

# **Governor's Keynote Address at the 2nd Malaysian Islamic Finance - Issuers and Investors Forum 2007 "Malaysia as Global Sukuk Centre: Towards Greater Vibrancy of Malaysian Sukuk Market"**

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**Venue** : Mandarin Oriental Hotel, Kuala Lumpur  
**Date** : 13 August 2007  
**Language** : English

It gives me great pleasure to speak at the 2nd Malaysian Islamic Finance - Issuers and Investors Forum 2007 that brings together industry practitioners and investors to discuss recent developments and key issues in Islamic finance. Islamic financial markets in particular, have experienced significant evolution and rapid expansion. We are now seeing the emergence of highly innovative products and services in sukuk market. My remarks today will focus on the vast growth potential of the global sukuk market and Malaysia's experience in strengthening our market for Global Sukuk activities.

## **Vast Growth Potential for sukuk**

The growing role of Islamic finance in mobilising and channelling funds to productive investment activities across borders contributes to more efficient allocation of funds across borders and facilitates international trade and investment. Greater diversification of risks also contributes towards promoting international financial stability. The more recent developments in Islamic finance is the growing significance of the sukuk market to become an increasingly important component of the Islamic financial system. Five major trends are having a significant bearing on the future development of the global sukuk market.

Firstly, the bond market is now becoming key to meeting the funding requirements for both the public and private sectors in emerging market economies. This is particularly the case for the Middle East and Asia, which are among the fastest growing regions in the global economy. This includes financial needs of the private sector following the privatisation and implementation of infrastructure projects. The development of the Islamic Bond Market, the Sukuk Market will provide opportunities for the corporate sector, the government agencies, multinational corporations and multinational development institutions to raise funds through the issuance of sukuk to meet their financing requirements. The sukuk market also serves as an important platform, complementing the conventional bond market, in enhancing the effectiveness and efficiency for the mobilisation and allocation of funds within the domestic financial system, as well as in the international financial system.

Secondly, while there has been growing interest in the issuance of sukuks by corporations, sovereigns and multinational corporations, the demand for sukuks significantly exceeds the supply. Today, the global sukuk market, denominated in international currencies, is estimated to exceed USD50 billion. Although the size of the market is modest by global standards, the sukuk market is experiencing remarkable growth, increasing at an average rate of growth of forty per cent per annum.

The significant demand for sukuks have been spurred by the high levels of surplus savings and reserves in Asia and in the Middle East. This has been reinforced by increased liquidity in the international financial system in search of higher returns and greater diversification of risk. Since the issuance of the first sovereign global Islamic sukuk by the Government of Malaysia in 2002,

there has been a series of other issues by the governments of United Arab Emirates, Qatar, Bahrain and Pakistan. An increased number of multilateral agencies have also issued sukuk to finance development projects. In addition, both government agencies and the corporate sector have considered the sukuk market as an attractive instrument of financing.

Thirdly, there is a great number of global players such as investment banks, Islamic banks and securities firms that are involved in the issuance of sukuk in the international financial markets. A large number of Western banks are also providing Islamic financial services taking advantage of the opportunities and to provide customised products and services to their customers.

Fourthly, the established international financial centres have also shown interests to have an active role in promoting the development of the sukuk market including enacting the appropriate legislative provisions. These developments would augur well for the development of the sukuk market.

Finally, the regulatory and supervisory paradigm continues to evolve. Indeed, the recent decade had witnessed significant global shifts in the approach to regulation and supervision across many countries. In addition, the harmonisation of standards and practices is also important. The establishment of the international standard setting organizations such as the Islamic Financial Services Board (IFSB) and the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), to formulate appropriate prudential and accounting standards that would not only facilitate the process of harmonisation but also contribute to the strengthening of the Islamic financial system. The IFSB has already formulated the prudential treatment for sukuk investment by the Islamic financial institutions as stipulated in the Capital Adequacy Standards.

## **Malaysia's Strength in the Sukuk Market**

Let me now turn to Malaysia's sukuk market. Significant progress has been achieved in the development of the Malaysian sukuk market. In 2007, Malaysia accounted for about two-thirds of the global sukuk outstanding, amounting to about USD47 billion. Malaysia not only represents the largest sukuk market in terms of outstanding size, but also in terms of number of issuance.

In developing the sukuk market, Malaysia provides a total solution for sukuk activities by providing a complete sukuk issuance and trading platform, that is supported by four elements: a wide range of Islamic instruments, strong legal and regulatory infrastructure, sound Shariah governance framework and the talent supply. These elements are also further strengthened by Malaysia's comprehensive Islamic financial system with all the key components of the financial system comprising the Islamic banking, takaful, Islamic money and capital markets that are now at an advanced stage of development. These different parts of the Islamic financial system not only facilitates the issuance and the distribution of the papers but also creates a strong demand for sukuk by providing a broad investor base.

There is also a variety of Islamic instruments in the sukuk market in Malaysia that includes currency swaps and Islamic forward contracts available to facilitate hedging and other risk management activities. The Malaysian Sukuk market, is also supported by appropriate rules and regulations, and by the pool of experienced global and domestic players as well as the legal and accounting professionals including legal and tax consultancy, as well as documentation in the issuance and trading exercise.

