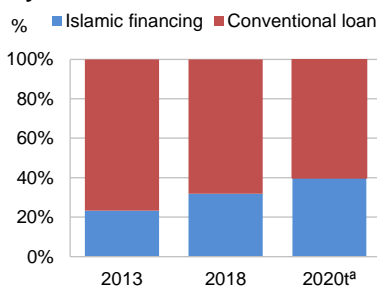


# 2019 Malaysian Islamic Banking Overview

Continued Momentum Amid Regulatory Push

Special Report

## Malaysian Banking System Loan Mix



<sup>a</sup>Government target

Source: Fitch Ratings, Bank Negara Malaysia (BNM)

**Healthy Financing Growth:** Malaysia's (A-/Stable) Islamic banks' financing grew by 11% in 2018 (2017: 9.3%), outpacing that of conventional banking's 3.3%, underpinned by the banks' sustained 'Islamic First' strategy – where banks offer new customers Islamic products over conventional ones – and a supportive regulatory environment. These factors should continue to support Islamic financing growth in the near term.

**Entrenched Sector:** Malaysia's Islamic finance sector is ingrained in the domestic financial market, with Islamic financing and bonds accounting for 32% and 60%, respectively, of domestic banking system loans and outstanding bond issuances at end-2018. The sector also benefits from favourable demographics, tax incentives and prudential banking requirements that are broadly similar to that of conventional banks, providing a level playing field.

**Manageable Asset Quality:** Fitch Ratings expects mild asset quality pressure due to a more subdued economic outlook in 2019, although asset quality indicators remain benign. The Islamic banking sector's gross impaired financing ratio was unchanged yoy at 1.2% as of end-2018 – lower than conventional banks' 1.5%.

**Competition to Pressure Margins:** We expect funding competition to intensify in the run-up to the implementation of net stable funding requirements, potentially as early as 1 January 2020. Islamic banks' lending rates are competitive, and broadly in line with conventional banks' rates. Islamic deposit costs rose faster than average lending yields in 2018, pressuring margins.

**Satisfactory Capital Buffers:** The Islamic banking system's common equity Tier 1 (CET1) ratio of 13.6% at end-2018 (end-2017: 13.8%) should provide an acceptable buffer against significant asset slippage. The Islamic banks enjoy some capital savings for assets funded by investment accounts<sup>1</sup>, in which underlying assets are managed separately from that of Islamic deposits. Islamic Financial Services Act stipulates that investment accounts will be resolved separately using their own asset pools, independent of other funds in a liquidation scenario.

Investment accounts are risk-absorbing and not guaranteed under the deposit insurance scheme. These characteristics make the accounts more risky compared with Islamic deposits.

**Acceptable Funding, Liquidity Profiles:** The system's financing/deposit ratio (FDR), which includes investment accounts, stood at 93% at end-2018. Banks with FDR above 100% bridge their funding by intragroup and other interbank sources. The Islamic current and savings accounts (CASA) mix of 20% is lower than banking system's 26%. We see room for improvement in the CASA mix, aided by better infrastructure and deeper customer penetration.

**Potential Shift in Business Models:** The adoption of the value-based intermediation (VBI) – a sharia equivalent of sustainable and impact financing – may make banks review their credit assessments and business models. Financing that is deemed not directly supportive of real economic activities, such as personal financing for debt consolidation or lending for trading purposes, is discouraged under the guidelines. This may moderately dampen financing growth.

<sup>1</sup>These accounts have a profit-sharing structure and may offer higher returns for customers relative to conventional Islamic deposits.

