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Islamic Finance and Banking in Malaysia with Special Reference to Sukuk Industry

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Abstract

Malaysia is seen as a success story of rapid growth and structural change with equity. The country has enjoyed a stable macroeconomic environment with low unemployment and inflation rates for decades. However, due to the recent 2008 global financial crisis, the economy has experienced a slowdown in the growth rate. The government has introduced the New Economic Model of 2010 (NEM2010) to shift the country from a middle-income economy to a high-income economy by 2020. In support of these goals, the government has taken steps to liberalize its financial sector since Malaysia is one of the key players in Islamic finance. The present chapter looks into the Islamic finance landscape of Malaysia by focusing on the sukuk industry as well as prospects and challenges facing the industry. By examining sukuk market behavior, it is hoped that policymakers may utilize sukuk as key financial tools to drive the domestic financial sector and demonstrates its bearings on equitable growth.

Index terms— islamic finance, sukuk development, malaysia?s financial sector blueprint, maqasid shariah, banking industry.

1 I. Introduction

he Global Islamic Finance Report 2016/2017 crowned Malaysia as the global leader in Islamic banking and finance based on the Islamic Finance Country Index (IFCI). The IFCI was first introduced in 2011 to indicate government's commitment to use Islamic banking and finance as a policy tool and in the economic agenda.It is not a small achievement for a small, open economy such as Malaysia, with a population of approximately 31.16 million people, which is equivalent to only about 0.42 percent of the total world's population.

Domestically, the market share of Islamic banks in Malaysia quadrupled from 7.1 percent in 2010 to reach 28 percent in 2016 (Bank Negara Malaysia, 2017). However, the industry's annual growth rate slowed from 24.2 percent in 2011 to 8.2 percent in 2016. Hence, there is a need to explore for sustained growth given the rise of Islamic finance globally. Shariah-compliant financial products and services are now offered in 50 Muslim and non-Muslim jurisdictions worldwide (Thomson Reuters, 2017). Khalid Howlandar of Moody's rating agency expects 2018 to be "the landmark year" for Islamic finance propelled by a paradigm shift in the economics of sukuk.

According to Thomson Reuters's State of the Global Islamic Economy Report t2016/2017, the exisiting Islamic finance market stood at an estimated USD2 trillion in assets in 2015 and of this USD$2 trillion, Islamic banking was responsible for USD1.451 trillion, the takaful (Islamic insurance) sector for USD$38 billion, sukuk outstanding for USD342 billion, Islamic funds for USD66 billion, and other financial institutions for USD106 billion.The same report projected that the total Islamic finance assets are expected to reach USD3.5 trillion by 2021. Islamic banking would be the key driver of growthand is expected to reach USD2.7 trillion in assets by 2021.

In March 2017, Islamic banking comprises 25 percent share of the banking sector of the country. Recent observation points out, however, that the sector has been slow in capturing the market share from conventional banks. This might pose challenges to achieve the targeted 40 percent market share as outlined in the second Malaysian Financial Sector Master plan.

2 II. Islamic Banking and Finance in Malaysia

The evolution of Islamic Banking in Malaysia could be traced to the establishment of the Pilgrims Fund Board in 1963. However, it was twenty years after that that the first Islamic Bank, Bank Islam was established in July 1983. Subsequently, numerous other events took place thatboosted the development of Islamic banking in the country as shown in Table **??**.

As for the growth in the banking sector, Figure 1 shows the expected trend until 2020, in which double digit financing growth performance is expected for Islamic banking, which is higher than the single-digit forecasted for conventional banking growth. However, from 2018 until 2020, the growth rate is expected to be stabilised around the 2017 growth rate.

Earlier last year, Malaysia made headways in the Islamic finance market by introducing the world's first shariah-compliant pension fund; 'Simpanan Syariah', which was later launched with a total of RM59.03 billion and taken up by 635,037 members as at January 2017.The scheme is an alternative to the conventional Employment Provision Fund (EPF) for contributors who are interested in converting their savings to a fully compliant-shariah status. Another latest development in December 2017 is a new requirement for shariah committee members to have certified shariah qualifications when they seek reappointment at various financial institutions in Malaysia. The move is made to address shariah risks that are complex in nature and might be difficult to discern except for trained professionals.

3 III. Malaysia's Financial Sector

Blueprint, **??**2011] **??**2012] **??**2013] **??**2014] **??**2015] **??**2016] **??**2017] **??**2018] **??**2019] **??**2020] The 10-year Malaysia Financial Sector Blueprint "?charts the future direction of the financial system as Malaysia transition towards becoming a high-value added, high income economy." According to the Blueprint, Malaysia's financial system has become less fragmented through consolidation and rationalisation from 1980 to 2011.The recommendations in the Blueprint outline the roadmap and strategies of the financial landscape in the next ten years (2011-2020).

The Blueprint highlights the financial sector developments from 2001 until 2011. During this period, the financial sector recorded average an annual growth rate of 7.3 percent to account for 11.7 percent of real Gross Domestic Product (GDP) in 2010 (2001: 9.7%). Financial sector is expected to grow at the rate of 8-11 percent annually and contributes 10-12 percent of nominal GDP in 2020 (2010: 8.6%).

Chapter One of the Blueprint covers the global and domestic landscapes and the expected financial land cape in 2020. It is projected that 60 percent of the global total world output will be produced by the emerging economies of Asia, Middle East, Latin America and Africa, hence increasing the significance of these economies. Two key trends are indentified. First, the strengthening of the domestic sources of growth through private dometic demand. Second, greater global and regional economic and financial integration. This will help achieve greater balance between domestic and external demand as sources of economic growth. By 2020, the share of private consumption is expected to be 61 percent of GDP (2010:53).

Chapter Two continues with the topic of 'The Financial Sector that Best Serves the Malaysian Economy.' By 2010, the financial sector has accounted for 11.7 percent of real GDP (2001: 9.7 percent). After the first Financial Sector Master plan in 2001, Malaysia is expected to create a financial sector that best serves the Malaysian economy by 2020. Islamic banking and finance would be expected to contribute 40 percent share of total Islamic domestic financing by 2020 (2010:29 percent).

