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## Bahrain's First Islamic Investment Bank buys stake in French retailer

First Islamic Investment Bank E C, the Bahrain-based investment bank and its co-investors have bought a substantial interest in VGC S A (Vogica), a leading French retailer and wholesaler of kitchens and bathrooms.

In a statement released on Oct 20, First Islamic did not disclose the total transaction value but intends to place about €45 million of the transaction with its investors. Bank of Ireland, in its first sole lead-arranged transaction in France, provided the entire financing package consisting of acquisition and working capital facilities.

Vogica operates a network of 28 company-owned stores and 9 exclusive distributors selling fitted kitchens and bathrooms directly to end customers under the Vogica brand name. The company also supplies kits for home assembly and installation through two of the largest DIY-specialized retailing chains in France.

## Marc Reaffirms MISC's RM1.5 billion *murabahah*

The Malaysia Rating Corporation Bhd (MARC) has reaffirmed MARC-1ID/AAID ratings on Malaysia International Shipping Corporation Bhd's (MISC) RM1.5 billion *murabahah* commercial paper/medium term notes programme (2000/2005).

In a statement issued on Oct 21, the rating agency says the reaffirmation of the ratings is predicated by MISC's solid operating fundamentals and its dominant position in the Malaysian shipping industry particularly the liquefied natural gas (LNG) segment.

It adds that the reaffirmation is predicated by the group's extensive global reach with the acquisition of American Eagle Tankers Inc Ltd; sound financial profile characterised by improved profitability and low debt leverage; exceptional financial flexibility and the strong support of its majority shareholders,

First Islamic's CEO Atif A Abdulmalik says of the deal: "The Vogica transaction completes the establishment of First Islamic's presence in Europe, following two years of significant investment in the development of our franchise there. All three of our business lines, real estate, asset-based and corporate investment, are now generating diverse investment opportunities in the European market for our investors."

He adds that the bank has completed transactions worth in excess of US\$2 billion in the European market, and expects its operations and investment activities to continue growing.

Headquartered in Bahrain with offices in Atlanta and London, the Bank has completed 31 transactions with a total value of almost US\$6.0 billion and has an equity capital base in excess of US\$300 million.

Petroleum Nasional Bhd (Petronas).

MARC says MISC's balance sheet shows ample liquidity and the group's cash flow protection measures are capable of accommodating a reasonable degree of earnings volatility in the non-LNG shipping business.

MISC's strong internal cash generation has reduced the need for excessive external financing to fund its capital expenditure programme. The group's debt leverage is considered low by shipping industry norms of 0.7 times as at June 30 2004, as compared to the global industry average.

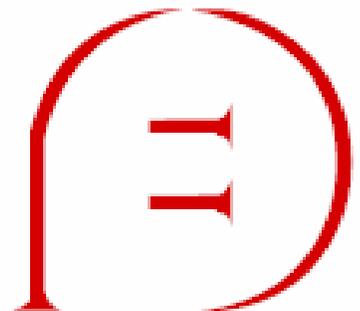
Furthermore, MARC, said that the US dollar denominated shipping revenue provides a natural hedge against exchange rate volatility in relation to the group's sizeable foreign currency debt obligations.

## Islamic Finance *training*

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Dear Colleague,

Welcome to the launch issue of Islamic Finance News. From the 22<sup>nd</sup> of November 2004 Islamic Finance News will be available every other Monday morning.

Due to the rapid evolution and growth of the Islamic financial industry, the need for education, easily accessible information and industry knowledge has increased dramatically.

Islamic Finance News has been created as a bi-weekly e-newsletter to provide that information through sector reports, first-hand experience and knowledge and coverage of the global *Shariah* compliant capital markets.

Drawing on experience and understanding from industry practitioners, professionals and leading academics, Islamic Finance News is the place to turn to for unbiased, up-to-date information covering all areas of Islamic finance.

### Regular Features will include:

- News Review
- Country Reports
- Sector Reports
- Research Review
- Legal Updates
- Case Studies
- League Tables
- Islamic Funds Update
- Moves & Promotions
- Round Table Discussions
- Event Diary
- Terminology

Our homepage, [www.IslamicFinanceNews.com](http://www.IslamicFinanceNews.com) will accommodate all past issues of the newsletter along with additional reports, supplements, contact information, a full Islamic finance terminology glossary and links to industry related sites we believe you will find helpful.

We hope you find our first issue of interest and we welcome any comments or suggestions you may have.

Warmest Regards,

Andrew Morgan  
Managing Director & Publisher  
Islamic Finance News

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## NEWS BRIEFS (continued...)

### US\$337 million Islamic debt securities to finance water projects

Malaysian water utilities provider Ranhill Utilities Bhd says its unit SAJ Holdings Sdn Bhd has secured RM1.28 billion (US\$337 million) worth of *Al-Bai Bithaman Ajil* Islamic debt securities to finance its ongoing projects.

SAJ signed an agreement with its joint lead arrangers and joint lead managers, Aseambankers Bhd, CIMB Bhd and Bank Islam Malaysia Bhd on Oct 18. The debt securities maturing in 15 years are to fund SAJ's infrastructure improvement projects under its second operating period from 2003 to 2005.

Ranhill says this is the first issuance of Islamic bonds by SAJ with the consortium. The Johor state government has appointed SAJ to exclusively supply treated water to the state. Ranhill meanwhile manages about 450 reservoirs that supply about 1.3 billion litres per day to 2.3 million consumers in Johor.

### Dubai Islamic Bank launches *murabahah* car financing scheme

At the start of Ramadan the Dubai Islamic Bank (DIB) launched a 3.70% *murabahah* car financing scheme that comes with a competitive insurance rate combined with a free AAA membership road assistance.

DIB's offer comes with no down payment, competitive profit rate, insurance and service finance. Once finance details are agreed, the bank proceeds to buy the vehicle and then resells it to the customer in monthly instalments with no hidden costs or penalties.

"DIB is constantly on the lookout to provide the best offers and services for its customers, especially during Ramadan. This new offer is expected to attract a large number of potential car buyers all over the Emirates especially that DIB is the leader in the car financing industry in the UAE," said Vice President sales Abdulla Al Shams.

### Islamic Bank NPL at 96%

The state-owned Al-Amanah Islamic Investment Bank of the Philippines reported higher non-performing loans (NPLs) for the third quarter of this year. The bank reports that loans that were at least 90

days past due represented 96% of its total loan portfolio, an increase from 95% in June.

Land Bank of the Philippines saw its bad loans up marginally by 2.37% to P23.3 billion from P22.76 billion in June. As a share to total loans, bad loans amounted to 16.59% as against 15.15% in June.

Union Bank of the Philippines meanwhile reported its NPLs at P3.98 billion representing 12.93% of its loan books. Chinatrust (Philippines) Commercial Bank Corp says its bad loan level stands at 6.96% of its total loan portfolio as of September, down from 7.14% in the second quarter.

### Malaysian construction company to issue *murabahah* notes

Malaysia's Peremba Jaya Holdings Sdn Bhd, a subsidiary of PECD Bhd signed an agreement for the issuance of *murabahah* notes issuance facility and/or *murabahah* medium term notes (MUNIF/MMTNs Program) of up to RM200 million.

