

## 2nd Islamic Finance news Roadshow Hong Kong

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### Opening

Good morning Ladies and Gentlemen.

This is the 2nd series of the Islamic Finance news Roadshow organised by REDMoney following last year's successful inauguration. I was told that this year the Roadshow will tour 14 major Islamic financial markets, with eight return trips including this one to Hong Kong.

May I take this opportunity to give everyone a very warm welcome back. It gives me great pleasure to meet you again here in Hong Kong and have this chance to update you on the developments of our financial markets, with respect to Islamic finance in particular.

### Islamic finance development amid challenges of the financial turmoil

At the G-20 Summit held in Washington D.C. last November and the one in London early April, world leaders met amid serious challenges to the global economy. The Group has been working to lay the foundations to move beyond the crisis to a sustainable recovery by a concerted, coordinated international response from not only developed economies but also emerging markets like China, Russia and Saudi Arabia, thus recognising a wide participation by all these countries. Cross-country workgroups have been formed to take forward work in the following five areas:

- Strengthening transparency and accountability
- Enhancing sound regulation
- Promoting integrity in financial markets
- Reinforcing international co-operation
- Reforming the International Financial Institutions

As part of China, Hong Kong has been providing inputs to the workgroup for enhancing sound regulation and strengthening transparency, as well as the workgroup for international co-operation and market integrity.

Looking at the Islamic finance industry, can the industry be entirely insulated from the impact of the current financial crisis due to the underlying principles requiring deals to be backed by tangible assets, and imposing prohibitions on speculative activities? It is obvious that the



answer is “no”, given the crisis has been transcending into an economic recession affecting everybody in the world.

Compared to conventional financial players, Islamic banks and financial institutions have, to a degree, demonstrated a more resilient position against impact of the crisis because of the non-leverage approach. However, there is certainly no way for a total escape. The contagious effects of the crisis are enormous, affecting adversely both macroeconomic factors and general market sentiments. It is, therefore, inevitable that the Islamic finance industry would slow down in its pace of development, as has already been evidenced by a significant decline in the total value of Sukuk issuance last year - US\$23.6 billion, which was less than half of the size for the previous year, according to market data.

While central bankers and regulators around the world are working towards a new and improved international system for what might be called conventional finance, Islamic finance can also contribute to the stability of markets and economies because of its underlying principles that stress prudent investments and ethical practices. There have been growing calls for a greater role and involvement of Islamic finance in the global financial system. As the President of the Islamic Development Bank said, the opportunities offered by Islamic finance in promoting global financial stability and financial inclusion are worth assessment by the leadership of the G-20 countries and it is time that the wider world should consider mainstreaming Islamic financial services.

Islamic finance is an alternative way of financial intermediation both within and outside of Islamic communities, and is recognised as a potential source of funding to fill the financing gap when both the traditional securities and bond markets have significantly shrunk. Therefore, although the financial crisis has brought times of instability and volatility, this is also the moment where chances arise for the Islamic finance sector to capitalise on this opportunity to promote the benefits of Shariah-compliant products and expand its market reach worldwide.

Indeed, although the pace of growth has been affected due to the financial turmoil, Islamic finance has seen a healthy development in the past both in its breadth and depth.

- Breadth in the types of Islamic financial instruments on offer: Sukuks, Takaful, retail funds including ETFs and Shariah indices, as well as the types of Islamic finance expertise that have emerged: Islamic banking, asset management, rating agencies, law firms, accounting firms, and in its demographics, covering Islamic and non-Islamic countries alike.
- Depth in terms of the size of different Islamic deals and the initiatives that Islamic practitioners are taking to establish Islamic finance as one of the main streams in the global financial market.

As an international financial centre, Hong Kong is committed to playing an active part in Islamic finance’s continuous growth story.



## **Globalisation of Islamic finance across Muslim and non-Muslim jurisdictions**

Islamic finance has successfully carried across the message that the seller or buyer of an Islamic financial product does not have to be a Muslim. Islamic products are provided to serve the genuine financial needs for Muslims and non-Muslims alike, and can be an integral part of an overall financial industry and hence are something that should be catered for by major financial centres.

One obvious example is that we see the UK, a non-Islamic country, being ranked the 8th largest global centre for Islamic finance, ahead of Turkey, Pakistan and Bangladesh. Over the past five years or so, London has built up its Islamic finance capabilities through regulatory and fiscal adjustments, the licensing of a number of Islamic banks, Takaful companies, and the authorisation for conventional players to offer Shariah-compliant products in the UK.

The French have lagged the British initially, but since mid-2008 the French government has signalled a change in attitude and is set to adjust its fiscal and legal framework to render its regime friendlier to the development of Islamic finance. French Finance Minister Christine Lagarde has announced France's intention to make Paris "the capital of Islamic finance" and announced that several Islamic banks would open branches in the French capital in 2009. This is in addition to fiscal and legal clarifications and modifications necessary to facilitate Sukuk issuance and structured real estate transactions.

## **Hong Kong's commitment to developing Islamic finance**

The Hong Kong Government has stressed on numerous occasions its policy to develop Hong Kong into an Islamic finance platform. Our Chief Executive's policy address of both 2007/08 and 2008/09 continuously underscored the importance to develop Hong Kong as a hub for Islamic finance.

In the recent budget speech made by our Financial Secretary in February, it was reckoned again that in order to consolidate Hong Kong's position as an international financial centre, particular measures would be made to improve Hong Kong's regime as a platform for the growing area of Islamic finance, including our tax regime. To this end, the administration is putting in place tax neutrality measures to spearhead the development of Islamic finance including the issuance of Sukuks in the city.

