Series 1 – Investment in the Future: Shariah Fraternity’s Role in Islamic Capital Market

Positive screening is now becoming a key area in Malaysia, focusing not only on Shariah-compliance, but also on integrating ESG principles into companies’ strategic decision-making, thereby ensuring that Maqasid-al-Shariah gain prominence in investment decisions.

Islamic finance industry professionals need to understand and cater to all different groups of investors and customers, from large institutionalists all the way to young retail clients.

The Shariah fraternity plays an important role in implementing and instilling a Shariah-compliant culture within organisations through education, raising awareness, and ongoing training.

A utopsy of Islamic Capital Market: Prof Dr. Ashraf Md Hashim started his discussion by highlighting global statistics pertaining to the Islamic finance market, noting that the global Islamic finance asset base, which stood at USD 2.52 trillion in 2018, was expected to increase to USD 3.4 trillion by 2024 according to the Islamic Financial Development Report 2019. In addition, 70% of industry assets in 2018 were held by 520 Islamic banks spread across 72 countries, whilst Sukuk comprised 18% of the global Islamic finance industry in the same year. Prof Hashim urged the Islamic finance market community to unite and coordinate with each other, to ensure greater synergies and propel the industry. Prof Hashim also noted that the global Islamic finance industry accounted for just 0.65% of the total financial sector’s assets across the world, which he deemed insignificant to initiate change.

Based on the statistics of the Securities Commission Malaysia as at 31st August 2020, Malaysia’s Islamic capital market stood at MYR 2.2 trillion, accounting for 66% of the country’s total capital market. Prof Hashim noted that, of the country’s total capital market worth MYR 3.2 trillion, the majority was comprised of equity, of which Shariah-compliant equities accounted for a 71% share. Likewise, the fixed income market in Malaysia, valued at MYR 1.57 trillion was also dominated by Sukuk, which held a 63% share. Prof Hashim stressed that assets under management (AUM) needed to be developed, with Islamic AUM accounting for just 24% of the total MYR 0.9 trillion AUM sector in Malaysia.

Prof Hashim highlighted that Shariah-compliant companies attracted a wider investor base, both conventional and Islamic. He added that there was room for improvement in the management of Shariah-compliant securities, with some organisations missing out on being classified as Shariah-compliant due to their insufficient efforts to adhere to the threshold guidelines. Prof Hashim further stated that Islamic Exchange Traded Funds (ETFs) and Islamic Real Estate Investment Trusts (REITs) were areas that could be improved on. Commenting on Sukuk’s development, Prof Hashim discussed expansion avenues pertaining to the development of Retail Sukuk (which require a minimum investment of MYR 1,000) and Waqf Sukuk, emphasising the need for Malaysia’s Islamic finance industry to work together to develop these instruments. Highlighting additional industry statistics, Prof Hashim commented on the promising outlook for the Shariah market based on industry performance. Between 2010 and September 2020, Shariah market capitalisation was up 46%, whilst the Shariah Average Daily Trading Value was up 235% over the same period. He also noted the performance of Shariah indices that have consistently outperformed the FBM KLCI benchmark index over the past decade.

Regarding Shariah investing principles, Prof Hashim stated that this type of investment was open for everyone, and not limited to the Muslim community. He went on to showcase the overlap between Shariah-compliant investment principles and the Environmental, Social, and Governance (ESG) criteria, concluding that both types of investments had almost the same objectives. Prof Hashim also explained that positive screening was now becoming a key area in Malaysia; a screening focused not only on ensuring that Shariah-compliant companies refrained from prohibited activities such as gambling and Riba (interest), but also that they integrated ESG principles into their strategic decision-making, thereby ensuring that Maqasid-al-Shariah gain prominence in investment decisions. Reiterating the potential of ESG investing, Prof Hashim cited that global equities which were up 4.3% annually on average between 2007 and 2019, paled in comparison to ESG investments, which grew 10.2% annually over the same period. Prof Hashim then listed key Shariah investing principles, with the main value proposition centred around sustainable, responsible, ethical, and relatively low-risk investments targeting a larger investor base, with a greater focus on the performance and quality of these Islamic investing instruments. Ending his session, Prof Hashim listed out the key tasks assigned to Bursa Malaysia’s Shariah Committee, which included the provision of advice in product structuring, evaluation and approval of proposal procedures, review and advice on Shariah verification, and provision of input on industry products.

Prof Hashim then responded to an audience question related to the use of Islamic capital market to boost Malaysia’s economy in the wake of the COVID-19 pandemic, particularly with regards to employment. Prof Hashim stated that the Government of Malaysia’s Penjana (National Economic Recovery Plan) Sukuk were a small effort relative to what could be achieved with instruments such as Waqf Sukuk. He noted that the current constraints restricting the uptake of such instruments centred around a lack of investor confidence, which could be overcome with a sound structure supported by Malaysia’s capital market regulation and political willingness. He further discussed the possibility of making Waqf Sukuk a retail instrument to allow investments from a wider investor base, especially that there were funds available in the market waiting for industry experts to find ways to tap into.
Role of the Shariah Fraternity: The second session of this Series 1 consisted of a panel discussion on the importance and relevance of the Shariah fraternity, its role and contribution to Malaysia's Islamic finance industry. Prof Hashim served as a moderator for this leg of the discussion and invited Makhtar Abdullah to share his insights on the efforts made by the Association of Shariah Advisors in Islamic Finance (ASAS) for the development of Islamic finance in Malaysia.

