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# 6th Islamic Financial Services Board Summit

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## Opening

Good morning ladies and gentlemen. May I first thank the Monetary Authority of Singapore and the Islamic Financial Services Board for their invitation. It gives me great pleasure to be here in Singapore. For my presentation this morning, I would like to share with you the latest financial market developments in Hong Kong, with particular emphasis on Islamic financial services.

## International appeal of Islamic finance

Like the speakers who addressed you yesterday, I will not give you another blow-for-blow account of what has already happened in the current financial crisis, I would rather talk about what we are doing to fix things in a co-ordinated manner. For instance, Hong Kong, as part of China, plays an active role in providing input to the various G-20 workgroups to help global markets recover. In doing so, we look into a wide variety of possible initiatives to promote sound regulation and better transparency, and to strengthen international co-operation and market integrity.

One increasingly important pillar of the global marketplace that appears to hold plenty of promise is the area of Islamic finance. Traditionally, the Islamic finance industry caters to the needs of investors in Islamic countries, who seek financing requirements and investment opportunities that accord with their religious beliefs.

Because Islamic finance advocates more prudent financial practices, including prohibitions on speculative activities, and adherence to the principle that deals have to be backed by tangible assets and genuine business activities, Islamic finance looks set to have a bigger role to play in the new financial order, when investors worldwide, and not just those in Islamic countries, start turning to more basic investments, with returns that are based on lower-risk parameters and better defined assets.

Of course, all financial sectors have been affected by the crisis. The Islamic finance industry included new Sukuk issuance for instance, have fallen two-thirds to a three-year low of US$15.77 billion[1]. However, according to the Standard & Poor's Rating Services, Takaful firms and Islamic financial institutions remain less affected by the global financial downturn due to its Shariah compliant nature, which includes shying away from excessive leverage and imprudent risk-taking activities. The fact that Islamic financial institutions place less

[1] Reuters, quoting Islamic Finance Information Service, in April 2009.

reliance on debts and debt-based instruments have helped the industry to weather the storm with greater resilience.

In the medium to longer term, therefore, investors' preference for more prudent investments would likely lead many of them to the Islamic finance industry. This is indeed an opportune moment for the Islamic finance industry to take bigger and bolder steps forward.

**Hong Kong to develop Islamic finance**

The Hong Kong Government has also demonstrated its steadfast commitment to develop Hong Kong into an Islamic finance platform. For two consecutive years in his policy address, our Chief Executive emphasised the importance of developing Hong Kong as an Islamic finance hub.

Of course, this objective cannot be achieved overnight, as the introduction of Islamic finance in our market would require some re-adjustments to our tax and legal infrastructure. However, we are in the process of making the necessary changes. In his budget speech delivered in February this year, our Financial Secretary stated that specific measures, such as tax neutrality, would be considered to encourage the development of Islamic finance in our city. This would clear the way for Sukuks to be issued, once there is a level playing field in terms of tax treatment between Sukuks and other commercial bonds.

In fact, Hong Kong has already introduced its first Sukuk in March 2008, when Khazanah Nasional Berhad successfully issued a US$550 million Sukuk on the Hong Kong Stock Exchange. The Sukuk, which is exchangeable into shares of the Parkson Retail Group Limited, was well received by investors and the offering was 10 times over-subscribed. To me, this is encouraging development as it shows that Hong Kong investors recognise the potential benefits of Islamic finance products.

Aside from Sukuks, Hong Kong has great potential to be a strong platform for the development of Islamic funds. We have a deep investor base which includes both institutional and retail investors who are always ready to delve into the latest fund products. The SFC's Fund Management Activities Survey for year 2007 showed that 68.4% of our fund management business originated from non-Hong Kong investors. This underscores our role as the premier asset management centre in the region. Above all else, we are capturing a steady stream of liquidity from the mainland of China whose investors are now able to invest overseas through QDII programs.

Hong Kong so far is the most popular destination. One of our key priorities is to develop the depth and breadth of our asset management market. The SFC authorised the first retail Islamic fund to be offered in Hong Kong in November 2007. The fund tracks the Dow Jones Islamic Market China / Hong Kong Titans Index and has been actively traded since its launch. This is only a start, and we expect more of such products to be introduced in Hong Kong.

