Increased utilization of Islamic financing a boost to secondary markets

The lack of supply in Sukuk has been one of the major factors in the underdevelopment of the secondary markets. CHUNG CHEE LEONG explores why the global secondary markets in the Islamic finance industry are underdeveloped and how the development in other sectors can bring the much-needed boost to the secondary markets.

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With more infrastructure projects utilizing Islamic financing coming to the fore in recent times, there is growth opportunity for the Islamic capital markets, given that there will be a better liquidity prospect which would help provide the much-needed boost to the secondary markets.

The global Sukuk outstanding stood at US$349.1 billion as at the end of 2016, indicating a remarkable increase of over 600% or six times in the last 10 years. In addition to that, Malaysia currently represents around 53% or more than half of the global Sukuk outstanding, making it the top Islamic debt capital hub in the world. Within the domestic market, government Sukuk papers outstanding have grown considerably where the outstanding amount stood at RM263 billion (US$61.67 billion) of Malaysian Government Investment Issues (MGII) as at the end of 2016; however, this is still lower than the outstanding Malaysian Government Securities (MGS) of RM357 billion (US$83.71 billion).

First and foremost, the lack of foreign investors' understanding on Islamic finance in general and Sukuk in particular, has been identified as a reason for the low secondary market volume in Sukuk. It is true that investors would not buy into something that they do not know or have little knowledge of. Furthermore, based on feedback from investors, inclusion into widely followed global indices could greatly improve the debt securities tradability since some of these investors would use these indices as portfolio benchmarks and measures of broad fixed income market returns.

The secondary turnover ratio for MGII for 2016 was at 127%, higher than the ratio registered for 2015 at 92%. However, it is still lower compared to the secondary turnover ratio for MGS for 2016 at 160%.

On the other hand, corporate Sukuk has been growing rapidly domestically since 2006 as compared to corporate bonds. Corporate Sukuk outstanding for 2016 made up 73% of total corporate bond/Sukuk outstanding as compared to corporate bonds' share of 27%. Correspondingly, the corporate Sukuk trading volume for 2016 was 78% of the total corporate bond/Sukuk trading volume as compared to corporate bonds' 22%.

Initiatives to further increase liquidity in the secondary market for local Sukuk

Among the initiatives undertaken by the relevant authorities to increase liquidity in the secondary market are as follows:

- The inclusion of MGII into world-renowned global indices, namely Barclays Capital Global Aggregate Bond Index in March 2015 followed by JPMorgan Emerging Market Bond Index in October 2016 to increase and enhance visibility and tradability of these MGII.
- The introduction of 30-year MGII into the central bank's 2017 auction calendar for the expansion of the MGII yield curve to match the MGS auction tenors and indirectly manage the pricing gap between MGS and MGII.
- Accommodative and advanced Islamic finance platforms to support and encourage the issuance of different types of Sukuk such as covered Sukuk and perpetual Sukuk to add diversity to the local Sukuk market.

Furthermore, Bank Negara Malaysia, the central bank, in its continuous initiatives to further spur the liquidity of the domestic bond and Sukuk market, had allowed regulated short-selling of MGS to include all resident entities effective the 2nd May 2017. The measure would improve the liquidity in the local bond market. To this effect, a consultation paper would be issued to financial industry players for market feedback on the proposed inclusion of MGII as eligible securities under the regulated short-selling framework.

The aforementioned initiative followed the Securities Commission Malaysia (SC)'s recent consent on the 13th April 2017 to allow banks to undertake regulated short-selling of corporate bonds and Sukuk in the local capital market. The initiative was part of the SC's continuous efforts to boost the liquidity of the secondary bond and Sukuk market while ensuring a comprehensive and facilitative infrastructure and regulatory framework.

Initiatives undertaken by Malaysian corporate issuers to increase liquidity in the secondary market for their Sukuk

Various proactive initiatives have been taken by Malaysian corporate issuers to promote secondary market liquidity of their Sukuk to local and international investors. Some of these include the establishment of exclusive pricing pages on Bloomberg and Reuters platforms, the reopening of their outstanding Sukuk, offering value-tracking assistance to investors as well as the inclusion of their Sukuk in widely-followed global indices to enhance the visibility of their debt securities among local and international investors. Evidently, the aforementioned initiatives have resulted in much higher secondary market turnover for their Sukuk as compared to conventional bonds.

In addition, the increased acceptance of Malaysian Sukuk among foreign institutional investors bodes well as demonstrated by the increased subscriptions of foreign investors in the overall ringgit primary Sukuk issuances and holdings.