

## **Eddie Yue: Hong Kong's possible role in Islamic finance**

Welcome address by Mr Eddie Yue, Deputy Chief Executive of the Hong Kong Monetary Authority and Executive Board Chairman of the Treasury Markets Association, at the Hong Kong Showcase on Islamic Finance, Dubai and Amman, 11-12 May 2008.

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Ladies and gentleman,

It is with great pleasure that I welcome you all to the Hong Kong Showcase on Islamic Finance, presented by members of the financial services industry in Hong Kong, and jointly organised by the Hong Kong Monetary Authority, the Hong Kong Treasury Markets Association and Hong Kong Trade Development Council, which is being held over two days in Dubai, UAE and Amman, Jordan.

I would first like to thank Her Majesty Queen Rania Al-Abdullah of Jordan, who is hosting the Islamic Financial Services Board's Annual Summit, the Central Bank of Jordan, and of course the IFSB itself, for graciously agreeing to allow us to organise this event under the auspices of the Annual Summit.

This forum is indeed an excellent opportunity for the regulators, industry practitioners and investors in the Gulf region and Hong Kong to share new perspectives in the rapidly expanding area of Islamic finance, which transcends national borders and is fast penetrating global financial markets. Today we will be focusing on what Hong Kong has to offer and where it fits into this changing global financial landscape.

What I would like to do in the next ten minutes or so is to give you an overview of the current landscape of Islamic finance in Hong Kong from the perspective of both a financial regulator and a market facilitator, and tell you about how we could help promote this initiative from the Hong Kong Monetary Authority (HKMA) point of view.

### **Why does Hong Kong wish to develop Islamic finance?**

First, allow me to share with you some thoughts in how we see the relevance of Hong Kong to the development of Islamic finance in Asia. From its early phase of development in the 1980's, Islamic finance has grown tremendously and undergone a rapid transformation in less than two decades. Today, it has gained widespread recognition, not just among investors of the Muslim faith, but also among other investors who see Islamic finance as a new investment alternative. Islamic finance is therefore no longer characterised by its uniqueness, but rather seen as an integral part of the international financial system.

This brings remarkable opportunities for Hong Kong, as a frontrunner in international finance, which possesses key strengths in financial intermediation on an international scale to bring together investors and fund raisers from different parts of the world. With that we see great potential for Hong Kong to take on the intermediary role for Islamic financial products, just as it currently does for conventional products to a high degree of sophistication across all asset classes.

Our contacts with investors and financial institutions in the Gulf region have also reinforced our belief in promoting the development of Islamic finance in Hong Kong. This has in fact been articulated as a key policy initiative set out by the Chief Executive of the Hong Kong Special Administration Region in his 2007 Policy Address. In other words, it is now official Government policy to develop Islamic finance in Hong Kong and our commitment to this is beyond doubt.

Being a major international financial centre in Asia, Hong Kong should seek to become an important player in the booming Islamic finance arena by providing a platform for Middle East

investors to access investment opportunities in the Asia Pacific region. Hong Kong can also leverage on its experience, innovation and market diversification to serve as a capital-raising centre for Middle Eastern issuers to tap the funds made available by the high savings rate in Mainland China.

Some people have expressed scepticism about how Hong Kong could play a role in these segments of the market. But market players in Hong Kong have answered this scepticism by quickly introducing our first Shariah-compliant product. In late 2007, we witnessed the first Islamic fund introduced by a local bank in Hong Kong. The fund is an index-tracking fund which tracks the performance of the Dow Jones Islamic Market China/Hong Kong Titans Index. In December last year, the Hong Kong Mortgage Corporation signed a joint venture agreement with Cagamas Berhad, Malaysia's national mortgage corporation, to establish a company to develop mortgage guarantee business in Malaysia and other parts of the world. Earlier this month, a new Dow Jones Islamic Market Index came to the marketplace to track China-related equities listed in the Hong Kong stock exchange, further enriching the Islamic index infrastructure in Hong Kong. These initiatives clearly demonstrate the dynamism of Hong Kong's financial systems in responding to an emerging market opportunity.

### **Is the timing right?**

Some observers have questioned whether it is a bit late for Hong Kong to develop Islamic finance, when some other financial centres in the region have already made a head start. It may be true that Hong Kong has started the development only recently, but so long as the demand is there, it's never too late for Hong Kong to contribute to this vibrant and growing sector. The Islamic financial sector we believe has huge headroom for growth.

Hong Kong can also learn from the experience of other established centres, and co-operate with them to grow the market. Indeed, there is no better time than now to contribute to the development of Islamic finance. This region is in possession of a significant part of the global oil reserves and has topped the world in the accumulation of wealth. The abundance of oil-driven liquidity generates a huge appetite for investments that cannot now be satisfied within the Gulf area alone. Such investments can be found in the emerging markets of Asia, especially in China.

Although the dynamics are somewhat different in China, its tale of economic growth is as legendary as that of the Middle East. China has experienced a huge inflow of funds in search of growth opportunities and at the same time the Mainland authorities have been gradually opening up the country's outward investment. As a Special Administrative Region of China, Hong Kong plays a pivotal role as the IFC of China in the course of financial liberalisation. Not only has it acted as a conduit for Mainland companies accessing international markets through IPOs, but also one of the largest sources of foreign direct investments for Mainland China. With the continuing financial liberalisation on the Mainland, Hong Kong is positioned as the most attractive destination both for investing into China and tapping China's funds.

