BY ADELINE PAUL RAJ

It has been some ten years since Malaysia opened up its Islamic banking sector to foreign players but the Middle Eastern financial institutions that were first to come have made little headway.

The early birds were Kuwait Finance House (Malaysia) Bhd (KFH Malaysia), Al Rajhi Banking & Investment Corp (Malaysia) Sdn Bhd and Asian Finance Bank (Malaysia) Bhd (AFB).

Fatality returns and increasingly tough competition from local rivals over the years are taking a toll on them, raising questions about their future here.

Industry sources say some of AFB's shareholders are looking to exit and are currently in talks for their stakes to be acquired by Malaysian Industrial Development Finance Bhd (MIDF), via a potential merger. AFB's shareholders are Qatar Islamic Bank with a 66.69% stake, Saudi Arabia's RUSD Investment Bank Inc (16.67%), Yemen's al-Thumaini International Islamic Bank (10%) and Financial Assets Bahrain WLL (6.67%).

“The due diligence was completed a few weeks ago. It's now a question of getting an offer from MIDF,” a source tells The Edge. As early as August last year, The Edge had reported that the two unlisted financial entities were in merger talks.

AFB, in an email response to questions, acknowledged that there are negotiations at the shareholder level but does not make specific mention of MIDF.

“As far as the bank is concerned, we are aware that there are negotiations going on between the shareholders and a new party for a block of shares to be transected. At the moment, the bank is not privy to this transaction, as it is conducted by the shareholders.”

AFB emphasised, however, that there are no plans for it to exit Malaysia.

“AFB wishes to state very clearly that there are no such plans, and the current shareholders of the bank are committed to grow the bank within the economic and business environment in Malaysia. Should the share transaction as stated above, not materialise, then the current shareholders shall take all necessary steps to grow the bank to the next level.”

Given the "transitory situation of the possibility of the share in the bank changing hands", AFB says it has deferred the appointment of a new CEO to replace Bank Asahari Ramli (picture), who retired on Jan 1. The bank is currently managed by an Interim Management Committee, of which the chairman is businessman Anizy Daud.

MIDF, a financial services entity wholly owned by Permodalan Nasional Bhd (PNB), is about twice the size of AFB in terms of assets. Its key businesses are investment banking, development finance and asset management. MIDF is believed to be keen on AFB so as to be able to expand into corporate/commercial banking. It did not respond to a request for comment.

AFB had been making intermittent annual losses since it began operations in 2005, but managed to swing to a net profit of RM5.57 million in FY2013, which then almost doubled to RM10.88 million in FY2014. For the nine months of FY2015, its net profit slipped to RM5.58 million compared with RM13.32 million in the previous corresponding period.

It has two branches—one in Kuala Lumpur and the other in Johor.

Apart from AFB, the talk in banking circles is that Kuwait Finance House (KHF), the parent company of KFH Malaysia—the first and largest of the three Middle East banks here—is keen on selling the Malaysian unit to focus on other growing Islamic banking markets like Turkey.

In May last year, the Kuwaiti entity said it hired Credit Suisse to advise on its options, which included a potential sale of KFH Malaysia. But, in September, after Qatar National Bank came out to say it had ended preliminary talks to buy KFH Malaysia, KFH's CEO Mazin al-Nahedh told Reuters that the company was ruling out a sale or merger for the Malaysian

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Whither the Middle East banks here?

Malaysia: Islamic finance milestones

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Source: MICB

*International Investment Corporation is a common arm of the World Bank
*MICB operates the national stock and futures exchanges.
Local Islamic banks shine, but at the expense of conventional banking?

By Joyce Goh

Unlike some foreign Islamic banks which are still struggling to establish a foothold here, all local banks are openly competing for the same pool of retail customers and foreign investors who have become serious standbys of Islamic banking today.

From setting up small Islamic windows over two decades ago, local banks have grown to become serious standbys of Islamically compliant financial institutions. Today, six out of 16 Islamic banks in Malaysia are foreign-owned.

Islamic banking is a story of change and development. It has experienced a long period of promotion and growth, and continues to evolve and adapt to changing market conditions.

Some leading Islamic banks in Malaysia are:

1. Maybank
2. RHB
3. UOB
4. HSBC

Islamic banks are known for their ethical and socially responsible practices, which have gained popularity among consumers who are conscious of their social impact.

