

Speech
by
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**ENABLING ISLAMIC ENVIRONMENT – MALAYSIAN CAPITAL
MARKET GROWTH**

Introduction

1. Islamic finance has fostered new linkages, created new markets, mobilised previously untapped funds and opened new windows of opportunities for all. It is a development that can no longer be ignored by markets worldwide. National capital markets and international financial centres alike are racing to put in place the basic prerequisites for Islamic capital markets (ICM) to flourish. The gravitational force of Islamic finance can be seen in the surge of interest from all corners of the globe.

2. For us in Asia, the growing economic linkages with the Middle East are of great significance. Islamic finance, in particular the ICM, can reinforce and expand these linkages. Substantial wealth has been generated in both regions. Just as important, are the substantial opportunities for investment and financing to fund economic development and growth in such areas as infrastructure and trade finance, capital markets, managed funds, and real estate. The potential for financial intermediation between pools of investible funds and economic opportunities in Asia and the Middle East are tremendous. Vast opportunities beckon in the oasis of these two hinterlands.

Malaysia's ICM

3. Over the last decade or so Malaysia has made significant strides in the area of ICM. Today, we have the full complement of products, infrastructure, institutions, intermediaries and investors. This has contributed immensely to the development and deepening of the entire capital market. ICM products and services are now an integral component of the Malaysian capital market, offering viable and competitive financing and investment tools as alternatives to conventional products and services.

4. For the first 6 months of this year, RM10 billion or 41 per cent of bonds approved in the Malaysian capital market were sukuk. The size of outstanding corporate sukuk as at July of this year stands at RM166 billion. In the equity

market, 875 of the companies listed on Bursa Malaysia are Shariah compliant. They make up 62 per cent of the total market capitalisation of the Exchange. In the area of investment management, there are 116 Shariah-based unit trust funds with total net asset value in excess of RM12 billion, or over 8 per cent of the total net asset value of our unit trust industry. Although this figure is rather modest, it has grown very rapidly over the past decade and in fact represents almost 40 per cent of the net asset value of the global Islamic unit trust industry.

5. Indeed developments similar to those in Malaysia are also being seen in other parts of the world. Globally, Islamic finance is growing at phenomenal rates. In 2000, there were only three sukuk available worldwide worth USD336 million. As at end June 2007, the size of the global sukuk market stood at USD57 billion. The market capitalisation of the Dow Jones Islamic Index now totals more than USD10 trillion.

[The Islamic Financial Services Board estimates that assets that will be managed under Shariah principles will triple to USD2.8 trillion by 2015.]

The initial years

6. The enabling environment for any market varies according to the stage of growth of a particular market. The same is true of the Malaysian ICM. The environment that existed two decades ago was at best, rudimentary. Yet that period saw the birth and the formative years of the Malaysian ICM. At that time we had no masterplans, no guidelines for Islamic products, no tax incentives and initially, no Securities Commission or other agency specifically tasked with the development of the capital market.

7. What we had then was a young yet fast growing Islamic banking and takaful industry, a well established institutional fund (Tabung Haji) seeking Shariah compliant investments and a private sector that was willing to push the frontiers of innovation in seeking cost effective means of financing through the capital market. It is after all a well-known fact that the first sukuk in Malaysia was issued by a multinational company, Shell MDS, in 1990. The new opportunities offered by the then nascent ICM were quickly seized by market intermediaries – hence the birth of sukuk, Islamic unit trust and Islamic stockbroking.

8. While the enabling environment at that time saw the birth and the evolutionary growth of the ICM, those factors alone would not have brought our ICM to where it is today nor prepared us for the challenges in an increasingly globalised and competitive international financial arena.

Policy initiatives and effective execution

9. Malaysia is therefore fortunate to have realised early that a quantum leap in this relatively new market segment could not be achieved by market forces

alone. The Government and the regulators stepped in particularly through top-down policies and initiatives to ensure that this new market not merely survives but thrives and flourishes by driving the ICM agenda – articulating the vision, putting in place the necessary building blocks, removing impediments and providing the incentives for growth; at times, even playing the role of issuer as was the case when Malaysia issued the first global sovereign sukuk in 2002.

