

Deepening the Islamic Financial Market and Liquidity Management

Introduction

Malaysia aspires to be a global leader and international gateway for Islamic finance. This has to be supported by a well-developed Islamic financial market comprising an effective liquidity management system and fund raising or financing avenues. Bank Negara Malaysia (BNM) has been at the forefront of efforts to promote the growth and resilience of Islamic financial market as an important pillar to support a sustainable, inclusive and diversified economy.

The development of the Islamic financial market in Malaysia

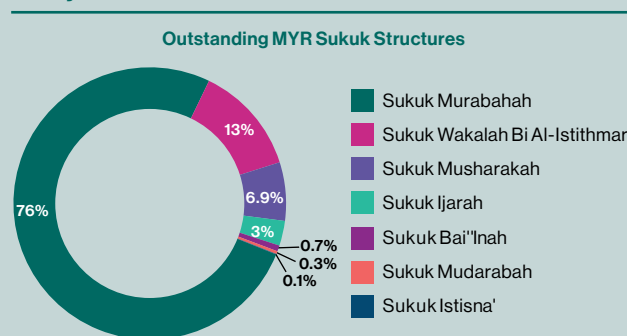
Malaysia's Islamic financial market benefits from a diverse range of market participants including Islamic banks, takaful and retakaful operators, fund managers and multilateral development banks (MDBs). An array of products and Shariah-compliant instruments including sukuk and equity instruments have been developed and are actively traded. The vibrant Islamic financial market also helps to facilitate efficient product pricing and liquidity management.

BNM continues to develop the Islamic financial market with the following key focus areas:

i. Continued product innovation

Innovation is fundamental to the growth and adaptability of Malaysia's Islamic financial market, ensuring it meets the demands of a rapidly changing economic environment. The Islamic financial market offers a wide array of instruments to investors including the Malaysian Government Investment Issues (MGII). In 2024, Government of Malaysia announced *wakalah bi al-khadamat* (agency contract for services) structure which will add to the diverse array of MGII. Approved by the Shariah Advisory Council (SAC) of BNM on 30 April 2024, this structure serves as an alternative to *Murabahah*, aiming to diversify the underlying Shariah concepts of the instrument. This approach enhances the global appeal of MGII among investors by accommodating more structures to meet diverse investor requirements, aligning with both progressive Shariah interpretations and international market standards. The inaugural issuance of *wakalah bi al-khadamat* structure is scheduled for 2025.

Diagram 1: Composition of Shariah Structures in the Malaysian Sukuk Market in 2024