Islamic banking finance is a means of financing activities that are considered to be in line with Islamic values, such as agricultural and small business loans.

Islamic banks offer a range of products and services, including savings, loans, and deposits, which are managed in accordance with the principles of Islamic finance.

Islamic banks are considered to be more transparent and accountable than conventional banks, as they are subject to Islamic law and have a focus on social responsibility.

Islamic banking has become an important part of the financial landscape in Malaysia, and its growth is expected to continue in the coming years.

Islamic banking remains a niche market, but its potential for growth is significant. With the increasing demand for socially responsible investments, Islamic banks are well-positioned to continue their growth and expansion.

Islamic banking is a growing sector in Malaysia, with a strong presence in the country. It has become an important part of the financial landscape, offering a range of products and services that are in line with Islamic values.
Islamic banking assets with rapid-growth markets

Qatar 9%
Indonesia 4%
Saudi Arabia 43%
Malaysia 22%
The UAE 15%
Turkey 7%

Note: Assets share within QISMUT (Qatar, Indonesia, Saudi Arabia, Malaysia, the UAE and Turkey). International Islamic banking assets exclude Iran, which has a rather domestic industry.

Sources: Central banks; BMI analysis

Global Islamic finance assets - US$1.2 trillion (2012)

Global Islamic banking assets - US$0.3 trillion (2012)

Theridge Malaysia | February 22, 2015

Tough competition from local Islamic players

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unit and it would begin restructuring the unit with immediate effect.

KFH Malaysia, which slipped into a net loss of RM65.3 million in the first nine months of 2014, compared with a net profit of RM79.7 million in the corresponding period in 2013, has been keeping a low profile since. "I think, at the right price, they might sell. But they are not actively looking for buyers at the moment," an industry source tells The Edge.

KFH Malaysia, in an email response to The Edge, says: "Our parent company in Kuwait is committed to the growth of business at KFH Malaysia. With that in mind, we are working closely with them to ensure the business, its aspirations and goals are met."

In FY2014, KFH Malaysia made a net profit of RM80.85 million, slightly lower than the RM97.34 million it turned in a year earlier.

KFH Malaysia hit some rough patches in the three years from FY2009 to FY2011, incurring losses after having to make massive provisions for problematic loans that drew much scandal in the industry at the time.

Bank Negara Malaysia came down hard on it amid speculation that its problems were a result of mismanagement in the earlier years and lax risk management practices. KFH Malaysia returned to the black in FY2012 after a change in leadership and concerted efforts to clean up its books.

The bank's current CEO, its fourth so far, is Ahmed Al S Kharji, a Kuwaiti who took the helm from Al Rajhi in late 2013.

Al Rajhi, who has a stronger focus on retail banking, was the only one of the three Middle East banks to see marginal growth in profit for the first nine months of 2015. It reported a net profit of RM12.74 million in the previous corresponding period. Annual profit in FY2014 stood at RM4.6 million, with RM3.1 million in FY2013.

The bank has yet to appoint a CEO since Bank Negara Malaysia's 1H2014 reshuffle. The acting CEO is Selamat Sirat.

WHY THEY STRUGGLE

The fact that the Middle East banks are struggling, with some likely considering an exit, does not come as well for Malaysia's ambition to become an international Islamic finance hub. This is especially so as more other hubs are emerging, industry observers say.

The country needs to be able to attract and retain Islamic financial banks if it is to remain competitive.

"It could deal a major blow to Malaysia's ambition to become an international Islamic finance hub. Since we began the liberalisation and opening up of our Islamic financial services industry in 2004-05, we have not been able to attract other foreign Islamic players, especially from the Middle East. This gives the sense of lethargy or lack of commitment to capitalise on our first-mover advantage in the quest to be an international financial hub, or at least, a regional financial hub. Either we cajole them to stay a while longer or quickly work on luring new entrants, especially from the Middle East, to Malaysia's Islamic finance sphere," an industry observer tells The Edge.

But why has it been difficult for KFH Malaysia, AFB and Al Rajhi's business to take off? Some 10 years on, they have, at best, seen tepid growth not just in profits, but also assets and market share.

Industry sources put this down to a combination of factors. A key one is that these standards are not yet fully entrenched in Malaysia's thrifts by local banking groups like CIMB and Maybank that have Islamic banking operations backed up by larger balance sheets — allowing them to take on the bigger financing deals and cough up relatively more products.