## Major Malaysian Islamic Banks

Asset Size (MYRbn)		% of group assets
Maybank Islamic Berhad (MAYISL)	211.3	27%
Bank Kerjasama Rakyat Malaysia Berhad (Bank Rakyat) <sup>a</sup>	106.5	100%
CIMB Islamic Bank Berhad (CIMBISL)	95.4	18%
Public Islamic Bank Berhad (PBISL)	61.6	15%
RHB Islamic Bank Berhad (RHBISL)	59.1	25%
Bank Islam Malaysia Berhad (BIMB)	59.1	100%
AmBank Islamic Berhad (AMISL)	39.1	26%

As of Sep 2018 except <sup>a</sup> as of June 2018  
Source: Fitch Ratings, banks

## Related Research

- Fitch: Malaysian Banks 2018 Results in Charts (March 2019)
- Fitch Ratings 2019 Outlook: Asia-Pacific Emerging Market Banks (December 2018)
- Fitch Affirms Malaysia at 'A-'; Outlook Stable (February 2019)

## Analysts

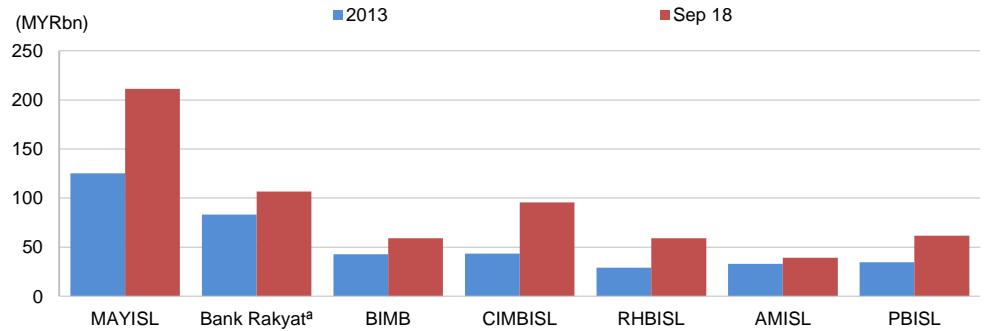
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- There are 16 Islamic banks in Malaysia (excluding development financial institutions). State-linked entities remain dominant. CIMBISL and RHBISL have grown faster than the rest over the past two years.

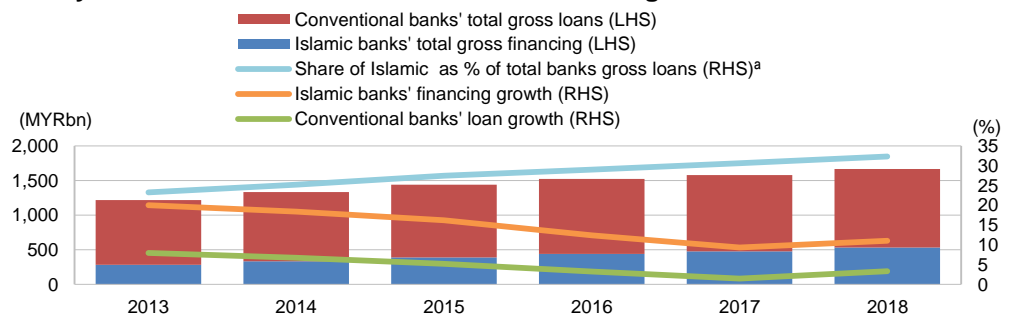
**Major Malaysian Islamic Banks' Asset Sizes**



<sup>a</sup> September 2018 data refers to June 2018  
Source: Fitch Ratings, banks

- Islamic financing, including financing extended through Islamic window, have been growing strongly, and accounted for 32% of system loans at end-2018.
- We believe the government may fall short of its Islamic financing mix target of 40% by 2020, although growth is likely to remain robust.

