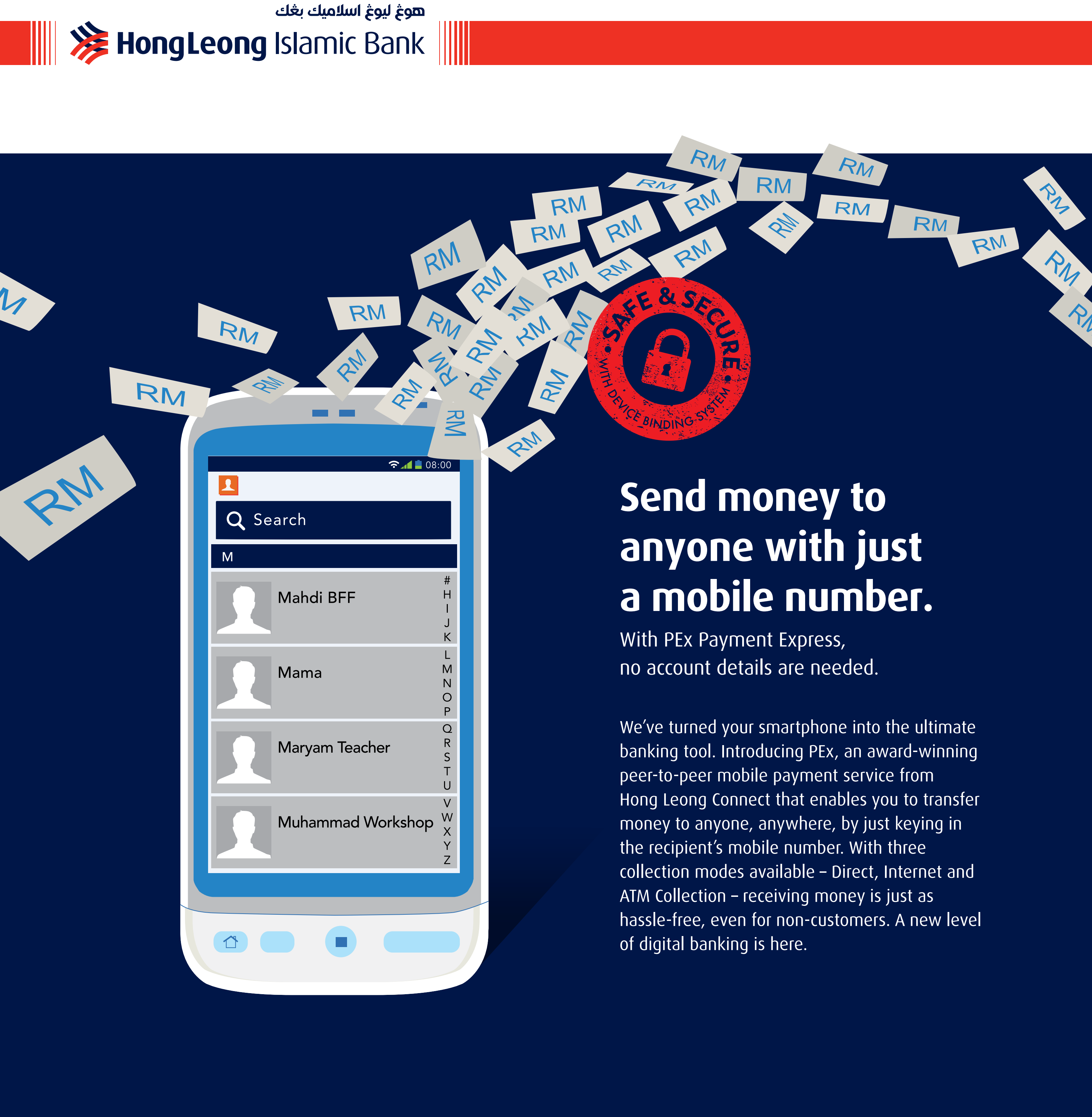
International Investor

MALAYSIA 2015

GLOBAL ISLAMIC FINANCE

Roundtable Debates
Government Interviews
Business Leaders' Opinions
Sector Data
Focus Reports
Market Analysis
Business Intelligence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ISLAMIC FINANCE IN NUMBERS

International Investor's summary of key data and quantitative dynamics of the sector.
For more detailed information, please contact International Investor directly.

