Heng Swee Keat: Monetary Authority of Singapore’s initiative to develop Singapore dollar sovereign-rated sukuks

Speech by Mr Heng Swee Keat, Managing Director of the Monetary Authority of Singapore, at the 5th Annual Islamic Financial Services Board Summit, Amman, Jordan, 13 May 2008.

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Introduction

It is my honour this afternoon to join my IFSB colleagues in discussion of this very current topic.

I am very glad that we are addressing this issue of regional integration of Islamic Financial Services at this point. This is very timely and relevant to both the soundness and vibrancy of Islamic Finance. Let me explain.

The global Islamic finance industry has grown rapidly – it is estimated that total assets are now over US$750 billion. This is impressive. Still, this is a small proportion of conventional finance. The potential for growth is hence very large. While each country is taking measures to promote Islamic Finance, we can grow much faster as well as increase the scope and depth of the industry if we work towards integration at an early stage. Integration increases market size, efficiency and liquidity. This in turn provides for more competitive cost of capital, spurring further growth. Second, having service providers from different regions allow risks to be distributed across a wider group of players, and can improve the overall stability of the financial system. Regional integration between Middle East and Asia, which may have different business cycles, provides a cushion for financial institutions and investors from country specific shocks. Third, integration promotes greater interaction and knowledge sharing, and can help lift the standards of the Islamic finance industry. In short, the 3 facets – development, integration and stability of markets – are closely intertwined. Proper attention to all these 3 facets will enhance the soundness and vibrancy of Islamic financial services.

We are in fact seeing greater integration already with more cross borders flows, both within the Middle East and Asia, and between the two regions. Banking and capital markets are opening up to foreign investors, more Shariah products are listed on stock exchanges and Islamic financial service providers are expanding their operations overseas. This is a promising trend.

Three tasks

We should build on this positive momentum. Allow me to share my views on three broad categories of essential tasks in promoting greater integration in the coming years.

1st task: promoting more economic integration

First, financial integration and economic integration are deeply linked, and mutually reinforcing. Hence, to promote financial integration, we also need to focus on economic integration. An important tenet of Islamic Finance is that one must not focus on money per se, but on how money can facilitate trade in goods, and investment in productive capacities.

By extension, regional integration of Islamic Finance can promote regional integration of our economies. Linking borrowers and lenders across the Middle East and Asia, will help to deepen trade and investment links between the two most dynamic regions, and provide for a more efficient intermediation of savings. In other words, financial integration can help drive economic integration.

The converse is also true – economic integration can drive financial integration. The deeper the trade and investment links, the greater the opportunity for financial integration. While not everything will be funded through Islamic Finance, a growing volume will, as these trade and investment flows increase. In this regard, the trends are promising. Trade flows between the Middle East and Asia have grown significantly, in Singapore alone doubling to USD37 billion within the last four years.

In fact, the potential for even greater flow of trade and investments has been an important reason for the interest in Islamic finance among financial institutions in Asia such as those in Malaysia, Hong Kong and Singapore. This is evident by our countries respective participation in the country showcases yesterday. I made this point to a reporter here who unfortunately misquoted me as saying that Malaysia and Hong Kong are competing with Singapore. That is not my view as I believe the scope for cooperation is large. I share Professor Rifaat's view that we should collaborate to broaden and deepen markets so as to enhance the vibrancy and resilience of Islamic financial services.

Indeed, we can do more to build on existing synergies. We need to continue to promote more trade and investment. The leaders of ASEAN have agreed to establish the ASEAN Economic Community by 2015, so that ASEAN will become a single production base with freer flow of goods, services and investments. I am pleased that negotiation on a GCC-Singapore Free Trade Agreement has just been completed. This will help to expand trade ties. I hope this can also catalyze the broader pact between the Middle East and ASEAN, which will help to expand trade and investment flows between our two regions.

