

Zeti Akhtar Aziz: Growing significance of Islamic finance

Opening remarks by Dr Zeti Akhtar Aziz, Governor of the Central Bank of Malaysia, at the Malaysian Islamic Finance 2008 Issuers and Investors Forum – ISSUER'S DAY (Launch of the MIFC Global Communications campaign), Kuala Lumpur, 11 August 2008.

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Bismillahir Rahmanir Rahim

It is my pleasure to be here this morning at this third Malaysian Islamic Finance (MIF) 2008 Issuers and Investors Forum. It was at the first MIF Forum in August 2006 that the Malaysia International Islamic Financial Centre or MIFC initiative was launched. This was part of our efforts to strengthen further our economic and financial linkages with the rest of the world. It is our firm conviction that as an international Islamic financial hub this will be an important element facilitating the realisation of this aspiration. Since our launch, other traditional financial centres such as Hong Kong, Singapore, Dubai and London have also intensified their participation in the Islamic financial system.

As one of the fastest growing segments in the international financial system, there is a growing number of Islamic financial institutions and an increasing range of innovative Islamic financial products. Of importance is that this progress has been supported by a rigorous and well developed legal, regulatory and Shariah framework, thereby ensuring its stability and sustainability.

The operating environment for Islamic finance

With the internationalisation of Islamic finance and the rapidly changing international Islamic financial landscape, Islamic finance is becoming increasingly integrated to the international financial system. This development has taken place in all segments of the Islamic financial system including the Islamic banking and takaful industry, and in the Islamic money and capital markets.

There are now a large number of diverse players and institutions in the Islamic financial system. There has also been a growing range of products and services being offered. The pace of product innovation has intensified with more sophisticated Islamic financial products including the structured and investment-linked products. These products have become competitive both in terms of product structure and pricing. There has also been enhanced depth of the Islamic financial markets. This has increased the attractiveness of the Islamic financial instruments as an asset class for investment.

The Prudential standards are developed by the Islamic Financial Services Board (IFSB) to govern the operations of Islamic financial institutions. The IFSB has, not only, an important role in the harmonisation of prudential standards, but also contributes towards the consistent development of Islamic finance across different jurisdictions. Several parts of the world, including in Malaysia, have implemented the prudential standards issued by the IFSB. These prudential standards which have been designed to take into account the unique features specific to Islamic finance will contribute towards ensuring its soundness and stability.

Developments in the sukuk markets

The year 2007 saw an exceptional growth of the global sukuk market which expanded by more than 70 percent during the year. New issues during the year reached a record high to about US\$47 billion and the outstanding global sukuk market has now surpassed the US\$100 billion mark. Despite the more challenging international financial environment arising from the financial crisis that has occurred in a number of the advanced economies in the

recent twelve months, the sukuk market while also affected, it has been to a lesser extent. Up until June 2008, it has held its ground with a total global issuance now exceeding US\$10 billion. With greater recognition of the sukuk market as a competitive and attractive form of financing, the global sukuk market is expected to continue its growth going forward.

The International Islamic financial hub evolving in Malaysia is supported by five pillars.

Pillar 1: sukuk origination

Following the first ever sukuk in the world that was issued in Malaysia in 1990, Malaysia has now developed a deep, liquid and vibrant sukuk market. Recently, the largest sukuk ever was raised in the Malaysian sukuk market in 2007. The magnitude was approximately RM15 billion or about USD5 billion equivalent. Despite being issued during the height of the sub-prime crisis, it attracted huge demand and was oversubscribed by more than two times. Sukuk origination has thus been identified as one of the important pillars of the Malaysian Islamic financial system. As of the end of 2007, more than 60 percent of the outstanding global sukuk originated from Malaysia. It has been increasing by an annual rate of about 20 percent and it accounts for about 56 percent of the outstanding bond market in Malaysia.

Several foreign multilateral development banks, quasi sovereign agencies and MNCs have received the approval of the authorities for the issuance of sukuk in our domestic sukuk market. The Malaysian foreign exchange administration rules have been extensively liberalised to enable non-resident corporations to raise ringgit and foreign currency denominated funds from our market. International issuers may thus issue multi-currency sukuk in addition to having the flexibility to swap domestic currency funding into other currencies.