The loan facility is to finance the construction and development of Phase 2 and Phase 3, involving government residential units comprising landed and high-rise properties, of the Precinct 11 project in Putrajaya – Malaysia's new federal government administrative centre.

The MUNIF/MMTNs program was fully underwritten by a consortium of financial institutions comprising Affin Bank, EON Bank, RHB Sakura Merchant Bankers Bhd, Malaysia Discount Bhd and Bank Muamalat Malaysia Bhd.

Malaysian Rating Corporation Bhd (MARC) has assigned Peremba Jaya Holdings MUNIF/MMTNs facility a long term rating of AID ('A' flat Islamic Debt) and a short term rating of MARC-2ID indicating high ability for timely payment on the instrument issued.

The MUNIF/MMTNs Program shall have a tenure not exceeding five years from the date of first issue and shall be reduced to RM100.0 million on the 42nd month commencing from the date of first issue.

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## NEWS BRIEFS (continued...)

### Citibank & HSBC lead managers for Pakistan's US\$500 million sukuk

The Pakistan government on Oct 19 appointed Citibank and Hong Kong Shanghai Banking Corporation (HSBC) the lead managers to float US\$500 million Islamic bonds (*sukuk*) in Europe and Asia including the Middle East.

Economic adviser to the Ministry of Finance Dr Ashfaque Hasan Khan says the size of the *sukuk* was yet to be determined but that it would be in the region of about US\$300 million to US\$500 million.

He adds that the successful issuance of the US\$500 million Euro-bond has encouraged the government to also float Islamic bonds to attract investors from the Middle East. He says the government would soon be holding road shows in Europe, Asia including the Middle East to promote the Islamic bond.

### 64% profit rise for Bank of Sharjah

The National Bank of Sharjah in the United Arab Emirates posted a 64% profit climb in the first nine months of this year compared to the same period last year. The net profits from January to September reached Dh 95.5 million, and customer deposits rose 18% to hit Dh 2.06 million on September 30. Total assets grew by 12% from Dh 2.75 million in September 2003 to Dh 3.08 million in September this year, while advances increased by 19% to reach Dh 1.85 million.

Founded in 1975, the National Bank of Sharjah was originally a conventional retail bank. Today it is rated as one of the top four registered banks in Sharjah with branches stretching from Sharjah to Dubai, Abu Dhabi, Khorfakkan, Dibba Al Hisn, and Kalba.

### Malaysia to become Islamic banking hub

With eight full-fledged Islamic banks including three Middle East players, Malaysia is laying the groundwork to become the Southeast Asian region's key Islamic financial hub. The central bank recently completed a plan to bring forward the liberalisation of the Islamic banking industry, three years ahead of the World Trade Organisation deadline in 2007.

On Oct 14, it awarded the remaining two Islamic banking licences to Saudi Arabia's largest bank Al Rajhi Banking and Investment Corp and a consortium led by the Qatar Islamic Bank. The first Islamic banking licence for a foreign bank was awarded to Kuwait Finance House in May.

Three local banking groups - Hong Leong Bank, Bumiputra-Commerce Bank Bhd and RHB Bank - were also granted approvals recently to open Islamic banking arms, joining existing players Bank Muamalat and BIMB Holdings Bhd.

Analysts say the entrance of foreign players would push local banks to innovate and compete more aggressively in developing Islamic products and services.

While neighbouring Singapore and Hong Kong have established themselves as the financial centres in Asia, Malaysia is reported to be carving a niche to tap billions of dollars of Muslim funds seeking new investment homes after the 2001 terror attacks in the United States and uncertainties in the Middle East. The Islamic finance market worldwide is estimated to be worth 200 billion dollars and is growing at 15 percent per annum.

### Egypt's first shariah-compliant fund launched

Faisal Islamic Bank of Egypt in cooperation with EFG-Hermes, an investment bank, launched the Faisal Islamic Bank of Egypt Mutual Fund on 11 October.

Hermes Fund Management will manage the equity growth fund - the first *syariah*-compliant fund dedicated to the Egyptian market. All investments of the fund have to conform to the investment policy and restrictions specified by the *Syariah* Supervisory Board of Faisal Islamic Bank.

The fund's initial size amounts to EGP50 million distributed over 500,000 certificates with a par value of EGP100. The minimum subscription in the fund is EGP1,000 and subscription is open to both institutional and retail investors for adults and minors. The fund aims at distributing a semi-annual dividend to unit-holders.

Investors may subscribe in the fund at Faisal Islamic Bank of Egypt and all its branches in addition to all offices of the National Post Office. Subscribers may redeem part or the full value of their certificates weekly at bank branches or the post office at which they subscribed.

### US\$65 million sukuk listed on Bahrain Stock

The Bahrain Stock Exchange (BSE) and The Liquidity Management Center (LMC) signed an agreement on Oct 17 that paves the way for the listing of LMC Emmar Sukuk Company's US\$65 million *Ijara sukuk* on the BSE.

BSE Director Fouad Rashid and LMC Head of Risk Management Khalid Bucheeri signed the listing agreement. The 5-year *sukuk* maturing in July 2009 bears an interest rate of 0.70% over LI-BOR per annum and is payable semi-annually.

With this listing the number of Islamic *sukuk* and conventional bonds listed on BSE has reached 20 with an approximate total value of US\$3 billion.

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# COUNTRY UPDATE - ISLAMIC DEBT MARKETS

**New Challenges, New Frontiers** *By Baljeet Grewal*

The Islamic Capital Market in Malaysia has been an essential element of the capital market and has effectively functioned as an alternative market for capital seekers and providers. At the same time the Islamic capital market also plays an important complementary role to the Islamic banking and takaful industry. In short, the broadening and deepening of the Islamic financial market in this country has all the three strategic pillars, namely banking, takaful and the capital market.

It has taken Malaysia over 20 years to build what is now considered as a complete Islamic financial system. As of June 2004, Islamic banking assets make up 9.9% or RM89 billion of total banking assets.

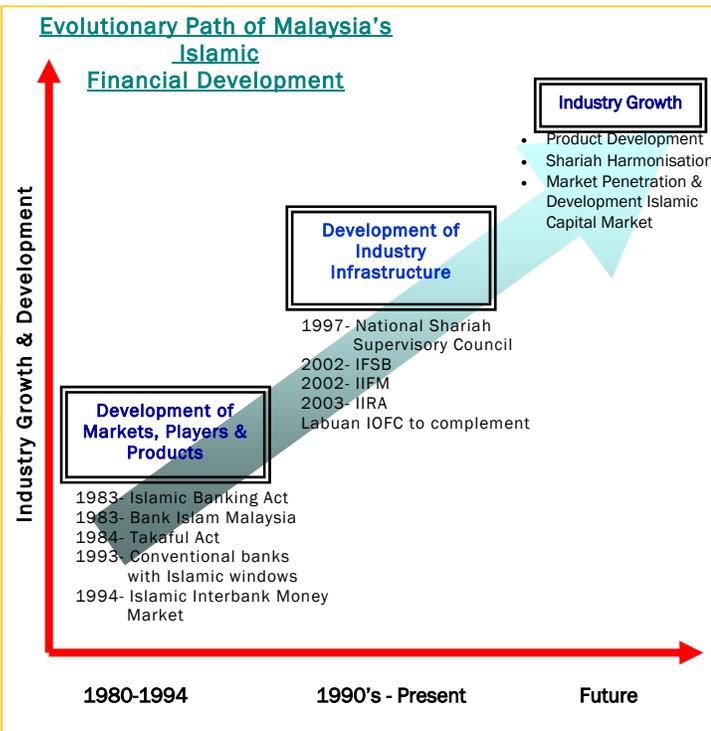
### Rising interest in Islamic PDS

In a niche mainstream financial industry, Islamic debt instruments account for a large proportion of the Private Debt Securities (PDS) market. Since 1997 the composition of Islamic fixed rate securities has been on the uptrend.

