-

BNM: Bank Negara Malaysia
FIC: Foreign Investment Committee
LOFSA: Labuan Offshore Financial Service Authority
MITI: Ministry of International Trade and Industry
MOF: Ministry of Finance
SC: Securities Commission

Key Governing Laws

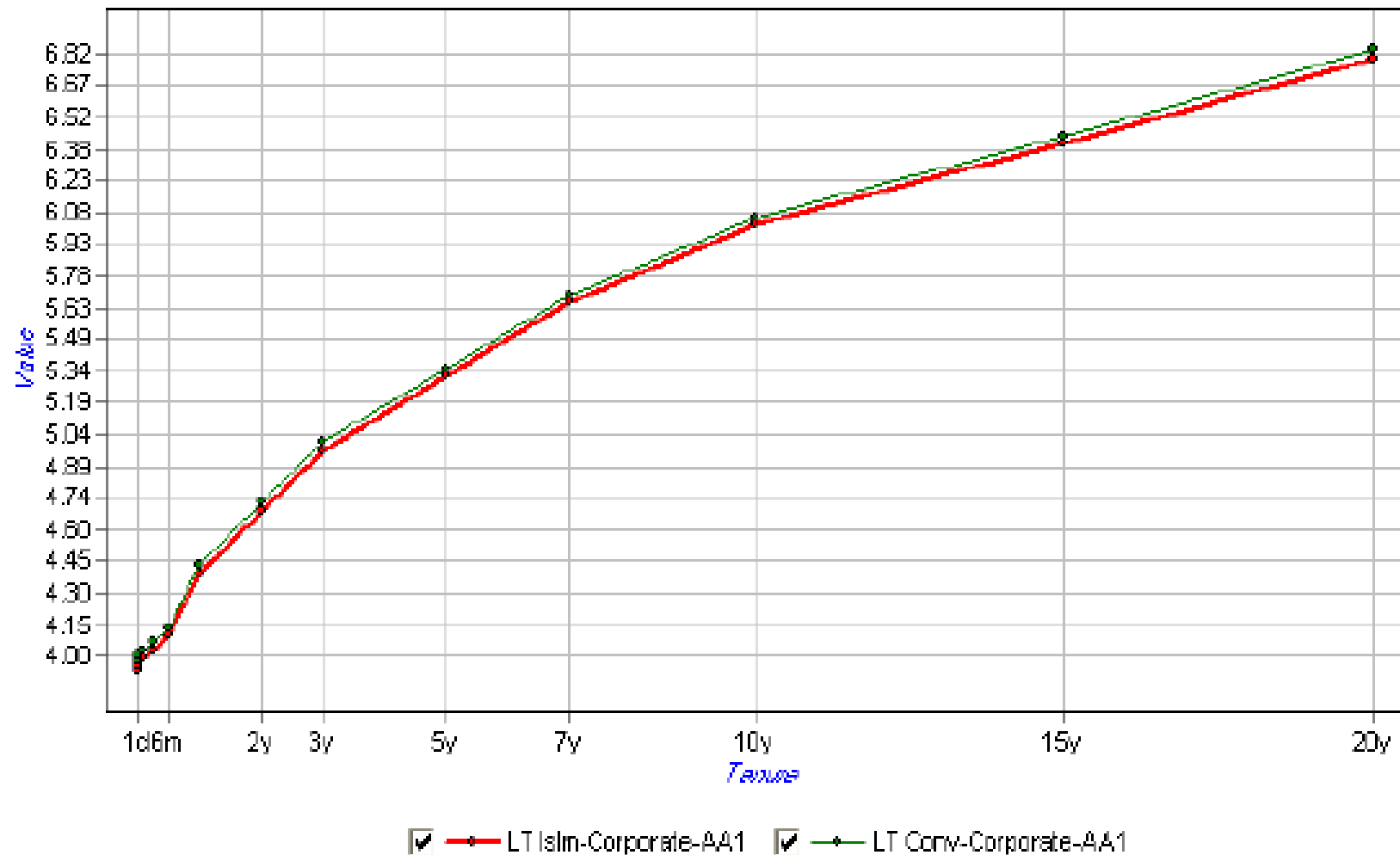
- Banking Laws (Islamic Banking Act 1983 ("IBA"))
- Securities Laws (Guidelines on the Offering of Islamic Securities 2004 ("IS"))
- Shariah requirements (incorporated in IBA and IS)

"Accidental" Governing Laws

- Land Laws
- Securities Laws i.e. merger/ takeover, beneficial ownership
- Lease Laws (Ijara transaction)
- Tax/Stamp Duty legislation
- Others

