

**4th IFSB Summit: “The Need for a Cross-Sectoral Approach in Supervision of Islamic Financial Services”  
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by

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Your excellencies, distinguished guests. While having to urgently leave Dubai, I am not here in person, but most certainly I am here in commitment to the Islamic finance agenda. It is my honour to speak at this 4th IFSB summit hosted by the Central Bank of United Arab Emirates. The theme of the summit on “The Need for a Cross-Sectoral Approach in Supervision of Islamic Financial Services” suggests that a concerted and coordinated effort is needed to ensure financial stability in the Islamic financial system and to strengthen its role as a viable form of contemporary financial intermediation. The issue before us is how this cross sectoral approach is adopted so as to contribute towards increased global financial stability.

***I. Dynamism of Islamic finance enriches the global financial architecture***

The significant growth of Islamic financial markets, the development of the supporting financial infrastructure and the standardised international prudential rules and regulations that are being issued by the Islamic Financial Services Board (IFSB) have considerably strengthened the international Islamic financial architecture, thus contributing towards ensuring the stability and soundness of the Islamic financial industry. The theme of this summit reflects the continuous attention being directed towards this important aspect in the development of Islamic finance.

***II. Impact of “convergence” on market development and supervisory framework***

The unprecedented process of convergence and the transformation in the financial

industry in this recent decade has constantly reshaped and reconfigured the landscape of the financial sector both domestically and internationally. Disintermediation and the blurring of traditional sectoral boundaries between the banking, insurance and the securities industries are among the trends in the financial services industry. Driven by the pressure for efficiency, the convergence has been along several dimensions, including among the different types of financial institutions and across different national jurisdictions. While it has increased the value proposition for consumers, it poses new challenges for the supervisors in the course of ensuring the safety and soundness of the overall financial sector. These challenges range from ensuring adequacy of the surveillance framework, addressing the complexity in assessing the quality of risk management practices, minimizing the potential for regulatory arbitrage, to meeting the demands for consistent supervisory responses within and across jurisdictions.

Given the significant implications of convergence on the market development and supervisory framework, this aspect needs to be addressed for the rapidly evolving Islamic financial services industry. In most jurisdictions, Islamic financial institutions have evolved within the framework and parameters of the conventional system. It has however essentially required constant enhancement of the supervisory regime to ensure that it adequately addresses the risks that are specific to Islamic financial transactions. This becomes important for a contract-based system in Islamic finance, where the financial transactions by the financial institutions in the respective sectors often share common underlying contracts with comparable risk profiles being subject to separate sets of

rules of the different respective financial sectors. This is evident in the efforts to maximize the competitive advantage of the Islamic finance in relation to the concept of profit and risk sharing. The application of this concept in the deposit taking activity of the Islamic banking institutions could conceptually result in a risk profile that resembles that of an Islamic fund manager and that of the securities market players. It involves a similar degree of fiduciary risk on the Islamic financial institutions in ensuring that the investment deposits funds are managed in the most effective and efficient manner. An unlevelled playing field could thus arise if different prudential rules in the areas of capital adequacy requirements, risk management practices, market conduct and rules of financial disclosure, transparency, governance and the Shariah framework are imposed solely based on traditional sectoral boundaries. It is therefore important to ensure that such similar risk profiles and regulatory issues are addressed in a consistent manner across sectors so as to maintain a healthy competition and so as to avoid any potential for regulatory arbitrage.

### **III. Towards optimal efficiency of a cross sectoral supervisory approach**

In recognizing the relevance of a cross sectoral approach for the supervision of the Islamic financial services industry, allow me to discuss three strategic issues that are key to charting the way forward for achieving optimal efficiency of a cross sectoral supervisory approach.