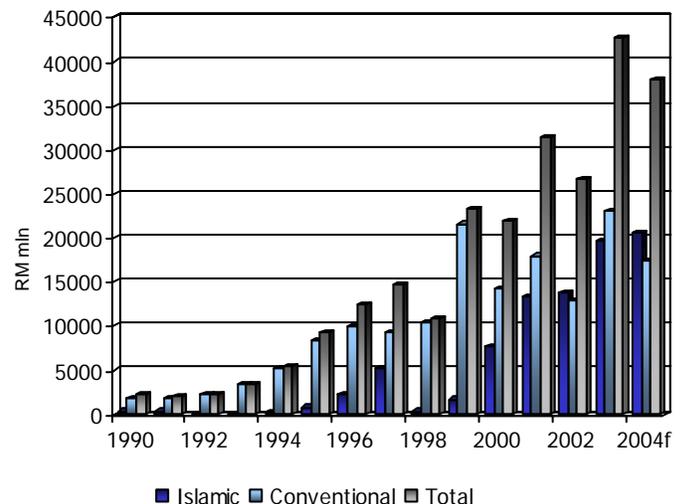
Demand for Islamic debt instruments - accounting for only 7% of total bonds raised in 1999 - grew to 25% in 2000 and subsequently to 36% in 2001. This increase is primarily due to investor awareness of alternative funding sources and the rise in the number of Islamic funds launched over the years.

It is crucial to note that no fewer than 50% of all Malaysian domestic bonds are now *Shariah*-compliant, especially the larger issues, and this proportion continues to grow. As a result Malaysia's Islamic financial landscape has developed in terms of diversity of instruments and its modernity. The scene also boasts a dual banking model - a developing Islamic financial system and the conventional banking system.

In charting the growth of Islamic fixed income securities, total Islamic PDS (IPDS) issued since 1991 (matured and outstanding) amounts to RM114.78 billion at 243 issues. By sector, property and infrastructure/utilities lead at 30% and 28% respectively, thanks to the large-scale nature of these projects.



**Development in Islamic PDS (1990-2004)**



The Islamic capital market complements the conventional market by providing value-added services that meet the needs of the market for a broad range of instruments, and have effectively mobilised and channelled funds to fuel economic growth. Going forward the industry's growth depends on product development, *Shariah* harmonisation, market penetration and development.

More importantly the emergence of a distinct Islamic capital market, where investment and financing activities are structured in accordance with *Shariah* principles, is the outcome of a natural progression in the growth of the Islamic industry.



## COUNTRY UPDATE - NEW CHALLENGES, NEW FRONTIERS (continued....)

The *Al-Bai Bithaman Ajil* ("ABBA") structure has been the preferred choice to finance such projects with long gestation periods. Under this principle, the financier purchases an asset from the issuer and sells it back to the same party at a premium.

Another popular Islamic PDS tool is based on the *Murabahah* concept which caters for short- to medium-term requirements. These two financing structures have dominated the local scene largely because they closely mirror conventional bonds in terms of cash flows and are easily understood by issuers and investors.

### Market to see greater growth

The Malaysian bond market has thus far displayed exemplary growth through the introduction of Islamic debt. Besides enhancing competitiveness and sophistication in the increasingly robust and competitive world of banking, Islamic PDS also enhances the resilience of the overall international financial architecture.

What lies behind the increasing popularity of Islamic bonds? The advantages fundamentally lie in the structure of Islamic finance itself. Islamic bonds provide an avenue for Islamic investors to invest in *Shariah*-compliant investments thus, guaranteeing access to a larger investor base. It also offers potentially lower pricing to issuers via the wider investor pool thanks to the participation of many Islamic investors.

In the international arena, it is anticipated that within a decade global Islamic capital markets will be responsible for managing at least 50% of the total savings of Muslims worldwide. Today there are around 250 global financial institutions that operate in about 75 countries promoting Islamic investment banking products.

Given the rate at which this industry is growing, no global operator targeting clients or businesses can afford to ignore this market without suffering a loss in market share, a loss in global competitiveness, or for that matter a foregone opportunity loss.

### Issues in long-term sustainability

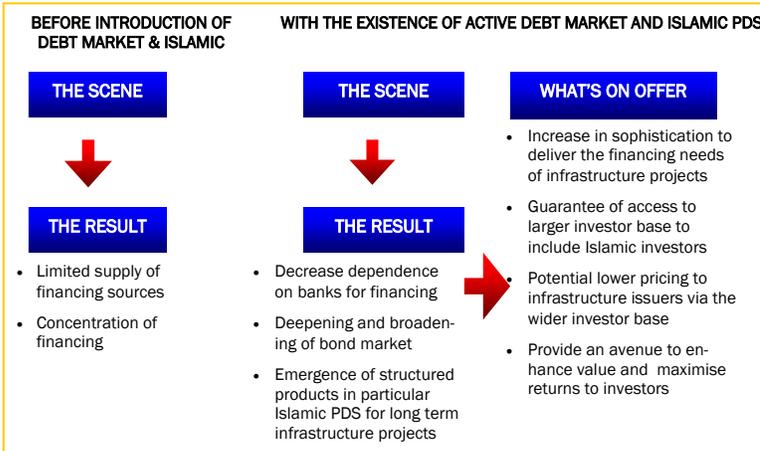
Nevertheless, like all financial mechanisms that are in the formative stages of development, the Islamic industry poses some challenges. One very crucial challenge and pre-requisite to the growth of Islamic markets has been the inculcation of market awareness and understanding of its varied investment opportunities.

The main hurdle identified by players is in accessing long-term investors and ensuring sustainability of the Islamic industry. On top of this creating a deep and liquid secondary market for Islamic instruments through the enhancing of risk management tools is also viewed as a challenge.

Innovation of new products is also crucial. Structures that can be explored include the gradual shift to *Istisna*, *Ijarah\** and *Salam* based products, short-term oil and commodity linked products, equity/debt hybrids as well as internationalising distribution lines. Continuous research and development in the areas of product development can also enhance growth in Islamic equity funds, cultivate liquidity management of assets as well as creating *Shariah*-based equity benchmarks. Further prospects also exist for Islamic products in the areas of Asset Origination and Asset Management.

At the same time establishing sizeable and organised institutions, ongoing research and development as well as consensus among Islamic jurists and scholars on *Shariah* issues also remains an integral part of Islamic finance. Progressively, this will enable Islamic institutions to partake in financial engineering and product innovation whilst preserving the uniqueness of Islamic finance.