The Hong Kong market distinguishes itself by offering investors unparalleled access to Chinese stocks. China-related stocks in Hong Kong are known as H-share and red-chips companies (depending on their place of incorporation) and they account for over half of the market capitalisation of Hong Kong's Main Board. These stocks cover a wide range of sectors from minerals, commodities, energy, transportation, aviation, petrochemical, telecommunications, construction, property and many more. By carefully selecting from the huge range of China-related shares available on the Hong Kong market, product providers from around the world are able to create products for investors who wish to capture the growth opportunities offered by Mainland.

Increasingly investors are interested in exchange-traded funds because of their transparency and lower costs. ETFs could be the ideal vehicle through which an Islamic equity-linked product could be offered in Hong Kong.

According to data from the World Federation of Exchanges, in 2008, Hong Kong's ETF market was the largest in the Asia-Pacific region (including Japan) in terms of turnover.

Currently, we have over 10 indices that are tracking H shares and red-Chips. In addition Hong Kong was the first financial centre to offer, in as early as 2004, an ETF that tracks the China A-share market, giving overseas investors the opportunity to indirectly invest in Mainland China's restricted A-share market. We now have three ETFs which offer this investment strategy, and together they account for over 69% of the total volume of ETF trading on the Stock Exchange of Hong Kong. This underscores the significant amount of global investor interest in the China A-share market. Managers who have the expertise could just as easily create Shariah compliant ETFs that track shares of Chinese companies.

**Hong Kong's edge**

Being a part of China, we stand to benefit from the country's policy and development. Of course, we have to earn our keep and continue to give value especially at this time as China takes it place in the league of the world's biggest economies. The question that will be asked is, what is it that we can offer?

The answer is, we are China's open, off-shore market. Hong Kong has recently been named the world's freest economy for the 15th consecutive year by the Heritage Foundation. We have always recognised that to be successful, we have to be completely open – only through that, and through transparent government policies, a corruption-free society and a rigorous adherence to the rule of law and international standards could we achieve critical mass of capital, talents, and international institutions gathered from all over the world. As western markets that have to be bailed out by government money start to take a socialistic / internationalistic characteristic, we in Hong Kong must remain committed to an open and free market.

Today, of the world's top 100 banks, about 70% have established operations in Hong Kong. Over 60% of the turnover in our stock market is attributable to institutional investors. Among them, more than half are with national investors.

Hong Kong has been dealt two cards - the China card and the international card. We play our hands deftly, and use both cards to our best advantage. China needs to go into the world and the world wants to come to China. Hong Kong provides the bridge and the connection. In the Islamic finance space, our strength clearly lies in the ability to intermediate between funds coming in from Islamic countries and the ample investment opportunities in the Mainland. With these competitive advantages, I see no reason why Hong Kong should not be able to develop a robust and vibrant Islamic finance industry.

**International co-operation**

In Islamic finance, Hong Kong is a new kid on the block. Consequently, the SFC places great importance on establishing and maintaining strong relationships with the authorities and financial institutions in Islamic financial centres, with a view to developing the Islamic finance sector in Hong Kong.

In April 2008, the SFC entered into a Memorandum of Understanding (MOU) with the Dubai Financial Services Authority for mutual co-operation on capacity building and human capital development in our respective Islamic capital market segments. Hong Kong and Dubai have since begun examining a framework for the mutual recognition of our regulatory regimes on Islamic funds to facilitate cross-border marketing and distribution of such funds. We are also actively engaged in ongoing discussions with the Securities Commission of Malaysia to examine areas in which co-operative synergy could be achieved with respect to the development and distribution of Islamic finance products in both jurisdictions.

I would also like to extend an invitation to industry players to come in and discuss with us about what more can be done to shape and develop Hong Kong's fledgling Islamic finance industry. I think that such discussions are mutually beneficial in that they add to our understanding of Islamic finance business models, and in turn, it helps Islamic financial institutions get a better grasp of our regulatory framework. It also helps us to focus on areas within our regulatory regime that may require improvement to better facilitate the healthy expansion of Islamic finance in our city.

In closing, I would like to say that industry seminars and road shows, with the present occasion being an excellent example, serve as a productive bridge for the relevant authorities, industry practitioners and promoters to come together to share ideas and to collectively chart a course towards the development of Islamic finance in new frontiers. I would like to once again extend my thanks to the organisers for their invitation and wish all of you attending the IFSB Summit great success!

Thank you.