

Muhammad bin Ibrahim: Sukuk as a viable fund-raising and investment instrument

Opening remarks by Mr Muhammad bin Ibrahim, Deputy Governor of the Central Bank of Malaysia, at the HKMA-BNM Joint Conference on Islamic Finance, Hong Kong, 14 April 2014.

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Much has been talked about the global financial crisis that had brought about unparalleled financial miseries, economic calamities and social grievances. While the focus has been on financial reforms and economic remedies, the thought on the minds of governments and regulators is how to create a more sustainable global financial landscape. Emphasis on ethics is key to this approach. Greater involvement in ethical-related business has made its strides in contributing towards the overall strength of the global financial system. Ethical investment itself has gained international recognition in recent years. Estimated to be worth more than USD13 trillion, the ethical investment market now represents over a fifth of total assets managed globally. Pension funds, sovereign wealth funds and institutional investors are leading the way. Europe, the United States of America and Canada make up 96% of the share of this market. In Asia, the market is still relatively small – at less than USD100 billion. As ethical investment catches on in Asia, so too has investment in sukuk. Sharing a close affinity, they optimise financial returns while maintaining social good and upholding strong governance.

It is my pleasure to be here today at this Joint Conference on Islamic Finance, organised by the Hong Kong Monetary Authority and Bank Negara Malaysia. This inaugural conference is set to mark a significant step to enhance collaboration and deepen financial linkages in Islamic finance between Malaysia and Hong Kong. The theme “Sukuk as a Viable Fund-Raising and Investment Instrument” is most apt, given that the ethical-based fixed income instrument has increasingly gained recognition by the global financial community as an attractive source of funding for real sectors and long-term development.

Adoption of best practices for sukuk issuance

The growth of the global sukuk market has been very promising. It reached a stock value of USD268 billion at the end of 2013 and since 2000 has grown at a cumulative average rate of 50% per annum. The creation of a sukuk market in Hong Kong is a timely initiative as it has the potential to further spearhead its foray into Islamic finance. Sukuk, as a new asset class, is ideal for portfolio diversification and is increasingly well-accepted all over the world. From our experience, the new venture by Hong Kong into the sukuk market may be able to deepen its bond market further and open the opportunity to tap the burgeoning investor pool seeking good quality Shariah compliant and ethical-based instruments.

Being a player in an increasingly developed sukuk market, Hong Kong has the opportunity to adopt the best practices in sukuk issuances. Firstly, in the area of Shariah standards where it provides principle-based guidance on the execution of Islamic financial contracts. Such standards are designed to cover the needs of different jurisdictions. The adoption of these standards would contribute towards promoting greater transparency, recognition and consistency – thus facilitating greater cross-border Islamic financial transactions.

We have given priority in promoting consistent and transparent standards on Islamic financial contracts. The development of Shariah standards is aimed as a point of reference on all Shariah principles governing Islamic financial contracts, and the standards is envisaged to become the globally preferred standards. The standards specify the requirement of Shariah and its application for product offerings. The standards are issued based on the three tenets of Shariah contract – the contracting parties; offer and acceptance; and subject matter of the

contract. The other part of these standards specifies the execution or the operational aspects of the contract that covers the regulations, accounting, risk management, the appropriate legal documentation and the disclosure. Hence, these standards provide greater clarity, transparency and disclosure to each Islamic financial transaction.

Secondly, is to have proper legal infrastructure and dispute resolution mechanism in place to safeguard Islamic finance transactions and integrity of the financial system. To share our experience, Malaysia enacted a complete set of legislation and guidelines for Islamic finance, and instituted tax neutrality in order to create a level playing field vis-a-vis conventional finance. Recently, the central bank introduced the Islamic Financial Services Act 2013 to replace the existing Islamic banking and takaful laws. The comprehensive legal framework provides a clear focus on Shariah compliance and governance in the Islamic financial sector.

