



HONG KONG MONETARY AUTHORITY

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## **Islamic Capital Markets in Asia, Emerging Challenges and New Entrants**



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## **Growing connections between Middle East and Asia**

- Two-way trade flows between the GCC nations and Asia ex-Japan have expanded four times in the past decade to US\$22bn in 2006
- Equivalent of 15% compounded annual growth
- Rising oil prices also results in massive accumulation of wealth and an increasing awareness for investment diversification



## Growing connections between Middle East and Asia (cont'd)

- A survey conducted by the Economist Intelligence Unit found that ...
  - 59% of the surveyed Middle East financial service professionals expected a significant rise in Islamic finance products in the next three years
  - Over 20% expected the Asia Pacific region to attract the largest portion of equity investment among their clients



## Growing connections between Middle East and Asia (cont'd)

- S&P estimates the current size of global Shariah-compliant assets to be worth US\$400 bn, roughly 10% of the OIC nations' GDP
- Total market potential is also estimated to be around US\$4 trillion.
- With global Islamic finance industry estimated to be worth US\$1 trillion, these figures suggest that the growth of the Islamic finance industry has not been fast enough to match the increase in Islamic wealth



## Where Hong Kong fits into this

- Hong Kong seeks to become an important player by providing a platform for Middle East investors to access investment opportunities in the Asia Pacific region
- It can also serve as a capital-raising centre for Middle East investors to tap the funds in the region, particularly China
- Leveraging Hong Kong's key strengths in international financial intermediation



## Key strengths of the Hong Kong platform

- A dynamic financial market in responding to emerging market opportunities
  - Shortly after our government unveiled the policy of developing Islamic finance, a local bank introduced our first Islamic fund
  - In May 2008, Dow Jones Islamic Market Index was launched to benchmark Shariah-compliant China equities listed in the HK Stock Exchange



## Key strengths of the Hong Kong platform (cont'd)

- Deep and highly liquid capital markets
- Largest and deepest Chinese equity and debt markets outside Mainland China
- The first and remain the only major IFC that has banking business and financial products related to the Renminbi or Chinese yuan
- Development of a local Renminbi bond market firmly positioned Hong Kong as a proving ground for China's continuing financial market liberalisation



## Key strengths of the Hong Kong platform (cont'd)

- Investors looking for Shariah-compliant products can gain exposures to different sectors of China through Hong Kong
  - Real Estate Investment Trusts (REITs) listed in Hong Kong with underlying exposures in Mainland China
  - Issuance of exchangeable sukuk linked to the underlying shares of a Mainland China company listed on the Hong Kong stock exchange
    - High subscription from Middle East investors
    - Reaffirmed the demand for investment opportunities with China growth prospects through Hong Kong



## Challenges and opportunities for Islamic capital markets in Asia

- Development of Islamic finance is not a zero-sum game. Asian players together can benefit from greater efficiency, diversity and stability of a more integrated capital market in our region
- Promoting financial integration in Asia, in the context of Islamic capital markets in particular, is challenging
- Also provides a strong catalyst for change and growth to leapfrog developments in conventional capital markets in Asia



## Strengthening financial market integration in Asia (1)

- Promote links between jurisdictions across the whole spectrum of financial infrastructure
  - trading, payment, clearing, settlement and custodian systems
- Reducing uncertainties and risks in cross-border financial transactions is conducive to market development
- Hong Kong and Malaysia has strengthened financial infrastructure links – PvP and DvP – to facilitate cross-border financial transactions



## Strengthening financial market integration in Asia (2)

- Relaxation of non-supervisory restrictions to remove unnecessary hurdles to the development of Islamic finance in the region
- Mutual recognition agreements signed between Malaysia Securities Commission and Dubai Financial Services Authority (DFSA) for fund marketing and distribution
- Framework of co-operation already established between Hong Kong and the Dubai International Financial Centre (DIFC) to look at market facilitation measures



## Strengthening financial market integration in Asia (3)

- Harmonisation of standards needed on practical and operational perspectives
- Regulatory harmonisation also needs to be addressed as different countries adopt different approaches in defining the standards for Shariah-compliant products in determining, for example, the granting of tax neutrality treatment
- Hong Kong is reviewing its tax law to provide tax neutrality to Islamic financial transactions having regard to overseas market experience



## Strengthening financial market integration in Asia (4)

- Strengthening of dialogues and stepping up regional co-operation can expose regulators to developments elsewhere
- Create an environment conducive to a higher degree of regulatory harmonisation
- Strong commitment by HKMA to these efforts – it has become an associate member of the IFSB



## Strengthening financial market integration in Asia (5)

- Greater capital mobility is a necessary condition for financial integration
- Relaxation of controls on cross-border transactions can drive more efficient allocation of resources
- Ultimately conducive to the development of larger capital market with greater breadth and depth



## Strengthening financial market integration in Asia (6)

- Growth in Islamic finance in the recent decade is enormous, but the talent pool is still relatively small to meet the global needs
- Need to nurture a larger pool of talent with expertise in Islamic finance
- In Hong Kong, local industry bodies such as the Accounting Association and the Treasury Markets Association can play a significant role
  - to serve as a forum for open and useful discussion and the sharing of expertise by experts in this field



## Concluding Remarks

- Crucial and mutually-beneficial for Asian markets work more closely together to seize the opportunities brought by Islamic finance
- Greater stability and efficiency in capital flows in the region will also enhance diversification and integrity of financial markets in Asia



Thank You