“GROWTH & INNOVATION IN ISLAMIC FINANCE”

Dato’ Sri Zukri Samat
Managing Director, Bank Islam Malaysia Berhad
TRANSFORMATION OF THE ISLAMIC FINANCIAL LANDSCAPE
...rapid expansion is reflected in more than 600 Islamic financial institutions operating in more than 75 countries, even beyond so-called Muslim nations. Total assets > USD1trillion
Instituting Foundation

- Merely as an alternative to conventional banking

Institutional Building, Activity Generation & Market Vibrancy

- 1993-2005 (Deepening, Creating Critical Mass & Liberalization)
- Ensuring greater access to Islamic finance

Strategic Positioning & International Integration with Global Financial System

- 2006 onwards
- Becoming an international hub of Islamic finance

... a step-by-step approach. 1st Phase - Discovery & Familiarization; 2nd Phase - Mainstream Acceptance; 3rd Phase - Integration & International linkages.
## Transformation of the Islamic Financial Landscape

### Islamic Banking Modality

#### Standalone Full-Fledged Islamic Banks
- Independent financial institutions
- Independent infrastructure (IT, Risk Management, Human Talent, etc)
- High cost-to-income ratio
- Offer full range of Islamic compliant products & services
- Retail banking, Wealth/Asset Mgmt/Corporate Banking, Advisory & Capital Markets
- Bank Islam Malaysia Bhd, Bank Muamalat Bhd, Al Rahji, Al-Baraka Banking Group, Kuwait Finance House, PT Bank Syariah Muamalat, etc

#### Islamic Windows
- Specialized set-ups within conventional banks
- Different balance sheet but common operations/infrastructure
- Dominated by global players with limited presents in the country that they are operating
- Similar offerings to standalone Islamic banks
- Generally targeted at affluent market segments and institutional investors
- Private banking, structured deposits, and corporate banking
- Citibank Islamic, Bank Simpanan Nasional, PT Bank Rakyat Indonesia etc

#### Subsidiaries of Conventional Banks
- Subsidiaries of domestic conventional banks
- Dedicated governance structure
- Shared infrastructure (branch networks, IT, Risk Management, etc)
- Transfer Pricing - cost
- Minimal staffing
- Low cost-to-income ratio and high productivity index.
- Similar offerings to standalone Islamic banks
- Retail banking, Corporate Banking, and Capital Market.
- Offered Wealth/Asset Mgmt/Advisory via sister company, another subsidiary of conventional bank.
- Maybank Islamic, CIMB etc

#### Specialized Institutions
- Takaful & Re-Takaful Players i.e. Syarikat Takaful Malaysia Bhd
- Islamic Mortgage Companies i.e. Ameen Housing Co-operative of USA
- Islamic Investment Fund Management Companies i.e. Aberdeen Islamic Asset Management Sdn Bhd
- Islamic Trustee Companies i.e. Amanah Raya Berhad
- Ar Rahnu or Islamic Pawnbroking – i.e. Ar Rahnu Bank Islam
- Islamic REIT Companies
- Shariah Advisory –i.e. Amanie Advisor Sdn Bhd
TRANSFORMATION OF THE ISLAMIC FINANCIAL LANDSCAPE

- STAND-ALONE VS WINDOW

Benefits of moving from a window-based to stand-alone structure

Increased participation of foreign players (via, e.g. JVs)
- Window structure discourages investment by foreign Islamic banks as conventional bank not Sharia-compliant

Opens up possibility of listing on stock market
- Faster growth prospects than conventional banking

Greater autonomy, more visibility and increased focus
- Stand-alone will have own board, resources, capital
- Window operations restricted because of need to compete for resources with the conventional bank

Increased talent retention
- Career progression may be limited under window structure

Source: Boston Consulting
• Dedicated vs sharing of resources & infrastructure – balancing act between group synergy & autonomy of IS
  • Lack of autonomy: Timely to review structure
  • Same board members of IS and parent banks – does governance being compromised?
  • Diversity of Board composition – comprising board members with Islamic finance knowledge?
  • Sharing of expertise based on conventional mind-set
  • Lack of capacity building initiatives: Invest for long-term benefit (Talent, product developments)
  • IT system - based on conventional product parameters
  • Cross-selling & branding of Islamic products/ entities at parent’s branches - How effective branches are pushing for Islamic products?
  • Visibility of Islamic finance – ‘bricks & mortars’ – Foreign players are more visible
  • Service Level Agreement – cost sharing must reflect cost-benefit
  • Issue of cannibalization?

