

Zeti Akhtar Aziz: Sustaining Malaysia as a platform for international Islamic finance

Address by Dr Zeti Akhtar Aziz, Governor of the Central Bank of Malaysia, at the Launching of HSBC Amanah Malaysia Berhad: "Sustaining Malaysia as a Platform for International Islamic Finance", Kuala Lumpur, 25 November 2008.

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It is my pleasure to be here today at this official launch of "HSBC Amanah Malaysia Berhad" (HSBC Amanah). This launch is significant in a number of respects. It reflects the continued expansion of Islamic finance in Malaysia, taking place at a time of great uncertainty in the global financial system. The launch of HSBC Amanah, as an Islamic subsidiary of an international financial group, is also significant as it will contribute towards enhancing further the international dimension of Islamic finance in Malaysia, thus strengthening our international financial and economic linkages with other parts of the world.

The Islamic subsidiary represents the transformation of the Islamic banking window operations into a dedicated entity that allows for greater strategic direction and drive of performance for the Islamic banking business. The advancement of the Islamic subsidiary institutions structure has the potential to further complement the goals of the group by providing an alternative model to spur the expansion of the banking business. It will pave the way for providing strong support in terms of capital, resources and operational infrastructure to elevate performance. In doing so, it will also contribute towards enriching further the diversity of players and strengthening the institutional infrastructure of the Malaysian Islamic banking system.

The continued growth of Islamic finance in Malaysia

The international economic and financial environment is expected to remain very challenging with several major economies now in recession and continued uncertainties prevailing in the international financial system. In spite of this, the Asian economies are still growing, albeit at a more modest pace. The dominance of domestic demand and increasing regional economic integration have enhanced the prospects for Asia to sustain a modest pace of growth.

In this challenging international financial environment, it is encouraging that Islamic finance has continued to demonstrate its evolution and strong growth. Islamic finance has now become a new vehicle contributing to increasing the financial linkages not only within Asia but also with the rest of the world thereby facilitating cross-border allocation of capital globally. Indeed, a number of international financial centres have recognised Islamic finance as an integral part of their financial system in order to complete the suite of financial products and services being offered, and therefore are actively developing this segment. The Islamic finance industry has not only continued to grow but it has also been able to present a higher level of dynamism.

The key indicators of the Islamic banking sector continue to record a progressive pace of development. The Islamic banking assets have expanded by 23% to RM234.9 billion compared with a year ago. The Islamic banking industry now accounts for 16.7% of total assets in the industry. Similar trends can be observed in the growth of deposits that have reached RM180.4 billion, an increase of 27.7% during this period while, total financing has also increased by 24.5% to RM143.4 billion. This growth has also accompanied by an increase in the number of full-fledged Islamic banking branches. From January to September this year, 93 new branches were opened thereby enhancing the outreach of Islamic financial products and services.

Another area that has seen significant growth is in the Sukuk market. The Malaysian sukuk market has expanded significantly with an average annual growth rate of 22 per cent since 2001. Despite the current market conditions that have affected the volume of new bonds and Sukuk issuance, the Islamic capital market has continued to structure innovative Islamic financial instruments. By the first half of 2008, the composition of the more innovative Sukuk *Musharakah* had increased to 84% as compared to 58% of the total sukuk issuance in 2007.

In addition, several new Islamic financial products have been introduced including residential mortgage backed securities, Commodity *Murabahah* deposit products, commodity based financing, credit card based on *ujrah*, as well as, structured products based on *Musharakah*, *Mudarabah* and *Ijarah*.

Malaysia has acquired a unique market space for driving Shariah-based innovation by combining the depth of knowledge with the drive for innovation. The Islamic financial services industry in Malaysia possesses a conducive environment for innovative advancement that is supported by a regulatory framework that ensures not only the stability of the system but also promotes the active and vibrant functioning of the system.

These developments and continued evolution of Islamic finance have demonstrated the ability to not only meet the rapidly changing requirements of the global economy, but also to remain competitive in a challenging environment. Following the greater international interest in Islamic finance, it has gained an increasingly prominent role in the international financial system. This is reflected by the active involvement from governments, corporate sectors and global investors from both Islamic and non-Islamic countries.

Potential role of foreign Islamic subsidiaries

The policy for the establishment of foreign Islamic subsidiaries in our Islamic financial system is also part of the initiative to enhance the outreach of Islamic finance and to strengthen our international linkages. It reflects part of the further liberalisation of the Islamic financial services industry in Malaysia. Foreign Islamic subsidiaries have the potential to promote innovative product development and enhanced international integration of the Islamic financial system.

Firstly, by leveraging on the global networks available, foreign Islamic subsidiaries are well positioned to engage in innovative product development in a more cost effective manner. Malaysia provides an enabling platform such structuring of Islamic financial products and instruments. The recent establishment of the International Shariah Research Academy (ISRA) as a premier research entity has further enhanced the infrastructure to facilitate this innovative process. ISRA focuses on applied research in Shariah and Islamic finance, and provides the avenue for greater engagement between industry players and scholars. In addition, the tax neutrality treatment, has paved the way for the introduction of innovative products such as *Ijarah Munthahiah Bithamleek* (leasing ending with ownership) and *Musharakah Mutanaqisah* (diminishing partnership) in home financing, and currency option using the concept of *Hamish Jiddiyah* (security deposit) and *Tawarruq* (monetisation).

Secondly, foreign Islamic subsidiaries have an important role in enhancing the international linkages of the Islamic finance industry regionally and internationally. Reinforced by a well developed legal, regulatory and Shariah framework and with three decades of experience, our Islamic financial system offers a unique platform as a meeting place between those that require funds and those with surplus funds. Malaysia has the full complement of the financial infrastructure, products and institutions. This is reinforced by the adoption of international regulatory best practices and liberal foreign exchange administration rules. This environment has encouraged the issuance of ringgit denominated sukuk by multilateral institutions and foreign multinational corporations in our market. It has also increased participation of investors in our Islamic financial markets. In a number of the sukuk issuances, the foreign subscribers (other than from Asian region) represent more than two thirds of total

subscribers. Given the investment opportunities in the East Asian region, there are significant potential business activities, especially in the Asia-Pacific region. To optimize the business potential, Islamic financial institutions need to develop their niche strengths and leverage on Malaysia's resources to extend the operations to both the regional and global market.

As a foreign Islamic banking subsidiary, the potential to provide greater market access in the domestic economy and improve the overall financial inclusion is also important. This includes the offering of new financial products to the different domestic economic segments.

Concluding remarks

On this occasion of the official launch of HSBC Amanah Malaysia Berhad, let me take this opportunity to congratulate HSBC Bank Malaysia Berhad on the initiative to establish its own of the Islamic banking subsidiary and for its commitment to contribute to the success of Islamic finance. By allocating dedicated resources in the Islamic subsidiary in Malaysia, HSBC Bank will enhance its potential to contribute to the advancement of Islamic banking business going forward.

I wish HSBC Amanah Malaysia Berhad every success in its endeavours.