*Note: The author is Chief Economist and Head, Fixed Income Research with Aseambankers Malaysia Berhad, the investment banking arm of Malayan Banking Berhad (Maybank). Aseambankers has a notable fixed income research initiative with the primary task of undertaking comprehensive and proficient research in the area of Malaysia's debt capital market.*



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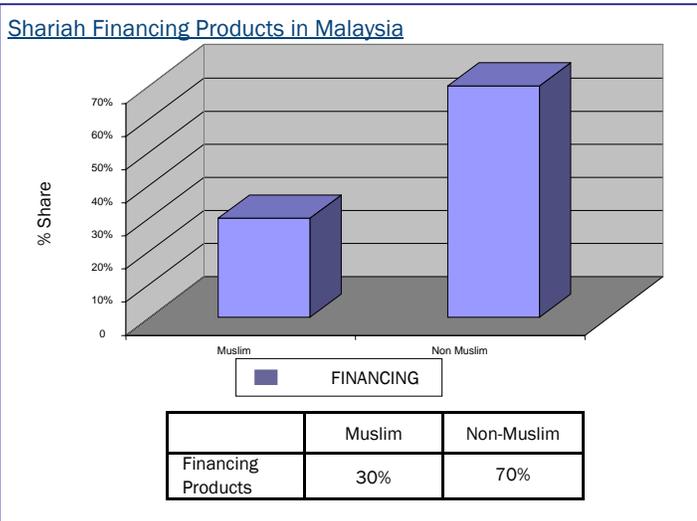
### \*TERMINOLOGY- Ijarah

A *manfaah* (usufruct) type of contract whereby a lessor (owner) leases out an asset or equipment to his client at an agreed rental fee and predetermined lease period based upon the *aqad* (contract). The ownership of the leased equipment remains in the hands of a lessor.

# INDUSTRY SECTOR UPDATE

Marketing Islamic Financial Products : What needs to be done *By David Vicary (Daud Abdullah)*

In recent years Islamic finance has made significant strides forward – in Malaysia for example Islamic financial products make up 10% of the total number of financial products in the market. While the building blocks for progress may be in place, there is still a long way to go. Almost 25% of the world’s population is Muslim but this ratio is not reflected in the amount of funds that are *Shariah*-compliant products globally. That ratio is likely to be a mere 4%!



As was discussed in the recent OIC Business Forum, held in Kuala Lumpur in early October, part of the challenge lies in enhancing economic development in many of the Muslim countries, so that citizens of these countries have sufficient net disposable income to be able to enter in to the banking system. While this may form the basis for a longer-term strategy, there are, however, a number of things, which can be done in the short-term to ensure that Muslims are aware of and can get access to *Shariah*-compliant products as well as attract a broader global customer base to the value proposition of these products.

In essence there are three critical areas where work can be done: attracting the broader customer base, *Shariah* coordination and developing an integrated global marketing strategy.

### Broader customer base and coordination

Fundamentally attracting a broader customer base involves developing a sound value proposition for *Shariah* products. In Malaysia, for

example, this is going quite well, as the majority of *Shariah* financing products are taken up by non-Muslims. In other countries, however, because of misconceptions held about Islam, much needs to be done to help overcome this problem.

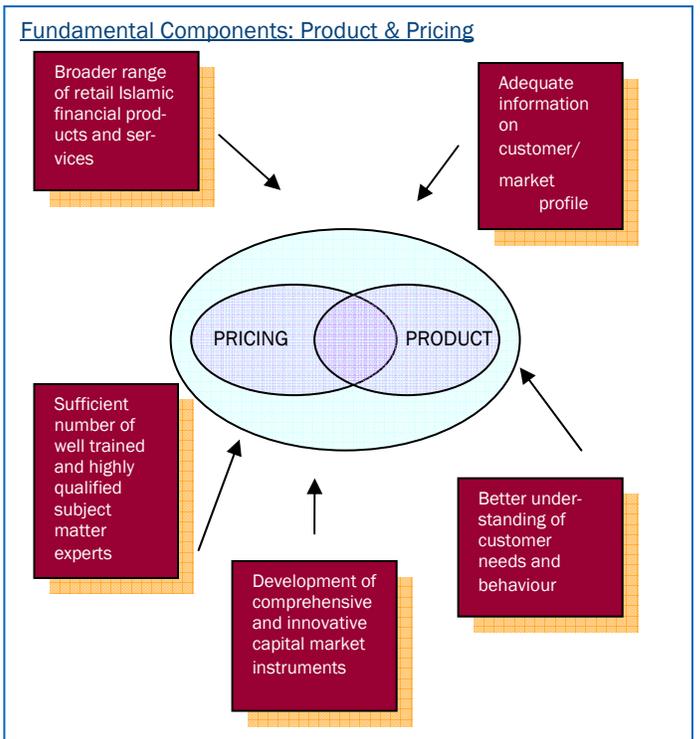
Our experience indicates that if there is an opportunity to do business and a value proposition exists, any preconceived ideas about Islam start to fall away.

Islamic products have demonstrated that they can compete with conventional products and significant opportunities exist for the development of Islamic wealth management products in the future.

*Shariah* law plays a pivotal part in globalising the industry. It stands at the heart of product innovation, consumer confidence, risk mitigation and banking operations. As such greater coordination of *Shariah* standards will further enhance the profile of Islamic banking.

The Governor of the Bank Negara Malaysia Tan Sri Dr Zeti Akhtar Aziz puts it well when she mentioned in a recent address that “The *Shariah* should therefore be viewed as an enabler of innovation....rather than a constraint”.

In addition, with the cross fertilization of *Shariah* Supervisory Boards, the opening up of Islamic banking markets to foreign Islamic financial institutions and the continuing



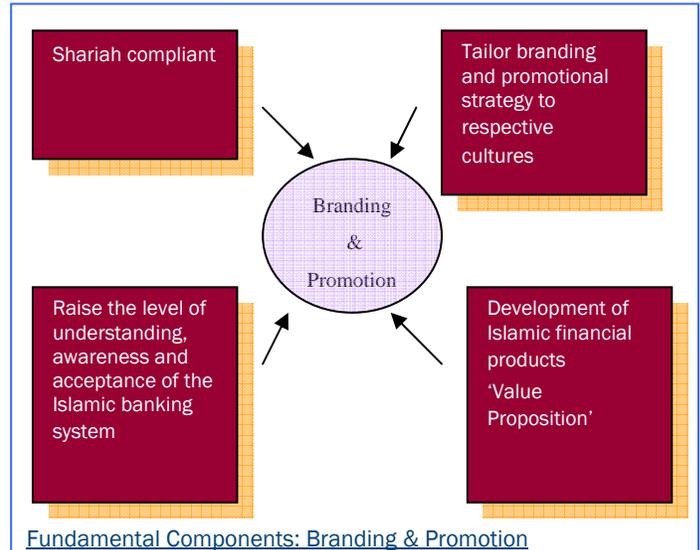
## INDUSTRY SECTOR UPDATE (Continued...)

development of *Shariah* scholars in their understanding of banking and business issues, will ensure an increase in the level of *Shariah* coordination.

### Integrated global marketing strategy

The Islamic banking community will also need to develop a strategy around the four fundamental components of pricing, product, delivery channel and brand, in order to meet the ever demanding customer needs.

In developing pricing and product there are 5 key areas that need attention namely getting adequate information on customer and market profile; developing a better understanding of customer needs and behaviours; development of comprehensive and innovative capital market instruments; the provision of sufficient number of well trained and well qualified subject matter experts; and the provision of a broader range of retail Islamic products and services.



