

Zeti Akhtar Aziz: Malaysia as an international Islamic financial centre

Keynote address by Dr Zeti Akhtar Aziz, Governor of the Central Bank of Malaysia, at the dialogue with industry participants on MIFC (Malaysia International Islamic Financial Centre), Kuala Lumpur, 1 November 2006.

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The MIFC initiative was launched on 14 August 2006 amidst strong foundation and steady performance of the Islamic financial industry. It marks the beginning of a new era for the future landscape of the Islamic financial system in Malaysia. Several landmark measures were announced to initiate the MIFC agenda. It is to set the stage for Malaysia to position itself as a centre for the offering of Islamic financial products and services in international currencies to the global and domestic financial community. This presents new prospects and business considerations for financial institutions to realise the potential of evolving a vibrant Islamic financial hub.

Today's dialogue, the first of its kind among key stakeholders, is aimed at promoting greater awareness on the initiative, to discuss implementation issues and to foster greater collaborative effort for the MIFC's overall success. We have with us here today the members of the MIFC Executive Committee, the country's high level coordinating body that has been set up to advance forward this national agenda.

Objectives of MIFC

This national agenda aims to achieve several major objectives. As one of the key intermediation linkages in the global market place, the MIFC can have an important role in accelerating the process of bridging and strengthening the relationship between the international Islamic financial markets and thereby expand the investment and trade relations between the Middle Eastern, West Asia and North Africa regions with East Asia. Situated centrally in the Asian time zone, Malaysia is well positioned to effectively serve the East Asian region. Among the key intermediation role for MIFC is to act as a centre for origination, issuance and trading of Islamic capital market and treasury instruments such as sukuk, and to act as an investment gateway to the region specialising in Islamic fund and wealth management, and as a takaful and retakaful centre.

In promoting capital and cross-border trade flows between the financial communities of these regions, it will thereby strengthen the international integration of our domestic Islamic financial system. In addition, this initiative is expected to improve further the performance of the Islamic financial industry and strengthen its competitive edge in this increasingly more challenging global environment.

Currently, assets of the Islamic banking and takaful in Malaysia have been increasing at a double digit growth rate of 19 percent and 25 percent respectively in the recent five years. The Islamic banking and takaful markets which amounted to RM122 billion and RM6.6 billion in assets are among the largest in the world. The Islamic sukuk market has now exceeded RM120 billion and represents the largest Islamic bond market in the world.

Malaysia has developed the comparative advantage in the area of Islamic finance. The comprehensiveness of the Islamic financial system in Malaysia has been mutually reinforcing with the key components of the financial system comprising the Islamic banking, takaful, Islamic money and capital markets now being at an advanced stage of development. In addition, the established legal, regulatory and Shariah frameworks in the Islamic financial infrastructure is also a key competitive advantage for Malaysia, placing it ahead of other financial centres offering Islamic financial services.

In terms of Shariah governance, it has enabled the development of Islamic finance to be orderly and compliant with the Islamic injunctions, thereby ensuring that customer confidence be maintained. The conducive Shariah environment has also ensured that Malaysia is sustained as a centre of product innovation, producing cutting-edge products for the increasingly sophisticated customers. In respect of Shariah interpretation and practices, the MIFC will adopt a stance of mutual recognition and accommodate the various juristic reasoning that has been approved by recognised Shariah advisers. Next week, Bank Negara Malaysia will again host the 2nd International Shariah Scholars Dialogue, gathering the Shariah scholars from different regions in our endeavour to continuously bridge and

foster greater interaction and promote understanding on the issues and challenges faced by the Islamic community on the aspect of Shariah.

Malaysia also has a strong and advanced regulatory regime and legal structure in the Islamic financial system. This was deliberately undertaken since the inception of Islamic finance in this country to sustain the soundness and stability of the system and thus the confidence of the financial community. Reinforcing this is the Islamic Financial Services Board (IFSB) as the international standard-setting body of the prudential and supervisory framework that was established in 2002. The balanced regulatory approach being applied also aims to ensure that the trust and efficiency of doing business is maintained.

In undertaking a holistic approach to drive the MIFC initiative, the Government has streamlined the associated delivery system to facilitate advancing the MIFC agenda with the formation of the MIFC Executive Committee. The Committee comprises a high-level group of 28 top officials from the key relevant Ministries, Government departments and agencies, financial and market regulators and representatives from the banking and takaful sectors. Through the shared vision and commitment, this Committee is responsible for providing the direction as well as undertaking a review of all existing policies that are relevant for the comprehensive and coordinated promotion of the MIFC. Two meetings thus far have been convened and several issues have now been resolved with solutions provided to several key implementation issues which ranged from foreign ownership to immigration policies.

The Secretariat, formed by Bank Negara Malaysia will not only serve the Executive Committee but will also act as a single contact point for the implementation of the MIFC initiatives. Working level committees have also been formed to undertake the task of considering new proposals and monitoring the implementation of the MIFC recommendations. To take into consideration global trends and to provide insights on the strategic direction, an **International Advisory Panel (IAP)** comprising industry leaders and experts from the global community is also being established.