**Firstly, is the need for greater focus to be given to arrive at common vision on the future landscape of the Islamic financial services industry.** Clarity of the parameters of the scope and nature of business activities of the financial institutions and financial markets is paramount in achieving the objective of financial stability. Within the current Islamic financial landscape, across jurisdictions, there exist however disparities and a perceived lack of clarity in

the specific scope and nature of the Islamic financial services that are permitted within each respective sector. The challenge for supervisors has been to formulate a comprehensive supervisory framework that adequately addresses the respective risk exposures for the Islamic financial institutions. Islamic banking institutions in Malaysia may for example have different parameters on the scope of business and permitted activities in comparison to Islamic banking institutions in other jurisdictions. This may result in a disparity in understanding among sectoral regulators and the industry players on the scope of business activities of Islamic financial institutions in different jurisdictions. There is therefore a need to be on the same wavelength within and across jurisdictions on the nature and scope of business activities of an Islamic banking institution, takaful operator or Islamic capital market player to serve as a guide for the orderly development of the industry. In essence, the structured development of the industry that is able to meet the new demands of the environment and to address the newly emerging challenges is critical to ensure sustainable development of the Islamic financial services industry.

A recent joint effort by the Islamic Development Bank and the Islamic Financial Services Board has laid the foundation to achieve this objective with the impending issuance of the Ten-Year Strategy and Plan for the Development of Islamic Financial Services Industry and the establishment of the Standing Committee to oversee its implementation. The formulation of the ten-year master-plan for the Islamic financial services industry marks an important step in setting the blueprint for leading the development of Islamic finance in a structured and synchronized manner across jurisdictions to achieve the common goal of a vibrant and comprehensive Islamic financial system. This document will provide a framework for the national authorities to put in place a strategic plan for an orderly development of the Islamic financial services industry and thus facilitate greater understanding of the nature of the cross sectoral supervisory approach that is required.

**This brings me to the second issue relating to the need for a more collaborative effort to be garnered among the financial supervisors.** A structured collaboration among supervisors across sectors would provide a framework for rationalizing the key policies across sectors and allow for more efficient supervision of the Islamic financial institutions. Inter-agency coordination is important to address the common risks across sectors not only through the sharing of information, but also through the harmonization of prudential and market conduct rules, the adoption of consistent Shariah governance framework and the setting up of a comprehensive shared safety net. A structured collaborative approach for consultation on issues of common interest rather than ad hoc coordination would be more effective in addressing events such as crisis management and the effect of systemic contagion. A strong collaborative culture would contribute towards the development of more consistent rules and their application across sectors while leaving the discretion to each jurisdiction to determine the most appropriate supervisory model to be adopted based on the context and distinct environment of its own respective sector.

In Malaysia, a cumulative and comprehensive cross sectoral development strategy has been adopted from the inception of Islamic finance. Legislation covering Islamic banking, takaful and the capital market activities were enacted more than two decades ago to provide the legal and regulatory framework of Islamic financial services industry. A consistent Shariah governance framework is also in place for the Islamic financial industry. There is also a common membership of the Shariah Advisory Council at Bank Negara Malaysia and the Shariah Committee at the Malaysian Securities Commission to achieve coordination between the sectoral supervisors. The inter-agency collaboration has also been formalized with the execution of a Memorandum of Understanding between

Bank Negara Malaysia and the Securities Commission. The recent formation of a high level inter-agency Executive Committee has also elevated further the collaborative arrangements to a wide involvement. The Committee comprises a high-level group of top officials from the key relevant Ministries, Government departments and agencies, financial and market regulators and the representatives from the banking, takaful and capital market sector. Through having a shared vision and commitment, this Committee is responsible for undertaking a review of all policies relevant for the comprehensive development and promotion of Islamic finance.

In Malaysia, Bank Negara Malaysia is mandated with the responsibility to oversee the operations of monetary policy and to safeguard the financial stability of the financial system. It is in this context that the overall management of the Islamic financial services sector remains within the functions of Bank Negara Malaysia. The Islamic financial services sector requires specific focus in the aspect of regulation and supervision of its contractual nature and unique characteristics of Islamic finance that has greater involvement of the Islamic financial industry in the real economic sector through the principles of murabahah, musyarakah and mudarabah in the Islamic financing contracts. In this regard, the management of risks in Islamic finance requires a different set of techniques and expertise. In reality, the contractual nature of Islamic finance has implications for monetary policy in terms of credit creation and in relation to the rate of return or asset yield. As such, the overall impact of this on the Islamic financial system and monetary policy has reinforced the taking on of these important mandates - a case of upholding the form rather than the structure, given this relationship between financial stability and the operations of monetary policy. To further reinforce this framework, the Central Bank in Malaysia has shifted from a sectoral

regulatory approach, to one that integrates the Bank's regulation of the different financial institutions under its purview along functional lines to better position the Bank to ensure financial stability in the overall system.

