

Peter Pang: Islamic capital and money markets

Welcoming remarks by Mr Peter Pang, Deputy Chief Executive, Hong Kong Monetary Authority, at the workshop on “Islamic capital and money markets”, Hong Kong, 19 March 2013.

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Distinguished guests, ladies and gentlemen,

1. It is my great pleasure to welcome you to this Islamic finance workshop. We are particularly grateful to Mr. Mohd. Radzuan, Mr. Azidy and Mr. Azahari, the experts from Malaysia, who have flown all the way to Hong Kong to share with us their knowledge on Islamic capital and money markets and their valuable experience in developing these critical components of Islamic finance. I would also like to thank Mr. Najmuddin of Bank Negara Malaysia for bringing the Malaysian delegation here.

Two fast developing asset classes in the global markets

2. This workshop comes at a very opportune time as Hong Kong is looking to develop Islamic finance as a way to diversify our financial platform and further enhance our capability as an international financial centre. In my view, to be a truly international financial centre, one needs to develop a conducive platform for the two fast developing asset classes in the global markets – Islamic financial products and RMB-denominated investment assets.

3. The development of Islamic financial markets has been phenomenal in the past two decades. The size of global Islamic finance assets made a quantum leap from only US\$150 billion in the mid-1990s to US\$1.3 trillion at the end of 2011.¹ Although the investment climate has been clouded by the US sub-prime crisis and the European sovereign debt problems in recent years, the global sukuk market is powering ahead. Indeed, last year was the best year for the global sukuk market on record, with sukuk issuances growing by more than 60% year-on-year, taking the outstanding sukuk amount to a new height of US\$240 billion.² According to some market estimates, the size of the global Islamic finance industry has the potential to increase five-fold from the current level to some US\$6.5 trillion by 2020.³

4. The development of RMB-denominated investment products is equally impressive. In a short space of 6 years, the size of the RMB dim sum bond market in Hong Kong has grown from a modest amount of 10 billion yuan in 2007 to 237 billion yuan at the end of 2012. Offshore RMB financial products have also become more diversified, expanding from only RMB bonds to RMB equities, RMB investment funds, RMB A-share exchange-traded funds (ETFs) as well as RMB insurance products. The growth momentum of the offshore RMB financial markets is expected to pick up further, as more and more financing and investment activities can now be conducted in RMB, especially following the introduction by the Mainland authorities of the arrangements for inward and outward direct investments in RMB and the RMB Qualified Foreign Institutional Investors (i.e. RQFII) scheme.

5. Hong Kong is fortunate to have made a good start in offshore RMB business. Since the introduction of offshore RMB business in 2004, we have developed a wide variety of RMB-denominated financial products. In particular, the offshore RMB bond market in Hong Kong is by far the largest in the world. We also possess the largest RMB liquidity pool outside of

¹ KFH Research.

² Zawya.

³ KFH Research.

Mainland China. As at the end of 2012, the aggregate amount of RMB customer deposits and certificates of deposits has reached a high of 720 billion yuan. Notwithstanding these, when it comes to Islamic finance, Hong Kong is a relative newcomer and would need to catch up in this area.

Legislative exercise to promote the development of sukuk market

6. In developing Islamic finance, we are taking a step by step approach. As a first step, our current focus is to put in place the supporting legal infrastructure. Specifically, the HKSAR Government is set to change the tax laws in Hong Kong to facilitate the development of the sukuk market. In terms of economic substance, sukuk are no different from conventional bonds. However, since Islamic law prohibits the payment and receipt of interest, sukuk are often structured with the use of special purpose vehicles and multiple transfers of underlying assets. This may result in additional tax liabilities and hence higher issuance costs for sukuk when compared with conventional bonds under the existing tax regime.

7. It is therefore necessary to refine our tax laws to provide a tax framework for sukuk that is comparable to the one applying to conventional bonds. But this does not mean that we are going to confer special tax favours on the Islamic finance sector; rather, our aim is to level the playing field so that financial instruments of similar economic substance will be given similar tax treatments.

8. On this, I am very pleased to see that an amendment bill has been introduced into the Legislative Council earlier this year. The bill adopts a prescriptive and religion-neutral approach, and covers five of the most common types of sukuk globally. Products that can meet the key features and qualifying conditions specified in the bill will be given tax treatments similar to those currently afforded to conventional bonds. This means that sukuk issuers and investors alike will no longer be subject to additional tax and stamp duty charges over and above what they would need to pay for conventional bonds. So, passage of the bill will be a very positive step forward in furthering the development of Islamic finance in Hong Kong.

Synergy between Hong Kong and Malaysia

9. With the legal infrastructure to be in place soon, the next important step will be to develop the Islamic financial markets here. We definitely have a lot to learn from Malaysia in respect of product development and market operation. As I see it, Hong Kong and Malaysia each has different edges in the financial services industry, and the potential synergy between the two places in developing the Islamic financial markets is tremendous.

10. Malaysia is undoubtedly an important leading centre in the global Islamic finance industry that has accumulated vast experiences and invaluable expertise over the past three decades. It has developed a well-diversified Islamic financial market, offering a full suite of products covering sukuk, Islamic equities, Islamic funds, Islamic ETFs, etc. Its sukuk market is by far the largest in the world, accounting for more than 70% of global sukuk issuances last year.⁴ It has also put in place well-developed financial infrastructure which can facilitate local and overseas market players alike in conducting Islamic financial transactions.

11. On the other hand, Hong Kong as an international financial centre has developed a deep and highly liquid capital market with a diverse base of investors coming from all around the world. More importantly, with Hong Kong's unique role as a gateway to Mainland China and a leading hub for offshore RMB business, Hong Kong can offer an ideal platform to link Islamic and RMB financing together by developing financial products that are Shariah-

⁴ Zawya.

compliant and, at the same time, denominated in RMB. Through Hong Kong's platform, international investors in the Islamic world can easily tap the appealing growth story of the Mainland. This is especially given the fact that many investors are now actively looking for investment opportunities in Asia, particularly Mainland China, to diversify their investment portfolios. At the same time, Mainland issuers can also make use of our platform to reach out to the increasingly wealthy investor base in the Islamic world.

12. Clearly, there is a strong foundation for both sides to work together to complement each other, grow the pie bigger and achieve a win-win proposition in developing Islamic finance. For this important reason, the HKMA entered into a Memorandum of Understanding (MoU) with Bank Negara Malaysia in 2009 to strengthen mutual co-operation in the area of Islamic finance. We are very pleased to have worked closely with Bank Negara Malaysia to put together and bring this workshop to Hong Kong under the framework of the MoU. Building a deep talent pool is crucial for further development of the Islamic finance industry. Workshops of this kind will undoubtedly help to promote market awareness and knowledge of Islamic finance, while also providing an excellent forum for market players to exchange views and business contacts. We will continue to work closely with the Treasury Markets Association to raise the expertise in Islamic finance in Hong Kong.

13. Apart from our continuous efforts to put in place a conducive platform, it is also crucial for market players to maximize their readiness to grasp the opportunities brought by the development of Islamic finance in Hong Kong. After all, market players will be the ones who drive the growth of the market ultimately. So, I highly encourage you all to gear up for the new opportunities ahead of us. On this, I am pleased to note that some financial institutions have already started to get ready by mobilizing their staff in the Middle East or Malaysia to Hong Kong, as well as providing training to their staff in Hong Kong. The fact that you are here today is also a good indication that you are keen to prepare yourselves. I hope you would take the most out of this workshop.

14. Thank you.