Finally branding and promotion will need careful attention, particularly in the tailoring and branding of promotional strategy to respective countries and cultures; development of Islamic financial products' value proposition; ensuring *Shariah* compliance; and raising the level of understanding, awareness and acceptance of the Islamic banking system

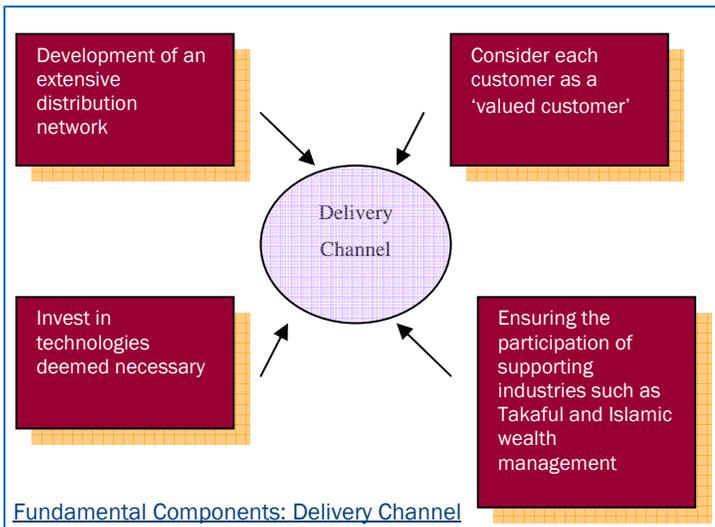
In a nutshell long-term success will depend on our ability to provide a sound value proposition to Muslims and non-Muslims alike. In setting about capturing a larger share of the market, we must work on appealing to a broader customer base, improve on *Shariah* coordination and develop a global marketing strategy for Islamic banking. There is much to do and not a moment to lose!

*Note: The author is director financial services at Deloitte Malaysia.*

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In terms of the delivery channel the following should be present – the development of an extensive distribution network; investment in the technology needed to support this distribution network; viewing each customer as a valued customer; and ensuring the participation of the supporting industries such as *takaful* and Islamic wealth management.

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MALAYSIA

## LEGAL REPORT

### Islamic Financing in Malaysia: Are we doing it right? *By Roseleen Abdul Rahman*

*Those who devour usury will not stand except as stands on whom the satan by its touch have driven to madness. That is because they say that trade is like usury, but Allah has permitted trade and forbidden usury - Surah 2 verse 275 of the Al-Quran.*

Islamic financing in Malaysia has, in recent years, experienced a tremendous growth spurt in the local banking and financing industry, especially among the non-Muslims. Indeed, a significant amount of non-Muslims in Malaysia have indicated their preference for Islamic financing; a study by professional services firm Deloitte shows that non-Muslims represent about 7 out of 10 Malaysians who opt for Islamic banking.

While the direction Malaysian Islamic financing is taking - to make it more attractive to non-Muslims as well as Muslims - is to be applauded there is the issue of whether or not Malaysian Islamic financing is within the heart and soul of the *Al-Quran*, especially with regards to the injunction that is *Surah 2* verse 275. There have been queries raised on the probability that the banking and legal sectors in their pursuit to satisfy the needs of the client, customer and investor, have inadvertently “forgotten” about what is truly Islamic.

Let's take for example Islamic private debt securities (PDS), which have gained tremendous popularity in Malaysia. Much has been debated with regards to the specific mode of financing, as more and more banks show their partiality towards sale-based financing. Indeed, a majority of Islamic private debt securities PDS rated by the Malaysian Rating Corporation Berhad (MARC) use the *Al-Bai Bithaman Ajil* and *Murabahah* structures.

This is unsurprising due to these products' ability to virtually guarantee a fixed flow of return to the financier - by virtue of the debt obligation created by the deferred payment mode together with the mark-up. As a result of the immediate sequence of the sale and purchase contracts entered into by the parties, risks to the financiers, especially those attributable to ownership of the property, are viewed by some to be at an all-time low.

The local banks have found that these sale-based modes provide the best form of security in Islamic financing. As it is very similar to conventional banking practice, crystallising the banks' claim and obtaining summary judgement and enforcement is actually quite easy. It is however this similarity that is being questioned here. Are we figuratively trying desperately to fit a square peg into a round opening?

Indeed, it has been said that these sale-based structures have been found so favourable that they have been used to finance “literally everything that can be bought and sold”.

**“Just another commercial bank without the interest tag?”**

An article by International Islamic University Malaysia Private Law Department lecturer Dr Engku Rabiah Adawiah analyses the sale-based Islamic modes of capital mobilization and project financing as practised in Malaysia, in terms of their compliance with the Islamic law requirements.

The article raises three basic issues namely *Bai' Al-Inah*, suitability of assets used and *Bai' Al-Dayn*. Let's discuss the first issue, *Bai' Al-Inah*, or sale of cash. It is first and foremost, a controversial form of sale in Islamic law and is not accepted worldwide. However, in most of the sale contracts as practised in Malaysia, there are two consecutive sales entered into between the same parties and using the same assets - that is opined to be a sale of cash - albeit disguised under the name of *Al-Bai Bithaman Ajil*.

It was further stated that these attempts to persist with the sale-based financing structures in multi-layered projects may result in the structures being controversial, or at least seen by some quarters to be compromising some Islamic law requirements in its implementation.

In Pakistan, for example, the Supreme Court found that *Murabahah* and/or *Al-Bai Bithaman Ajil* transaction, when used as a mode of trade financing, is at the borderline with the conventional interest-bearing loan. The court also took the view that *Murabahah* and/or *Al-Bai Bithaman Ajil* concept is most vulnerable to exploitation and is not an ideal financing system and should only be used where equity financing such as *Musharaka* and *Mudaraba* is not applicable.

This is probably because it is found that the mark-ups in the deferred payment scheme will somehow equal to the rate of interest charged by the banks. Therefore, the Islamic banks have been said to charge interest in a disguised form. The real status of Shariah banks is then questioned - is it really an “Islamic” bank in both letter and spirit? Or is it just another commercial bank without the interest tag?

#### Suitability of assets

The other two issues that were of concern to Dr Engku Rabiah are the suitability of assets used and *Bai' Al-Dayn*. First of all, her worry is that in Islamic sale contracts, failure to meet the stringent conditions for the subject matter may render the contract void. One of these conditions is the requirement for the subject matter to be a valuable property that is capable of possession.



## MALAYSIA

## LEGAL REPORT (continued...)

In Malaysia, the asset used in the debt capital market is more often than not the right of the company under a particular agreement. Her question then is whether these rights fall within the meaning of valuable property that is capable of possession. While the Malaysian market has since accepted that a government award is an independent asset by itself and is capable of being bought and sold, other rights such as rights to receivables and rights to future benefits from a concluded contract are of interest.

The practice of *Bai' Al-Dayn* or sale of debt, relates closely to the issue of suitability of assets discussed above. The issuance of Islamic bonds, for example, evidences the indebtedness of the purchase price that is to be paid at the end of the tenure. These bonds are then sold to interested parties at the secondary market. In this event, the asset used is the debt itself and therefore the issue of whether or not a "debt" is a suitable asset for trading arises.