Chapter Three is themed 'Enhancing Regional and International Financial Linkages.' The focus is on the internalisation of Islamic finance and stronger cross-border linkages. According to the Asian Development Bank (IDB), Asia needs to invest around USD8 trillion from 2010 to 2020. Islamic finance has contributed 2.1 percent share to GDP in 2009. This is in line with global ethical consumer demand for Socially Responsible Investment (SRI) as an important asset class in the future.

Chapter Four continues with the topic "Safeguarding the Stability of the Financial System'. The focus is on the roles of Islamic finance. Governance and risk management, an effective regulatory and supervisory regime, stability, integration, and crossborder linkages are the key areas discussed. Based on content analysis method, the author investigates the presence of social capital in this particular chapter. In general, there is a strong emphasis on the structural organization and rules and regulations. The Blueprint emphasizes the governmental component (effectiveness of formal institutions in facilitating collective action) of social capital. There are also quite a number of references to cooperation, integration and cross-border networking among the Islamic banking institutions and other entities.

Chapter Five concludes with 'Key Enablers for the Development of the Financial System'. This chapter comprises three sub-topics covering electronic payments, empowering consumers and talent development. The plan is to increase e-payment transactions per capita to 200 transactions per capita by 2020 (2010:44 transactions). At the same time, financial consumer education to gain financial literacy will also be promoted. Therefore, there would be greater demand for high-quality talent by the financial sector. The Credit Counselling and Debt Management Agency will have an important role to educate adult consumers in financial literacy. An extensive institutional infrastructure has been put in place to ensure a sufficient pool of talent for a dynamic financial sector.

4 IV. An Overview of Sukuk Industry

The sukuk market is the fastest growing and most promising segment of Islamic finance. It has become an important component of the global sukuk market. There is also an increase in the issuance of sukuk by corporate and public sector entities due to growing demand for alternative investments. Malaysia stands out in terms of domestic market issuance in Asia, followed by Indonesia. Bahrain and Gambia both have more than 200 issues over the years since their first issuances in early 2000. The non-OIC sukuk issuers include Singapore, United States, United Kingdom, China, Hong Kong, Germany, Japan and France.

A reliance on sovereign issuances and global economic slowdown has taken their toll on the sukuk industry. Sukuk issuances fell 43 percent in 2015 and continued to fall by 18 percent for the first nine months of 2016 globally. The decline is due to several reasons. First, the global economic slow down after the 2008 financial crisis. Second, the sharp fall in global commodity prices. Third, the policy change by Malaysia whereby the central bank suspended sales of short-term ringgit denominated sukuk due to the depreciating ringgit. Fourth, the posibility of interest rate hikes in the United States (Nikkei Asian Review, 2016). However, the sukuk market is expected to continue to record issuances of more than USD100 billion and to expand into a wider variety of countries and sectors.

The development of the sukuk market can be represented by four main phases. The first phase accounted for small local issuances by the Malaysian Government from 1996 to 2001.The second phase, from 2002 to 2007, started with the Malaysian Government issuing the first rated international sukuk, followed by other local and international issuances. The third phase, from2008 to 2010, was marked by a series of defaulted events, global financial crisis, and shariah-compliant issues raised by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI). The fourth phase, from 2011 to date, sukuk remain competitive due to a wider range of investors (Thomson Reuters Zawya, 2013). The next challenge is for the industry to gain greater market share.a) What is Sukuk? Sukuk 1

The Securities Commission Malaysia (SC) defines sukuk as 'a financial document or certificate which represents the value of an asset evidencing an undivided pro rata ownership of an underlying asset'. Sukuk must comply with shariah law, which must be free from interest (riba), excessive risks (gharar) or investments that promote Islamic vices or are discouraged by shariah (such as alcohol and gambling). Sukuk financing activities are mostly for the infrastructure and utilities, financial services, property and real estate, oil and gas and energy. Like (plural of sakk) is the Arabic term for Islamic securities, which in economic terms is akin to conventional bonds. The literal meaning of sukuk is certificates. Technically, sukuk refer to securities, notes, papers or investment certificates with features of liquidity and tradability. Sukuk have both bond and stock-like features issued to finance trade or the production of tangible assets. Unlike conventional bonds, sukuk need to have an underlying tangible asset transaction either in ownership or in a master lease agreement. It represents ownership of underlying assets, usufructs (benefits), services, or investment. The money that a sukuk holder gets represents a share in the profit of the underlying asset.

1 sukuk refer to securities, notes, papers or investment certificates with features of liquidity and tradability. conventional bonds, sukuk can be traded, rated by credit agencies and redeemed.

5 b) Origin of Sukuk

There is evidence to suggest that sukuk structures were used within Muslim societies as early as the Middle Ages. The word 'sukuk' can be traced back to classical commercial Islamic literature as the method of paying the salaries of government officers who would later redeem the certificate to buy goods or groceries (Clifford Chance Report, 2009). The contemporary sukuk today is based on the decision of the Islamic Jurisprudence Council dated 6-11 February, 1988, which stated that "any combination of assets (or the usufruct of such assets) can be represented in the form of written financial instruments which can be sold at a market price provided that the composition of the group of assets represented by the sukuk consist of a majority of tangible assets."

The history of modern sukuk started during the late 1980s. In February 1988, the Fiqh Academy of the OIC countries legitimized the concept of sukuk. The first sukuk was issued in 1990 in Malaysia by Shell MDS, valued at RM125 million (USD 33 million) of Bai'-Bithaman Ajil type. Therefore the sukuk market has been around for only about two decades. However, the industry has gone through the default, bankcruptcies and restructuring life-cycle. It has taken 400 years for the conventional bond market to get where it is today. A more recent development saw a larger number of non-Muslim entities joining the market due to increasing preferences for ethical financial solutions especially in Europe. In additon, sukuk appear to fit in well with Basel III principles. Financial institutions regulated by Basel III are required to invest in specified high quality liquid assets (HQLA) offixed income instruments.