**The third issue relates to global coordination which is key to the efficient supervision of the Islamic financial industry as its international dimension gains significance and as it becomes an integral part of the international financial system in an increasingly globalized environment. This can be achieved by leveraging on the existing international infrastructure and enhancing collaboration in the working arrangements.**

Best practices and rules in the financial services industry have been influenced by the international standards of the International standard setting bodies such as Bank for International Settlement (BIS), Islamic Financial Services Board (IFSB), International Association of Insurance Supervisors (IAIS) and International Organization of Securities Commissions (IOSCO) and the international accounting standards setting entities that are all aimed at ensuring best practices in the financial industry. There needs to be however a degree of consistency of the rules that are applicable in the international financial system. The efforts of the Joint Forum of the Basel Committee, IAIS and IOSCO in addressing the cross sectoral issues, such as the similarities and differences of the core principles ( i ), and in the cross sectoral regulatory and market differences ( ii ), have set the foundation for achieving such consistency in the rules across sectors at the international level.

For the Islamic financial services industry, the comprehensive mandate of the IFSB that covers the major components of the financial sector and the broad-based membership comprising the regulators and industry players of the respective sectors

presents a platform for achieving such cross sectoral consistency. In undertaking its core role to promote prudent, transparent and the robust development of the Islamic financial services industry through the promulgation of international prudential standards, the IFSB with its wide network membership across sectors from more than 20 countries is well positioned to ensure that cross sectoral issues are rigorously addressed. The on-going work by dedicated working groups on the standards for corporate governance for the takaful industry and the industry-wide Shariah governance framework are a manifestation of the broad mandate of the IFSB that transcends beyond the banking industry. In addition, the IFSB, through its linkages with other international bodies that includes the International Monetary Fund, Bank for International Settlements, AAOIFI, IAIS and IOSCO, will be able to create synergies in the future development of the international standards for Islamic finance. Greater engagement and collaboration would build the foundation for enhancing the understanding of the dynamics of the inter-linkages that is important in the sound development of Islamic finance.

The strong collaboration among supervisors is also important to address the home-host issues in cross border Islamic financial services. The application of consistent rules across jurisdictions, such as in the implementation of capital standards for Islamic financial services, will facilitate the orderly global development of Islamic finance. The IMF, together with the World Bank in initiating the formation of the Joint Forum, have a potentially significant role in facilitating the cross sectoral initiatives for the Islamic financial services industry. Within the context of the Financial Sector Assessment Program, encouragement can also be provided for the adherence and implementation of the IFSB standards and rules across jurisdictions along with the core principles and standards of the Basle Committee, IAIS and IOSCO. This would indeed contribute towards the efforts

of achieving global financial stability in the international Islamic financial system.

#### ***IV. Conclusion***

Let me conclude my remarks. Aligning cross sectoral approaches is a key part of the process of building a viable and sustainable Islamic financial system. Efforts therefore need to continue to strengthen the international Islamic financial architecture

and to enhance international cooperation and collaboration in addition to developing a strong domestic supervisory framework to deal with the changing configurations of a highly dynamic and rapidly evolving environment. It is our hope that this summit will contribute towards building greater collective efforts through multi-stakeholder deliberations and networking activities to improve our understanding on the cross sectoral issues in Islamic finance.

**Malaysia-Indonesia Investment & Finance Summit  
18 June 2007, Jakarta, Indonesia**

**“Enhancing Financial Integration in the New Nusantara”**

Luncheon Address by

**Tan Sri Dato’ Sri Dr. Zeti Akhtar Aziz**  
Governor, Bank Negara Malaysia

There has been a long history that transcends several centuries in which international trade flourished in the Malay archipelago. The South East Asia region contained the important maritime routes for the trade between the East and West. This had brought with it, robust economic growth and regional prosperity.