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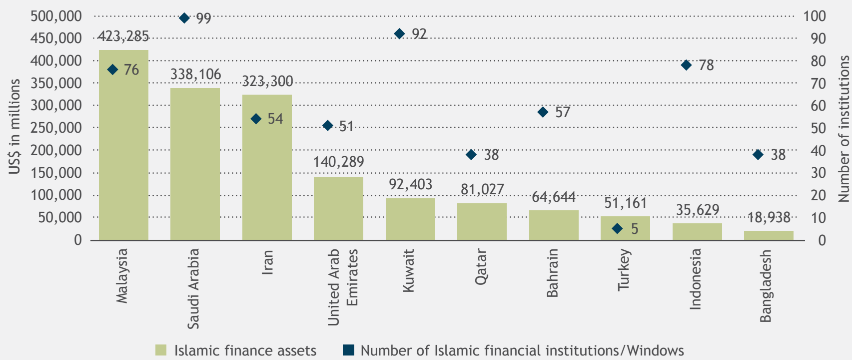
KEY GLOBAL ISLAMIC FINANCE STATISTICS*	
Total Islamic finance assets (US$ in trillions)	1.658
Total number of Islamic finance institutions	933
Total Islamic banking assets (US$ in trillions)	1.214
Total fully fledged Islamic banks/Windows	411
Total takaful assets (US$ in billions)	27.84
Total takaful institutions	281
Total OIFI** assets (US$ in billions)	85.54
Total number of OIFIs	301
Total volume of sukuk issued (US$ in billions)	116.9
Total sukuk issues	812
Total outstanding sukuk volume (US$ in billions)	279.6
Total outstanding sukuk issues	1812
Total Islamic funds volume outstanding (US$ in billions)	50.7
Total Islamic funds outstanding	791
Total Islamic funds launched	121