Pillar 2: Islamic fund and wealth management

The sukuk market has been an important source of financing for productive investment activities, while for investors it provides potential for diversification into new asset classes. The second pillar in the Malaysia Islamic financial hub is the Islamic fund and wealth management industry. Malaysia is centrally located in the ASEAN region that has a population of 570 million. It is also positioned centrally between the major Asian economies of India, China, Japan and Korea. Malaysia has always been a highly open economy in trade and investment activities and has been a major recipient of foreign direct investment for more than a hundred years.

As a destination for financial investment, the Malaysian capital market offers a wide range of world class financial products. More than 85 percent of the listed companies in the equity market are Shariah compliant, representing about 60 percent of total market capitalisation. Other investment opportunities include in Shariah-compliant real estate investment trusts (REIT), in unit trusts and in the Islamic exchange traded fund (ETF). The capital market intermediaries in Malaysia, that is, the investment banks and Islamic fund management companies have had a key role in supporting the development of this industry. Both retail and wholesale products are being offered in ringgit and non-ringgit currencies. There is also no restriction in investing 100 per cent of the funds abroad. The foreign exchange administration rules now allow for the free mobility of inward and outward movement of funds.

Pillar 3: international Islamic banking

The Islamic financial system has also been extensively liberalised to allow for the entry of foreign Islamic financial institutions that offer both domestic and international banking business. In addition, the foreign equity ceiling in Islamic financial institutions has been raised to a maximum of 49 percent as part of the effort to promote strategic alliances. The Islamic banking business in foreign currencies can be conducted by the international

currency business units (ICBUs) that may be set up within existing financial institutions and the international Islamic banks. Such international Islamic banks may be established as either a branch or a subsidiary. Currently, about 16 percent of total assets in the Malaysian banking system is Shariah compliant.

Pillar 4: international takaful business

The fourth pillar is takaful and retakaful business. There are now eight takaful operators, several of which are joint ventures with foreign shareholding that conduct both domestic and international takaful business. In addition, licences have been granted to three reinsurance players to undertake retakaful business in Malaysia. Several existing takaful operators have set up international currency business units (ICBUs) and one new international takaful company has been licensed as an international takaful operator to conduct foreign currency takaful business.

Pillar 5: human capital and thought leadership

The fifth pillar is human capital and thought leadership. Several important human capital development projects have been implemented to foster Islamic finance thought leadership and to create a supply of talent for the Islamic finance industry. Having a sufficient pool of the talent and expertise has been key to the development of the Islamic financial hub in Malaysia. The International Centre for Education in Islamic Finance (INCEIF) which has an international faculty and students from more than 40 countries, is focused on programmes for Islamic finance professionals and specialists to meet the human capital requirements of the global Islamic financial services industry. The first group of students for the Chartered Islamic Finance Professional, or CIFP, offered by INCEIF is expected to graduate at the end of this year after completing a three year programme that includes an internship with an Islamic financial institution.

Strengthening the MIFC initiative

Let me turn to today's event. Malaysia's Islamic financial hub has been built on the foundation of a comprehensive and progressive Islamic financial system that has been developed in the recent three decades. Activity in the Islamic financial system has become vibrant, in particular, in the sukuk market and in the other wholesale Islamic financial transactions. Going forward, Malaysia will collaborate with other financial centres with the aim of strengthening the international interlinkages in the global Islamic financial system.

Today, Malaysia is taking another step forward and launching a global communication campaign to the world. The campaign is part of our efforts to strengthen our connectivity with the rest of the world. The MIFC global communication campaign highlights the opportunities and offerings – here in Malaysia – for investors, issuers, industries in the economic sectors and for professionals and practitioners with interest in the Islamic financial services industry. Malaysia presents itself as a meeting place for those with surplus funds and those who seek to raise funds from any part of the world. As an Islamic financial hub, the Islamic financial intermediaries are supported by institutions of learning for human capital development in Islamic finance.

It is Malaysia's aspiration to participate in this exciting journey at the frontier of Islamic finance as it progresses as the fastest growing segment in the global financial industry today. In conjunction with the opening session of the MIF 2008, it gives me great pleasure to launch the MIFC Global Communication Campaign. To all the participants, I wish you a successful and productive conference. Thank you.