Today, the South East Asian region—the Nusantara region continues to be one of the world’s most dynamic regions. Since the turn of this century, our economies have re-emerged to be amongst the fastest growing in the global economy, amidst new challenges and fundamental economic and financial developments. Our steadfast reform and restructuring efforts have rewarded us with strengthened macroeconomic fundamentals and sound and stable financial systems. These efforts continue to be augmented by the strong foundations that the region possesses, namely abundant natural and human resources, high savings rates and the ingrained aptitude to persevere and rise to the challenge.

The ASEAN 5 group of economies that includes Indonesia, Malaysia, the Philippines, Thailand and Singapore have now for an extended period of time been on a steady growth path.

A more recent phenomenon in this decade, has been the increased economic and financial linkages within the region spurring further regional economic and regional financial integration. The geographical proximity and cultural similarities have been reinforced by the diverse strengths

that exists in the region. These factors have been important in enhancing the integration process.

As this greater regional economic and financial integration is advanced, it will serve as a powerful catalyst for the future expansion of intra-regional trade and investment, creating a self-sustaining and mutually reinforcing economic growth in the New Nusantara region.

It is my pleasure today to speak on the potential role of an integrated economic and financial platform within the Nusantara region, a region of rapid economic growth in which almost 300 million Muslims resides. My remarks will focus on the potential generated by a collaborative platform and the significance of building linkages between the Nusantara region with other parts of the world.

The region’s current economic progress, prosperity and financial stability has now accorded us a new strategic window of opportunity to develop new value propositions to unleash the full potential accorded by the accelerating economic and financial integration process. There are already encouraging formal and informal inter linkages between our respective financial markets as well as a higher level of engagement between the respective corporate communities, the market participants and the authorities.

A collaborative platform that is based on the diverse comparative advantages of the Nusantara economies can benefit from the complementarities between our respective economies. Essentially, these opportunities

will increase the potential to expand markets, increase products lines and deepen the research and development capabilities. In this regard, the emergence of Islamic finance into the mainstream of the financial system is an opportunity for the Nusantara financial intermediaries, in particular, for Malaysia and Indonesia and other neighbouring countries, to open new frontiers and in so doing strengthen further the economic and financial linkages.

The building of a Nusantara financial platform would not only facilitate and mobilise the pool of investable funds from the respective economies but also allow for the more efficient allocation of the funds into the productive investments in other parts of the region. This would not only contribute towards lowering the cost of funds but it would also allow for greater diversifications of risks.

More recently there has been growing interest in cross border participation in investment activities in our respective economies. Malaysia's capital inflows into Indonesia has increased by three-fold totalling USD2.2 billion in 2006 compared to the previous year. It is estimated that Indonesia requires approximately an annual investment of USD22 billion for the next several years for the development of its infrastructure, with a large part of the funding to be provided by the private sector. In the same way, the Ninth Malaysia Plan for the period of 2006 to 2010 has a financing requirement of RM107.6 billion. The development of our regional financial intermediaries and markets will facilitate the mobilisation of resources towards financing these potential activities and thus contribute to sustaining development in the Nusantara economies.

The profound changes in the global economic and financial environment, has created a greater urgency for the Southeast Asian markets to achieve a greater degree of financial integration. This is so as to

provide the scale and increased efficiency of the financial intermediation process. As the ASEAN economies move towards the formation of an economic-bloc by 2015, the pace of financial integration will need to accelerate, to better facilitate achieving this goal. The wide spread distribution of innovative hybrid financial products and regional cross selling activities will however increase the multi-dimensional dynamics of the markets and the risks across national borders. There will be increased complexity in identifying the risks which will in turn complicate the process of risk management. The increasingly integrated and liberalised markets will also expose our porous economies to greater external influences and to contagion risks. A higher level of vigilance is thus required to allow for pre-emptive policy measures in a timely manner. This will require adequate levels of cooperation among the regional regulators in addressing potentially contagion systemic risks and ensuring regional financial stability.