"The local players also have more branches and have invested much more heavily in technology and infrastructure, which are vital for reaching out to retail customers," an industry source says.

AFB's former CEO, Azahari, when contacted, says while the Middle East banks do have many opportunities to tap, they are sometimes cut-tailed by their relatively smaller capital base.

"As you know, with Islamic banks, the challenges are always about liquidity. And when you talk about the three banks that have got licences in Malaysia, their capital is very small. This is where the challenge is — we do not have the liquidity or the infrastructure to be able to work effectively with the established Islamic banks in Malaysia."

He says the risk appetite of most of these banks is small. "They do not want to take extraordinary risks. So generally, in order for them to do the bigger financing, it has to be part of a syndication. But because their balance sheets are rather small, they will never be able to participate in the big syndication."

He says the banks' Middle Eastern shareholders, most of which have deep pockets, would likely pump in more capital if they find there is a strong value proposition. "It's for the management to convince the shareholders that the returns on their investment would reciprocate the risk-return framework."

On a positive note, while some challenges exist, the case is the lack of pertinancy on the shareholders' part to work more on the investments into Malaysia that has held back the banks' growth. "It's for reasons known only to them, although we could guess a few: the need to invest more back home to develop their own Islamic financial services industry; their perception that Malaysia does not have the skills for Islamic finance has dimmed and; resource conservation in preparation to move to another Islamic financial centre deemed more attractive from various perspectives."

PWC Malaysia executive director of risk assurance services practice, Nik-Shahrazad Sulaiman (picture), points out that while it is true that the local Islamic banks have an advantage when it comes to foreign banks in terms of their bigger balance sheets and retail network, the situation in Malaysia is no different in many other countries.

"But it does not stop the foreign-owned banks from competing effectively in the market. I think the issue goes back to what is the market niche or differentiator which drives the foreign Islamic bank's distinctive value to the customers. Banks which are able to offer superior customer service, a wide array of banking services and consistent risk-management practices would generally flourish in any environment," an industry observer says.

Industry observers note that since most foreign Islamic banks dabble in large part in corporate and project financing, the trend of joint ventures and connections count a lot to secure big deals and transactions, particularly those from the public sector, including government-linked companies.

"This is one area where Middle East Islamic banks lag quite far behind compared with their local counterparts and even Western Islamic banking players," an industry observer says.

It is also a crowded market for a small country like Malaysia which has a population of around 30 million. According to Bank Negara Malaysia's website, there are 16 Islamic banks in Malaysia, of which six are foreign — the three Middle East ones, as well as HSBC Amnah Bhd, Standard Chartered Syariah Bhd and OCBC Al-Amin Bank Bhd.

Additionally, there are three that are categorised as "international Islamic banks", namely Bahrain's AlBaraka International Islamic Bank Bhd (formerly known as Unicorn International Investment Bank), Deutsche Bank Aktiengesellschaft and PT Bank Syariah Muamalat Indonesia Tbk.

This is a number of players for a relatively small market. As such, stiff competition and even overcrowding could be another issue for Malaysia in the years to come.

These Islamic banks may have barely been able to overcome through product differentiation or unique propositions especially in retail banking to maintain the tendency of the banking and finance industry to offer rather homogeneous products and services," the earlier industry source says.

The Islamic arms of big global/regional banks have fared better than the Middle East banks. Over the FY2011-FY2014 period, HSBC Amnah's profit grew in each year to peak at RM40.77 million in FY2017, before slipping marginally to RM41.83 million in FY2014. OCBC Al-Amir's profit showed a similar trend, peaking at RM64.49 million in FY2011 before falling to RM37.53 million in the following year.

Over the same period, Standard Chartered's profit grew steadily to RM64.36 million in FY2012 before falling in the next two years. Profit stood at RM37.53 million in FY2014.

What’s clear is that the foreign banks here need to up their game if they are to survive for the long haul in Malaysia. What’s at stake is that losing them could be a gain for other emerging Islamic banking markets such as Indonesia which, even with the country still at the infant stage, has of late been drawing plenty of interest from Middle East banks keen to tap the world’s largest Muslim population.

Bank Negara Malaysia says it will respond to The Edge’s questions on the state of the industry this week.