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(Article 3)

## NON-CONVENTIONAL FUNDING: ISLAMIC BONDS OR SUKUK – Part 3

Our last 2 articles had discussed 6 different types of Islamic contracts in Malaysia. Part 3 will touch on the important elements for the proliferation of Islamic financing in a new market. As with any other new market or product, there will be challenges that will pave the way for future development. The Islamic capital market is no different. However, some key initiatives that had spearheaded the development of Islamic financing in Malaysia may well be useful in the Sri Lankan context.

### **IV Essential Elements for the Development of Islamic Financing in a New Market**

#### **a) Achieving consensus and proper coordination**

Key to the development of Islamic financing in a new market is to achieve consensus among bankers and Islamic jurists. In Malaysia, the supervision of the Islamic financial market is a coordinated effort by the various regulatory authorities. Malaysia's banking and insurance sectors come under the purview of the Central Bank of Malaysia (or Bank Negara Malaysia) while the capital market is regulated by the Securities Commission. To ensure proper coordination, the scope of these regulatory bodies' jurisdiction encompasses both Islamic and conventional finance.

In Malaysia, the Islamic capital market – including the Islamic banking and *takaful* sectors - has dedicated *Shariah* advisory councils (“SACs”). The SAC of the Central Bank advises on matters relating to Islamic banking and *takaful* operations, as well as any other Islamic financing areas under the purview of the latter. The SAC of the Securities Commission, meanwhile, dispenses advice on matters pertaining to the Islamic capital market. Members of the 2 SACs comprise prominent *Shariah* scholars, jurists and market practitioners who have vast experience in banking, finance, economics, law and application of *Shariah*, particularly in the areas of Islamic economics and finance.

The SACs are also responsible for analysing specific issues related to the mechanisms of Islamic finance, to provide guidance and advice to the government, investors and the industry as a whole. The SACs under both regulatory authorities in Malaysia have published their *Shariah* resolutions as reading and reference materials vis-à-vis the development of Islamic finance products - to create a more organised and efficient Islamic finance market in Malaysia.

#### **b) Creation of internationally acceptable financial products**

With regard to the different interpretations of *Shariah* rulings among the different regions of the world, the way forward would be via the creation of new financial products that are internationally acceptable. This can be further developed by forming strategic alliances between local institutions and those in other Islamic countries, such as Bahrain.

#### **c) Active participation by all parties in research and talent development**

Another pertinent area is research and development. This function should be undertaken by *Shariah* experts to produce new Islamic financial products that meet the present and future requirements of financial institutions. Malaysia has placed strong emphasis on human-capital development alongside the advancement of the Islamic financial industry, to ensure the availability of talent in this arena. The Central Bank of Malaysia has established endowment funds with the primary objective of enhancing knowledge, research, talent and intellectual discourse in the fields of *Shariah* and Islamic finance.

To cultivate the country’s Islamic capital market, professionals and *Shariah* experts should all be actively involved in research and development to come up with new products. In Malaysia, such initiatives are undertaken by various institutions such as the following:

***Islamic Banking and Finance Institute Malaysia Sdn Bhd*** (“IBFIM”) . IBFIM is an industry-owned institute dedicated to producing well-trained, highly competent personnel and executives with the required talent in Islamic finance, through its Islamic training programmes.

***International Centre for Education in Islamic Finance*** (“INCEIF”).

By offering the world’s first Chartered Islamic Finance Professional qualification and post-graduate programmes in Islamic finance, INCEIF is committed to build a globally competitive and sustainable source of Islamic finance professionals and *Shariah* scholars.

***International Shari’ah Research Academy for Islamic Finance***

More commonly known by its acronym, ISRA, the academy promotes applied research in the area of *Shariah* and Islamic finance. ISRA acts as a repository of knowledge for *Shariah* views on *fatwas* (a religious opinion on Islamic law issued by an Islamic scholar) relating to studies and contemporary issues in Islamic finance.

***Securities Industry Development Corporation*** (“SIDC”)

Supporting the Securities Commission, SIDC develops and facilitates training - both locally and internationally - including exam-based programmes, as part of the licensing regimen for Malaysian capital-market intermediaries. SIDC is also responsible for the development of *Shariah* capacity in the capital markets and the harmonisation of rulings through its Islamic Capital Market Professional Development programmes.

#### **d) Education of the general public**

There is also a great need to educate the general public on Islamic principles, as well as the relevance of Islamic financing as an alternative financial tool. With sufficient exposure and proper understanding come greater market acceptance that will lead to product development and the deepening of Islamic financing. To this end, RAM Ratings Lanka - with the experience of its Malaysian-based sister company, RAM Rating Services Berhad - is fully committed to doing its part for Sri Lanka.

### **e) Continuous improvements in Islamic accounting, tax and regulatory frameworks**

Meanwhile, the accounting, tax and regulatory frameworks for the Islamic capital market should be benchmarked against the standards set by AAOIFFI, i.e. the Accounting and Auditing Organisation for Islamic Financial Institutions. Informed decision-making should be formulated by market participants, and timely disclosure of relevant and reliable information should be ensured. Although such a comprehensive framework is currently lacking in Sri Lanka, initiatives are being undertaken to bring about the necessary changes.

## **V Prospects and Future Direction**

To build an Islamic capital market that is competitive and attractive to issuers and investors alike, there must be cohesive efforts to develop a variety of Islamic instruments.

In the case of Malaysia, the various initiatives to expand the range of Islamic capital-market products and services have led to an inaugural sovereign Islamic bond issue, the world's first global Islamic bonds, the launch of the country's first *Shariah* index fund, and the maiden issuance of Islamic asset-backed securities.

In Sri Lanka, market players are gathering to collectively propose accounting, tax and regulatory amendments to facilitate the growth of Islamic finance. RAM Ratings Lanka views these initiatives in a positive light as they will encourage uniform accounting practices, standardise contracts to minimise legal risks, and afford the investing public the safety net of regulatory oversight.

*This series of articles on non-conventional financial instruments are proudly brought to you by RAM Ratings (Lanka) Ltd. For those interested in learning more about sukuk, please contact RAM Ratings Lanka at +9411 2553089 to find out about the available workshops.*