The deepening of co-operation between the Nusantara's monetary and regulatory authorities is thus a key factor in the development of a robust integrated platform. Enhanced cooperation will promote greater resilience and reduce regional vulnerability to external developments. There are now various regional mechanisms in place to undertake regional surveillance, to facilitate the exchange of information, to enter into greater engagement on issues affecting the region and in developing regional financial markets. In addition, frameworks for enhanced regional risk management, crisis management and resolution are also being put in place.

With greater financial integration, the region will be able to leverage on the advantages of economies of scale, innovation and more importantly place greater reliance on the cumulative strengths that resides within the region including our financial resources, skills and knowledge. It will also better

position the region to collectively address emerging issues and challenges faced by the region taking into consideration the region's socio-economic context.

While Islamic finance is gaining global interest and acceptance, the world's most populated Muslim region in the world, the New Nusantara offers opportunities for the accelerated expansion of Islamic finance. The intrinsic nature of Islamic financial structures encourages stability. Islamic principles require that the financial transaction be supported by genuine economic transactions. To further reinforce this, the governing Shariah principles also serve as a built-in self-regulatory mechanism that insulate Islamic instrument issuers from unproductive, speculative and unethical elements and thereby contributes to the stability of the financial system.

Historically, capital financing and investment flows into the Nusantara region have generally been sourced from the developed financial markets. While we may see continued growth in short term capital inflows from these traditional sources, the more competitive global environment provides no assurance of the sustainability of such longer term investment flows. Meanwhile, our own South East Asian region and that of North Asia and the Middle East countries continue to have high surplus savings seeking opportunities for investment and new asset-classes for greater risk diversification and improved returns on their investments.

Hundreds of years ago, the ports of Nusantara were destinations for the spice trade to Europe via India and the Middle East. In this context, Islamic finance can serve as a bridge that links the Nusantara region to the capital surplus economies. Already, our financial institutions are venturing to have a presence in the Middle East and we welcome their presence in our financial system. This has now in fact resulted in the cross-pollination of talents and resources, giving rise to innovative

products and services, creating depth and breadth to the respective financial markets.

Just as the Straits of Malacca served as an important maritime conduit for the Nusantara region, Malaysia and Indonesia has the potential to serve as an important intermediary for mobilising capital to meet the requirements of the Nusantara region, and to be a distribution centre for shariah compliant securities and to extend the regional Islamic capital markets to other parts of the world. Of importance will be our joint efforts to promote the standardisation of the Islamic regulatory and compliance matters. In relation to this, Malaysia and Indonesia is already working jointly to promote research capabilities and the pool of talent and technical expertise in Islamic finance.

A critical success factor for the cross-border promotion of Islamic finance is the harmonisation of the governing shariah frameworks between our jurisdictions. In this regard, Indonesia's extensive history of scholarly achievement in the subject matter relevant to the principles of Islamic finance can be leveraged upon for the benefit of the region. We are most hopeful for substantive convergence of interpretation and application of the shariah laws and guidelines for the region. The greater collaborative engagement between our respective scholars would indeed facilitate the process.

The large gathering of senior representatives of the public and private sectors here today hints to the significant interest to capitalise on potential of the Nusantara economies. The efforts of the private and public sectors in building a collaborative platform as a resilient base for a network of linkages to the wider world, with God's grace, insyallah, will contribute to advancing the Nusantara Agenda that would unleash the potential of the region for a greater shared prosperity.

**Sukuk Summit 2007: “The Challenge for a Global Islamic Capital Market:  
Strategic Developments in Malaysia”  
20 June 2007, London**

Keynote Address by

**Tan Sri Dato’ Sri Dr. Zeti Akhtar Aziz**  
Governor, Bank Negara Malaysia

It gives me great pleasure to be here in London to speak at this landmark sukuk summit. The Islamic bond market - the sukuk market - represents a key component of the Islamic financial system. This recent decade has seen the accelerated development of this market and its significant role in strengthening the evolution of Islamic finance. The global development of this market is particularly important in this more challenging financial and economic environment. It has contributed to enhancing the effectiveness and efficiency of the mobilisation and allocation of funds within national financial systems and in the international financial system. This development is also evidenced by the level of innovation and sophistication of the products and services being offered by the Islamic financial institutions. The encouraging development of the Islamic bonds market has also had an important role in enhancing the linkages between financial markets as it facilitates cross-border flows in the international financial system.

