Suruhanjaya Sekuriti
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Malaysia

**Keynote Address**
**by**
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**The World Islamic Banking Conference: Asia Summit 2013**
***Supporting the Further Growth of Islamic Finance***
***in Asia and Internationally***

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***Opening & Introduction***

The Honourable Lim Hng Kiang
Minister for Trade and Industry of the Republic of Singapore and
Deputy Chairman, Monetary Authority of Singapore,

His Excellency Dr Mohammad Y. Al-Hashel
Governor of the Central Bank of Kuwait

Distinguished guests,

Ladies and gentlemen,

A very good morning.

1. First of all, I wish to extend my appreciation to the Monetary Authority of Singapore and the organizers for inviting me to speak at this 4th World Islamic Banking Conference Asia Summit 2013. I am honoured and delighted to be able to share the platform with such a distinguished panel of speakers and to share my views with an impressive cross section of participants from the Islamic finance industry. I am also encouraged by the turnout this morning, not only in terms of the size but also the

diversity of the delegates, which reinforces my belief that Islamic finance is firmly on its way towards achieving mainstream recognition at the global level.

2. Having just heard from The Honourable Minister and His Excellency Dr Al-Hashel, please allow me to share my thoughts and views on the growth and internationalisation of Islamic finance. But before I go into this subject matter specifically, let us take a moment to consider the current landscape and outlook for the Asian and indirectly the global economies, which I will return to later in my speech, in the context of opportunities for Islamic finance.

***Current Asian Economic Landscape***

3. The strength of domestic demand especially in the populous South East Asian markets has been credited as a key driver of economic growth in the region. Sustained domestic consumption following years of wealth accumulation during periods of strong economic performance, combined with robust infrastructure spending, has also enabled these nations to withstand, to a large extent, the impact of external vulnerabilities during the global financial crisis and contributed to the relative stability that we are enjoying today within the region.

4. Furthermore, the resilience of the Asian economies amidst the global uncertainties has been partly an outcome of effective policy coordination among the Asian countries through regional cooperation. ASEAN is a good example. It has been a model for a successful regional political and economic cooperation, in line with the growing interconnectivity between countries in the region. The target for the establishment of the ASEAN Community by 2015 represents another significant milestone and recognition of the need for and benefit of greater integration among Asian nations. While there will certainly be challenges in achieving regional integration among countries with varied cultural, economic and social backgrounds, the potential benefits of scale, coordinated resources and competitive advantages will drive stronger economic and financial performance for the region.

5. The favourable economic outlook together with the strengthening of connectivity and linkages across the region will present significant opportunities for cross border financing and investments. More specifically, there is strong and real potential for

Islamic finance especially the Islamic capital market to capitalise on these opportunities.

***Development of the Global Islamic Financial Services Industry***

6. The Islamic financial services industry has developed very significantly across the globe in the past decade. The three main segments of Islamic finance – Islamic capital market, Islamic banking and takaful – have penetrated and established strong presence, either separately or collectively, in a growing number of jurisdictions across different continents.

7. In this regard, the sukuk segment has been prominently featured as a representation of this global development in view of the increasing number of both corporate and sovereign issuers tapping domestic and international capital. Indeed, the sukuk market has registered strong growth in recent years with 2012 being a record with a total issuance size of USD131.2 billion globally, a 54% increase over 2011. In 2012, Kazakhstan and France were among the jurisdictions that issued sukuk for the first time, while several other countries have indicated interest to issue sukuk in the future.[1] 2013 is developing to be another promising year with total issuance size of USD31.7 billion globally in the first quarter.[2]

8. Shariah-compliant equities are also a very significant segment of the Islamic capital market. Based on the Dow Jones Islamic Market World Index as an indicator of the size of Shariah-compliant equities globally (in the absence of an official measure), the market capitalisation of the 2,387 component stocks of the Index stood at USD19.3 trillion as at April 2013.

9. The large universe in terms of value as well as number offers vast potential to drive further growth of the Islamic finance industry through the development of Islamic equity-based products such as Islamic funds. While the size of assets under management in the Islamic fund management industry is still relatively small, at less than 1% of global mutual funds[3], the potential lies in serving the growing demand from Shariah-based investors who increasingly seek to diversify their investments not

[1] Source: KFH Research Ltd, Global Sukuk Report (January 2013)
[2] Source: IFIS
[3] Source: Ernst & Young Islamic Funds & Investments Report 2011

only from a geographical perspective but also in terms of product structures. In addition, the universality of the values underlying the Shariah principles of Islamic funds may also attract investors seeking ethical and socially responsible investments.

