

Investor guide to Islamic Finance in Malaysia

International islamic banking



Introduction

International Islamic banks (IIB) are qualified foreign or Malaysian financial institutions that conduct a wide range of international Islamic banking business in international currencies other than Ringgit Malaysia with residents and non-residents.

The first Islamic bank in Malaysia, Bank Islam Malaysia, was established in 1983. Currently, there are 19 Islamic banks (including two IIBs) representing about 34% of the total number of banks in Malaysia. Nearly all the major conventional banks have Islamic banking operations.

As at May 2009, the total Islamic banking sector in Malaysia by asset size stands at RM203 billion (US\$58 billion).

ACKNOWLEDGMENT

We would like to acknowledge Bank Negara Malaysia, Malaysia International Islamic Financial Centre and other organisations for the use of information extracted from their publications and websites.

Scope of business activities

Islamic banking business in international currencies include:

- commercial banking business;
- investment banking business [subject to laws, guidelines and regulations enforced by the Securities Commission of Malaysia]; and
- other banking businesses in Malaysia, as may be specified by the central bank, Bank Negara Malaysia.

These businesses include dealing in international currencies, deposit-taking, provision of finance, investment banking services, and investment in securities and properties.

An IIB may also carry out the following businesses:

- In transacting with a resident, the IIB is allowed to:
 - a) maintain a foreign currency account for the resident to retain any foreign currency receipts other than export proceeds; and
 - b) extend foreign currency credit facility to the resident other than trade financing facility involving exports.
- In respect of Ringgit Malaysia transactions, an IIB is allowed to:
 - a) hold Ringgit Malaysia instruments for investment purposes;
 - b) maintain a Ringgit Malaysia account with any onshore Islamic bank licensed under the Islamic Banking Act 1983 (IBA); and
 - c) maintain an external account in any onshore Islamic bank licensed under the IBA to facilitate Ringgit Malaysia investments by its non-resident customer.

Eligibility criteria

An applicant wishing to establish an IIB shall observe the following general eligibility criteria:

- a well capitalised and reputable licensed financial institution;
- adopts international banking practices formulated by the Bank for International Settlements, the Islamic Financial Services Board (IFSB) or any other international standard-setting body(ies) of equal standing;
- regulated and supervised by a competent home regulatory authority; and
- possesses a sound track record.

Modes of entry

All IIBs are governed and licensed under the IBA and may be established either as a subsidiary or as a branch in Malaysia.

100% foreign equity ownership allowed.

Capital requirements & licensing fee

The minimum paid-up capital and net working funds for IIB set-up as subsidiary or branch is RM10 million (US\$2.9 million) or its equivalent in other currencies.

The annual licence fees for either set-up is RM50,000 (US\$14,500).

Application requirements

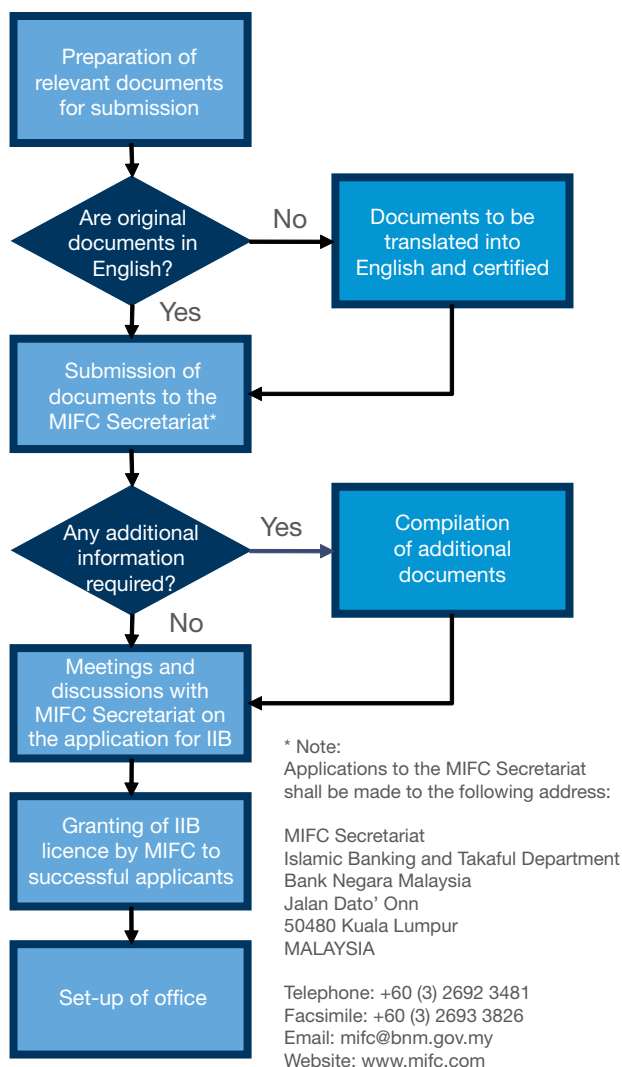
An application to establish an IIB must be made in the prescribed Form IIB to MIFC Secretariat that includes, among others, the following:

- Audited financial statements of the applicant for the last two years;
- A business plan of the proposed IIB that outlines, among others:
 - a) objectives and types of banking business to be carried out;
 - b) target markets and business operations; and
 - c) risk management plan and the reporting control.
- A memorandum of association and articles of association or other instrument under which the applicant is incorporated, duly verified by a statutory declaration by a senior officer of the applicant;
- Letter of awareness from the home regulatory authority that supervises the applicant;
- Letter of undertaking from the parent company; and
- Letter of application to the Controller of Foreign Exchange Bank Negara Malaysia to allow the IIB to deal in international currencies.

Upon obtaining approval for an IIB licence, the bank must then be incorporated under the Companies Act 1965 via the Companies Commission of Malaysia.

Application process

An overview of the application process can be illustrated as follows:



Government incentives

- 10-year income tax exemption for IIBs up to year of assessment (YA) 2016;
- Withholding tax exemption on:
 - a) profits received by resident and non-resident depositors; and
 - b) income received by non-resident experts in Islamic finance.
- 10-year stamp duty exemption up to YA 2016 on instruments executed pertaining to Islamic banking businesses conducted in foreign currencies;
- Fast and easy immigration approval for expatriates in Islamic finance and their family members; and
- Tax neutrality has been accorded to Islamic finance instruments and transactions executed to fulfill Shariah requirements. Malaysia's tax neutrality framework promotes a level playing field between conventional and Islamic financial products, hence reducing the cost of doing business in Islamic finance.

Regulatory requirements

IIBs established as subsidiaries are required to observe capital adequacy as provided under the Capital Adequacy Standard issued by the IFSB. Where the home regulatory authority of the IIB has adopted a more advanced approach specified in the International Convergence of Capital Measurement and Capital Standards (Basel II) issued by the Bank for International Settlements, the IIB is allowed to adopt the more advanced approach.

The IIB shall at all times, also observe the following:

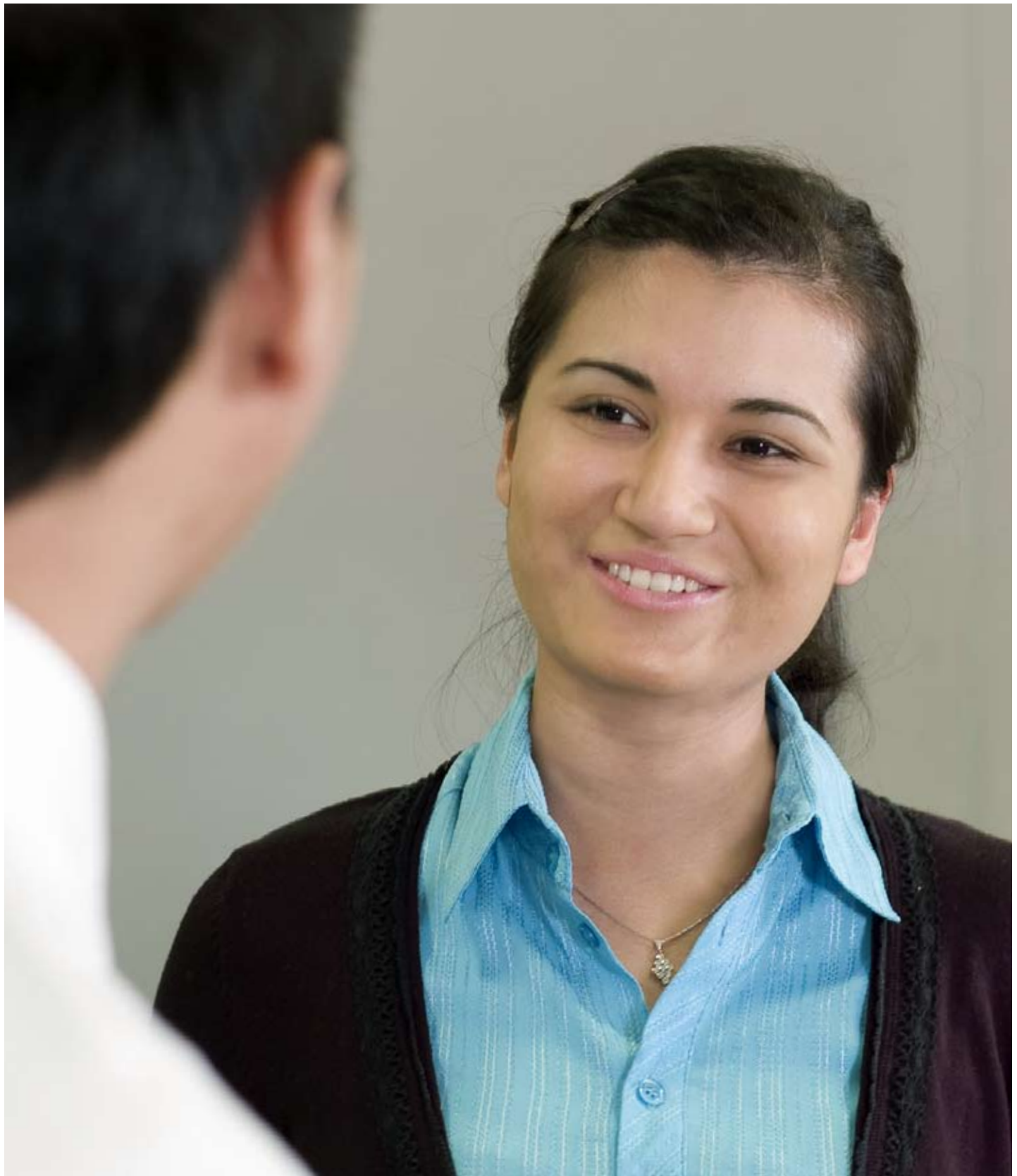
- have in place a comprehensive risk management infrastructure to identify, measure, monitor, and control risks arising from the IIB's business activities;
- maintain sufficient liquidity to meet its obligations at all times as it becomes due and ensure sufficient funds to finance increases in asset;
- effective corporate governance practices;
- ensure that its banking and financial activities are conducted in conformity with the Anti-Money Laundering and Anti-Terrorism Financing Act 2001 and other relevant laws and regulations; and
- appoint Shariah advisors to review the institution's operations and activities to ensure compliance with Shariah requirements, be it by way of appointment of the Shariah advisors in the form of establishing its own Shariah committee, or leveraging on its parent's or group's Shariah committee, or appointing external Shariah advisors.

The IIB is not allowed to source funds from the domestic Islamic money market operations.

Reporting Requirements

- All financial accounts and statements must be prepared and maintained in accordance with the Financial Reporting Standards issued by the Malaysian Accounting Standards Board. Where necessary, further guidance may be sought from International Financial Reporting Standards or standards issued by the Accounting and Auditing Organisation for Islamic Financial Institutions.
- Where an IIB is established as a subsidiary, it is required to appoint an external auditor to provide an independent view of the financial statement's reliability.
- Interim financial statements and the audited financial statements are to be submitted to the Banking Supervision Department of Bank Negara Malaysia within specified timelines.

In addition, the IIB is a resident for the purpose of foreign exchange administration rules and subject to the relevant foreign exchange administration rules for transaction(s) involving foreign currencies.



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