The sukuk market as an important source of financing for large scale investment projects, has a key role in facilitating the economic development process. For investors, it provides greater potential for diversification into new asset classes. My remarks today will focus on the vast potential of the Islamic bond market in the economic development process, in its role in ensuring financial stability and its role in promoting greater financial integration in the global financial system. I would also like to take this opportunity to share with you Malaysia’s experience in the development of this market. The Malaysian sukuk market has now evolved into one of the world’s largest Islamic bond market.

***Immense role of sukuk market in the economic development***

The financing requirements for economic development are immense. The bond market is key to meeting these funding needs for both the public and private sectors. This is particularly important for emerging market economies. In the Middle East and in Asia, two of the fastest growing regions in the global economy are taking place following privatisation and implementation of infrastructure projects. Asia alone will be spending an estimated USD1 trillion on infrastructure over the next five years, while infrastructure requirements in the Middle East are estimated to be USD500 billion over the same period. The challenge is to put in place an intermediation system that will channel the surplus savings in both these regions into productive investments. It is in this context that the Islamic capital market, in particular the sukuk market will serve as an important avenue to efficiently mobilise longer term funds to meet these funding requirements.

The global experience has shown that the lack of well developed bond markets brings with it vulnerabilities arising from over-reliance on financing from the banking sector. This has often resulted in funding mismatches with adverse implications on financial stability. The development of the bond market allows for access to funding with the appropriate maturities, thus avoiding the funding mismatches. It also allows for the diversification of risks by issuers and investors.

The central merit of the sukuk structure is that it is based on real underlying assets. The ijarah sukuk for example - an Islamic

bond which applies a sales and leaseback arrangement - is an asset-backed instrument providing continuous security to the investor. This approach discourages over-exposure of the financing facility beyond the value of the underlying asset, given that the issuer cannot leverage in excess of the asset value.

In addition, Islamic finance requires that the financing must be channelled for productive purposes, such as for project financing, rather than for speculative activities. The risk exposure is therefore to the project and not to the uncertainties or activities that have no real economic benefits. Islamic financial intermediation therefore has the potential role of contributing towards financial stability.

In the current environment, the demand for sukuk significantly exceeds the supply. Today, the global sukuk market, denominated in international currencies, is estimated to be USD18 billion. If domestic sukuk issuance is included, it has now exceeded USD50 billion. Although the size of the market may seem modest by global standards, the sukuk market has been registering an impressive average growth of 40 per cent per annum. The phenomenal demand has been spurred by the high levels of surplus savings and reserves in Asia and Gulf regions. Asia has a savings rate which is higher than any other region in the world and is expected to remain between 30 and 40 per cent of GDP for many years to come.

The sukuk market brings with it many benefits to both issuers and investors. Issuers can benefit from the huge increase in liquidity in the Islamic world, and can tap on these new sources of funds. Raising funding from the Islamic bond market in the current environment has been 10 to 20 basis points lower than mainstream bonds. An increased number of multilateral agencies are issuing sukuk to finance development projects. In addition, both government agencies and the corporate sector have considered the sukuk market as an attractive source of financing. From the investor perspective, there are the

benefits of diversification. In a sukuk issue in 2005, 48 per cent of the issuance were subscribed by conventional-based investors. This increased appetite for sukuk reinforced by excess liquidity in the global financial system is part of the reasons sukuk are attractively priced for issuers.

### ***Extending the linkages to other parts of the world***

The emergence of Islamic financial products, in particular, in the capital market has also promoted greater global financial integration. The bringing together of financial institutions and market players across continents to participate in this expansion of inter-regional investment flows has fostered financial linkages among the major regions. This will not only provide great synergies and opportunities but will contribute towards facilitating international financial stability.