A dedicated high court of common law has been assigned to adjudicate Islamic finance cases more expeditiously, giving due recognition on issues surrounding Shariah. For a complete dispute resolution on Islamic finance, the Kuala Lumpur Regional Centre for Arbitration (or KLRCA) has introduced the i-Arbitration Rules. The first of its kind, the rules incorporate a reference procedure to a Shariah Advisory Council or Shariah expert for professional opinions whenever the arbitral tribunal has to form an opinion on a point related to Shariah principles.

Thirdly, is to develop a strong governance framework for Islamic financial institutions. We introduced a dedicated governance framework in 2010 that outlined the requirement for the Shariah governance structures, processes and arrangements to ensure that all the operations and business activities are in accordance with Shariah. This framework ensures that talent in lead arranging of sukuk, among others, have the expertise and Shariah knowledge to ensure that the sukuk structures are in compliant with the necessary rules and principles.

Areas of collaboration between Hong Kong and Malaysia

There are a few areas where Hong Kong and Malaysia can collaborate for mutual benefit.

Firstly, is to have both Hong Kong and Malaysian expertise to work together in the quest to launch the first sukuk out of Hong Kong. We look forward to sharing our Islamic finance marketplace with Hong Kong in terms of expertise in structuring, managing and distributing the sukuk, as well as providing advice on legal and Shariah matters. In addition, Malaysian issuers can tap into the Renminbi and Dollar liquidity in Hong Kong. Past track records of the two Renminbi sukuk issuances by Malaysian entities, Khazanah and Axiata, had shown strong interest from Hong Kong investors, with subscriptions for both sukuk at 55% and 26% respectively.

Secondly, is to initiate a dual listing for the sukuk on Bursa Malaysia and the Hong Kong exchange to capture greater profiling, visibility and transparency in the bond market for the Asian investors.

Thirdly, is to set up more global sukuk funds on a mutual cooperation basis to provide the buy-side support. Funds can tap the existing Mutual Recognition Agreement (MRA) between the Securities Commission of Malaysia and the Securities and Futures Commission of Hong Kong as a platform for both jurisdictions to distribute Islamic investment products to benefit investors in each other's market.

Fourthly, to bridge the gap in the availability of Islamic assets in Hong Kong, potential sukuk issuers may leverage on Malaysia's end-to-end Shariah-compliant commodity murabahah platform, the Bursa Suq Al Sila' (or B – SAS) for their fund raising exercises. With an average daily volume traded of USD1.5 billion, issuers can utilise this 24/7 web-based multi-currency facility through the BSAS members from over ten countries. Of course, there are other areas of collaboration that can benefit both markets and where Hong Kong can leverage on us given the experience we have gained over the years. Examples include using the Kuala

Lumpur Regional Centre for Arbitration that offers services as dispute resolution for Islamic financial contracts; Hong Kong issuers tapping the Ringgit sukuk liquidity for cost-effective pricing given the depth of the sukuk market in Malaysia; as well as enhancing knowledge and expertise in Islamic finance through our higher learning education centres such as the International Centre for Education in Islamic Finance (or INCEIF).

Forward-looking scenario – A common trading platform for sukuk

Future growth prospect for the sukuk market is tremendous. Growth is expected to come from the GCC and Asian regions as infrastructure projects are estimated to be USD2 trillion and USD8.3 trillion respectively till 2020. Hong Kong, with its sizeable bond market to GDP of 72% can play a role in funding these projects. Moving forward, more efforts are needed towards developing financial inter-linkages between our two markets. One area is for our financial communities to explore a common sukuk trading platform for cross-border transactions. A common platform that incorporates international standards and best practices in all aspects of the sukuk trading is key to instil confidence in secondary markets. It can also increase cross-border activities. It has the potential to spur further diversification of product offerings, reduces cost of intermediation and boosts trading activities. This common platform would give both the Hong Kong and Malaysia financial markets the added critical mass for sukuk and boost liquidity in the secondary market, thus contributing towards the development of a global Islamic money market for a more efficient cross border liquidity management.

The benefits that can be realised from the cooperation between our two markets are enormous. On that note, I wish to thank HKMA for hosting this joint conference and I bid the participants a productive endeavour.