Some 250 Middle East companies, including the Saudi Basic Industries Corporation, Proclad Group from Kuwait and the Emirates National Oil Company, are currently using Singapore as a base for their Asia-Pacific operations. Recently, the Al Futtaim group bought a major department store, Robinsons, in Singapore, as part of their strategic decision to expand into South-East Asia. Shariah-compliant funds which are deployed for investment in Asia have attracted strong interest from Middle East investors. One example is the ARC-CapitaLand Residences Japan Fund which was issued by a Singapore-based property developer. These are just examples from Singapore. I am sure there are more in Malaysia, Indonesia and other parts of Asia. My general point is this: the more we can bring the issuers and investors from both regions together, the more we can promote the use of Islamic Finance to fund some of these projects.

2nd task: addressing the need for appropriate legal, regulatory and supervisory frameworks for Islamic finance

All of you would be aware that the IFSB and IDB have co-issued The Ten Year Framework and Strategies.[1] It is a thoughtful blueprint. The Framework highlights the need for appropriate legal, regulatory and supervisory frameworks that effectively cater for the specificities of the Islamic services providers. This is an essential 2nd task not only for the development of Islamic Financial services but also for their integration.

Each country will have to look at the legal and supervisory structures for Islamic Finance. However, inconsistent standards, in areas such as legal documentation and settlement of unresolved issues, can inhibit the growth of the Islamic financial services sector across borders. Conversely, when consistent standards are applied across jurisdictions, the cost-effectiveness of Islamic financial service operating across borders improve. It also improves the attractiveness of the institution's products to international investors, regardless of the

[1] Islamic Financial Services Industry Development Ten Year Framework and Strategies. This was a joint initiative between Islamic Financial Services Board, Islamic Research & Training Institute, Islamic Development Bank and Islamic Research and Training Institute.

country of origin. A significant challenge today is the need for greater convergence of rules and practices in Islamic Finance.

In this regard, I commend the work of international standard setting bodies for Islamic Finance – AAOIFI, IIFM, IDB and IFSB. For example, IFSB's recent publications on corporate governance, disclosure and capital adequacy standards are very useful. It is important that as regulators, we participate in appropriate standard-setting international organisations, and work towards the convergence of rules and practices across jurisdictions. Where convergence is not possible, we can work towards mutual recognition of those rules.

The Ten Year Framework and Strategies also highlights the need to ensure tax neutrality between the Islamic services providers and their conventional counterparts. Tax neutrality is important – a recent McKinsey report[2] indicates that investors are more likely to invest in Shariah-compliant products if returns are comparable to that of conventional products. In facilitating the growth of Islamic finance in Singapore, MAS works with financial institutions to ensure a level playing field between Islamic and conventional financing deals. This includes the waiver of additional stamp duties incurred by qualifying Islamic financing arrangements involving immovable property.

In developing the Islamic financial services market during its nascent stage, we also provide tax incentives to help offset the initial additional costs. In February this year, our Finance Minister announced a 5% concessionary tax rate on the income derived from qualifying Shariah compliant financial activities. In addition, all investors will enjoy tax exemption on income derived from qualifying Sukuks. This is to create a seamless framework for the industry in Singapore, although I understand that in the GCC and Malaysia the tax framework is even more favourable.

The various changes in our regulatory and tax framework are done in partnership with the industry. Based on our latest consultation, to promote the further growth of Islamic Finance and to meet the needs of financial institutions conducting Shariah-compliant activities in Singapore, I am pleased to announce that Singapore will develop a facility to make available sovereign-rated sukuks. Our facility is likely to be different from traditional issuances in two respects. First, the issuance will be on a reverse enquiry basis, which means we will issue according to the needs of financial institutions in Singapore conducting Islamic Finance. Second, at the initial stage, we plan to price these against the liquid Singapore Government securities market. This will provide a transparent price discovery mechanism for this new instrument in Singapore. As the S$ sukuk market grows and deepens in time, it can then develop its own pricing benchmarks. The design of our sukuk issuance facility reflects our effort to harness the price discovery potential of existing liquid instruments, while adhering carefully to Shariah principles. Further details of this arrangement will be announced in due course and we look forward to your feedback.