Just as the old Silk Road in the 14<sup>th</sup> century offered a route that facilitated the spice trade from the East to the West, we can now envisage the new Silk Road which financial flows across borders between the East and West, thereby promoting international financial integration. In this context, the Islamic capital market, in particular, the sukuk market has a major role in strengthening this interlinkage. The essence of the New Silk Road is to provide a route for such flows and promote greater financial integration for the benefit of a wider community. The New Silk Road should not be envisaged as just a link between Asia and the Middle East but that which extend to Europe and the rest of the world. Indeed, we are already seeing the participation of global investors and the international financial community. The participation of a financial centre like London will foster the global growth and international integration of this market. The involvement of regulators and government agencies is also contributing to accelerating this process.

Malaysia is one of the key intermediary destinations along this New Silk Road that

offers a platform for the origination, distribution and trading of Islamic capital market and treasury instruments, including sukuk. Malaysia is positioning itself as an Islamic investment gateway to Asia, with a niche in Islamic fund and wealth management. Malaysia has developed a comprehensive Islamic financial system that operates in parallel with the conventional financial system. Of significance, is the inter-connectivity within the system that includes the banking and takaful industries, and the Islamic money and capital markets - a matrix which mutually reinforces the integrity and stability of the Islamic financial system. This is supported by the financial infrastructure, the legal and regulatory framework and the expertise to contribute to the growth of Islamic finance.

### ***Malaysia's achievements in developing the sukuk market***

Allow me to share the Malaysian experience in developing the sukuk market. The Malaysian Islamic bond market has made significant progress since the first sukuk issue in 1990 by a multinational corporation operating in Malaysia. The development of the market involved initiatives to facilitate an efficient issuance process, the price discovery process, the broadening of the investor base, the establishment of a benchmark yield, the liquidity in the secondary market and the strengthening of the regulatory framework. These initiatives have been reinforced by the legal and Shariah framework and the supporting financial infrastructure including the settlement and bond information system.

Following the development of a robust and vibrant domestic market, initiatives have now been taken to raise the significance of the international dimension of our Islamic financial system. This has included wide ranging liberalization measures including bringing in new Islamic finance foreign players into our system through the issue of new licences and allowing for greater levels of foreign interest in our domestic financial institutions.

The liberalisation has also involved the potential for greater foreign participation in our domestic financial markets.

In 2002, Malaysia achieved a further significant milestone when the Malaysian government issued the first global sovereign sukuk, raising USD600 million. With this issuance, it became an international benchmark for the issuance of global sukuk. The sukuk issue was listed on the Luxembourg Stock Exchange, Labuan International Financial Stock Exchange and Bahrain Stock Exchange. There has since been further sovereign issues in the global capital market.

In 2006, the Malaysian market saw the launch of a sukuk using concepts such as Mudharabah, Musyarakah and Ijarah. The issuers included Malaysia's government-linked companies. A landmark example was the USD750 million exchangeable sukuk Musyarakah by Khazanah, the government's investment corporation for the purpose of selling a stake in Telekom Malaysia. It marked the world's first issue of its kind, incorporating full convertibility features common to conventional equity-linked transactions.

Following these developments, the Malaysian sukuk market has attracted a wide range of lead arrangers. In addition, the rising demand and the growing number of issuers and the broadening investor base has led to the growing sophistication of the market. By January 2007, Malaysia accounted for 67 per cent, about two-thirds of the global sukuk outstanding, amounting to about USD47 billion.

The growth in the sukuk market also reflects the commitment and combined efforts of the Malaysian government and regulators. There is a clear articulation of the vision and policies to drive the local Islamic capital market. This is reinforced by the implementation of a strong legal, regulatory and tax framework.

Bank Negara Malaysia and the Securities Commission have worked closely on a sequence of vital blueprints: the 10-year Financial Sector Master Plan, the 10-year Capital Market Master Plan and the Islamic securities guidelines. The government has reaffirmed all these plans and initiatives with the announcement of a range of tax measures in the 2006 budget.

