

Peter Pang: Strategies for the development of Islamic capital markets

Welcoming remarks by Mr Peter Pang, Deputy Chief Executive of the Hong Kong Monetary Authority, at the IFSB seminar on “Strategies for the development of Islamic capital markets”, Hong Kong, 27 June 2013.

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Secretary-General Jaseem Ahmed, Your Excellency Abdullah Salem Al-Turifi, distinguished speakers and delegates, ladies and gentlemen,

Good morning.

1. The Hong Kong Monetary Authority (HKMA) is very honoured to host this seminar organised by the Islamic Financial Services Board (IFSB) with the support of the Treasury Markets Association (TMA). It is a great pleasure to welcome you all and a special thanks to the speakers and delegates who have travelled a long way from overseas to attend this event.

2. This year marks the 10th anniversary of the IFSB. Let me take this opportunity to congratulate the Board for the invaluable contributions it has made in the last decade to develop the Islamic financial services industry, particularly in bringing Islamic financial products to the mainstream by issuing prudential standards that are in compliance with Shariah principles while being consistent with international standards, and organising international events to promote market awareness of the opportunities offered by the Islamic capital markets.

3. The theme of today's seminar – “Strategies for the Development of Islamic Capital Markets” – is most timely and relevant to Hong Kong as we are about to introduce an enhanced legal framework as a first step to promote the sustainable development of Islamic finance and we are eager to learn the other key components to form a coherent strategy. We very much look forward to the insightful views of the distinguished speakers on the latest developments of the global Islamic capital markets, the prospects and opportunities that lie ahead, and further ideas to bring Islamic capital markets to the mainstream.

Growing importance of Islamic finance in the global financial scene

4. Being an international financial centre, it is important for Hong Kong to embrace Islamic finance given its rising prominence in the global financial arena. The size of the global Islamic capital markets has expanded more than 10-fold since its early phase of development in the 1980s, reaching an estimated US\$1.6 trillion at the end of 2012.¹ With this critical mass, Islamic finance has become an integral part of the global financial system not only catering for the needs of Muslims, but also attracting other investors and fund raisers, regardless of race and religion. Reflecting the deepening sophistication of this market, we are seeing an increasing variety of products and services, ranging from Islamic banking products and sukuk, to Islamic equities, Islamic funds and takaful.

5. This remarkable market deepening process has not been retarded by the challenging financial landscape. Despite the global financial crisis and European sovereign debt problems, the Islamic capital markets have shown unparalleled resilience over the past few years. In particular, the sukuk market climbed to new heights for the fourth year in a row, with global sukuk issuance exceeding US\$130 billion in 2012, three times higher than that before the global financial crisis.²

¹ Source: KFH Research.

² Source: KFH Research.

Strengths of Hong Kong in developing Islamic finance

6. Hong Kong is well positioned to add momentum to the globalisation of Islamic finance. As a free and open economy and major international financial centre, Hong Kong has developed a highly liquid and deep capital market with a strong presence of international financial intermediaries and a diverse base of borrowers and investors, a well-established financial infrastructure, a sound legal system, a transparent regulatory framework and a simple tax regime.

7. In addition to these general capabilities in financial intermediation, Hong Kong can play a unique and pivotal role in bridging the investment needs from the Middle East and the funding needs in Mainland China.

8. Many Middle East investors are now actively looking for investment opportunities beyond their domestic borders to diversify their investment portfolios. This trend has been supported by the huge pool of oil-driven liquidity in the Middle East. Last year alone, oil revenues in the Gulf Cooperation Council countries were estimated to be about US\$700 billion.³ Mainland China has been one of their favourite investment destinations given its strong economic growth and emerging market opportunities.

9. On the other side, Mainland China is facing huge funding needs for infrastructure development projects. As China's global financial centre, Hong Kong is an important conduit for Mainland companies to access the international markets and the preferred offshore capital raising centre for Mainland issuers over the past decade. This is apparent from the fact that over half of our stock market capitalisation is Mainland-related and from the high participation of Mainland entities in our dim sum bond market.

10. Against this backdrop, we believe Hong Kong is well-placed to meet the strong investment demand from the Middle East and other parts of the world for Mainland-related Islamic financial products. At the same time, Hong Kong can also provide an ideal platform for issuers from the Mainland and other parts of Asia to issue Islamic financial instruments for satisfying their funding needs.

Bringing Islamic capital markets to the mainstream

11. Addressing one of the key issues to be discussed today, Hong Kong's involvement in Islamic finance will also help to bring Islamic capital markets to the mainstream in two ways: provide a level playing field and encourage market participation in Islamic finance.

12. To bring Islamic financial products to the mainstream, a key task would be to level the playing field with their conventional counterparts. On this front, a study conducted by the Hong Kong Government in conjunction with TMA earlier concluded that there are no major legal or regulatory obstacles to transactions involving wholesale Islamic financial instruments in Hong Kong.

13. However, there is a need to refine the tax regime in Hong Kong in order to provide a level playing field between sukuk and conventional bonds. Owing to Shariah requirements, structuring sukuk often involves the originator setting up a special purpose vehicle for the purposes of issuing sukuk to sukuk holders, and multiple transfers of underlying assets between the originator and the sukuk issuer in order to generate profits. These complex structures, which are not required for conventional bonds, may incur additional tax and stamp duty expenses for the sukuk issuers.

14. I am pleased to see that an amendment bill to address this issue has been introduced into Hong Kong's Legislative Council and is now in the final stages of enactment.

³ Source: *Institute for International Finance*.

The bill, once passed, will enable sukuk to enjoy tax treatments similar to those currently afforded to conventional bonds. This would be a significant milestone in the development of a sukuk market in Hong Kong.

15. Apart from providing a level playing field, equally important is the active participation of market players, including non-Islamic arrangers, issuers and investors in the Islamic capital markets, as they will be the ones who lead market development in the future. Hong Kong is fortunate to have a strong presence of international financial intermediaries who can leverage on their global network of expertise to develop and structure a variety of Shariah-compliant products here.

16. It is also crucial for fund raisers and investors to be aware of the benefits of Islamic capital market instruments and understand their structures and operations. So, we have been working very closely with the TMA and international bodies like the IFSB in bringing Islamic finance seminars and workshops to Hong Kong market participants, like the seminar today, in an effort to raise the awareness and deepen the knowledge of Islamic finance among the financial community. With the gathering of such a distinguished group of speakers, I am sure that we shall obtain useful insights and get a clearer picture on how to prepare ourselves for the exciting developments in the years to come.

17. I wish this seminar every success, and to our overseas friends, an enjoyable stay in Hong Kong. Thank you.