6 c) Sukuk, Shares and Bonds

Bonds and shares are two basic capital market instruments. Bonds represent debt capital while shares represent equity capital. With its fixed interest return and principal guaranteed, a bond is classified as a fixed income security. Since bonds are loans, their returns are predetermined and have no relation to the actual performance of the firm. In contrast, shareholders, as owners of a firm, will earn a return based on the performance of a firm.

Unlike interest which is set exante (expected), dividends are determined ex-post (historical) and are not typically guaranteed.

7 d) Selected Sukuk Structures

Various sukuk structures and contracts based on shariah principles are available namely ijarah, salam, istisna', musharakah, mudarabah and wakalah. Ijarah and musharakah structures are the most popular sukuk structures. There are also innovative various forms, concepts and hybrids of sukuk, such as exchangeable and convertible and foreign currency sukuk. These types Islamic Finance and Banking in Malaysia with Special Reference to Sukuk Industry of sukuk can be further categorized into sale based, lease-based and equity or agency based namely: salebased sukuk (bay bithamin-ajil, murabahah, salam and istisna), lease-based sukuk (ijarah), equity-based sukuk (musharakah and mudarabah) and agency-based sukuk (wakalah). The common sukuk structure and their salient features are listed in Table 2.

8 e) Development of Sukuk Industry

Islamic capital market consists of debt market and equity market. Sukuk, or Islamic bond, are the most active Islamic debt market financial instrument to date. The development of sukuk market was initiated in 1990 since the first sukuk issued by Shell MDS Pvt. Ltd., a multinational corporation operating in Malaysia. Subsequently, after the 1997 financial crisis, there was growing importance of sukuk financing. The first international sovereign sukuk was issued by the Government of Bahrain in 2001, followed by Indonesia in 2002. Since then, there has been increasing participation in sukuk issuance from both Muslim and non-Muslim countries. Figure 2 shows global sukuk timeline from its first inception in 1990 until September 2012.

The figure highlights some important landmarks in the development of the industry which are detailed out in Table 3. The World Bank issued its first sukuk from Malaysia in 2006. Germany was the first country to issue sukuk in Europe in 2004. It was a ?100 million quasi government sukuk ijarah issued in the federal state of Saxony-Anhalt in Germany. In November 2012, FWU, a Munich based financial group, announced the first and the largest corporate issuance in Europe worth ?55 million sukuk ijarah. The underlying assets are a proprietary computer software system and assoc?ated property rights developed in-house by the FWU Group. It marks the first sukuk to have intellectual property as underlying assets.

The global Islamic finance industry has grown from about USD10 billion worth of invested assets in 1975 to USD2.2 trillion today. By the end of 2010, 5.5 percent of the USD2.2 trillion invested in Islamic instruments was held in dedicated Islamic funds, with 31.1 percent in broader-based assets (mainly in shariahcompliant bank accounts and money-market vehicles). The rest was held in other Islamic instruments, particularly sukuk, insurance packages (takaful) and equity products. Real growth in the sukuk market started in 2003 when the Accounting and Auditing Organization for Islamic Institutions (AAOIFI) issued a standard on investment sukuk and listed 14 different types of sukuk.

Research suggests that there will be a need for trillions of dollars of Islamic assets (sukuk and other instruments) in the near future to fulfill the liquidity surpluses of this growing market. The 2008 global financial crisis has contributed to the second wave of rising sovereign sukuk issuers. In early 2013, the sovereign issuers contributed more than half in terms of the percentage in value contribution to the industry. However, in terms of number of issues, the corporate sector dominates.

For the domestic market, the isuance is also sovereign-lead. This would insulate domestic investors from curency risk exposure and help develop bench mark curve to facilitate growth of the domestic market. It is exected that more countries will issue sukuk in their home currency to meet domestic funding needs. In another recent development for the sukuk mutual funds market, a number of banks are setting up their own sukuk funds to offer to their private clients. This would help diversify the investment portfolio of sukuk investors. The trend in global sukuk issuances during 2006 to 2016 is illustrated in Figure **??**.

The growth was affected by the 2007, financial crisis since there was a noticeable drop of the growth rates in the global market. To date, Malaysia and the United Arab Emirates (UAE) are still the two leading countries in terms of sukuk issuances. Due to the flight to safe heavens of fixed income investments after the 2007 crisis, sovereign and quasi-sovereign types of sukuk issuances dominated the market. Sukuk are mostly issued either in Malaysian ringgit or United States dollar (USD). The USD continues to be the preferred international currency for issuance.

It is expected that with the rising importance of Bahrain and the Dubai International Financial Exchange (DIFX), there would be more issuances in riyals and Kuwaiti dinars (SC, 2010). For the period 2004 to 2006, the international sukuk market was bigger than the domestic sukuk market. However, the trend was reversed in 2007when domestic sukuk market was bigger. The IIFM (2010) refers to the situation as the "currency effect," in which as a consequence of the financial crisis in 2007, that originated in the United States, there has been a shift away from dollardenominated issues towards local currency-based issues arising from the Gulf Cooperation Council (GCC), Indonesia and Pakistan.

The Asia and Far East region,the Gulf Cooperation Coucil (GCC) and the Middle East continue to dominate the issuance based on both the number of issues and the percentages of total value. The more advanced economies that have issued sukuk, besides the traditional Muslim economies are Turkey, United States, United Kingdom, Germany and France. The local currency domestic market is expected to develop further, spurred by Indonesia, Turkey, Pakistan and the GCC countries. Sovereign or sovereign-linked entities continue to dominate issuances domestically and this would assist in the setting up of local benchmark curves.

Table 4 depicts the top sukuk markets in 2016 and their global market share. Malaysia is still leading with 46.4 percent, followed by the GCC countries with At the international level, sukuk ijarah, sukuk almusharakah, Islamic exchangeable sukuk and sukuk almudarabah are the top four sukuk structures issued in 2001 to 2010. The more recent years show a slightly changing composition where the top four issuances, from highest to lowest, are sukuk ijarah, wakalah, hybrid and musharakah. There was no sukuk hybrid issued domestically. In addition, Islamic exchangeable sukuk, al-mudharabah and al-salamwere not issued in recent years.