Another important aspect of the development of the sukuk market is the development of the other key components of the Islamic financial system, the money market, banking, and takaful sectors. The various components are able to meet the different requirements of the economy including the differentiated tenor for which the funds are required. This includes providing stable long-term funds for large investments and development projects. These would allow for a balanced allocation of financial and economic resources within the economy, diversifying the risks through the Islamic financial system, and enhancing its flexibilities to adjust, thus strengthening its resilience.

As Malaysia moves to a more liberalised and globalised Islamic capital market, the role of the industry in advancing the Islamic financial system becomes increasingly important. The role of the industry has been important in spearheading product innovation, branding, profiling, promotion and marketing of the Islamic capital market products and services. This has contributed to the development of a deeper and more liquid, efficient, transparent and effective sukuk market.

### ***Challenges in the development of the Global Islamic capital market***

While much has been achieved, much remain to be done. Let me turn to some of the challenges and initiatives taken to address them. A vital ingredient for the development of capital markets, including the Islamic capital market, is the creation of a secondary trading

platform for the capital market instruments. This will provide investors with the flexibility in managing their liquidity requirements. In this respect, more needs to be done in terms of the creation of a continuous supply of Islamic papers and instruments that would promote the secondary trading of instruments and add greater depth to the market.

There also needs to be greater diversity in the type and maturity of the sukuks in the market for Islamic financial institutions and portfolio managers to manage their funds effectively. As part of the efforts to address these issues, the Malaysian government regularly issues sukuk with different maturities in order to create a benchmark yield curve. Since the year 2000, the government has developed an auction calendar for both the conventional and sukuk government issues. In 2005, the government commenced issuing shorter term Islamic treasury bills and longer-dated sukuk, with a maturity of 10 years, to further diversify the instruments available to investors. In the Malaysian sukuk market, Islamic private debt securities now account for 50 per cent of the total private debt securities market.

Another challenge to the growth of the market concerns pricing issues. For the Islamic security to be efficiently priced and credible, further initiatives need to be undertaken to develop its own indicator. For example, if a sukuk is issued based on the Ijarah principle, and uses the property as its underlying asset, the actual rate of rental may be explored to be used to determine the rate of return on the instrument. It would then fluctuate depending on the demand and supply for that property. It will then give a true reflection of the price of the underlying asset.

Shariah experts, who have a full understanding of the mechanics of sukuk, are key to ensuring its proper governance. And shariah decisions, when made, should be transparent and disclosed. This will allow others to appreciate the juristic reasoning, which in turn should lead to wider acceptance

of shariah decisions, particularly if they have implications on cross-border transactions. In relation to this, a guide for issuers and investors to refer with regards to shariah decisions would facilitate the development of the market.

Of further importance is the attainment of the convergence of Shariah principles and interpretation to ensure market confidence among investors from different parts of the world. To achieve this, there needs to be continuous investments in intellectual capital and greater engagement among Shariah scholars. The regular engagement that is now taking place among the scholars is already producing this convergence.

Similarly for the global acceptance of Islamic finance, the harmonisation of standards and practices is important. Full support has to be accorded to the international standard setting organizations such as Islamic Financial Services Board (IFSB) and to the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) to formulate appropriate standards that would strengthen 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. The IFSB has also undertaken initiatives to

strengthen the framework and practices in the Islamic money market. Further work is being undertaken to formulate strategies for strengthening the liquidity management framework and to identify measures to develop benchmark Islamic securities that can help to determine benchmark rate for system-wide application.

### ***Global co-operation to develop the Islamic financial markets.***

Indeed, while there remains many challenges that need to be overcome, the overall direction and potential of the global Islamic financial markets are certainly well recognised. Greater engagement and interface between the industry, the scholars, and the authorities will create greater awareness, understanding and appreciation of the issues and the direction for its resolution. This will provide an environment in which the full potential of Islamic finance can be realised. This is indeed a global challenge and it will be the cumulative efforts of the scholars, industry and authorities that will produce the best outcome.

In conclusion, I would like to congratulate the organisers in successfully providing a platform at this conference for all the sukuk stakeholders ranging from the issuers to investors. I wish all of you a highly productive and successful conference.