The Islamic Fiqh Academy of the Organization of Islamic Conference has ruled that sale of debt is permissible as long as it is free from *riba* and *gharar*. This therefore depends on the nature of the debt. For example, if the debt has receivables in monetary form, it is considered to be similar to money and thus the rules of the exchange of money will apply.

Dr Engku has then commented that the practice of debt trading in Malaysia may not be compliant for a number of reasons: firstly, it involves monetary receivables, secondly, the price paid for the debt is in monetary terms and lastly, the rule on parity in the exchange of money for money is not observed because of the practice of discounting. Yet, the *Shariah* Advisory Council of the Securities Commission of Malaysia has ruled that the practice of sale of debt to third parties together with discounting is permissible.

## Forging the right path

Another interesting factor to note is the doctrine of *helah*. Developed by the *Hanafi* jurists to achieve a purpose, which in form is seen to be within the spirit of *Shariah* law, but which end result is not deemed essential. As long as the form subscribes to the compliance of Islamic norms on usury, the *Hanafi* jurists opine that the *intention* does not matter.

Indeed the operation of many products or instruments currently offered will appear to be an infringement of the Quranic injunctions, if not for the acceptance of the doctrine of *helah* in modern Islamic literature.

Some quarters have argued that *Shariah* banking in Malaysia and other parts of the world is at its transitional state and criticisms should not then be dispersed so harshly. The *Al-Quran* has been around since Prophet Muhammad's days and countless transactions have been tried and tested successfully since then.

It should be remembered that the *Al-Quran* is not just about dos and don'ts and it is definitely not just about religious beliefs. For purposes of this article, it is about, among other things, legal and economic sense. This article is therefore written as a gentle reminder – lest we forget that in our quest to satisfy the mass market – the correct mode of Islamic banking is disregarded and the true value of *Shariah* banking laws will never be fully appreciated.

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Note : Roseleen Abdul Rahman is an advocate and solicitor practicing in Malaysia. She graduated with LLB (Hons) from University of Kent at Canterbury and was called to the Malaysian Bar in 2001. Her current practice includes private debt securities, corporate banking with a keen interest in Islamic banking and finance.

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# INDUSTRY SECTOR REPORT

## Corporate Governance within an Islamic Banking Paradigm *By Professor Bala Shanmugam*

**Business activity took centre stage in the livelihood of early Muslims and having encouraged and subsequently established a very mercantile society the scriptures went on to make righteousness within business a divine pre-requisite.**

To assist the community on what constitutes good and bad, *halal* (allowed and praise worthy) and *haram* (prohibited and blame worthy) codes were introduced to regulate all production and distribution. Business virtues were codified into positive values such as *iqtisad* (moderation), *adl* (justice), *ibsan* (kindness), *amanah* (honesty), *infaq* (meeting social obligation) and *sabr* (patience). Negative values were identified as *zulm* (tyranny), *bukhl* (miserliness), *hirs* (greed), *ikhtinaz* (hoarding) and *israf* (extravagance).

Business ethics and governance guidance came hand in hand with Islamic commercial activity giving it the basic building blocks needed for today's (western) notion of corporate governance. Nonetheless there are some major differences between Islamic and Western perspectives of governance and best practices.

For a start, the central authority in guiding best practices is rather secular or humanist in nature in the West, while it is strictly religious (*Quran* and *Hadith*) within the Islamic system. The source of all conventional (western) activity emanate from the need for the preservation of rightful self interest while within the Islamic system the wider society (*ummah*) is just as important, if not more.

Yet another view, which makes Islamic concepts of governance totally different from the West is the central thought of stewardship or trusteeship. In the West the governance debate is largely an agency issue whereas the Islamic view is one of stewardship or trusteeship, in other words wealth belongs to the Maker and everyone else – from the manager, shareholder to the stakeholder – is the trustee to this wealth.

How does this Islamic notion of governance fit into an Islamic banking paradigm? Even within the conventional system, corporate governance is a thorny issue with respect to banks. Issues of confidentiality have major consequences for banks that result in banks being more opaque compared to other institutions. This variable greatly intensifies the agency problem. What's more unlike other corporate entities banks are exposed to extreme regulation that stifles efforts to become more 'broad-based' in their outlook.

On top of this government ownership of banks (even indirectly) makes the governance of banks different and difficult relative to other types of organisations. Then of course, there is the on going debate of the length of the arm of corporate governance. Should it reach out only to shareholders or be extended to stakeholders? Does the management owe fiduciary duties of care and loyalty to shareholders or extend it to stakeholders and if so how far down the line (of stakeholders) must their loyalty go?

The standard law and economics view regarding fiduciary duties (thus far) is that corporate entities (and their directors) owe fiduciary duties to shareholders and shareholders alone.

### Corporate governance in Islamic banking

Transplanting this unresolved and vexing predicament onto Islamic commercial institutions has major implications for Islamic banks, as they also have partnership relationships via their *mudarabah* transactions (*Mudarabah*, meaning speculation, is based on a contractual agreement for profit-sharing between an Islamic financial institution providing 100 percent of the capital of a venture and an entrepreneur managing the venture). The management therefore has two categories of equity holders - shareholders and *mudaraba* parties.

It has often been questioned how equity can be ensured between shareholders who are investors in the bank and depositors who are investors in *mudarabah* funds managed by the bank. Would a conflict of interest not arise? Needless to say the management of Islamic banks tend to be confronted with an ethical dilemma when faced with such a conflict.

On a practical note, the management must bear in mind that it is the shareholder and not the *mudarabah*-partner who enjoys the benefits of appointing, evaluating and dismissing the management. Since shareholders are the ultimate decision makers when it comes to renewal of management tenures, the management tends to favour shareholders as opposed to *mudarabah*-partners and as a consequence during distribution of profits between shareholders and partners the former tend to receive what may be due to the latter.

### Role of Shariah Supervisory Board

Even so, it has to be reiterated that ethics and governance issues are well entrenched in Islamic finance. It may not, however be as sophisticated to meet today's complex and complicated web of commercial dealings. To do so, the *Shariah* Supervisory Board (SSB) at each individual financial institution may have to extend their jurisdiction. (The SSB's primary role is to ensure that the bank's activities are *shariah* compliant.)

While board members include those who are qualified in Islamic Jurisprudence, the problem however lies in the fact that members of the SSB may lack such monitoring skills. Beefing up the composition of the SSB may overcome this problem.

The means, capabilities and the will of the SSB should also perhaps go beyond *fatwa* issuance that seems to be their mainstay in many countries. An alternative may be to have the *mudarabah*-partners to sit on the bank's Board of Management or be part of the SSB.

These are some issues that Islamic banks have to resolve in their stride to become major players in the global financial market place.

*Note: The author holds the Chair of Accounting and Finance at Monash University Malaysia. He is also the Director of the Banking and Finance Unit. As Head of the Accounting and Finance Department he supervises postgraduate research, undertakes independent research and consulting and teaches postgraduate classes. He has an extensive publication record.*



# COUNTRY UPDATE

## New Zealand Business Learns the Meaning of *halal* By Faris Azimullah

Until recently, doing business the Islamic way in New Zealand was probably best and only understood by its huge meat export industry where exported meat is currently certified *halal* (or acceptable under Islamic principles) as part of the slaughter procedure. This is understandable as agricultural products account for more than 50% of the country's total exports.