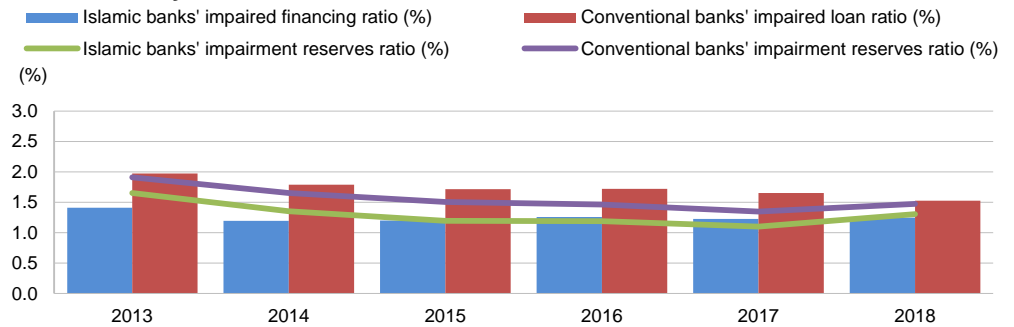
**Malaysia Islamic and Conventional Banks' Lending Growth**



\*includes loans extended through Islamic windows  
Source: Fitch Ratings, BNM

- We expect slight pressure on asset quality in light of the more muted economic outlook.
- Islamic impairment reserve ratio (as a percentage of total financing) of 1.3% is comparable with conventional bank's 1.5%.

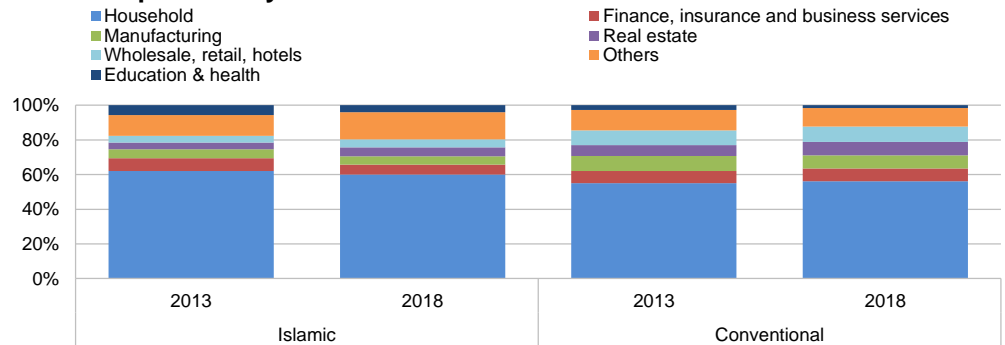
**Asset Quality**



Source: Fitch Ratings, BNM

- Islamic financing has a slightly higher household mix versus conventional banking loans. Financing mix may shift over time as banks adopt the VBI framework.

**Loan Composition by Sector**

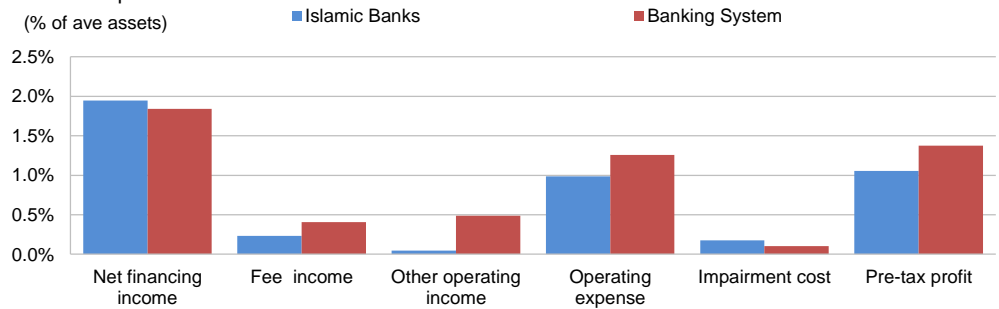


Source: Fitch Ratings, BNM

- Islamic banks have less non-interest income streams versus conventional banks. Trading of traditional financial instruments is prohibited under sharia rules.
- Leveraging group resources may explain the Islamic banking system's lower operating costs.

