



Event	5 <sup>th</sup> Islamic Financial Services Board Summit, Amman Regional Integration of Islamic Capital Markets – Key Issues
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Speech category	Speech

Your Excellencies

Distinguished Guests

Ladies and Gentlemen

1. Let me begin by congratulating the IFSB and the Central Bank of Jordan for organising this Summit which has brought together various parties who share a deep interest in Islamic finance. Indeed this Summit is timely given the increasing globalisation of financial markets and improving prospects for expanding access across the region.

### **Taking the global Islamic financial markets to greater heights**

2. Islamic finance has, in this decade, truly emerged as one of the fastest-growing and resilient components of the global financial system. The rapid growth signifies that Islamic finance has moved past the pioneering stage and provides conclusive evidence that Shariah-compliant financing instruments are a commercially viable and effective tool for mobilising investment assets to finance productive economic activities.
3. We must now set our sights higher and leverage on the growth momentum. The Asian and Middle Eastern economies have huge surpluses while at the same time require substantial investments to propel their economic growth. Clearly, there are opportunities for Islamic finance to strengthen its role in intermediating surplus savings into economic development.

4. While there is tremendous potential for Islamic finance, I think we all recognise that the pools of Islamic liquidity are currently fragmented and that this hampers our ability to tap these opportunities. Markets and innovation cannot thrive in isolation. It is therefore critical to build greater connectivity between our economies and markets to promote the growth of Islamic financial markets around the world.
5. A broad range of topics have been discussed on the promotion of greater cross-border investment flows. I would like to focus on the integration of Islamic capital markets – starting with broad strategic considerations and follow this by identifying potential initiatives that national governments and regulators can collaborate on to promote the integration of Islamic capital markets.

### **Integration of Islamic capital markets: Strategic considerations**

6. It is useful to review the progress in economic and market integration separately. In terms of economic integration, the most comprehensive model is the European Union where integration involves freedom of movement for goods, services, labour and capital, as well as political union through establishing a European Parliament and monetary union through a common currency.
7. Both the Association of South East Asian Nations (ASEAN) and the Gulf Cooperation Council (GCC) have adopted less extensive models for economic integration. ASEAN plans to create an ASEAN Economic Community by 2015 that would transform it into a region with free movement of goods, services, investment, skilled labour and freer flow of capital while the GCC, as I am aware, have implemented a customs union with capital and investment flows facilitated through relaxed regulation.
8. In relation to market integration, greater cross-border investments will generally facilitate pooling of liquidity and risks and improve the efficiency of capital allocation. More efficient capital allocation will promote faster economic growth. Capital market integration will also enhance the ability of the region to compete for capital and order flows while aligning national regulatory approaches will reduce the costs of operating in the regional market.

9. Integration of financial markets can occur through a broad range of channels to facilitate investors in one jurisdiction to transact or finance economic expansion in another. Strategic alliances among exchanges represent one such approach. For example, European bourses initially amalgamated into Euronext and OMX but these were subsequently taken over by the US exchanges. The European experience demonstrates that integration of exchanges is largely driven by market forces and is determined mainly by commercial considerations.
10. But exchange alliances is just one means of enabling market integration. There are other approaches and these include the harmonisation of standards, mutual recognition regimes, cross-border issuances, depository receipts and the expansion of intermediaries through branch offices and alliances. In fact, cross-border investing can also occur through the introduction of regional Exchange Traded Funds.
11. Overall, I believe that a strong case can be made for the integration of Islamic capital markets. The integration of markets need not necessarily be bound by geography but rather by identity. I would like to put forward a proposition in this context. The OIC member countries collectively form a substantial base that can be considered to logically offer a distinct Islamic “brand value” for both market-based intermediation and financing activities.
12. To elaborate, the 57 OIC member countries have a population of about 1.5 billion with a combined GDP of USD7.7 trillion (based on purchasing power parity) accounting for 12.8% of total world GDP<sup>1</sup>. In contrast, there are 23 exchanges covering 29 countries in the OIC with a combined market capitalisation of USD2.1 trillion accounting for only 3.3% of global market capitalisation<sup>2</sup>. The contrast between economic and market development with only half of OIC member countries having exchange operators suggest the Islamic community have insufficient access to market mechanisms to fund domestic growth.
13. This also suggests that substantial economic efficiency gains can be derived through pursuing a shared identity for Islamic markets through integration. One key aspect of the integration strategy must be to promote the recycling of surplus savings in some