While doing business the Islamic way hardly raises eyebrows when it comes to exported meats, the same cannot be said about the financial sector. With only 40,000 New Zealanders (Kiwis) who are Muslims - representing 1% of total population - there is virtually no Islamic financial offering at present. This is despite the Muslim community being tightly knit, very active and well represented within the full spectrum of New Zealand business.

While New Zealand has Mosques and Islamic schools, Muslims currently have no choice but to pay and receive interest on loans and savings, and there is currently no *Takaful* offering whatsoever.

But this looks set to change. The local financial players do understand the potential and see it as much more than servicing the Muslim population. Using Malaysian and other countries as examples, we have evidence showing Islamic products outperform conventional loans. In Malaysia for example non-Muslims represent 70% of the market take-up of Islamic products.

We understand that at least one Deloitte client plans to offer *Takaful* as early as February 2005 coinciding with the start of the Islamic New Year. In a country with nearly all consumers being rather sophisticated when it comes to personal and commercial banking and insurance, banks and insurers need to have innovative products to win and retain market share from competitors.

Through our public seminars, we see that more New Zealand businesses are keen to take up Islamic funded ownership schemes instead of conventional loans.

### Establishment of Islamic savings and loan co-op

One of the most significant and exciting developments as recently as October 2004 is the now approved project by the Federation of Is-

lamic Associations of New Zealand (FIANZ) to establish an Islamic savings and loans co-operative in New Zealand where no interest will be charged or taken.

The proposed structure will operate much like a conventional bank covering all the usual features such as Automated Teller Machines, Internet banking, telephone banking and card services. A US\$4 million investment is now being sought globally to establish the entire scheme.

Needless to say the major retail banks are watching to learn about this innovative and to see if it is a commercially viable alternative.

It is certainly heartening to see strong support locally for this initiative. It is understood that individuals in New Zealand are already raising their hands to pull some of the funds together. FIANZ will also be looking to beyond New Zealand's shores for financial support.

In promoting Islamic finance there is a need to work at multiple levels with various banking and finance players; targeting the niche Muslim population, to retail banks considering *Shariah*-based products for all New Zealanders as well as raising awareness within the government to facilitate foreign direct investment.

A Merrill Lynch study reports that some US\$1.3 trillion is being diverted from US markets since the terrorist attacks. While Australia is probably a few steps ahead in recognising this huge opportunity, New Zealand - thanks to its green image and neutral foreign policy - is probably still a preferred location for Middle East investors looking for *halal* investments in this region.

If the government does not cater for these clients, we will have simply missed the boat.

**"New Zealand businesses are keen to take up Islamic funded ownership schemes"**

*Note: The author, Faris Azimullah is a director of Risk and Assurance for Deloitte New Zealand*

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ISLAMIC FINANCE INFORMATION SERVICE

## ISLAMIC FUNDS UPDATE

Starting 22<sup>nd</sup> November 2004 Islamic Finance News in conjunction with EurekaHedge will bring you exclusive regional Islamic Fund League Tables. Including: Top 10 performers; along with the monthly, 3 monthly and Year-to-Date returns, in addition to newly launched Islamic Funds.

### ISLAMIC FUNDS INDUSTRY OVERVIEW *By Grant Koziol, EurekaHedge*

The modern Islamic fund management industry was born in the 1970s, when a new class of Arab investors, rich from oil profits and celebrating the 15th Century of the Islamic calendar (Hijra) in 1976, sought a culturally-aware alternative to the "profit at all costs" mentality of western investing, particularly in interest-dealings. The industry has been growing ever since: Islamic banking is active in 75 countries and is growing at 15 percent globally, with an estimated one trillion dollars waiting to be managed.

The primary characteristic that distinguishes Islamic fund management from conventional investing is its compliance with Shariah Law. Fund Managers who are Shariah compliant must adhere to moral economic activity and invest only in companies that have an ethical purpose. In addition, the investors cannot deal with conventional banks that deal in fixed rate interest, or *Riba*, but instead would depend *Ijara*, an Islamic method of financing. Investments must also be screened for companies that trade items restricted in Islamic laws, such as alcohol, tobacco, pork, gambling, or pornography. While limiting investment strategy might seem a hindrance, there are advantages to this "ethical" investing. For instance, Islamic funds were little affected by the scandals afflicting companies such as Enron and WorldCom several years ago, as these companies' highly leveraged balance sheets restricted Shariah funds from buying them. In fact, some conventional managers have adopted Shariah law for strategic purposes.

Today, there are over 250 Islamic financial institutions with assets around 230 billion. Vast wealth of Islamic fund management is not well-diversified Saudi Arabia controls 70% of all assets under management. The primary fund management companies that cater to these investors are Citibank (Saudi American Bank), HSBC (Saudi British Bank/Al Amanah), Al Rahji, and Al Ahli. Outside the Muslim world, London is the world's hub of Islamic banking activity; however, its

banks offer few retail products to the Muslim community.

In Southeast Asia, Malaysia is the aggressive force, holding nine percent of Muslim finances. Reciprocally, Islamic banking comprises 10% of Malaysian finances. With a dominant force like Saudi Arabia in the mix, Malaysia's goal of being the number one player in the Islamic fund industry presents a daunting challenge. However, its efforts to woo rich Saudis with industry liberalization following the 9-11 attacks have given it a decisive regional advantage.

One of the key factors towards propelling Islamic investment management into the mainstream is to acquire non-Muslim funds and clients, a trend which has already materialized in Malaysia: 70% of Malaysia's Islamic banking customers are Chinese. However, this trend may owe more to the distribution of wealth in Malaysia than to demographic preferences. Singapore also intends to throw its hat into the ring, according to the MAS's new chairman, Goh Chok Tong, who plans to attract more Islamic business to the country. In addition, OCBC, DBS, and UOB, Singapore's three principal banks, manage Islamic funds and are exploring opportunities in Malaysia, and to a lesser extent, the Middle East.

The world of Islamic finance extends far beyond basic fund management, particularly in Sukuk (Islamic bonds) and hedge funds. In fact, the first Shariah compliant hedge fund – the Shariah Equity Opportunity Fund – was launched on October 10 in the Gulf, although the Shariah restrictions reduce its risk and speculative structure. Given the recent surges in oil prices, private wealth in the Middle East is expanding at unprecedented rates, and currently stands at about 1.5 trillion, much of which is more inclined to invest domestically, as long as there is supporting infrastructure. To the victor who can capitalize on these investment opportunities, the spoils will undoubtedly be tremendous.

### THE EUREKAHEDGE ISLAMIC FUND DIRECTORY

*Launch: November 2004*

EurekaHedge are proud to announce our latest project, The EurekaHedge Islamic Fund Directory.

This is the world's first directory to approach this growing area of investment management in a comprehensive manner. We will bring our expertise in investor information to produce a text of unparalleled depth. The directory will represent a collection of mutual, Murabaha and hedge funds compliant with Shariah Law (see article below).

#### Key Facts and Figures

- With over 160 Islamic mutual funds the directory will be the largest of its kind.
- Approximately 10% of these funds will be Murabaha funds.
- 3000 copies will be printed and distributed to Islamic investors in the Middle East, Malaysia, Indonesia, Pakistan, India, UK & US.