Source: Bank Negara Malaysia

‘It is envisaged that greater strategic focus & resources as well as higher autonomy & governance will be accorded to the Islamic Banking business’

-Governor, Bank Negara Malaysia, March 2005
TRANSFORMATION OF THE ISLAMIC FINANCIAL LANDSCAPE

- SHARIAH CONTRACT DEVELOPMENT MILESTONES

Simple structure to cater for basic needs

Customer-driven structure/products

Cost effective structure to compete in the competitive marketplace

1983 - 1990

- Wadihah Current a/c
- Wadihah Savings a/c
- Mudharabah Investment a/c
- Mudharabah Financing
- Ijarah Financing
- BBA Financing
- Murabahah LC
- Musharakah LC
- Wakalah LC
- Bai’ Dayn Trade Finance
- Murabahah Working Capital Financing

1991 - 2000

- Sarf Forex
- Mudharabah Interbank Investment
- Musharakah Financing
- Bai Inah Credit Card
- Ar Rahn
- Bai Dayn, Mudharabah, Wadihah ICDO
- Wadihah Debit Card
- Bai Inah Overdraft
- Bai Inah Commercial Credit Card
- Bai Inah Personal Financing
- Bai Inah Negotiable Instrument of Deposit (NID)

2001 - 2005

- Commodity Murabahah Profit Rate Swap
- Commodity Murabahah Forward Rate Agreement
- Ijarah Rental Swaps-I
- BBA Floating Rate
- Murabahah Floating Rate
- Istisna’ Floating Rate
- Mudharabah Capital Protected Structured Investment
- Bai Inah Floating Rate NID
- Mudharahah Savings Multiplier Deposit
- Tawarruq Commodity Undertaking

2006 - 2008

- Tawarruq Business Financing
- Tawarruq Personal Financing
- Murabahah with Novation Agreement
- Istsina’ convertible to Ijarah
- Bai and Ijarah (Sale & Lease Back)
- Musharakah Mutanaqisah
- Istsina’ with Parallel Istsina’
- Wakalah Deposit
- Waqf
- Tawarruq Revolving Credit-I
- etc

Note – This listing is far from being exhaustive. Although they have been developed and/or approved, some products have yet to be rolled out at the time of drafting of this presentation.
TRANSFORMATION OF THE ISLAMIC FINANCIAL LANDSCAPE
- CONDUCIVE REGULATORY FRAMEWORK

- Comprehensive Legislation
- Dispute Resolution
  (Dedicated Shariah Commercial Court, Financial Mediation Bureau & Arbitration Centre)
- Tax Neutrality Policy
- Shariah Advisory Council & Shariah Governance Framework
- International Best Practices

... essentials to stimulate product development & innovation
... robust development of these components will enhance sustainability and resilience of the Islamic financial services industry
... growing recognition that the inherent tenets of Islamic finance are aligned to sustainable dimensions of ethical banking and responsible financing.
TRANSFORMATION OF ISLAMIC FINANCIAL LANDSCAPE
- IN A NUTSHELL

... changing financial landscape has accelerated expansion of Islamic finance industry
TRANSFORMATION OF ISLAMIC FINANCIAL LANDSCAPE
- IN A NUTSHELL...cont

... wide spectrum of financial products and services to cater to needs of all customers from small businesses to conglomerates, from common households to high net-worth individuals
TRANSFORMATION OF ISLAMIC FINANCIAL LANDSCAPE
- IN A NUTSHELL...cont

... increased focus on financial stability
(...strengthened prudential standards with a focus on building capital and capital buffers, increased transparency in financial transactions and exposures)

... evolves to become more diversified and more comprehensive to meet the changing requirements of the real economy

... increased pace of international connectivity

... accompanied by development of ancillary support services
“SUSTAINABLE GROWTH PARADIGM FOR ISLAMIC FINANCE”
SUSTAINABLE GROWTH PARADIGM FOR ISLAMIC FINANCE

- MATURITY CURVE

<table>
<thead>
<tr>
<th>Measure or success or profitability</th>
<th>High</th>
<th>Medium</th>
<th>Low</th>
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Emerging
- Large number of new entrants
- Rapid growth in value of the industry
- Increased recognition and awareness

Early Start
- Focus on product design and positioning
- Customer Awareness

Fast Growth
- Stiff Competition
- Focus on market share & innovation

Saturation
- Consolidation
- Demand for greater differentiation

Maturity
- Removal of incentives

Islamic finance probably stands here; best time in terms of business development BUT most damaging when a crisis hits
SUSTAINABLE GROWTH PARADIGM FOR ISLAMIC FINANCE

- KEY INGREDIENTS

- Islamic finance as national agenda
- Attractive tax & non-tax incentives
- Robust & comprehensive regulatory, legal, corporate governance & Shariah framework
- Wide & knowledgeable investor base
- Adequate pool of talents & capabilities
- Continuous product innovation
- Liberal foreign exchange rules