## **Fostering close ties with Islamic finance stakeholders**

To keep our development in Islamic finance dynamic, we maintain close dialogue with overseas regulators as well as the Islamic finance industry to strengthen regulatory ties and co-operation among different Islamic finance stakeholders.



### *Co-operation with overseas regulators*

In April 2008, the SFC entered into an MOU with the Dubai Financial Services Authority (“DFSA”) for mutual co-operation and capacity building and human capital development of our respective Islamic capital market segments.

In May 2008, the Hong Kong Monetary Authority (“HKMA”) and the Dubai International Financial Centre Authority (“DIFC”) also signed a MOU to establish the foundation for co-operation in the development of Shariah-compliant financial products and the financial infrastructures. In particular, that MOU sets out the framework regarding the identification of the means to foster Islamic financial activities on a cross-border scale between Dubai and Hong Kong, such as the trading of Sukuks and other Shariah-compliant financial instruments, as well as to enhance co-operation of the financial infrastructures between the two regions, in particular the payment systems.

In addition to regulators in Dubai, we have been communicating with the Securities Commission of Malaysia to explore avenues of co-operation in fostering better understanding of the development of Islamic finance products in Malaysia.

### *On-going dialogues with Islamic finance practitioners*

Hong Kong is keen to introduce Islamic finance to our community, and so are market practitioners. From time to time, we are approached by industry players to discuss with us their innovation or design of Islamic products as well as on matters relating to licence applications for conducting Islamic finance business in Hong Kong. We very much welcome all these direct discussions with the industry which is beneficial to both sides – for our understanding of their business proposals and, at the same time, their understanding of our regulatory regime.

After the authorisation of the first retail Islamic fund for sale to the Hong Kong investing public in November 2007, the Khazanah Nasional Berhad successfully issued a US\$550 million Islamic exchangeable trust certificate, on the Hong Kong Stock Exchange, in March 2008. That Sukuk, which is exchangeable into shares of Parkson Retail Group, was well received by investors as the offering was 10 times over-subscribed.

In August 2008, the HKMA has given permission for the operation of the first Islamic banking window in Hong Kong by Hong Leong Bank (“HLBHK”), with an initial focus on Islamic deposit-taking business backed by commodity trading (Commodity Murabahah Deposits). In November 2008, HKMA also gave permission to CIMB Bank Hong Kong to operate an Islamic banking window in Hong Kong.

More recently, you may have already heard about the potential Sukuk issuance by the Hong Kong Airport Authority.

### **Hong Kong’s competitive advantages**

As a strategic partner in the growth of Islamic finance, Hong Kong will continue to offer its competitive advantages as an international financial centre as well as the gateway to Mainland China.



### *An open market economy with transparent regulations*

I need no repeating here that Hong Kong continues to be the Number 1 on the league table published by the Heritage Foundation as the world's freest economy for the last 15 years.

Hong Kong has a judicial system where common law is practiced and we have no foreign exchange control. In July 2008, Hong Kong's long-term foreign and local currency sovereign ratings were upgraded to "AA+" from "AA" by Standard and Poor's with a "stable" outlook. Our market also enjoys high transparency in its policies and regulations, and provides market players with a level playing field.

### *Hong Kong as a premier fund management centre*

Hong Kong has over the past decade become a key management hub for both domestic and overseas funds and investors. The SFC's most recent Fund Management Activities Survey for the year 2007 reconfirmed Hong Kong's status as an international asset management centre. Our asset management sector continued its strong growth in 2007, with combined fund management business reaching HK\$9,631 billion, representing an increase of 56.5% over the previous year and more than double the figure in 2005. The Survey also revealed that 68.4% of our fund management business was sourced from non-Hong Kong investors, indicating large overseas investor participation in the Hong Kong market.

Islamic investors looking for investment opportunities can utilise Hong Kong as their platform to manage their wealth and invest into Mainland China and other markets.

### **Final remarks**

Globalisation of financial markets may have been slowed down in the current crisis – but the trend will continue. All markets are connected just as the world's economies are connected. This can sometimes have some unforeseen consequences. We have seen complex products increasingly finding their way into retail hands. The duty, both of investors and intermediaries who sell the product is to get a clear and full understanding of risks. It is clear that in this world of connected and complex markets – a shock in one part of the system has unforeseen effects. The failure of the Icelandic banks affected not just the UK and Europe but also holders of Credit Linked Notes in Hong Kong, same is true of Nortel Networks in Canada. Corporate failures in the US – whether that be the many failures already or the potential bankruptcy of General Motors and the US auto industry – will have an effect on Hong Kong – on overall sentiment but more explicitly, on holders of Credit Linked Notes. If investors have any doubts about what these effect might be they should contact the distributors of products now. We have told the issuers of Structured Products to make the information available via distributors and so there should be no excuse for investors not being able to get the full picture.

But globalisation of financial markets present opportunities as well as risks and it is encouraging to see Islamic finance building up its critical mass across Muslim and non-Muslim countries, and developing human capital outside of the Islamic communities and embracing healthy competition. At the same time, Islamic finance practitioners and promoters go further to support many industry forums and roadshows like the present one.



This is beneficial for the Islamic finance industry as a whole in terms of understanding and product development.

Notwithstanding the current financial turmoil, Hong Kong is committed to developing its Islamic finance platform. In addition to taking measures to improve our regime to facilitate such development, we will continue to work closely with the Islamic finance community including our overseas counterparts, to develop the city as an Islamic finance hub. Meanwhile, we welcome discussions with any new intermediaries or investors that are interested in coming to Hong Kong and invite all parties to experience first hand the advantages that the Hong Kong financial market can offer.

I wish the Islamic Finance news Roadshow a great success. Thank you.