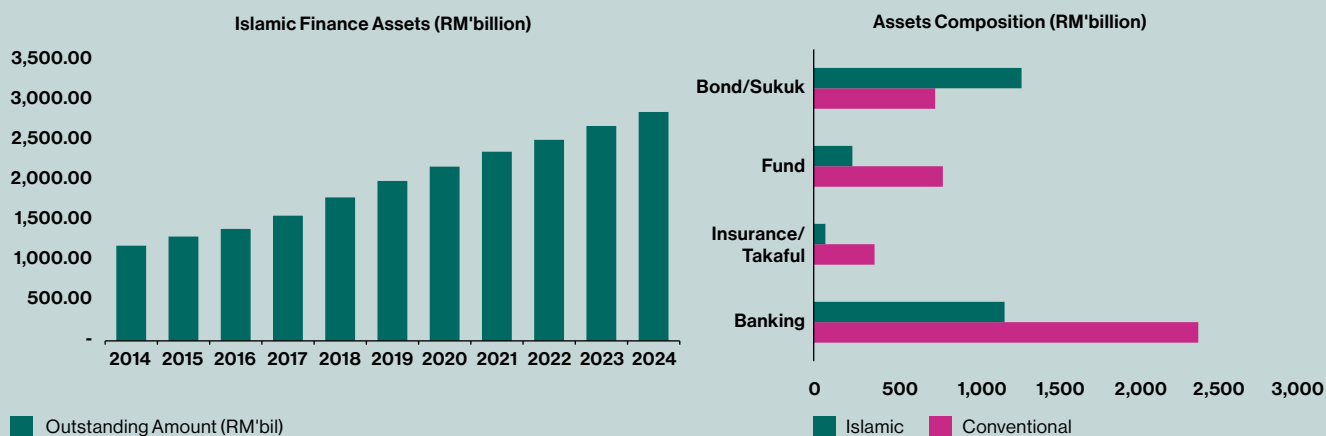


Source: Bloomberg

ii. Expanding the product offerings

To meet the growing investor demand and support the development of Islamic assets, BNM has taken several initiatives to broaden the availability of Shariah-compliant instruments. These initiatives include the development of social finance instruments, which aim to integrate *waqf*, *zakat*, and *sadaqah* into formal financial market instruments. This involves creating a *waqf*-based sukuk to fund community and infrastructure projects, thereby promoting financial inclusion and ethical investments. BNM has also been facilitative of the issuance of MYR-denominated sukuk by MDBs and qualified non-resident development financial institutions by providing regulatory flexibilities, such as broadening investment opportunities for institutional investors.

Diagram 2: Composition of Islamic Assets vs Conventional Assets



Source: Bank Negara Malaysia (Monthly Highlights & Statistics), Securities Commission Malaysia

iii. Aligning with sustainability initiatives

BNM continues to promote the issuance of green and Sustainable and Responsible Investment (SRI) sukuk to meet the expanding financing needs in the renewable energy, biodiversity and public infrastructure projects, in line with the projects identified in the National Energy Transition Roadmap.

Advancing Green Sukuk

Malaysia is well-positioned to support the growth of the green sukuk market domestically and globally. Various efforts are now being undertaken by BNM and market participants to scale up green sukuk adoption and position the country as a gateway for Islamic finance.

The Islamic Financial Market Subcommittee (IFMC)–MIFC Leadership Council (MLC) held a roundtable discussion on green sukuk on 19 August 2024. The roundtable aimed at advancing the sustainability agenda in Malaysia and supporting the Government’s biodiversity sukuk issuance plan. The roundtable identified three key strategies:

- build critical mass by encouraging businesses and issuers to explore green funding through capital market solutions, including blended finance and smaller-ticket sukuk issuances;
- strengthen collaboration with key stakeholders to activate market levers that will enhance the vibrancy of green funding. These levers include developing a green asset pipeline and repository, establishing a strong carbon pricing and market, implementing comprehensive disclosure and reporting practices, and targeted incentives to drive initiatives in transitioning to a greener economy; and
- broaden the investor base and advocate for stronger roles by the institutional investors in shaping the green investment landscape, including fostering stronger ties with MDBs that have aligned mandates and objectives.

Expanding the SRI Sukuk market

The SRI Sukuk market is poised for further expansion, driven by the priorities of energy transition, social inclusivity, and sustainability under the MADANI economy framework. This agenda is closely aligned with Malaysia’s 12th Malaysia Plan (2021–25), particularly Theme 3, which emphasises advancing green growth, enhancing energy sustainability, and transforming the water sector. These strategic focus areas bolster the ongoing push for sustainable financing, positioning SRI Sukuk as a key instrument in achieving the country’s long-term sustainability goals. Within this supportive framework, Malaysia’s ecosystem is well-positioned to facilitate SRI sukuk issuances. As a result, Malaysia experienced a significant growth in SRI sukuk issuances, reaching RM11.9 billion in 2024. This represents an almost ninefold increase since the sukuk’s initial introduction in 2017.

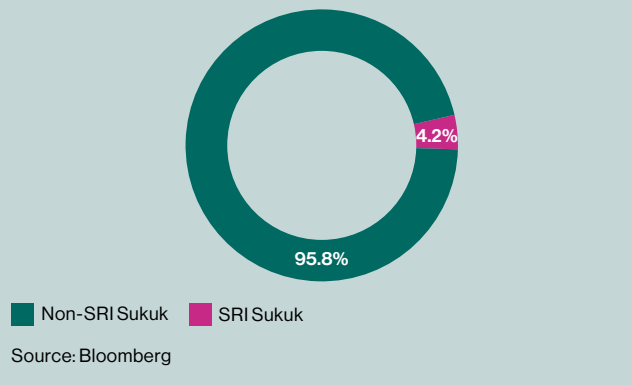
Regionally, Malaysia hosted the inaugural ASEAN-labelled sukuk issuance in 2017 under the SRI Sukuk Framework and has been instrumental in establishing the ASEAN Green Bond Standards. These standards ensure alignment with international best practices while addressing regional needs. Through collaboration with the ASEAN Capital Markets Forum, Malaysia supports efforts to enhance regional capital markets by focusing on sustainable finance, responsible

investment, and strengthening ESG disclosure frameworks. These initiatives have positioned Malaysia as a leader in advancing responsible investment practices within ASEAN’s sustainable finance framework.