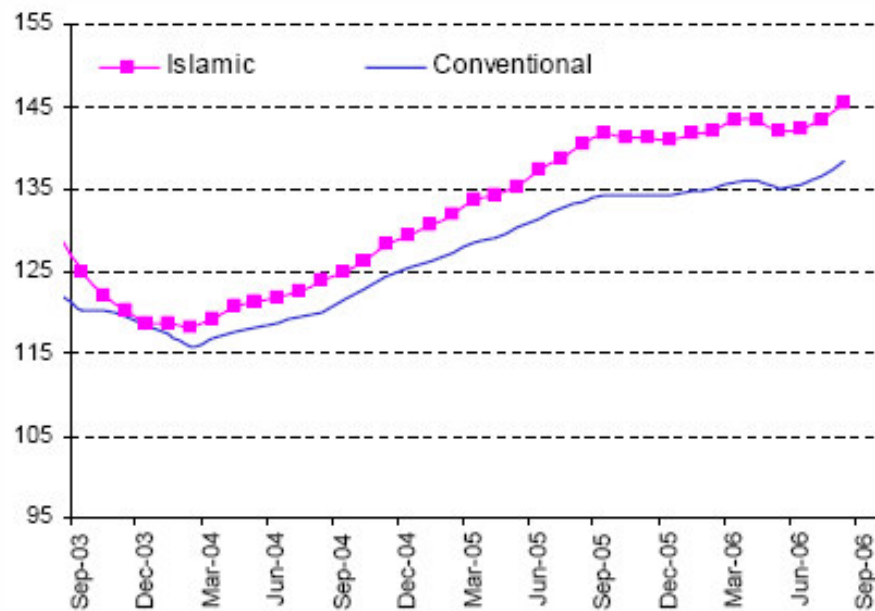
Impact of systemic approach, Shariah regulation and active legislation..

Long-Term YTM Curve for Corporate Bonds and Sukuk (Rated AA1)

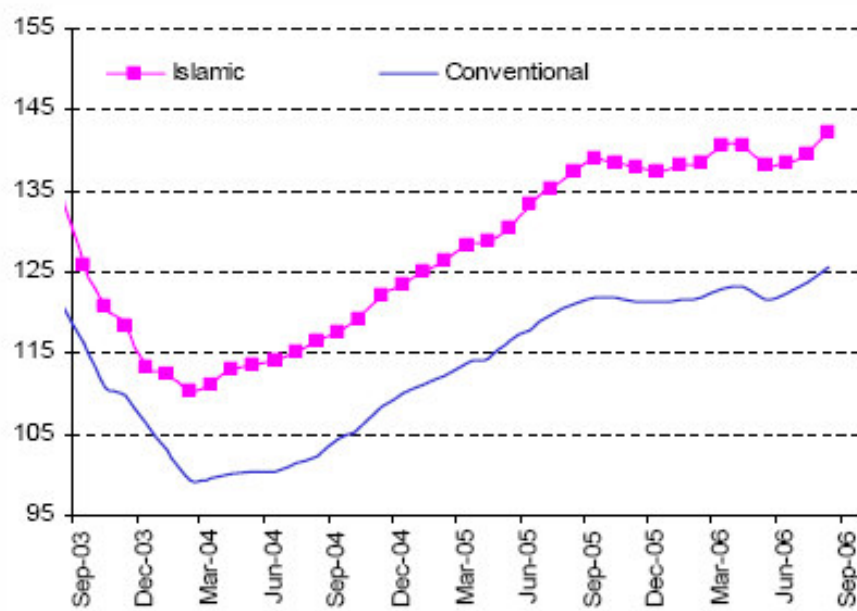


Islamic papers have always outperformed conventional papers in Malaysia..

Ringgit Bonds with maturities of 1-year and above



Ringgit Bonds with maturities of 5-years and above



	Index reading		Av. Annualized Returns		Average Duration	
	Islamic	Conventional	Islamic	Conventional	Islamic	Conventional
1-year and above	145.47	138.35	7.64%	6.27%	4.73	3.98
5-years and above	142.07	125.43	7.57%	4.39%	6.32	6.11

(Source: CIMB Fixed Income Research)