10. According to the Ernst & Young World Islamic Banking Competitiveness Report 2013, global Islamic banking assets held by commercial banks amounted to USD1.3 trillion as at 2011 with the top 20 Islamic banks registering robust growth of 16% per annum in the last three years. The top three countries with the largest Islamic banking industry are Saudi Arabia, with an estimated USD207 billion of Islamic assets, followed by Malaysia with total assets of USD106 billion and the UAE with total assets of USD75 billion. Furthermore, the growth momentum is expected to be sustained as global Islamic banking assets are forecast to cross USD1.8 trillion by end-2013.

11. The growth of Islamic finance is reflected not just through the wide and still expanding range of products and services available in the market, but also in terms of the entry of new jurisdictions, such as Oman which witnessed the opening of its first Islamic bank early this year. Furthermore, the government of the United Kingdom, which already has an established presence in Islamic finance, has renewed its commitment to further develop the industry by launching its Islamic Finance Task Force in March. There are similar examples of the growing commitment towards developing or strengthening the Islamic finance industry in other jurisdictions, which would collectively serve to broaden the industry reach and promote greater internationalisation.

### ***Sustaining the Growth of Islamic Finance***

12. To sustain the growth of the Islamic finance industry, it is important for an enabling ecosystem to be created in order to nurture further development of the industry. In this context, industry experts have deliberated on a number of key areas that require specific focus and I will touch on three of them:
    - Enhancing facilitative frameworks and cost efficiency
    - Broadening participation by investors, issuers and intermediaries
    - Intensifying intra- and inter-regional collaborations

13. The development of Islamic finance in the past decade or so has not been without its fair share of issues and challenges. To some extent, they have in fact affected the pace of adoption of Islamic finance within certain jurisdictions, or limited the scope of participation by the stakeholders as these challenges effectively create obstacles or uncertainty in conducting Islamic finance transactions.

14. Development of the relevant and supportive legal and tax frameworks has been a major challenge for the industry. To-date, there remains some degree of uncertainty as to the legal enforceability of the Shariah relative to local or national laws when dealing with Islamic financial instruments and structures. As the present-day Islamic finance industry is still relatively nascent, there are only a few cases that may serve as legal precedents. In this regard, it is imperative that both the public and private sectors collaborate towards enhancing legal certainty and clarity in Islamic finance transactions, including strengthening the dispute resolution mechanism and harmonising relevant documentation, in order to mitigate current market concerns.

15. The limited availability of an enabling tax framework in some jurisdictions has also hampered a more entrenched development of Islamic finance. As certain Islamic finance transactions or structures require relevant amendments to the tax laws to provide tax neutrality relative to similar conventional structures, any delay or reluctance in implementing these amendments will adversely affect the adoption of Islamic finance in these jurisdictions. We must seek to overcome this challenge by sharing the experiences of jurisdictions that have adopted tax neutrality regimes on the additional value that can be created through the offering of Islamic finance in their respective markets.

16. Islamic finance also faces the challenge of being generally less cost competitive from the issuers' perspective for certain products or in certain jurisdictions as a result of higher costs charged by the intermediaries or other service providers due to limited expertise and lack of scale, among others. The higher cost may in some cases be transferred to the customers, rendering the products less attractive compared to their conventional equivalents. It is therefore important for this issue to be addressed effectively, for instance through knowledge transfer, sharing of group resources or facilitating market access, to ensure that Islamic finance products and services remain competitive and commercially relevant in order to enhance its sustainability.

17. Less widely understood than its conventional counterpart, Islamic finance has generated mixed perception on the risks it purportedly carries. The development of Islamic finance has created many opportunities and has complemented the conventional system, but brings with it other challenges which reminds me of a point made by the Nobel laureate in Economics, Robert Merton, that "less apparent understanding of the new environment can create a sense of greater risk, even if the objective level of risk in the system is unchanged or reduced" (Merton, 1995) [4].