One of the key developments cited by Abdullah was the introduction of two certification programmes, announced in 2017, catering to Shariah-educated persons as well as those without any Shariah background. The aim of these courses was to motivate professionalism amongst Shariah advisors, equip them with the skill set and knowledge required to propel the industry, as well as to build up a talent pool to prepare a succession plan and serve effectively in a more challenging ecosystem.

Abdullah went on to describe the course content and delivery programme, noting that the modules were constantly revised to ensure up-to-date certificate programmes.

Abdullah highlighted that there was still a long way for the Islamic finance industry to go given its niche size compared to the global financial market, even after 50 years of existence. First, he noted the need to prepare for the future, with a focus on digitised banking, ESG and green investing, as there was now more chatter around social finance involvement. Added to this, the on-going COVID-19 pandemic also brought in a new dimension to strategy planning. Abdullah noted the widening shareholder base that now included larger institutional investors as well as younger investors. He stressed that the Islamic finance industry professionals needed to understand and cater to all these different groups of investors and customers. He reiterated the need to upscale professionals, consisting mainly of Shariah scholars and Islamic finance practitioners, beyond the realms of banking or finance, citing that Shariah committees should be well equipped to respond with clear Fatwas and references as needed.

Shariah Compliance and Stockbrokerage: Prof Hashim then went on to invite the final panellist, Prof Dr Younes Soualhi, to talk about the effect of Shariah compliance rulings and practices in the stockbroking sector. Prof Soualhi started off his discussion by sharing his views on the role of the Shariah advisors and Shariah committees to ensure Shariah compliance of Islamic financial institutions in capital markets, with a key focus on Shariah screening.

Highlighting participating organisations (POs) in the stockbroking industry, Prof Soualhi noted that in order for Islamic POs to work effectively within Bursa Malaysia, these POs must adhere to the Shariah Compliance Assurance Framework (SCAF), a governance framework encompassing guidelines, to ensure Shariah compliance in audit and risk management. A key best practice followed by POs is ensuring adequate training to all staff, particularly the Heads of Dealings and Operations, to reinforce the do’s and don’ts of Shariah investments and to facilitate sound investment management. Part of this role is making sure to follow best practices such as disposal of non-Shariah compliant securities, and to have a Shariah advisor providing advice within a defined Shariah governance framework. Prof Soualhi went on to describe the role of the Shariah advisors and the ways in which POs should deal with them. First, he noted that POs should ensure that Shariah advisors have free access to information and data needed for sound decision-making; second, that Shariah advisors should be given full independence without any interference from the law; third, that the opinions of Shariah advisors should be well documented for future reference; and lastly, that audits should be used to ensure that Shariah advisors’ opinions have been considered and their decisions have been implemented.

Prof Soualhi then explained the best practices expected by Bursa Malaysia from POs with regards to compliance of operational systems, procedures, and internal controls. He started with segregation of funds to ensure that any monies pertaining to Shariah-compliant stockbroking, whether used for funding or investing, were clean and interest-free. Prof Soualhi also emphasised that investments made by POs should always be Shariah-compliant and facilitated via contract notes that serve as a proof of completion of the transaction. POs were also expected to pay out Zakat. The most important best practice guideline noted by Prof Soualhi was the requirement to have an audit system to ensure internal control, compliance, and transparency.

Regarding the role of the Shariah fraternity in the Islamic stockbroking space, Prof Soualhi noted that this went beyond the realms of Shariah governance. The Shariah fraternity primarily comprises Shariah advisors and Shariah committees. It was important for the Shariah committee to first, clearly define the terms and conditions of their appointment in order to assist the Shariah advisors to achieve their goals, as well as the goals of the PO. Prof Soualhi then highlighted four key areas that the Shariah community should focus on to play a more responsible role beyond mere Shariah governance. First, the Shariah community can assist by instilling a compliance culture within the organisation.

Second, the Shariah community can drive the change towards value-based intermediation (VBI) within the organisation, focusing on Maqasid-al-Shariah. The third area of contribution for the Shariah community would be towards streamlining and enhancing micro and macro models of Islamic finance, by aligning Islamic financial activity (micro factors) of the organisation with the macro objectives of the country, namely financial and monetary stability, economic development, and enhancement of the real economy. The final key area of support would be the promotion of Islamic Fintech in Islamic stockbroking to facilitate investments and reduce transactional costs. This could be achieved using blockchain, artificial intelligence, big data analysis, and Internet of Things (IoT) according to Prof Soualhi.

Concluding the discussion, Prof Soualhi responded to an audience question pertaining to the role of the Shariah fraternity in implementing and instilling a Shariah-compliant culture within organisations. Prof Soualhi noted that the key element was to educate and raise awareness to promote the acceptance of Shariah governance and compliance, which should be followed by consistent, and ongoing training. Added to this, Prof Soualhi noted that it was crucial to monitor this Shariah-cultural acceptance from time to time by assessing the levels of awareness, understanding, and compliance across organisations.