- Directory contributors will receive both a hard copy and complimentary online access to the database.
- The inaugural edition will be printed in November 2004 and the accompanying website will be launched simultaneously.

#### Islamic Fund Market Information

- The Islamic fund market is estimated to cover US\$230 billion assets under management worldwide.
- The biggest investor pool for Islamic funds, representing around 70% of assets under management, is Saudi Arabia.
- Malaysia is the biggest player in Asia and currently holds 10% of all global Islamic assets.

[Please click here to view a sample fund in the directory](#)  
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# ISLAMIC LEAGUE TABLES

Islamic Finance News has teamed up with Dealogic to bring you up-to-date league tables every two weeks depicting the leading issuers and arrangers in the Global Islamic Debt Capital Markets.

TOP 20 ISSUERS OF ISLAMIC DEBT 2004 YTD				
	Issuer	Deal Value (US\$m)	Deals	%Shr
1	Kapar Energy Ventures Bhd	895	1	32
2	Putrajaya Holdings Sdn Bhd	395	1	14
3	BMA International Sukuk SPC	250	1	9
4	Optimal Chemicals (Malaysia) Sdn Bhd	149	10	5
5	Stichting Sachsen-Anhalt Trust	120	1	4
6	Optimal Glycols (Malaysia) Sdn Bhd	119	10	4
7	Mid Valley City Sdn Bhd	105	2	4
8	National Central Cooling Co (Tabreed)	100	1	4
9	Talam Corp Bhd	66	8	2
10	Petroliam Nasional Bhd - Petronas	66	5	2
11	Selia Selenggara Selatan Sdn Bhd	52	2	2
12	Lingkar Trans Kota Holdings Berhad- LITRAK	46	5	2
13	SI Capital Sdn Bhd	44	1	2
14	Ingress Sukuk Bhd	42	3	2
15	EP Manufacturing Bhd	39	1	1
15	Merbok Hilir Bhd	39	1	1
17	Pesaka Astana Sdn Bhd	37	3	1
18	Atlan Holdings Bhd	34	2	1
19	Glomac Bhd	30	5	1
20	OSK Properties Sdn Bhd	26	1	1
<b>Grand Total</b>		<b>2,757</b>	<b>76</b>	<b>100</b>

ISLAMIC DEBT 2004 YTD				
	Bookrunner	Deal Value (US\$m)	Deals	%Shr
1	AmMerchant Bank Bhd	1,333.9	3	49.0
2	RHB Capital Bhd	895.3	1	32.9
3	Aseambankers Malaysia Bhd	385.9	27	14.2
4	HSBC	376.3	28	13.8
5	Citigroup	370.4	2	13.6
6	United Overseas Bank Ltd	151.1	7	5.5
7	Credit Suisse First Boston	100.0	1	3.7
8	Amanah Short Deposits Bhd	92.1	7	3.4
9	KAF Discount Bhd	81.6	11	3.0
10	Abrar Discount Bhd	65.8	8	2.4
<b>Grand Total</b>		<b>2,722.8</b>	<b>74</b>	<b>100</b>

ISLAMIC DEBT BY COUNTRY 2004 YTD				
		Deal Value (US\$)	Deals	%Shr
	Malaysia	2,218.3	68	81.5
	Bahrain	250.0	1	9.2
	Germany	120.4	1	4.4
	United Arab Emirates	100.0	1	3.7
	Indonesia	34.1	3	1.3
<b>Grand Total</b>		<b>2,722.8</b>	<b>74</b>	<b>100</b>

ISLAMIC DEBT BY CURRENCY 2004 YTD				
		Deal Value (US\$m)	Deals	%Shr
	Malaysian ringgit	2,218.3	68	81.5
	US dollar	350.0	2	12.9
	Euro	120.4	1	4.4
	Indonesian rupiah	34.1	3	1.3
<b>Grand Total</b>		<b>2,722.8</b>	<b>74</b>	<b>100</b>



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## MOVES & PROMOTIONS

### Lehman Brothers - Hong Kong

Charles Alexander has been appointed as the new Head of Asian corporate finance to be positioned in Hong Kong where he will report to Kunho Cho, Lehman Brothers' Head of Investment Banking for the Asia Pacific region. He will head Lehman's non-Japan Asia corporate finance and M&A origination. Previously Alexander was co-head of European corporate finance based in London.

### National Bank of Bahrain - Bahrain

Adnan Fathalla A. Rahman has been promoted to the position of Manager in the Bank's Personnel Administration Department. Adnan joined the bank in 1994.

The promotion is in line with the bank's policy to develop Bahraini staff potential and encourage them to attain higher levels of responsibility.

### Sovereign Asset Management - Bahrain

James Fitter, Chief Executive Officer, has announced the opening of its office in Dubai, which has been registered to conduct business within the recently established Dubai International Financial Centre. Fitter said that the office in Dubai brings Sovereign closer to the Asian markets where the group already has considerable interests as well as placing them in a key centre for the energy markets.

### Abu Dhabi Commercial Bank - UAE

H.E. Saeed Mubarak Rashid Al Hajeri has been appointed as its new Chairman. He will succeed H.E. Fadhel Saeed Al Darmaki, who has been with the bank since its inception in 1985.

### ARAB Insurance Group - Bahrain

Sultan Ahmed Al Gaith has been appointed as a new board member of the Bahrain based Insurance Group.

Al Gaith has also been appointed a member of the Executive Committee of the board. Other prominent positions held by Al Gaith include; Director-General of the General Pension and Social Security Authority of the United Arab Emirates, board member of Emaar Property, Dubai Islamic Bank, Arab Bank of Foreign Trade and the Emirates Cooperative Society.

IF YOU HAVE ANY APPOINTMENTS OR MOVES YOU WOULD LIKE TO ANNOUNCE, EITHER EMAIL US AT [PressRelease@IslamicFinanceNews.com](mailto:PressRelease@IslamicFinanceNews.com) OR FAX US ON +603 2141 5033

#### EVENTS DIARY

#### Islamic Retail Finance 2004

The Grange Hotel, Holborn, London  
Monday 22<sup>nd</sup> - 23<sup>rd</sup> November 2004  
Organised By: Islamic Conferences Group

#### Islamic Retail Finance

The Café Royal, London  
Monday 29<sup>th</sup> - 30<sup>th</sup> November 2004  
Organised By: IQPC

#### Role of Islamic Financial Institutions in Resource Mobilization

Beirut, Lebanon  
Wednesday 1<sup>st</sup> - 2<sup>nd</sup> December 2004  
Organised By: Islamic Development Bank

#### The World Islamic Banking Conference

The Gulf International Convention and Exhibition Centre,  
Bahrain  
Saturday 11<sup>th</sup> - 13<sup>th</sup> December 2004  
Organised By: Middle East Global Advisors

#### The First International Symposium on Takaful

The Movenpick, Dead Sea Resort & Hotel, Jordan  
Wednesday 12<sup>th</sup> - 13<sup>th</sup> January 2005  
Organised By: Islamic Conferences Group

#### Marine Money Gulf Ship Finance Conference

Grand Hyatt Hotel, Dubai  
Wednesday 2<sup>nd</sup> February 2005  
Organised By: Marine Money Greece

If you would like to place your event in this section, please fax us your event details at +603 2141 5033.

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#### ISLAMIC FINANCE Training

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