18. However once this misperception is addressed, it could unleash new opportunities for Islamic investments while facilitating the funding of economic growth, and making available the supply of risk capital to support the creation of new assets in the Asian financial market.

19. I will now move on to the second area – broadening participation by investors, issuers and intermediaries.

20. An important aspect of broadening the participation in Islamic finance is through enhancing financial inclusion. Much work and study have been conducted in this area, including by the World Bank. Some communities have refrained from participating in the formal financial system due to the absence of a Shariah-compliant alternative. With the increasing availability of Islamic finance, the financial and investment needs of these communities can now be served and may become a significant growth driver in the future.

21. The broadening of participation is also critical as it addresses both the supply of and the demand for Islamic finance products and services. In this context, product innovation and development is an important element. The availability of Islamic finance products and services that are comparable to many of those in the conventional market has contributed immensely to the development of the Islamic finance industry over the past decade as investors and consumers were familiar with these products and services, and therefore accepted them more readily although their range was relatively narrower due to the prohibitions under the Shariah principles such as on *riba*, *gharar* and *maysir*. Nevertheless adherence to the Shariah requirements

[4] Merton, R. (1995). Financial innovation and the management and regulation of financial institutions. *Journal of Banking and Finance*, *19*, 461–481.

which promote universal values that are also embraced in other faiths is arguably the key factor that will drive product development in the future, which in turn will attract broader participation that will cut across religious boundaries and geographical borders.

22. For example, the requirement for Islamic finance instruments to be structured based on real underlying economic or productive assets provides significant protection for investors in mitigating risk of substantial loss. Such structures are increasingly popular following the global financial crisis, the aftermath of which is still being felt across many parts of the developed economies five years on. Furthermore, investors and issuers that seek more authentic, back-to-basic forms of investment or financing instruments based on the Shariah requirement on risk sharing, as opposed to risk transfer, will spur greater product innovation in Islamic finance thus attracting a wider range of participants into the market.

23. While product structures that are based on Shariah principles may appeal to segments of the population that extend beyond a specific community, the further growth and sustainability of Islamic finance will also require that these products offer a competitive risk-return profile. In this regard, it is important that the risk-return comparisons are made between products that are alike in substance, in order to avoid any misperception in the market.

24. The third area is intensifying intra- and inter-regional collaborations.

25. In the present globalised environment, cross border collaborations are absolutely critical for the sustained and inclusive growth of Islamic finance. Collaborations within a region, for instance within ASEAN or the GCC, is arguably the most effective and productive type of collaboration in view of the proximity of the markets as well as the generally closer cultural and social understanding within the region. Firmly established intra-regional collaborations will then set a conducive platform for inter-regional collaborations, for instance between ASEAN and the GCC, to promote greater linkages and cross border flows of Islamic finance transactions to support investment, financing and trading activities between the regions. It is with these potential benefits in mind that the ASEAN Capital Market Forum has recently commenced work on identifying opportunities in the development of the Islamic capital market within the grouping.

26. Other forms of collaboration spearheaded by or under the auspices of multilateral groupings or institutions can also further enhance the growth of Islamic finance. The Organisation of Islamic Cooperation (OIC) Countries, the Islamic Development Bank and the Islamic Financial Services Board (IFSB) are among such organizations that can facilitate the development of Islamic finance globally by harnessing and mobilising the resources across jurisdictions, promoting common standards and practices, and establishing platforms and infrastructure. An initiative that has been introduced fairly recently is the setting up of an Islamic Finance Task Force under the Standing Committee for Economic and Commercial Cooperation (COMCEC) Capital Markets Regulators Forum of the OIC, to explore potential areas for collaboration in the development of Islamic finance among member countries. Another initiative was a roundtable jointly organized by the IFSB, the International Organisation of Securities Commissions (IOSCO) and the Securities Commission Malaysia in September last year to discuss minimum disclosure requirements for Islamic capital market (ICM) products, with the primary aim of working towards a set of standards that would ultimately facilitate cross border offering of ICM products.

### ***Opportunities for Islamic Finance***

Ladies and gentlemen

27. The Asian economic landscape offers ample opportunities for Islamic finance to flourish.

28. Infrastructure investment is an important component of economic development. The Asian Development Bank has projected that ASEAN nations will require an average of about USD60 billion of infrastructure investment a year between 2010 and 2020. A recent McKinsey report has suggested that infrastructure investment in China will average about USD1 trillion per annum up to the year 2030, while India's infrastructure investment is forecast to be about USD1 trillion under its twelfth five-year plan, between 2012 and 2017.