** All statistics as of the end of 2013* *** Other Islamic financial institutions*

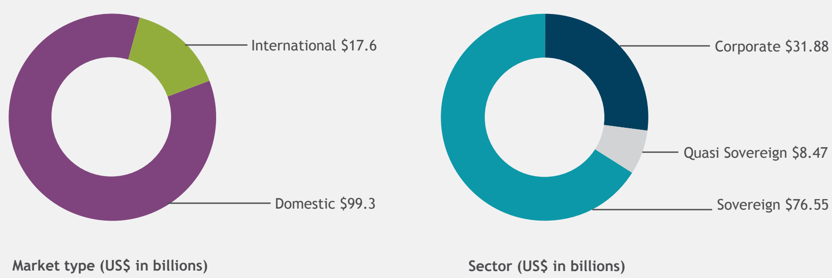
Source: ICD/Thomson Reuters 2014

TOP 10 GLOBAL ISLAMIC FINANCE ASSETS BY COUNTRY 2013



Source: ICD/Thomson Reuters 2014

GLOBAL SUKUK ISSUE BREAKDOWN BY MARKET TYPE AND SECTOR 2013



Source: ICD/Thomson Reuters 2014

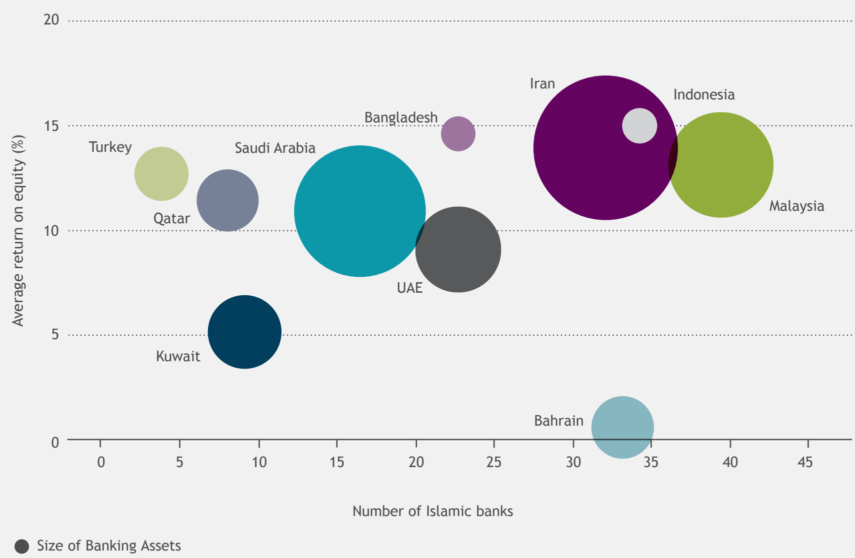
QUANTITATIVE DEVELOPMENT INDICATOR

	Country	Indicator value (0-100)
1	Malaysia	75
2	Saudi Arabia	45
3	United Arab Emirates	37
4	Qatar	36
5	Kuwait	35
6	Bahrain	27
7	Sudan	25
8	Iran	21
9	Pakistan	18
10	Indonesia	18
	Global average	6

The Quantitative Development Indicator is a weighted index of financial institutions, per country, that generate Islamic financial products and services. The index considers all five sub-sectors: Islamic banking, takaful, other Islamic financial institutions sukuk and funds, and provides an assessment of the size, depth and performance of each country's IF industry.

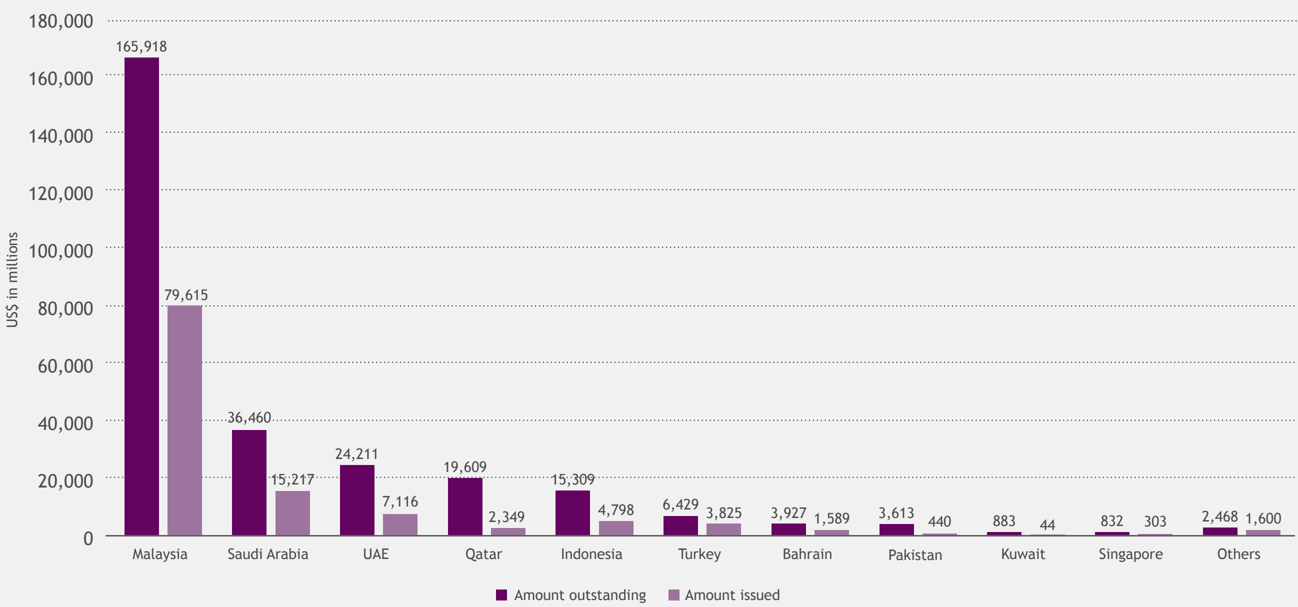
Source: ICD/Thomson Reuters 2014

ISLAMIC BANKING LANDSCAPE 2013



Source: ICD/Thomson Reuters 2014

GLOBAL SUKUK: AMOUNT ISSUED IN 2013 AND AMOUNT OUTSTANDING AS OF DECEMBER 31, 2013



Source: ICD/Thomson Reuters 2014

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Gain valuable market intelligence and an understanding of the opinions and business philosophy of those who are shaping the global Islamic finance landscape in Malaysia. Read International Investor's interviews with business leaders.

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Finance Accreditation Agency

All individuals held the positions stated at the time of International Investor's Roundtable event and interview process in Malaysia.