In promoting Malaysia as an International Islamic Financial Centre ([MIFC](#)) we aim to develop Malaysia into a centre for the origination, distribution and trading of sukuk to provide further impetus to the development of an increasingly vibrant and progressive bond market in Malaysia as well as in the Asian region. This would reinforce the international dimension of the sukuk market in Malaysia by providing linkages with international issuers and investors. To deepen and

widen the bond and sukuk markets, Malaysia has further liberalised the foreign exchange administration rules to allow multilateral financial institutions, multinational and other national corporations to issue both ringgit and non-ringgit denominated instruments in our capital market.

Malaysia also has in place the financial infrastructure and facilitative rules that contribute towards efficient price discovery and shorter time to market, thus providing an efficient platform for sukuk issuance and trading activities.

The established legal, regulatory and Shariah framework in the Islamic financial infrastructure in Malaysia is reinforced by the supporting financial infrastructure, including the settlement and bond information system.

To facilitate an efficient sukuk issuance process in Malaysia, an **MIFC One-stop centre** is being established as a single contact point for efficient delivery process to facilitate the issuance of sukuk. To further facilitate this process, there is no restriction on the ability to use international rating services, on the ability to hedge positions and on the ability to swap issuance proceeds into foreign currency.

As part of our ongoing efforts to position Malaysia as an attractive gateway for the issuance of sukuk, a number of legal and regulatory requirements are further customised to reduce the cost of sukuk issuance. Profits and dividends received by non-resident investors from holding of ringgit and non-ringgit Islamic instruments issued in Malaysia are exempted from withholding tax. Special Purpose Vehicles (SPV) for Islamic financing purposes via the Islamic capital market are not subject to the administrative procedures under the Income Tax Act 1967. In addition, companies that establish these SPVs are given a tax deduction on the issuance cost of the Islamic securities incurred by the SPV. The issuance cost for all Islamic securities approved by the Securities Commission are also eligible for tax deduction. Finally, there is a stamp duty exemption for 10 years on instruments relating to Islamic securities under the [MIFC](#).

Malaysia has also put in place an efficient platform for trading of bonds including the Real-time Electronic Transfer of Funds and Securities System (RENTAS), Fully Automated System for Issuance/Tendering (FAST), and Bond Information and Dissemination System (BIDS) to provide post-trade transparency and market liquidity on par with developed markets. Malaysia has a payment system link with Hong Kong Monetary Authority on US dollar settlements, while the Malaysian Government Securities are clearable with Clearstream.

Finally, of importance is a conducive environment for innovation and this has been put in place. In 2006, the Malaysian market continued to generate innovative products with the launch of sukuk using Mudharabah, Musyarakah and Ijarah. Landmark issuance such as exchangeable sukuk Musyarakah by Khazanah Nasional Berhad, marked the world's first issue of its kind, incorporating full convertibility features common to conventional equity-linked transactions.

An important enabling factor driving innovation is the availability of the pool of experienced talent. There are currently 9,000 staff with the Islamic financial institutions. They are also reinforced by the workforce of domestic and foreign conventional financial institutions. This expertise that resides in Malaysia allows for the development of innovative products so as to ensure that the product design and structure, as well as the risk management aspects that are being rigorously addressed.

There is also positive response from the local and foreign financial institutions to establish International Islamic Bank, International Takaful Operator, as well as International Currency Business Unit to undertake international currency business in Islamic finance in Malaysia. To date, eight financial institutions have been granted approval to set up such International Currency Business Units in Malaysia.

Commercial banks and investment banks licensed under the Banking and Financial Institutions Act 1989 (BAFIA) are allowed to establish International Currency Business Units to carry out Islamic banking business under their existing entities.

To enhance the delivery system to facilitate their establishment, an "executive green lane" has been accorded to expedite applications by expatriates for long-term employment passes with multiple entry visas. In addition, the Foreign Investment Committee rules are also relaxed further to allow for 100 percent foreign equity ownership in these financial institutions.

The [MIFC](#) portal has also been launched as the primary source of comprehensive online information on the latest initiatives and developments, and enables convenient access to application forms, procedures and guidelines related to entrance and participation in the [MIFC](#). This Portal, is now accessible online at [www.mifc.com](http://www.mifc.com).

The large gathering of practitioners here for these two days to discuss the wide ranging matters that relate to issuers and investors will contribute to enhancing the collective understanding and expanding the boundaries of our knowledge on the opportunities in the sukuk market and the potential that the Malaysian sukuk market provides and its linkages with other international Islamic financial systems. This would facilitate greater cross border flows and not only contributing to enhancing greater international economic and financial integration, and thus to the global growth, but also towards financial stability of the international financial system.

On this note, I wish you a successful conference.

**13 August 2007**

### **Supplementary Information:**

The [MIFC Secretariat](#) is pleased to announce that the [MIFC Portal](#) has been launched as a key communication platform to strengthen the global identity and branding of Malaysia as an International Islamic Financial Centre, or MIFC. The development of the MIFC Portal is an important initiative to promote awareness and global outreach of the MIFC.

The MIFC Portal provides comprehensive information on the latest initiatives, incentives and developments in the MIFC. In addition, the MIFC Portal enables convenient access to application forms, procedures and guidelines related to entrance and participation in the MIFC. The Governor of Bank Negara Malaysia announced the launch of the MIFC Portal during her keynote address at the 2nd Malaysian Islamic Finance - Investors and Issuers Forum 2007. The MIFC Portal is now accessible online at [www.mifc.com](http://www.mifc.com).

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