29. These substantial amounts provide tremendous potential for financing and capital raising through the issuance of sukuk, as many infrastructure assets are inherently Shariah-compliant. Furthermore, sukuk will naturally capture a wider subscriber base

as they appeal to both conventional and Shariah-based investors. Cross border offering of sukuk will also promote greater diversity in terms of the issuing currency, as well as the industry and geographical profile of the issuers.

30. At the same time, growing affluence among the Asian middle class will generate increasing demand for investment and savings products. With a large proportion of the Asian population potentially seeking Shariah-compliant alternatives, especially in South East Asia, the opportunity for Islamic investments to meet this prospectively strong demand should not be underestimated.

31. In the medium to longer term, demand for more sophisticated and comprehensive services will help to spur the development of a vibrant Islamic wealth management industry that will serve regional and international customers, incorporating various aspects of Islamic finance including fund management, takaful and real estate, to name a few.

***Regulatory Approach to Islamic Finance***

Ladies and gentlemen,

32. Let me conclude by touching on the area of regulation.

33. Arising from the vagaries of the financial markets in recent years, the role of regulators and the effectiveness of regulations have become even more important. It is therefore crucial that regulators develop appropriate and effective regulatory measures for the future to monitor and address emerging risks in an increasingly complex economic and financial environment.

34. A key aspect of the regulatory approach therefore is the development of supervisory and risk management frameworks that emphasise disclosure, transparency, strong governance and investor protection to strengthen the resilience and soundness of the market and its institutions, while supporting innovation and competition.

35. In this regard, the Securities Commission Malaysia has taken the view that our Islamic capital market products would be subject to the same regulation as their conventional counterparts, with additional requirements to ensure Shariah compliance. This

approach provides the participants – whether in Islamic or conventional products – with the assurance that the products and services are governed by the same standards of regulation and supervision.

36. Nevertheless, regulating for Shariah compliance is a critical process in respect of the Islamic capital market as it serves to enhance market confidence on the products and services. The process therefore should include appropriate and effective safeguards in the Shariah governance framework so as to ensure credibility, clarity and consistency.

37. It is instructive to note that Islamic finance is no longer confined to a narrow market segment but has gained traction in many other jurisdictions across the globe. While this development augurs well for the long term growth of the industry, it further adds to the complexity of integration and to systemic risk trend that we as global regulators certainly face, and therefore represents a significant challenge.

38. Each jurisdiction may have its own regulatory approach for the development of its Islamic finance industry, however in light of such rapid global growth today, the increasing need for a common understanding on regulatory issues in Islamic finance represents a crucial challenge that has to be addressed in order to facilitate the orderly development of the global Islamic finance industry and to ensure its sustainability.

39. Furthermore, regulatory cooperation to facilitate the internationalisation of Islamic finance should be explored, for instance establishing mutual recognition agreements for Islamic capital market products to be offered in each other's jurisdiction with minimal regulatory intervention. Collaborative efforts to develop regulatory standards that promote greater harmonisation should also be intensively pursued to facilitate faster development of cross border Islamic finance transactions and activities.

40. For an industry that is still relatively young, Islamic finance also needs to be seen to be properly and sufficiently regulated in order to provide confidence to market participants. A well-regulated industry will attract the participation of high quality investors, issuers and intermediaries, which in turn will lead towards a vibrant and robust Islamic finance industry.

***Conclusion***

41. On that note, I urge all stakeholders to collaborate and cooperate in pursuing the developmental agenda for Islamic finance in order to unleash the full potential that it has to offer. Such initiatives should also include effective branding and profiling of Islamic finance and its value proposition on a global scale in order to generate greater appreciation and ultimately acceptance of Islamic finance as a viable and sustainable alternative. There is always much more that can be achieved when efforts and resources are harnessed and combined within and across the regions, so that Islamic finance can not only serve a niche market segment but also spur greater cross-border financial and investment activities that support economic, trade and business linkages.

42. I wish everyone a productive and insightful conference.

Thank you.