9 g) Sukuk Issuance by Issuer Status

The same analysis is conducted to examine the issuer status of sukuk issuances from 2001 to early 2013. The issuers are categorised into either corporate, sovereign or quasi-sovereign. Before 2011, corporate and sovereign issuers are almost at par in terms of percentages. By 2011, due to the 2008 financial crisis and the consequent flight of investors to save havens, the number of sovereign and quasi-sovereign sukuk issuers increases due to lack of confidence and stability. Looking at the situation from the international perspective, prior to 2011, the corporate sector is very active with 68 percent of total issuances. However, by 2011, there is an almost similar number of issuances by the corporate sector (45 percent) and the sovereign sector (41 percent). The issuance by the quasisovereign sector remains at the same level over the years at 14 percent. Another noticeable trend indicates that financial institutions are no longer the majority investors in sukuk as fund managers, takaful operators, high net worth individuals (HNWIs) and others are now investing in sukuk.

10 h) Sukuk Issuance by Sector

Table 5 shows the global aggregate sukuk issued by sector for the period 1996 until 2012. Sectorwise, the industry was dominated by the governmental and financial services sectors, followed by transport, power and utilities, real estate, telecommunications and other category. The construction sector has a good potential to be developed. Global demand for investment in infrastructure is growing as existing infrastructure needs to cope with growing population and urbanization rates. The Organization for Economic Cooperation and Development (OECD) estimates that globally USD71 trillion is needed for investment in infrastructure by 2030 (Mardam-Bey et al., 2013).

11 V. The Sukuk Market in Malaysia

In Malaysia, as at December 2009, 57 percent of outstanding corporate bonds in the Malaysian bond market weresshariah-compliant (SC, 2009). From a macroeconomic perspective, the overall share of sukuk in GDP increased each year since 2000 until 2009. In 2009, the percentage share of domestic sukuk to GDP was 6.2 percent, corporate sukuk represented 0.73 percent of GDP and sovereign sukuk represented 5.47 percent of GDP in 2009 (IFIS and BNM). During earlier years, Malaysia dominated the sukuk market in terms of both number and volume (IFIS Report, 2010).

Table 6 shows the total issue and GDP share by sukuk category for the period 2000-2009 in Malaysia. The amount of corporate issues in the primary market has surpassed the sovereign sukuk in terms of absolute value and relative measure (percentage of GDP) for the first eight years. In the next two years, sovereign sukuk had the larger share in GDP.

As indicated in Table 7, there were 323 sukuk issuers for the period between 2001 and 2009 of which 92 firms were listed on the Main Board, Second Board, MESDAQ or ACE market of Bursa Malaysia and the rest were financial and non-financial firms. Three major industries dominate the corporate sukuk market of Malaysia. Financial firms, including banks, accounted for the biggest share of 28 percent. Companies involved in transportation, logistics, and telecommunications industries came second with 26 percent. The energy and utility companies (electricity, oil, gas, and water) constituted an aggregate share of 20 percent.

By domicile, Malaysia's secondary sukuk market stood at USD183.8 billion, representing a share of 52.6 percent of total sukuk outstanding. This was followed by Saudi Arabia and the UAE with a market share of 16.3 percent and 8.9 percent, respectively. Figure 5 shows global sukuk outstanding in Malaysia against other sukuk issuing countries.

The Securities Commission Malaysia (SC) estimates the size of Malaysia's capital market (comprising stock market capitalization and debt securities) to more than double from RM2 trillion in 2010 to RM4.5 trillion by 2020.Based on regional grouping, it is estimated that the internationalization of the stock market can increase the potential size of the Malaysian capital market by another 30 percent to RM5.8 trillion in 2020. In order to achieve the target, the facilitation of volume strategies and higher efficiency of increased economies of scale are required (Asian Development Bank, 2011).

12 Prospects and Challenges in Islamic Finance

There are challenges ahead facing Islamic banking and finance globally. The market watchers cited two possible reasons. First is the low banking penetration rate and second are costly financial services. Banking penetration is defined as the percentage of adults with an account at a formal financial institution. It remains low within the Organisation of Islamic Cooperation (OIC) member countries and in the world's Muslim population as a whole, with an average of around 32 and 29 percent, compared with the global average of 62 percent.

The Report also suggests that if pricing policy does not differ greatly between conventional and Islamic banking products, Muslims are more likely to opt for shariah-compliant products due to the risk-sharing and the ethical nature of its business model. However, at the moment the pricing of sukuk instruments are considered higher due to the shariah-compliant requirements. Costs of issuing Islamic bonds in Asia are still significantly higher than the costs of issuing conventional bonds.

To turn challenges into opportunities, the Alliance DBS Research believes that the growing Muslim population and anin-depth study of financial behavior among Muslims are factors that would drive growth. According to them, Islamic economies represented about 9.5 percent of the global gross domestic product (GDP) in 2014.Approximately one-sixth of the world's population is Muslim, most of whom are based in the Middle East and Asia. Hence, a careful study on the financial behavior of the users of financial services, based on different geographical regions and demographic groups are needed. A reliance on the supply side alone, according to Say's Law, will not be a sustainable approach in the long run for the industry.

Sukuk are structured to generate the same economic effects as conventional bonds, but in a shariah-compliant manner. This is achieved through using assets and various contractual techniques acceptable under shariah. The industry could benefit from economies of scale which would help to sustain it over the longer-term. Pricing policies and awareness are two important factors to capture the non-Muslim market share. It is reported that about 80 percent of the sukuk issued have been subscribed by conventional international investors (Aziz, 2007). Issuance of Islamic debt by non-Muslim countries is increasing recently due to the perception of less volatile market conditions and an improving regulatory backdrop (The Express Tribune, 2017).This trend could be exported world-wide in order to capture a bigger global market share.

Additionally, the industry lacks consistency in product structures and investment practices that might adversely affect its credibility and reputation. The industry players need to study market behavior and focus on risk-return characteristics of the products rather than concentrating on the shariah-compliant aspect only. Harmonisation of standards across different geographical locations and different schools of thought reduce uncertainty due to shariah concerns.