Furthermore, BNM continues to support the issuance of ringgit-denominated sukuk by residents and non-residents for use in Malaysia through the facilitative foreign exchange policy. A key objective is to scale up the issuance of SRI instruments to finance climate resilience, energy efficiency and social impact projects. This commitment underscores Malaysia’s leadership role in fostering innovation and growth in the green finance sector within the ASEAN region.

Diagram 3: Composition of SRI Sukuk vs Total Sukuk in the Market in 2024

Outstanding MYR SRI Sukuk vs Non-SRI Sukuk (RM1.33 trillion)



Liquidity management in the Islamic financial market

BNM plays a pivotal role in deepening the Islamic financial market. This includes ensuring that market participants have access to liquidity management tools that comply with Shariah principles while maintaining the efficiency, effectiveness and stability of the financial system.

As part of the efforts to enhance the liquidity management for market participants, BNM introduced the Islamic Collateralised Funding Policy Document (ICF PD) on 28 June 2024 to support the development of the Islamic repo market. The ICF PD provides a structured framework and standards for Islamic repo transactions, thereby improving the overall functioning of the Islamic Interbank Money Market (IIMM). The standardisation of Islamic repo transactions within the IIMM has promoted the efficiency and activity of the interbank market which facilitate short-term funding and liquidity management among the Islamic financial institutions in Malaysia. As a result, the volume of Islamic interbank repo transactions¹ increased by 2.4 times, from RM12.6 billion in 2023 to RM42.6 billion in 2024, indicating strong market adoption and growing liquidity.

Leveraging strategic collaboration to further advance the development of the Islamic financial market

i. Strengthening collaboration through IFMC

Established by the Financial Market Committee (FMC) in May 2022, the Islamic Financial Market Subcommittee (IFMC) serves as an important platform to foster cooperation between the central bank and market participants to drive strategic initiatives for the Islamic financial market. As a baseline, primary focus is to identify and address pain points and challenges within the Islamic financial market. In addition, the IFMC drives strategic initiatives aimed at improving market access and enhancing trading liquidity. The IFMC also focuses on initiatives to strengthen market

¹ Source: Bank Negara Malaysia

resilience through robust risk management frameworks and the adoption of anticipatory hedging tools, which help safeguard market stability against potential disruptions. In achieving its mandate, the IFMC promotes greater participation in the strategic initiatives among Islamic financial institutions, asset managers, corporate entities and MDBs, thereby fostering a dynamic and inclusive market environment.

ii. Advancing Shariah mutual recognition

Islamic finance operates in many jurisdictions with varying Shariah interpretations and a key component in enabling universal participation is mutual recognition. This concept has consistently been a central focus of the Centralised Shariah Authorities Forum (CSAF), an international networking platform that brings together central Shariah authorities from various jurisdictions. The forum aims to discuss current and emerging Shariah issues, leveraging the diverse perspectives and experiences of its member countries. The Malaysian sukuk market stands to benefit from increased foreign investments, which would boost market liquidity and help bridge the gap between conventional and Islamic financial instruments.

BNM actively engages with organisations such as the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and the Islamic Development Bank (IsDB) to articulate Malaysia's Shariah applications and positions to gain recognition and acceptance. While eliminating all differences may not be feasible as it could remove the uniqueness of Shariah itself, finding common ground is essential to promote the comprehensiveness (*shumuliyyah*) of Islam. These collaborations strive to balance local diversity with global applicability, thereby ensuring inclusivity and facilitating broader market integration.

Conclusion

BNM's sustained efforts in innovation, diversification and collaboration continue to position Malaysia as a global gateway for Islamic finance. The alignment of Shariah principles with sustainability agenda, along with strategic partnerships and the leadership of the IFMC, underscores Malaysia's commitment to addressing gaps and meeting future challenges in Islamic financial market. By continuing to innovate and achieve mutual recognition, Malaysia's Islamic financial market is poised for sustained growth, stability, and resilience within a dynamic global economy.