We will also make significant progress in integrating financial markets when we provide greater market access for Islamic service providers to operate across borders. I am glad that regulators in the Middle East and South-East Asia have been very supportive in this area. For instance, several major Islamic banks in the Middle East now have operations in Malaysia. More recently, several Middle Eastern banks have also established themselves in Singapore. The first home-grown Islamic bank in Singapore, the Islamic Bank of Asia was set up in Singapore in 2007. The IBA is a joint venture between Singapore's DBS Bank and Middle Eastern investors from Bahrain and the GCC countries. I am pleased that within one year of its existence, the bank will be opening a representative office in Bahrain next week.

However, as such cross-border operations become more common and complex, there is also the need to ensure the financial stability and integrity of each domestic market, and that the

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[2] McKinsey & Company: The World Islamic Banking Competitiveness Report 2007-08.

protection of its consumers and investors are not compromised. As several regulators on our IFSB Board have commented, risk management and prudential management cannot be compromised if we wish to have healthy growth and to avoid crisis. In this regard, the cooperation of supervisors is very important.

3rd task: promoting greater cooperation

Beyond economic integration and supervisory cooperation, the third essential task is what I would call the "soft" or "people" aspect. It may seem tangential to talk about this when we are looking at technical issues of accounting, regulations and capital adequacy, but all cooperation depends on trust. Without trust, we cannot work together. But trust cannot be built overnight. Trust is developed over time in the face of challenges. There is an old saying that you know how good a horse is only after you have traveled with it over long journeys.

At the highest level, we need strong political ties to promote integration between the Middle East and Asia. In this regard, I am glad to see numerous visits have taken place between the leaders of Middle East and Asia in recent years. This includes the visit of King Abdullah of Saudi Arabia to four Asian countries in 2006 and several meetings between King Abdullah II of Jordan and Singapore's President and Prime Minister, to name just a few.

I am happy that frequent dialogue and cooperation are taking place at all levels, via platforms such as the Asia-Middle East Dialogues or AMED. AMED was first held in 2005 in Singapore, and Egypt recently hosted the 2008 meeting. The 2008 meeting involved a total of about 50 countries from the Middle East and Asia.

I am also happy to see strong cooperation in training. The Islamic Development Bank's IRTI[3], Bahrain's BIBF[4] and Malaysia's INCEIF[5] are Islamic finance-focused training institutes which provide very good training in this area. Such training programmes, besides imparting knowledge, enable people to know each other better, and provide the basis for future cooperation.

Conclusion

To conclude, let me summarise. There are three essential tasks we face in promoting greater integration of Islamic financial markets. The first is to encourage greater economic integration and increased cross border flow of trade and investments. Economic integration drives financial integration and vice versa. The second task is to foster appropriate legal, regulatory and supervisory frameworks that effectively cater for the specificities of the Islamic services providers; and to work towards greater convergence of rules and practices in Islamic Finance. This requires greater trust and stronger ties among supervisors. The third is to cultivate stronger people-to-people bonds across all levels, through training, conference and dialogues.

There is a saying which is common to the Chinese and Arabs which goes, "the journey of a thousand miles begins with one step". I am glad to note that a lot of progress has already been made on all the three tasks. However, the journey ahead is long. Let us continue to work together towards integrating the Islamic financial markets. In this way, we can grow much faster and much more, bringing greater economic benefit to our regions.

Finally, we are honored to be given the opportunity to host IFSB's 6th annual Summit next year, which will be a landmark event for Singapore and our Islamic finance industry. May I

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[3] Islamic Research and Training Institute.

[4] Bahrain Institute of Banking and Finance.

[5] International Centre for Education in Islamic Finance.

thank the IFSB Council, Professor Rifaat and the IFSB secretariat. I would like to extend a very warm welcome to you all to Singapore.