There is also an accusation that Islamic banking is operating in a similar fashion as its convential counterpart, i.e profit oriented rather than serving the real needs ofthe society. Professor Khaliq Ahmad raises two questions pertaining to the profit-maximising behavior. First, form over substance. Second, are the maqasid shariah requirements (objectives of the shariah). As for the former, based on legal perspectives, Islamic banking and financial products are unique and distinct but, operationally, the practice is similar to conventional banking in terms of pricing, adopting interest-based benchmarks, the treatment of late payments and so on.

As for the maqasid shariah 2 2 Maqasid al-shariah should be the overriding objective to any economic decision-making.

, profit maximisation should not be the sole objective of financial institutions. But a genuine concern for society should involve risksharing contracts based on profit and loss sharing equity financing. However, Islamic banks are more interested in debt-based products and services such as murabahah and tawarruq while the equity-based financing such as mudharabah and musharakah are least popular. Professor Khaliq Ahmad ended with a sugggestion to ensure sustainable development by adopting Islamic financing as a tool. Maqasid al-shariah should be the overriding objective to any economic decision-making.

Islamic banks should work on maximising profit in a welfare-enhancing manner. This could be achieved through risk-sharing and wealth redistribution policies embedded in Islamic financing contracts. One alternative is to adoptan asset-light business model. For example, the latest issuance of sovereign sukuk by the Malaysian government in 2016 was not backed by any tangible assets. The sukuk was backed by equity and transportation vouchers instead.

There is also argument that sukuk industry has failed to secure greater market sharepost-2008 financial crisis .Could it be that the market players are unable to either identify or address the key challenges to the industry? The State of the Global Islamic Economy Report, 2016/17 (Thomson Reuters, 2017) summarises the key challenges as follows:

1. Lack of awareness and understanding of Islamic finance products and services among the public; 2. Few shariah-compliant monetary policy instruments; 3. Complex financial products and corporate structures in some countries; 4. Underdeveloped safety nets and resolution 5. Regulators who do not have the capacity or unwilling to ensure shariah compliance.

13 VII. Sukuk and The Way Forward

In order to ensure sustainable growth, the sukuk industry has to consider several issues. Among them are greater transparency, standardization, shariahcompliant risk and risk associated with the structure of sukuk. Efforts are being made to resolve the issues as evident in recent development of the sukuk industry, for example cross-border sukuk issuance and hybrid sukuk. Thomson Reuters in their Sukuk Perceptions and Forecast Study 2013 suggests that the sukuk industry might learn from the Eurobond market that took off in just two decades after it was launched, supported by changes in the macroeconomic environment and the use of cross-currency swaps. The report details out reasons for and against sukuk to become the next Eurobond. Among factors that would hinder growth are weak trading infrastructure, inability to standardize and shariah-compliant requirements. However, Basel III requirements and global appeal for shariah-compliant instruments would support the industry. There is also good prospect due to populous and diverse markets like Indonesia, Egypt and Pakistan. In addition, the shariah-compliance process adds to additional disclosure and greater transparency requirements.

One of the ways to ensure the success of recent efforts to get economies out of their fiscal imbalances would be introducing sukuk to manage the infrastructure needs of these economies. In addition to that, with the growing awareness of the green technology and climate preserving growth, sukuk provides another innovative solution for large-scale infrastructure requirements. As the global economy is transitioning towards a more sustainable energy use, the Islamic finance industry has the potential to contribute to climate resilient economies. Sukuk could mobilize essential finance needed to fund the rising number of clean energy initiatives since the majority of clean energy projects will rely on large, long-term infrastructure spending. For instance, bank financing for long-term infrastructure projects is becoming less attractive under the Basel III rules, shifting the financing of infrastructure to capital markets, which used to tap resources from long-term institutional investors such as pension funds and insurance companies. Since these projects are based on tangible assets to generate revenues, which are consistent with the Islamic finance norm of creating economic value, they are therefore suitable for sukuk financing.

The new Basel III Accord has highlighted two long-standing concerns about Islamic banking. First, Islamic banks have ample liquidity but lack of highquality Shariah-compliant instruments. Second, Islamic banking lacked secondary interbank markets to trade these instruments. Market watchers believe that an alternative solution is to popularize the sukuk market. Sovereign and quasi-sovereign sukuk would help mopup the excess liquidity problems of Islamic banks. Some suggest that for sukuk to reach a similar stage of the conventional bond cycle, standardized regulation is needed, and both value and volume of issuances should be increased. Sukuk should contribute to the real economy by promoting development, financing diversification and mitigating financial decline.

14 VIII. Conclusion

Sukuk has become the bellwhether of the Islamic finance industry. The biggest challenge for the industry, according to some, is in managing shariah non-compliance risk and the realisation of maqasid shariah in all sukuk transactions. Therefore, understanding sukuk market behavior is critical to the sustainability of the future growth of the industry. This will further facilitate faster sukuk issuances and monitoring of the secondary market and help the industry achieve the desired equitable economic development.

A survey of lead arrangers (sell-side) and investors (buy side) by Thomson Reuters Sukuk Survey conducted during August-September 2012 gives an insight into the current state of the industry. The responses from both the sell-side and buy-side are similar with respect to country of issuance, types of issuers, credit quality, types of issuance, currency and the emerging market for the issuance.