**Earnings Structure**

2015-2018p ave  
(% of ave assets)

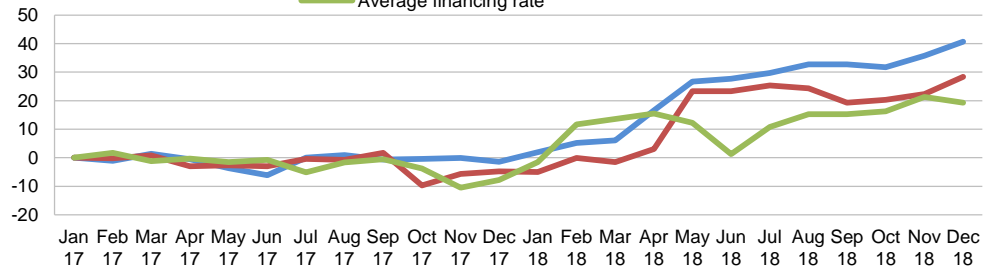


Source: Fitch Ratings, BNM

- Islamic fixed-deposit (tawarruq) rates rose faster than financing rates in 2018, pressuring banks' margins. We expect this trend to persist in 2019. Tawarruq comprise two-thirds of Islamic banks' total deposits.

**Financing and Fixed-Deposit Rates Increase**

(bp)  
 — Tawarruq 12-month fixed-deposit rates  
 — Tawarruq 3-month fixed-deposit rates  
 — Average financing rate

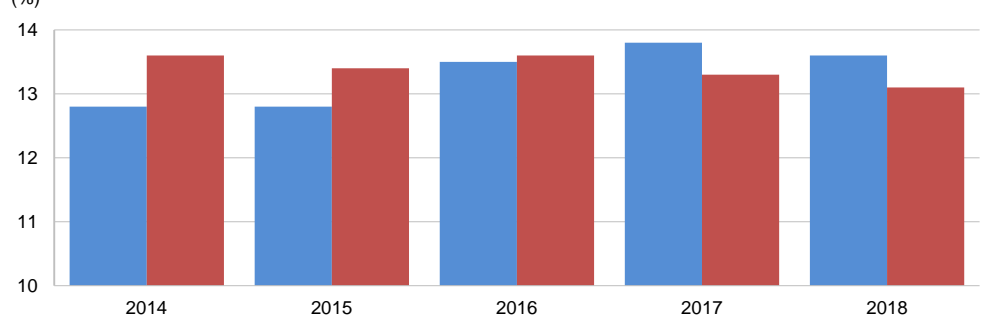


Source: Fitch Ratings, BNM

- Islamic banks have adequate capital buffers. Core capitalisation improved in part due to rapid growth in assets funded by investment accounts, which are zero risk-weighted. These accounted for 10% of Islamic banking assets at end-2018.

**CET 1 Ratio**

(%)  
 ■ Islamic banks  
 ■ Banking system

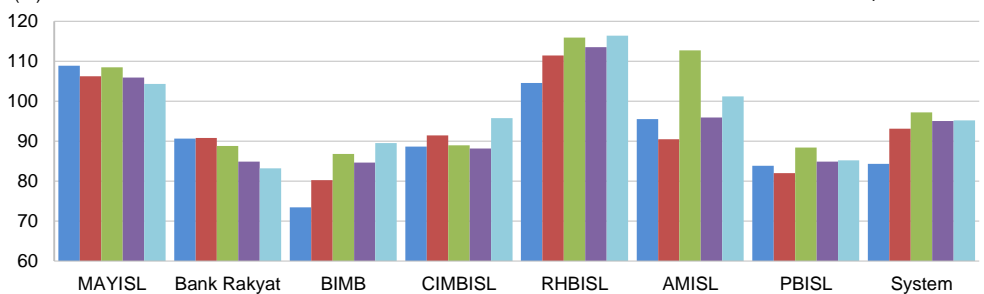


Source: Fitch Ratings, BNM

- System FDR has risen to 93% on rapid financing growth. This could continue to stoke deposit competition.

**Financing/Deposit Ratio**

(%)  
 ■ 2014 ■ 2015 ■ 2016 ■ 2017 ■ Sep 18



Includes investment accounts of customers  
 Source: Fitch Ratings, BNM, banks

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