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<sup>1</sup> Wikipedia

<sup>2</sup> End-2007 data from World Federation of Exchanges

Islamic nations to finance economic development in other Islamic countries. Hence, collaboration through market integration can expand intermediation activities in a positive and mutually reinforcing process that will grow both economies and markets in OIC and, in turn, strengthen the brand value of Islamic capital markets.

14. Let me discuss possible initiatives to address this in greater detail.

### **Catalytic role of governments and regulators**

15. Efforts to promote the various forms of market integration require the strong and active support and involvement of governments and regulators. There is therefore a major role for OIC governments and regulators to play in terms of creating an enabling environment to facilitate a sequenced and orderly integration of Islamic capital markets.
16. There is certainly a need to develop the appropriate frameworks to facilitate cross-border issuance and distribution of products, to establish bilateral or multilateral linkages through mutual and multilateral recognition to facilitate movement of intermediaries and other professionals, to formalise linkages between exchanges and intermediaries, to reduce potential friction to cross-border transactions and to liberalise market access.
17. In Malaysia, we have introduced various initiatives to facilitate cross border transactions and linkages. The first global Malaysian sovereign sukuk was listed in Labuan and Bahrain as well as in Luxembourg. The Khazanah Shariah-compliant exchangeable trust certificates issued in July 2007 was listed on the DIFX as well as in Labuan and Hong Kong. Under the Malaysia International Islamic Financial Centre (MIFC) initiative, new banking licenses have been granted to Middle Eastern banks, new capital market licenses are being offered to increase intermediation flows with the Middle East and a fully liberalised environment with attractive incentives has been established for Islamic fund management. Similarly, GCC members have also listed sukuk in Labuan and we hope to strengthen the cooperation in other segments such as for Islamic funds where we have inked the first mutual recognition agreement with the Dubai Financial Services Authority (DFSA) for cross border distribution and marketing of Islamic unit trust products.

18. In this regard too, the ASEAN Capital Market Forum – which comprises the heads of securities regulators - plays an active role in leading initiatives to promote integration of the regional capital market, in line with the ASEAN roadmap for regional financial integration. The ACMF has established various working groups to formulate a set of common standards for cross border offerings, for disclosure requirements, for distribution rules on IPOs, offering rules for debt securities, promote convergence with International Accounting Standards and mutual recognition regimes for market professionals and capital market products.
19. The integration of Islamic capital markets can be accelerated through greater collaboration to promote the growth of markets throughout the OIC. Capital markets in the OIC are not sufficiently well-developed relative to its economic capacity and this means that there is substantial upside growth potential. As mentioned earlier, only half of OIC countries have access to an exchange and some are relatively nascent and operate with insufficient regulatory and market infrastructure. In this regard, I would like to applaud the joint initiative by the Islamic Development Bank (IDB) and the Islamic Financial Services Board (IFSB) for their 10-year Framework & Strategies for the development of a dynamic, comprehensive and innovative Islamic financial services industry that is well integrated within the international financial system. We now need to move the agenda forward and identify specific areas and initiatives for collaboration between OIC members.
20. The Islamic capital market has considerable potential to recycle excess savings from surplus OIC countries and to intermediate these surpluses to promote economic development in deficit member countries. This is consistent with the Shariah principle to ensure equitable allocation of capital to achieve the objectives of the Ummah. To a large extent, the further growth of a global Islamic capital market will be hampered as long as many Islamic countries remain under developed.
21. An initiative that can potentially facilitate economic development in the lesser developed member countries is the recycling of regional savings to accelerate infrastructure development in such countries. In this regard, in ASEAN, the ASEAN Finance Ministers have established a task force headed by Malaysia to create an ASEAN Infrastructure Financing Mechanism to pro-actively address various inefficiencies and impediments that hamper the availability of financing for

infrastructure development. The Ministers recognise that infrastructure projects can have strong multiplier effects on economic growth and can significantly improve the welfare of the population.