10. Policies are made transparent to all through thoughtfully crafted plans and initiatives. Implementation of these plans is also closely monitored. The Capital Market Masterplan (CMP), released in 2000, identified as one of six strategic objectives, the establishment of Malaysia as an international Islamic Financial Centre. Specific recommendations to achieve this strategic objective are laid out in the CMP. These include the development of a wide range of products, creating a viable market for effective mobilisation of Islamic funds and establishing appropriate and comprehensive regulatory and tax frameworks. The CMP is being implemented over a period of ten years and we have now entered the third and final phase. I am proud to say that most of the recommendations with respect to the ICM have been completed. The fruits of these efforts can be seen in the entire landscape of the Malaysian ICM today.

11. Clarity, consistency and continuity of policies are essential for the attainment of identified goals. The Ninth Malaysia Plan reaffirms the Government's vision to make Malaysia a global hub in Islamic finance. The Plan extends the ICM agenda beyond the CMP. These have been further cemented with the launch of the MIFC initiative last year. The MIFC is a national agenda to strengthen Malaysia's leadership role in the area of Islamic finance and capital market and to create a vibrant, innovative and competitive international Islamic financial services industry in Malaysia. Key areas promoted under the MIFC include the origination, distribution and trading of ICM products and the development of Islamic funds and wealth management services.

A Shariah Advisory Council for the Capital Market

12. The SC, since our establishment in 1993, has proactively pursued a multitude of initiatives to develop the ICM. However, if I am asked to identify the single most important measure that the SC has initiated to catapult the development of the ICM, then it would have to be the establishment of our Shariah Advisory Council (SAC) for the capital market – a world first at the level of the regulator. The SAC was informally established in 1994 and formalised in 1996. Since then the SAC has not only been an enabler but also a catalyst for innovation in the ICM, contributing significantly to the phenomenal growth of the ICM in Malaysia in the last decade.

[For instance, through the continuous screening of listed companies, the SAC has facilitated the growth of the Islamic equity unit trust industry.]

Shariah-specific rules and Guidelines

13. The issuance of Shariah-specific rules and guidelines is also a significant enabler for the growth of our ICM, providing market participants with clarity and certainty on what is acceptable and what is not.

14. The introduction of the Islamic Securities Guidelines in 2004 effectively addressed legal and regulatory impediments to the development of the sukuk market and brought about the exponential growth in sukuk issuance in Malaysia. The Guidelines on Islamic REITS, issued in 2005, brought about the world's first listed Islamic REITS. The market has responded positively to these efforts by quickly bringing new products to the market, whether in the form of Islamic REITS or innovative sukuk structures using Musyarakah, Mudharabah and Ijarah. These guidelines have not only facilitated the issuance of new products in Malaysia but have also become a reference standard for other countries interested in developing their own ICM products.

Ensuring Tax Neutrality

15. Tax treatment can be a bane or a boon to the introduction of new products. A tax neutral environment is an essential tool in facilitating innovation and product promotion. Islamic transactions can be more expensive than conventional transactions ones because Islamic products like sukuk, for example, require execution of numerous underlying contracts. If left unaddressed, tax matters can stifle and stunt the development of new services and products. In this regard, the SC works closely with the government and the industry to ensure a conducive tax environment for the ICM.

We waived the imposition of stamp duties in Islamic transactions, introduced tax exemptions on income earned from investing in Islamic instruments and accorded the same concessionary tax treatment on income from sukuk as is afforded to conventional bonds.

Harnessing the private sector

16. Neither the government nor the private sector can single-handedly drive the growth of the ICM. Both must work together and effectively play their respective roles. Broad policies and initiatives must receive buy-in from, and be cascaded to, the industry because mere expression of goals and visions alone will not make a market. We need the products, the issuers, the investors and the intermediaries. In taking the ICM to its next phase, the role of the private sector becomes even more critical. Although, the Government and the regulators will continue to play their roles as catalyst and facilitator, product innovation, ensuring global compatibility and acceptance, branding and promotion must be pursued by the private sector.

