

## Understanding Islamic Finance

The last decade has seen impressive growth in Islamic Finance, the financial system compliant with the principles of Shariah – Islamic law. Through the current global financial crisis, Islamic finance remains resilient as Shariah principles link financial and productive flows, avoiding the excessive leveraging and the lack of underlying assets that have contributed to the current economic downturn.

management products. Malaysia, a well-established and sophisticated Islamic finance hub, is a world leader. From the establishment of the first Islamic bank in 1983, Malaysia has seen the emergence of a vibrant Islamic financial market and the availability of a full range of Islamic financial products and services.

The major factor contributing to the growth of the Islamic financial and capital markets in Malaysia is government commitment, says Zainal Izlan Zainal Abidin, CEO of IYCAP, a Malaysian asset-management institution. "These efforts are reflected in the range of incentives and benefits offered. In addition, the infrastructure and regula-

Islamic finance is one of the fastest growing sector in the global financial system, expanding at an annual rate of 15-20% and spanning more than 75 countries with over 300 Islamic financial institutions. There is rising demand for Shariah-compliant investments worldwide from both Muslim and non-Muslim investors and there are an estimated 1.6 billion Muslims worldwide with Islamic assets set to hit US\$1.4 trillion by 2010. Soon, the Islamic financial system will be managing approximately 4% of the world economy. Under the risk-sharing arrangement, the Islamic financial institution shares the profit or loss incurred by the entrepreneur, and this intrinsic principle of profit and risk-sharing provides in-built checks and balances to Islamic financial transactions. Explicit in this arrangement is risk management and good governance. Islamic financial business encompasses both Shariah-based products, and Shariah-compliant products which include private equity, project finance, sukuk (Islamic bonds), as well as fund, asset and wealth

tions supporting the Islamic financial and capital markets in Malaysia are well developed, with work for further enhancement being done on an on-going basis. Islamic finance in Malaysia has evolved into a competitive component of the overall financial system creating a comprehensive and conducive marketplace for both Islamic and conventional financial activities. The main components of the Malaysian Islamic financial system - Islamic banking, the *taqafu* (Islamic insurance) and the Islamic

scholars to promote the convergence of views from different Shariah jurisdictions in the global Islamic financial system. "Malaysia's robust regulatory, accounting

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institutions include new licenses for conducting foreign currency businesses, attractive tax incentives and facilitative immigration policies. Malaysia's unique dual financial environment, and its energetic adoption of excellent tax and living incentives, research into development of Islamic finance as an innovative economic system for the future, showcase the country's expertise. Malaysia's experience makes it the ideal base for those interested in Islamic finance, from foreign firms looking to invest in new markets to the cream of the world's financial talents.

and tax framework and the coherent efforts of all regulators in Malaysia will help to support international financial institutions using Malaysia as their international regional Islamic hub in the development of Islamic finance and investments", says Angella Chin-Sharpe, Country Head for BNP Paribas Investment Partners Malaysia and Head of Islamic Business Development Asia. "The presence of a vibrant Islamic financial landscape comprising Islamic banks, Islamic investment banks, *taqafu* and *retakaful* companies offers an attractive platform for BNP Paribas Investment Partners".

In 2006, Malaysia launched the Malaysia International Islamic Financial Centre (MIFC) to offer its value propositions in Islamic finance to the world. Under the MIFC initiative, financial institutions are welcome to use Malaysia as a platform for Islamic financial activities. "It was the strong will of the Malaysian government to become a global hub for Islamic finance that has prompted the group to set up its office for

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talent to not only make conventional products Shariah-compliant, but also innovate Shariah-based products. Dr Zeti Akhtar Aziz, Governor of Bank Negara Malaysia explains: "Human intellectual capital has become the defining factor in sustaining the performance and competitiveness of the Islamic financial industry". The International Centre for Education in Islamic Finance (INCEIF) was established in 2006 to develop Islamic finance professionals in order to address the human capital needs of this rapidly growing industry. The university with students from more than 66 countries, is focused on programmes for Islamic finance professionals and specialists. Forty Memorandum of Understanding (MOU) have been established to share resources and conduct joint research with participating universities including the universities of Indonesia, Bahrain and Abu Dhabi. At the UK's Reading University, part of INCEIF's Chartered Islamic Finance Professional (CIFP) curriculum is incorporated into the latter's MSc Investment

Banking and Islamic Finance programme. INCEIF has also entered into arrangements with institutions like the Jeddah-based Islamic Development Bank, The Central Bank of Syria and the National Institute of Banking and Finance, the training arm of the State Bank of Pakistan.



To promote thought leadership and research in Islamic finance, the International Shariah Research Academy (ISRA) was established in 2008 to conduct applied Shariah research on the contemporary Islamic finance issues. ISRA also provides a platform that promotes active engagement and dialogue among global Shariah

capital and money markets - operate in parallel with the conventional financial system. These are supported by the supervisory, the legal and the Shariah framework, the payment and settlement systems, and the mechanism for liquidity operations by Bank Negara Malaysia, Malaysia's central bank.

Malaysia's on-going research in Shariah interpretation makes it possible for the development and innovation of new products, another important growth area in Islamic finance. Assets of the Islamic banking system comprise 17.2% of the market, while the *taqafu* sector has 7.6% market share. Bank Negara Malaysia plans to raise the proportion of total banking assets under Islamic institutions to 20% by 2010. Islamic private securities represented 55.9% of total outstanding private securities and the number of Shariah-based unit trust funds has also increased to 149 with a net asset value of US\$5 billion while 85% of the listed Malaysian stocks are Shariah-approved counters.

Such market growth needs a supply of