... a defined strategic plan and initiatives under the Financial Sector Master Plan
SUSTAINABLE GROWTH PARADIGM FOR ISLAMIC FINANCE
MALAYSIA - ISLAMIC FINANCIAL SYSTEM AS AT DEC 2010

Assets
✓ 20.8% of total banking system
✓ Total IB asset: RM351 bil (USD116.2 bil)

Financing
✓ Market share – 22.7%
✓ Total financings: RM222.3 bil (USD73.6 bil)

Deposits
✓ Market share – 22.6%
✓ Total deposits: RM277.5 bil (USD91.9 bil)

Capital Market
✓ 57% of the outstanding PDS
SUSTAINABLE GROWTH PARADIGM FOR ISLAMIC FINANCE

- DIVERSITY OF PLAYERS: MALAYSIA’S ISLAMIC BANKING LANDSCAPE

Mega Islamic Banks (Paid Up Capital of US$1 bil)

17 commercial Islamic Banks, 6 FB windows, 6 DFIs & 4 IIBs.
Global Environment
- Sovereign debt woes and geo-political uncertainties
- Financial market volatility and potential spillover effects on the real economy
- Weak international trade conditions

Policy Environment
- Limited policy levers especially in developed economies to tackle macroeconomic challenges
- Increased regulatory scrutiny

Domestic Operating Environment
- Saturating domestic market and intensifying competition
- Margin squeeze due to stiff competition and rising costs
- Potential economic downturn due to contagion effect from a potential global recession which could lead to rising delinquencies
<table>
<thead>
<tr>
<th>Category</th>
<th>Description</th>
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<tbody>
<tr>
<td>Business Innovation</td>
<td>• To continuously develop new financial solutions and product offerings that suit the ever-evolving customer needs (comprehensive, competitively priced and innovatively packaged) and benchmarked to international standards.</td>
</tr>
<tr>
<td>Robust Risk Management</td>
<td>• To build a solid foundation for sustainable revenue generation and resilient asset portfolio as well as efficient capital management.</td>
</tr>
<tr>
<td>Strengthening Enabling Infrastructure</td>
<td>• To provide an infrastructure that would improve operational efficiency, increase productivity and reduce transaction costs.</td>
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</tbody>
</table>
| Building Capability & Capacity   | • To attract, retain and build future human capital capabilities: to capture and retain best talents in Islamic finance  
• To ensure that employees are fully equipped with the right knowledge, capability and skills to excel and steer the Bank.                                                                                                                                                                  |
| Franchise Development            | • To establish an extensive network of branches and to expand electronic delivery channels that would enhance our reach to customers.  
• To enhance brand positioning that would drive business growth and sustain its competitive edges.                                                                                                                                                                                 |
| Inorganic growth & Corporate Expansion | • To strengthen our market presence and stay ahead in an environment of heightened competition.  
• To tap the vast opportunities available in the South East Asian region.                                                                                                                                                                                                       |
“CAPACITY BUILDING TO ENHANCE FINANCIAL CAPABILITY”
CAPACITY BUILDING TO ENHANCE FINANCIAL CAPABILITY
- MALAYSIA AS A REGIONAL ISLAMIC FINANCIAL CENTRE

Centre of Shariah Reference

Centre of Capital & Money Markets
- Fund management and equity, Sukuk & money markets

Centre of Product Innovation

Diversity of players
- Domestic players with extensive global linkages
- International players

Centre of Fund Flows

Centre of Talent Development

Centre of Int’l Currency Business

Centre of Ancillary Services
- Legal, Shariah Advisory, Accounting & Processing services/Outsourcing services

... Malaysia has the competitive advantages to be a global Islamic financial hub
... Malaysia has put in place a comprehensive talent development infrastructure
CAPACITY BUILDING TO ENHANCE FINANCIAL CAPABILITY
- ENHANCING ISLAMIC FINANCIAL STABILITY

Source: GTNEWS, Association of Financial Professionals
“In today’s context, the growth in Islamic finance coincides with the current account surpluses of oil-exporting countries, dominated by Muslim countries. The new era of these countries desires for socio-political and economic systems based on Islamic principles and stronger Islamic identities.

In addition, the introduction of broad macroeconomic and structural reforms – in financial systems, the liberalization of capital movements, mega infrastructure projects in the Muslim world, privatization and the global integration of financial markets, have paved the way for a rapid expansion of Islamic finance.

Islamic finance is not restricted to Islamic countries, but is spreading wherever there is a sizeable Muslim population and demand for ethical banking”
“MAY ALLAH BLESS OUR EFFORTS TO STEER ISLAMIC FINANCE TO GREATER HEIGHTS”