Another potential benefit is the possibility of using the mechanism to fast-track corporate sector development through creating listed vehicles which could undertake or own infrastructure projects. This, in turn, could provide a deal pipeline for equities and debt instruments which could stimulate the development of the capital market. Similarly, there may also be opportunities to pursue collaboration among Islamic countries to finance infrastructure development in lower-income countries with a view to promoting the growth and integration of capital markets within the OIC.

22. As outlined in the 10 year Framework and Strategies for the development of Islamic Financial Services Industry mentioned earlier, Islamic countries should also endeavour to integrate their Shariah-compliant financial systems within the international financial system. Where Islamic capital markets are concerned therefore, rules should, as much as possible, be harmonised, in line with globally accepted standards and best practices.
23. This can range from benchmarking with the International Organisation of Securities Commissions (IOSCO) principles of securities regulation, adopting international accounting standards and promoting best practices for corporate governance. These efforts will increase the attractiveness of our Islamic capital markets to international investors as well as facilitate integration of markets on the basis of a common reference standard. The point needs to be made that the Islamic capital market is subject to the same regulatory framework as the conventional market and need to satisfy the same requirements for disclosure, transparency and governance. Naturally Islamic capital market products must also comply with Shariah requirements.
24. At the same time, there is also a need to intensify international collaboration on Shariah standards. It was natural that in the developmental stages that Shariah standards were formulated based on the domestic perspective and to be consistent with the national legal and tax frameworks. As the global Islamic Capital Market develops, we need to work closely together to foster greater convergence in these

standards. Towards this end, Shariah scholars from different jurisdictions have been pro-actively increasing their interaction and deepening their understanding of respective fatwa pronouncements.

International Islamic institutions such as the IFSB and AAOIFI have certainly provided intellectual leadership and Malaysia has also sought to contribute to the cause through publishing and disseminating our Shariah resolutions. But certainly more work is needed particularly in relation to follow-through on providing greater clarity and achieving greater consistency on the interpretation of the Shariah principles and their application to Islamic products. This will no doubt facilitate the development of guidelines and extend the possibilities in concept and application of the Shariah.

25. In tandem with this, there is also a need to increase international collaboration on the development of Islamic products. We have seen how the development of global products such as the sukuk has been a catalyst in promoting greater financial integration among Islamic capital markets. Malaysia recently launched a Shariah-compliant Exchange Traded Fund with the aspiration that such products can be used to provide convenient access for international Islamic investors seeking to invest in Malaysia as well as to provide index-based products that can be used by Islamic fund managers that deploy sophisticated investing strategies.
26. Lastly, by the same token, Islamic finance practitioners should also collaborate to promote greater awareness of the virtues of Islamic financial products and also to ensure greater reach to savers. In this regard, there is a need to shift towards a communication approach to investors that focus on the positive values of Islamic finance such as the concern on the welfare of humanity and the concepts of partnership and participation. It may also be timely to showcase these positive values through the launch of Islamic products that are branded as ethical, socially-responsible and environmentally-friendly.

## Conclusion

Ladies and Gentlemen:

27. To conclude, I would like to highlight that regional market integration is not a new concept to the Islamic world. In fact, if we trace back to the Islamic Golden Age and Muslim Agricultural Revolution, there existed a market economy and early forms of merchant capitalism between the 8<sup>th</sup> to 12<sup>th</sup> centuries. Islamic society flourished based on a dynamic economy through the amalgamation of many regions supported by the expanding circulation of a high-value currency (the dinar). Innovative business techniques and new forms of business organisation were pioneered by merchants and traders during that time enabling extensive networks to be developed to facilitate trade and financial transactions across the region.
  
28. In the new millennium, we have the opportunity to create a new "Islamic Golden Age" through adopting the same dynamic spirit to innovate and collaborate to bridge Islamic markets spanning the various continents. The future ahead for Islamic capital market practitioners is certainly exciting.