### **What are the challenges for us?**

Opportunities aside, we are of course aware that Hong Kong also faces challenges in developing Islamic finance. It is a fact that Hong Kong's Islamic community is not big, but we are confident that the development of Shariah-compliant financial markets can take off even in environments in which the domestic Islamic community is relatively small, simply for the fact that investors nowadays are looking beyond domestic boundaries and traditional finances as financial activities gravitate towards the Middle East and China. Indeed Hong Kong's relatively small population does not seem to undermine in any way our performance in the conventional financial and capital markets. Therefore we are not positioning ourselves as a market that can match the supply and demand of Islamic products from domestic angle.

Our objective is to make Hong Kong a platform for international intermediation activities for Islamic finance.

### **What can we offer to the Islamic investors?**

Hong Kong's advantages lie in its strategic location, highly developed financial markets and infrastructure, and a business-friendly free-market environment. We are strategically located at the heart of Asia with a broad hinterland that gives investors unique access to virtually every market in the Asia Pacific time zone. Almost all Asian countries are within reach by a three-hour flight from Hong Kong.

What makes Hong Kong a natural destination for Islamic funds is our deep and highly liquid capital markets. Almost all of the most actively traded financial instruments are available for exchange in Hong Kong, and this gives Islamic investors a much wider choice of where to place their funds.

More importantly, when it comes to investing in China, Hong Kong is about the only natural choice. Hong Kong has the largest and deepest Chinese equity and debt markets outside Mainland China. We are the first and remain the only major international financial centre that has banking business and financial products related to the renminbi. The development of a local renminbi bond market which started in the middle of last year has firmly positioned Hong Kong as a pilot market for China's continuing financial market liberalisation. Hong Kong is the ideal gateway for Middle Eastern investors who are keen to capitalise on the Mainland's rapid economic growth.

International investors can gain exposures to different sectors of China through the Hong Kong platform. For example, for investors wanting to access China's property market, they can make use of the Real Estate Investment Trusts listed in Hong Kong with underlying exposures to properties in Mainland China. There has also been encouraging innovation in combining sukuk with China equity exposures – what I refer to was the launch of an exchangeable sukuk linked to the underlying shares of a Mainland China company listed in the stock exchange of Hong Kong. The exchangeable sukuk, which is listed on our stock exchange as well, attracted a high subscription from Middle Eastern investors and reaffirmed the keen demand for investment opportunities with China growth prospect through the Hong Kong platform.

In terms of infrastructural support, many leading international banks have geared up for Islamic finance products and many of them have a very strong presence in Hong Kong. Our market players are therefore well-equipped to leverage on the expertise in other parts of the world in structuring Shariah-compliant products and meeting the needs of even the most demanding Islamic financier. Hong Kong's success factors lie not only in our premier location and versatility, but also in possessing the talent and infrastructure to become the conduit to facilitate the capital flows between the Middle East and Asia.

### **What more should be done?**

Notwithstanding the strong fundamentals of our financial markets and infrastructure, we are conscious of the need for greater efforts to be made to establish a level playing field in the conduct of Islamic finance business vis-à-vis conventional activities. This includes a review of tax laws in Hong Kong. The HKSAR Government is now conducting a review of tax laws to ensure that Islamic financial transactions will not be disadvantaged simply because of their special structure to cater for compliance with the Shariah law.

Apart from that, we are also focusing our efforts in three major areas.

The first involves efforts to connect the Hong Kong platform with financial institutions and investors interested in Islamic finance. That involves the need to raise the international profile

of Hong Kong's platform for Islamic finance. The presentation of this flagship Showcase in both Dubai and Jordan is an important milestone in advancing the city's profile and heightening awareness. Of equal importance is that, through this forum, we can establish complementary and mutually beneficial relationships for players in our financial markets.

The second area is our efforts to deepen market knowledge in Hong Kong about Islamic finance products. In this regard, the Treasury Markets Association can play a significant role in providing an avenue for open and useful discussions and the sharing of experiences from experts in this field, thereby enhancing the knowledge of our local market players.

Third, we are working hard to forge closer international links through co-operation with Islamic finance centres and organisations. Establishing business links is particularly important in face of the challenges brought by the integration of Islamic finance with the international financial system. In this regard, I am pleased to mention that Hong Kong has formed a working group with the Dubai International Financial Centre Authority to promote the mutual development of Islamic finance and financial market infrastructure.

### **Closing remarks**

In closing, I would like to point you to an analogy often made between the rise of Islamic finance and the renaissance of the Silk Road. Let's remember the Silk Road, in ancient times, was China's link to the outside world and a route for trade and exchange of art, music, culture and religion. Today, Hong Kong is right at the heart of the New Silk Road, standing astride East and the West, and providing a gateway to business and financial opportunities. We have already painted a picture of how the financial regulators and industry associations will strive to promote the development of Islamic finance in Hong Kong, and we hope very much that the enormous forces of the market will make the New Silk Road as prosperous and significant as the old one.

Thank you very much.