However, expectations differ with respect to risk classification, coupon types, tenor and sukuk structure. Notable From Jan. 2001 -Dec. 2015, international sukuk issuance breakdown based on percentage of value (USD mil) is as folllows: UAE -36.16%; Malaysia -20.27%; Saudi Arabia -15.60%; Qatar -6.51%; Indonesia -5.38%; Turkey -3.84%; and Pakistan -1.08%. The breakdown for domestic sukuk issuances with the same references as above are: Malaysia -78.68%; Saudi Arabia -5.86%; Indonesia -3.30%; Qatar -2.21%; the UAE -1.33%; Pakistan -1.29%; Turkey -0.88%; and Bangladesh -0.01% Sukuk issuances by issuer-type: Sovereign -53%; Corporate -19.3%; Supra-national -15.2%; Government-related entities -12.5% [1] [2]

[1]Year 2019 © 2019 Global Journals Islamic Finance and Banking in Malaysia with Special Reference to Sukuk Industry

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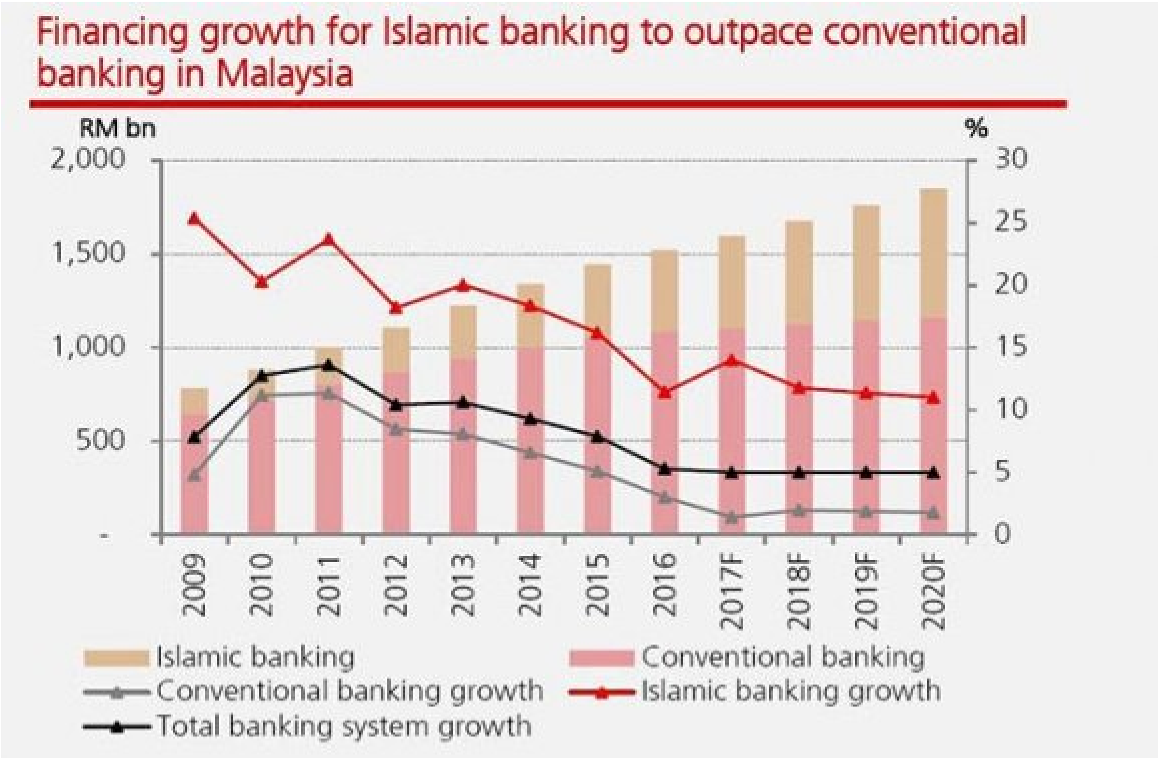


Figure 1:

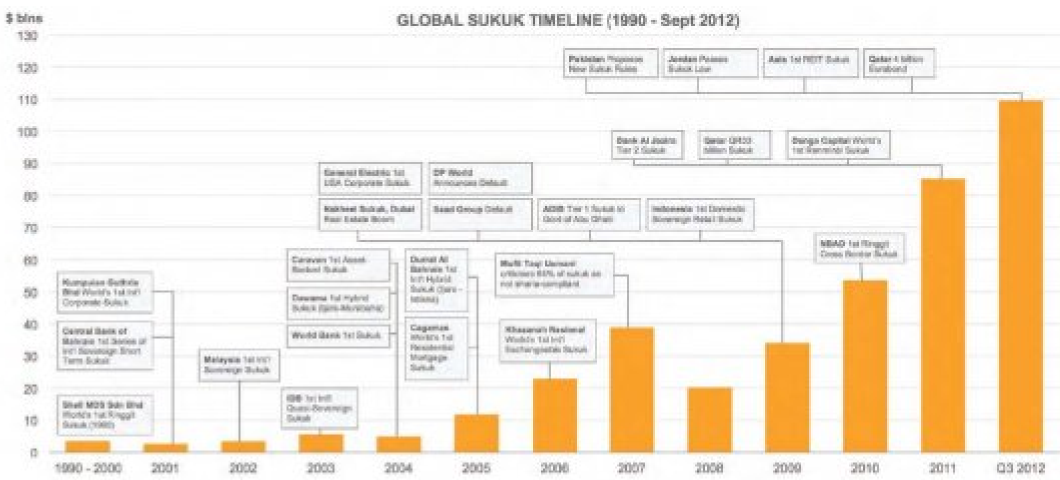


Figure 2:

1

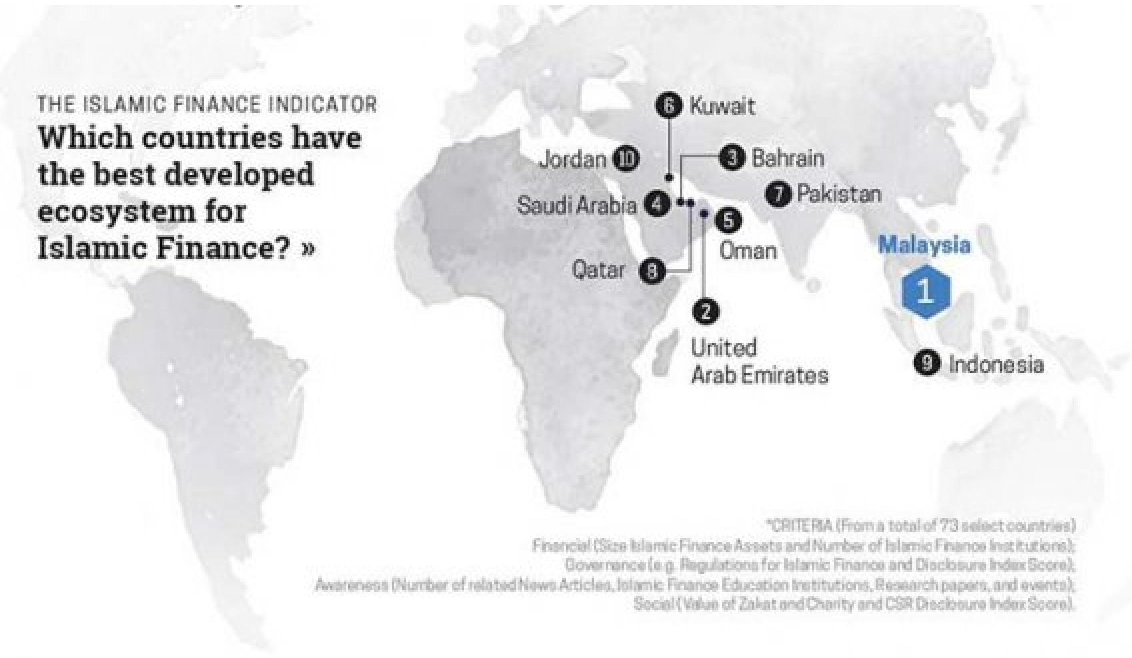


Figure 3: Figure 1 :

2

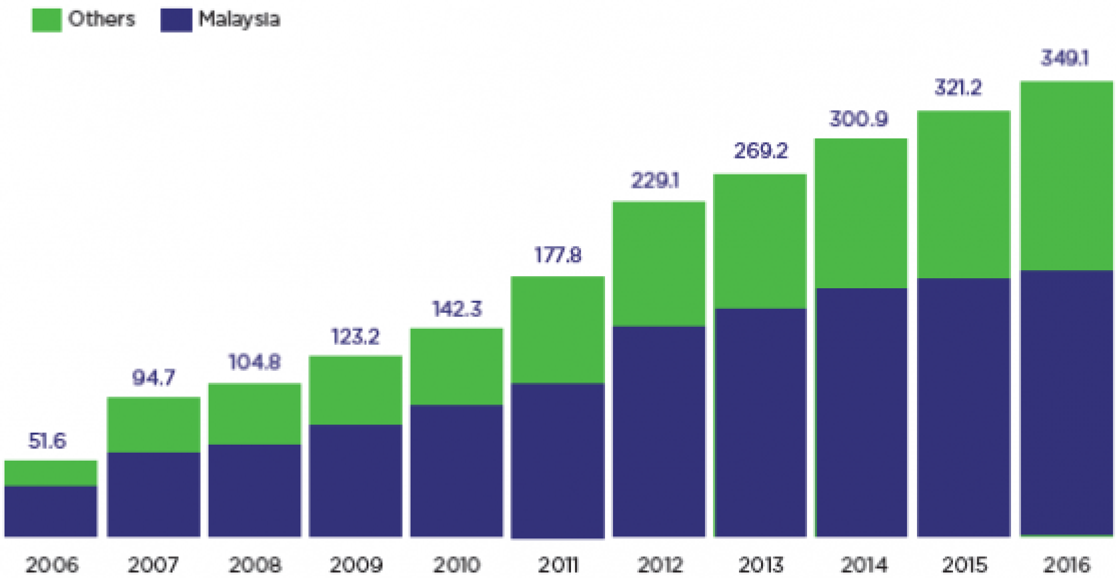
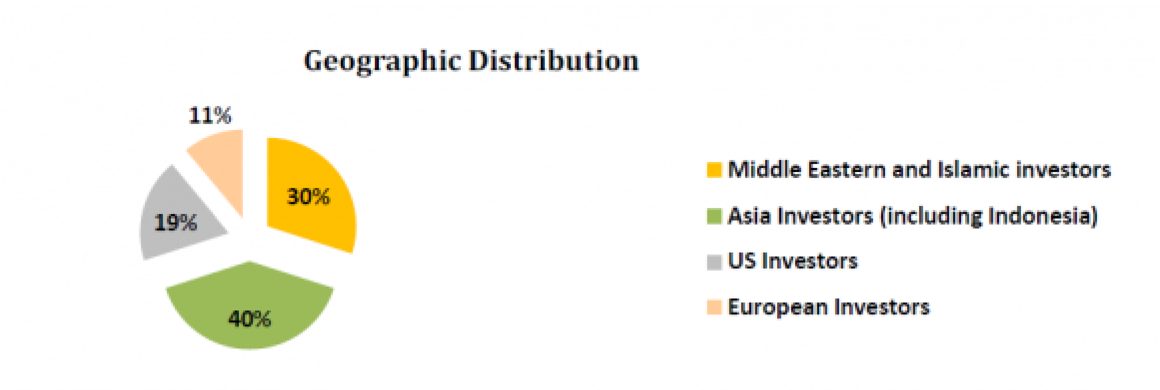


Figure 4: Figure 2 :



43

Figure 5: Figure 4 :Figure 3 :

2

Sukuk structure	Explanation	Sukuk-Holders	Return	Contractual recovery of principal expected
Murabahah (debt-based) Salam (debt-based) Istisna' (debt-based) Ijarah (asset-based) Musharakah (equity-based) Mudharabah (equity-based)	Sukuk holders (via a trustee) sell asset to obligor on a deferred basis Sukuk holders buy fungible assets (commodity) on a forward basis Sukuk holders construct/manufacture asset and sell it to obligor Sukuk-holders lease asset to obligor Sukuk holders and obligor are both capital providers and thus partners in venture Sukuk holders are capital providers to obligor in a business venture	Owners of debt (sales receivable) Owners of commodity to be delivered in future (debt of kind) Owners of debt (receivable via sale of asset under construction) Owners of leased asset Owners of underlying asset of venture Owners of underlying asset of venture	Profit from sale of asset Profit earned when commodity sold to third party upon delivery Profit from sale Rental of asset Income generated from asset/venture Income generated from asset/venture	Yes Yes Yes By control of the asset No No
Wakalah (agency-based)	Sukuk holders are principals/grantors; obligor is investment agent	Owners of investment undertaken by agent	Income generated from investment	No