Conducive environment for business

In continuously creating an enabling environment for the efficient functioning of the MIFC, the Government has identified several key strategic objectives. The Government has also granted an attractive tax package to promote Malaysia as a competitive international Islamic financial centre. The objective is to **build the base** - that is, to create the necessary critical mass of participating financial players and to increase the scale of activity. Malaysia aims to attract global players as well as to enhance the capacity and capabilities of the existing financial institutions. Among the measures that have been introduced are:

- first, **liberalising the Islamic banking, and takaful and retakaful markets** with the issuance of new licences to allow for increased foreign participation;
- second, **allowing foreign equity of up to 49 percent** in existing Islamic banks and takaful companies;
- third, issuance of **International Islamic Bank** and **International Takaful Operator** licences under the Islamic Banking Act and the Takaful Act respectively to qualified foreign and Malaysian financial institutions to conduct the full range of Islamic banking business or takaful and retakaful business in international currencies and enjoy tax holiday for 10 years under the Income Tax Act starting from the year of assessment 2007;
- fourth, granting approval to Malaysian Islamic banks and takaful operators to set up **International Currency Business Unit (ICBU)** to offer Islamic financial services in international currencies and enjoy similar tax holiday;
- fifth, provide greater flexibility to the Labuan offshore entities offering Islamic financial services to **open operation offices anywhere in Malaysia**. The Labuan tax law will continue to be applied to these players.

Players, therefore have the option in participating in the MIFC either by being licensed under Bank Negara Malaysia to benefit from the tax holiday for 10 years under the Income Tax Act and fully benefit from the **Double Tax Agreement**, or alternatively to be licensed under LOFSA and be taxed accordingly under the Labuan Offshore Business Activity Tax Act.

The second strategic objective is **activities generation** - that is, to promote Malaysia as the preferred choice as the centre for the offering of Islamic financial services. Associated with this objective is building the pool of talent and expertise, and to ensure that the environment is cost competitive and conducive for product innovation and product offering. The measures to address this include:

- first, setting up the **International Centre for Education in Islamic Finance (INCEIF)**. This represents the Malaysia 's investment in human capital to support the global development of the Islamic financial services industry;
- second, establishing a **Shariah Endowment Fund** for scholarships, research and international **Shariah dialogues** for the regional and international Shariah communities to enhance the harmonisation of Shariah interpretation and practices;
- third, an additional **20 percent exemption in stamp duty** on Islamic financial instruments on top of the stamp duty exemption that is currently available to ensure tax neutrality;
- fourth, encouraging Malaysian-owned banks including Islamic financial institutions to **expand their operations abroad** by allowing the profits of the newly established branches overseas or remittances of new overseas subsidiaries to be given income tax exemption for 5 years. This is to enhance market access and business networking, and also to widen the customer base and to generate new sources of businesses in uncharted territories;
- fifth, **liberalising the foreign exchange administration rules** to allow multilateral development banks and multinational corporations to issue ringgit denominated instruments in our domestic bond market.

In further liberalising the market, I am pleased to announce that resident and foreign issuers will now be **able to raise foreign currency-denominated bonds**, in particular, Islamic bonds, in the Malaysian capital market. The foreign issuers eligible to take this opportunity are the sovereigns, quasi-sovereigns, multilateral development banks, multilateral financial institutions and multinational corporations, while resident issuers are the local MNCs. This represents part of Bank Negara Malaysia's continuous efforts to promote the development of the Malaysian bond market, and to enhance Malaysia as a centre of origination, distribution and trading of sukuk. The issuance of foreign currency denominated bonds will also provide additional flexibility for both residents and foreign investors to diversify their investments into non-ringgit investments in Malaysia .

In taking the MIFC initiative to the next phase of development, I am also pleased to share with you some of the current work-in-progress to this agenda further forward. The International Islamic Bank (IIB) and International Takaful Operator (ITO) will be allowed to be set up as a **branch** in addition to a subsidiary as currently stipulated under the domestic banking and takaful legislation. To create greater international awareness on these new initiatives, financial ambassadors are being appointed to meet with potential players and investors and road shows will be conducted as part of the promotional plan.

In addition, the MIFC Executive Committee is formulating the **supporting immigration policies** with the Immigration Department where long-term employment pass, multiple entry permits, dependent pass and professional visit pass would be offered to expatriates identified as professionals and experts in Islamic finance. To attract specialist and high level expertise, a Permanent Resident status may also be offered based on the recommendation of the relevant financial regulators. A mechanism is also being put in place to ensure the efficient processing of these measures. This is aimed at addressing the acute current shortage of such talent and expertise in the global financial system. While the education infrastructure has already been put in place to address this shortage, Malaysia also needs to be competitive in attracting and retaining the talent. The Executive Committee will therefore look into customised incentives to attract best talents to Malaysia in addition to the entry of international legal firms that are able to provide services for the international currency business in Islamic finance.

Role to be played by financial institutions

One of the key success factors for a vibrant financial hub is having the critical mass of reputable and diversified range of financial institutions. With extensive incentives and measures in place, it is a priority for those already based in Malaysia to be encouraged to be the players in the MIFC. In building the base, the financial institutions in Malaysia , onshore and offshore, are encouraged to develop a niche in the overall landscape for MIFC. Players with expertise in structuring Islamic instruments should capitalise on the tax incentives by having the syndication team to be based in Malaysia for the

issuance of ringgit and non-ringgit sukuks out of Malaysia, while those with investment and private banking as well as fund management expertise should intensify their focus on efforts in this area and structure innovative Islamic investment instruments. Existing players are also urged to be MIFC players and develop Malaysia as their regional hub with the potential to have the international currency business operations either through the onshore regulatory framework or under the Labuan offshore structure.

The success of MIFC will depend on the collaborative efforts of the financial regulators, the delivery system, the industry players and the supporting professionals. In meeting the MIFC objectives, we encourage the exploitation of this new growth area. At the onset, it is also emphasized that an equally important part of this process is having the right people in place with the appropriate skills, having in place the appropriate systems and governance framework to ensure the viability and sustainability of this industry.

This morning's dialogue will provide the opportunity to deliberate the issues from the different perspectives and dimensions so that the full potential of the MIFC initiatives can be realized.

On this note, I wish you a successful Dialogue. Thank you.