17. The availability of high-quality intermediation services is critical to the next phase of growth. Malaysia's ICM can now boast a broad range of intermediaries – Islamic banks both local and foreign, investment banks, stockbrokers and fund managers. I am pleased to note that local intermediaries are beginning to make their presence felt in the region as well as in the Middle East. The expertise that they have developed can go a long way in helping to expand the size of the global ICM. It is also heartening to note the presence of foreign Islamic intermediaries in Malaysia. This will no doubt provide new conduits for the flow of funds from other parts of the world and help enrich the quality and scope of intermediation services available locally.

More significantly, it is hoped that the strengthening of the intermediation linkages will help foster better understanding and appreciation of the Shariah principles that are adopted in different markets. Going forward, we expect higher levels of investment into product origination and distribution capabilities, and into building intellectual capacity to accelerate growth momentum and to capture the opportunities.

Strategic alliances and linkages

18. When the Malaysian ICM was first conceived more than two decades ago, it was merely to fulfill a domestic need, and was therefore domestic-focused. But that is no longer the case. As our market competes for global fund flows and as we welcome foreign intermediaries and products to our shores and encourage our intermediaries to spread their wings abroad, establishing alliances and linkages with other markets is an absolute necessity.

19. While the global market offers infinite opportunities, it also demands that our products, services and practices are benchmarked internationally. To be a significant player in the increasingly crowded global marketplace, we must be on par with the best in class. The presence of foreign intermediaries in Malaysia, the pursuit of international alliances, the opening of offices abroad and the structuring and offering of products for the international market by local intermediaries will ensure that Malaysian intermediaries can extend their reach and influence to regional and international markets.

20. While the private sector is free to look for opportunities available globally for them to establish linkages, the SC has taken the initiative to establish a 'regulatory bridge' between the Malaysian capital market and the Dubai International Financial Centre. The MOU between the two, signed in August 2006, is the first between two Islamic financial centres. This MOU which allows the cross-border offering and distribution of Islamic funds in the two centres marks a significant milestone in providing the gateway for Malaysians to venture into the Middle East market and vice versa.

Adequacy of Human capital

21. A facilitative environment alone cannot take the ICM forward if we do not have the most important component – the human capital. A primary challenge for Malaysia and indeed for ICM globally, is building a new generation of innovators, regulators, intermediaries and risk managers with the right blend of capital market knowledge and understanding of Shariah principles. For the next phase of development of the ICM, we need to move more and more from adaptation of conventional products to originating indigenous Shariah products. This requires talented individuals with the right combination of talent and qualifications.

22. Malaysia recognises the importance of strengthening this aspect of the Islamic financial services industry. Apart from the establishment of INCEIF, other efforts are being pursued by various quarters to enlarge the pool of expertise for the ICM. The SC, through our training arm, the Securities Industry Development Corporation, provides regular training programmes for Shariah advisers, market intermediaries as well as for fellow regulators. Our Islamic Markets Programme, introduced last year, is fast becoming a significant event in the training calendar of intermediaries and regulators globally.

Conclusion

23. Tremendous strides have been made by various countries including Malaysia in developing the ICM. Countries around the globe are aspiring to play a bigger role in Islamic finance. We cannot allow ourselves to be outpaced. The rules of the game in my view are simple - innovate vigorously, consciously deal with and embrace current challenges and seize the on coming opportunities. These efforts if more aggressively pursued will no doubt entrench Malaysia's leadership in the global Islamic financial market. It will also broaden the opportunities for prospective issuers on one end at the spectrum, and both intermediaries and investors, Muslims and non-Muslims alike on the other end.

However for all the excitement being generated, Islamic finance is still just a sliver of the global financial market.

24. I am confident that based on what we are witnessing today there is going to be immense growth for Shariah compliant products and investments spanning over a wider geographical and currency spread. East Asia is the point of entry for the demand from the Gulf for greater portfolio diversification, seeking the Asian footprint. In addition, whilst we saw institutions in the driving seat, I predict that in the years to come, clients will play a greater role as they become more demanding and discerning given the increasing experience in Islamic finance.

25. A conventional climate can buy Shariah compliant products, but not necessarily the other way around. That irretraceable fact will drive the ICM space in the years to come. We should therefore optimise the opportunities by focusing on convergence and universality.

Thank you