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[Note: Source: Securities Commission Malaysia, 2010: 23, AAOIFI. Source:Ernst & Young, 2013]

Figure 6: Table 2 :

3

Year	Issuer	Highlight/ Feature	Amount (million)
1990	Shell MDS (BBA)	World's first ringgit sukuk issued by a foreign-owned, non-Islamic company	RM125 (USD33)
2001	Kumpulan Guthrie (Ijarah)	World's first global corporate sukuk	USD150
2002	Government of Malaysia (Ijarah)	World's first global sovereign sukuk	USD600
2003	International Finance Corporation	First ringgit sukuk issued by a supranational agency	RM500 (USD132)
2004	Cagamas MBS	World's first Islamic residential mortgage-backed securities	RM2,050 (USD540)
2005	PLUS	Complex and innovative structure, conversion of PLUS' existing debts into Islamic financing	RM9,170 (USD2860)
2006	Khazanah Nasional (Rafflesia Capital)	World's first exchangeable sukuk	USD750
2007	AEON Credit Services	First sukuk issued by Japanese-owned company	RM400 (USD125)
2007	Nucleus Avenue (Malakoff Corp)	World's first hybrid sukuk	(USD2,500)
2007	Khazanah Nasional (Cherating Capital)	Largest equity-linked sukuk issue and highest oversubscription rate	USD850
2007	Maybank	First international subordinated sukuk	USD300
2007	Binariang GSM	World's largest sukuk issue (at the time of issuance)	RM15,350 (USD4,800)
2010	Government of Malaysia	World's largest global sovereign sukuk	USD1,250
2010	Islamic Development Bank	First Emas Sukuk by a multilateral development institution.	USD500
2010	Khazanah Nasional	The largest and longest termed Singapore dollar-denominated 'Emas' Sukuk	SGD1.5 bil (RM3.6 bil)
2011	KhazanahNasional	World's first China renminbi-denominated 'Emas' Sukuk, World's First Offshore RMB Sukuk	RMB500 (RM246)
2012	PLUS	World's single largest Sukuk issuance	RM30.6 bil
2012	Khazanah Nasional	Exchangeable Sukuk that was first to be priced at negative yield and first Malaysian equity-linked deal since 2010	USD357.8

[Note: Source: RAM (2010), BNM & Securities Commission Malaysia (2012).]

Figure 7: Table 3 :

4

Jurisdiction	Malaysia	GCC Countries	Indonesia	Turkey
Issued amount & Global market share (%)	USD$34.7 bil 46.4%	USD$19.6 bil 26.2%	USD$7.4 bil 9.9%	USD$4.1 bil 5.5%
Top Sectors	1. Financial Services 2. Government 3. Power and utilities 4. Transportation	1. Financial Services 2. Government 3. Oil and Gas	1. Government 2. Financial Services Manufacturing 3. Industrial &	1. Financial Services 2. Government

[Note: Source: Thomson Reuters, MIFC estimates. Source: State of the Global Islamic Economy 2016/2017 Report.]

Figure 8: Table 4 :

5

Sector	No. of Issues	Amount Issued (USD millions)	Market Share (%)
Governmental Institutions	1,027	215,378	54.27
Financial Services	289	49,420	12.45
Transport	254	34,811	8.77
Power and Utilities	241	27,276	6.87
Real Estate	151	23,891	6.02
Construction	375	13,568	3.42
Oil and Gas	102	11,762	2.96
Telecommunications	66	6,437	1.62
Services	24	3,766	0.95
Conglomerate	12	2,628	0.66
Agriculture	78	2,168	0.55
Industrial Manufacturing	61	1,637	0.41
Leisure and Tourism	5	1,384	0.35
Consumer Goods	39	807	0.20
Food and Beverages	24	791	0.20
Health Care	19	468	0.12
Mining and Metals	10	460	0.12
Retail	9	101	0.03
Education	2	56	0.01
Information Technology (IT)	6	28	0.01
Grand Total	2,794	396,837	100

[Note: Source: ThomsonReuters, 2012.]

Figure 9: Table 5 :

6

Year	Domestic Total (RM Million)	Domestic Share to GDP (%)	Corporate Sukuk 1 Total (RM Million)	Corporate Sukuk 1 Share to GDP (%)	Sovereign Sukuk 2 Total (RM Million)	Sovereign Sukuk 2 Share to GDP (%)
2000	9,666	2.71	7,666	2.15	2,000	0.56
2001	15,306	4.27	13,501	3.77	1,805	0.50
2002	16,567	4.39	13,829	3.66	2,738	0.73
2003	9,872	2.47	8,143	2.04	1,729	0.43
2004	12,527	2.94	9,104	2.13	3,423	0.80
2005	13,537	3.01	9,537	2.12	4,000	0.89
2006	14,281	3.00	4,781	1.01	9,500	2.00
2007	22,127	4.37	12,127	2.40	10,000	1.97
2008	23,968	4.52	7,468	1.41	16,500	3.11
2009	32,285	6.20	3,785	0.73	28,500	5.47

[Note: Source: IFIS and BNM.]

Figure 10: Table 6 :

7

Year	Amount (RM million)	All	Listed Firms	Financial Firms	Non-Financial Firms
2001	18,922.1	31	5	0	31
2002	17,639.96	27	8	1	26
2003	12,048	26	6	0	26
2004	15,361.3	45	13	2	43
2005	43,317	60	22	4	56
2006	39,954	46	17	5	41
2007	121,002.24	41	14	3	38
2008	43,234	37	5	3	34
2009	38,955	10	2	1	9
Total	RM350,433.6	323	92	19	304

[Note: Source: Securities Commission Malaysia (SC).Source: Thomson Reuters, MIFC estimates (2016).]

Figure 11: Table 7 :

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