Islamic banking in Malaysia still growing despite global recession

	2001	2002	2003	2004	2005	2006	2007
Islamic Banking Institutions - Assets, Financing and Deposits							
(RM million)							
Total Assets	58,929	68,070	82,196	94,565	111,824	133,031	157,125
• Islamic Banks	17,328	20,160	20,955	24,854	43,433	73,809	94,894
• Commercial Banks	26,750	29,110	36,824	53,912	59,698	53,080	56,229
• Investment Banks / Merchant Banks	1,353	1,429	1,716	2,551	1,466	3,964	6,002
• Finance Companies	9,749	12,623	17,875	7,764	1,254	n.a	n.a
• Discount Houses	3,749	4,748	4,826	5,484	5,973	2,178	n.a
→ % of total banking system	8.22	8.93	9.72	10.45	10.99	12.18	12.80
Total Financing	28,201	36,717	48,616	57,868	67,364	78,513	89,857
• Islamic Banks	7,561	9,158	9,765	11,449	20,627	39,476	49,108
• Commercial Banks	12,256	16,706	22,324	38,803	45,398	38,833	40,655
• Investment Banks / Merchant Banks	771	803	781	793	268	204	94
• Finance Companies	7,613	10,050	15,746	6,823	1,071	n.a	n.a
• Discount Houses	n.a	n.a	n.a	n.a	n.a	n.a	n.a
→ % of total banking system	6.53	8.13	10.27	11.30	15.06	12.37	13.96
Total Deposits	47,106	53,182	60,213	72,859	83,874	99,181	121,975
• Islamic Banks	14,375	16,421	17,584	20,756	35,625	58,469	75,116
• Commercial Banks	22,031	23,353	26,519	39,775	42,775	36,867	42,027
• Investment Banks / Merchant Banks	673	684	852	1,527	797	2,572	4,832
• Finance Companies	7,664	9,094	10,966	5,952	684	n.a	n.a
• Discount Houses	2,963	3,630	4,292	4,849	3,993	1,273	n.a
→ % of total banking system	9.51	10.13	10.41	11.16	11.24	12.19	14.02

➤ At end of March 2009:-

Islamic assets in the system stood at RM194 million (23% growth since end 2007)

Islamic financing in the system stood at RM110 million (22% growth since end 2007)

Islamic deposits in the system stood at RM157 million (29% growth since end 2007)

➤ The target is for Islamic banking assets to reach 20% of total banking assets by 2010.

What about the controversial ruling on BBA?

The High Court has ruled that the Al-Bai' Bithaman Ajil is contrary to the Islamic Banking Act 1983

By HĀBHĀJAN SINGH

THE HIGH Court recently ruled that the application of the Al-Bai' Bithaman Ajil (BBA), a hugely popular Islamic home loan financing contract in Malaysia for the last two decades but much criticised abroad, is contrary to the Islamic Banking Act 1983.

In what is set to be another widely discussed judgement, High Court Judge Datuk Abdul Wahab Patail ruled that the sale element in the BBA is "not a bona fide sale". He also brought into question the profit portion of the facility.

The written judgement, dated July 18 but made available to lawyers involved in the case late last month, may force Islamic banks and financial institutions to re-examine their legal documentations.

- In 2008, the ruling by a high court judge that BBA, a popular Islamic home financing product in Malaysia, is contrary to the Islamic banking act 1983 created confusion and panic in the domestic Islamic financial system.
- Why did the judge think that BBA was not Shariah compliant?
- What did the local court of appeal have to say about this?
- Are BBA contracts valid and binding now?
- Has any good come out of this controversy?

'Malaysia is more liberal than the GCC when it comes to Shariah' – is this true?

- What are the key differences between Malaysia and the GCC?

Issues	Malaysian SAC Rulings	GCC Rulings
Inah / Tawarruq	Permissible	NOT Permissible
Bai' Al-Dayn	Permissible	NOT Permissible
Commodity Murabaha with Conventional Banks	NOT Permissible	Permissible

- Under Shariah it is stated that differences of interpretation and application of its principles are allowed and is in fact a blessing from Allah. There are many school of laws including the 4 major mazhabs – Shafie, Maliki, Hambali and Hanafi and each jurisdiction may have followers of the various school of laws amongst its user of Islamic financial market products and services.
- That is why in Malaysia, under the Islamic Banking Act 1983, Islamic banking activities are defined generically as those activities not in contradiction with shariah.
- Furthermore, Islamic finance or capital market falls under the muamalat section of Shariah. Under muamalat (man to man) all matters are allowed unless proven not allowed. Differing from Aqidah (man to god) where all matters are not allowed unless it is proven allowed.
- Shariah anywhere in the world is applied on a jurisdictional basis within local parameters.
- Criticism and condemnation for the sake of competition is...just not right.

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