International Investor would like to thank all the leaders from the public and private sector who have participated in and contributed to our work.

GLOBAL ISLAMIC FINANCE

Rapidly increasing its global competitiveness, the Islamic finance sector continues to promote its value proposition as a sustainable alternative to conventional finance. As the sector broadens its reach into markets around the globe, attention must be paid to the development of scale, a clear regulatory framework and sustained improvements in customer experience.

ON THE FAST TRACK TO GROWTH

The global Islamic finance market is growing rapidly but faces challenges in terms of scale and profitability.

Islamic finance (IF) is based on Sharia principles that ensure mutual risk and profit sharing among transacting parties. The core values of IF focus on promoting entrepreneurship, trade and commerce and prohibit activities that involve riba, maysir and gharar, which relate to the practices of raising interest, gambling, and speculative trading, respectively. Financial transactions must be backed with, or at least based on, tangible assets, ensuring their connection to the real economy.

After Sharia scholars had set the initial foundations for Islamic economics in the 1950s, the first financial institutions based on Islamic principles were established in Egypt and Malaysia in 1963. Due to the surge in oil revenues, markets in the Middle East became increasingly liquid in the 1970s, causing a growing demand for Sharia-compliant products. In 1975, the foundation of the Islamic Development Bank in Saudi Arabia generated international recognition for IF, and Muslim economists continued to develop alternatives to conventional finance.

Interest-free banking systems were adopted in various Muslim countries in the 1980s, attracting the attention of Western financial institutions. In 1990, Shell MDS issued the first tradable sukuk to finance its oil and gas activities in Malaysia and the industry enjoyed growth throughout the decade. Due to high domestic demand and strong support from the government, Malaysia remains the leading country in sukuk issuances, accounting for more than half of total global issuance. In addition, the market for takaful, or Sharia-compliant mutual insurances, is on the rise both in ASEAN countries, particularly Malaysia, Indonesia, Brunei, Singapore and Thailand, and Gulf Cooperation Council (GCC) countries (see fig. 1).

The industry continued to post double digit growth into 2014 and the global profit pool of Islamic banks is set to triple over the next five years with increasing market penetration in its principal jurisdictions (figures 2 and 3). The industry is gearing up to target a wider customer base in direct competition with conventional peers and is evolving toward technology-based, service-driven value propositions. In line with this, there is also an urgency to grow strong regional champions who can seize the opportunities in the diverse and dynamic markets and showcase IF as a powerful form of ethical finance.

However, despite the impressive growth prospects, this type of financing still only makes up a small percentage of the global finance industry. The question remains, therefore, whether it can be a viable alternative to conventional finance. The success of IF is strongly linked to finding opportunities to add volume and scale, as analysts believe that in order for the industry to realise its full potential, the players in the field will have to rise up to various challenges currently impeding scalability in the sector. This problem could be addressed if stakeholders from the key IF centres join forces and facilitate the required environment and scale to push the industry to the next level.

CHALLENGES

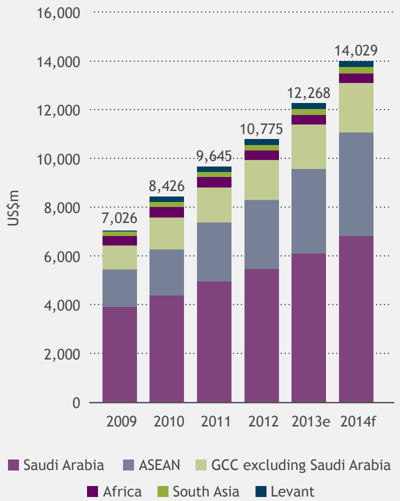
The average return on equity for the top 20 IF institutions is estimated at 11.9 per cent, which is lower than the 14.5 per cent of conventional institutions. Increasing scale and profitability is a key challenge for IF institutions, as well as improving the regulatory framework and talent development.

LACK OF SCALE AND PROFITABILITY

Primarily concentrated in a handful of markets, most IF institutions have not been able to achieve critical business volume and their cost to income ratio remains higher than that of their conventional counterparts. Accordingly, competition for market share among IF institutions is intense. This is compounded by the need to rival conventional financial institutions, particularly in the markets that operate the dual banking system model, such as Malaysia.

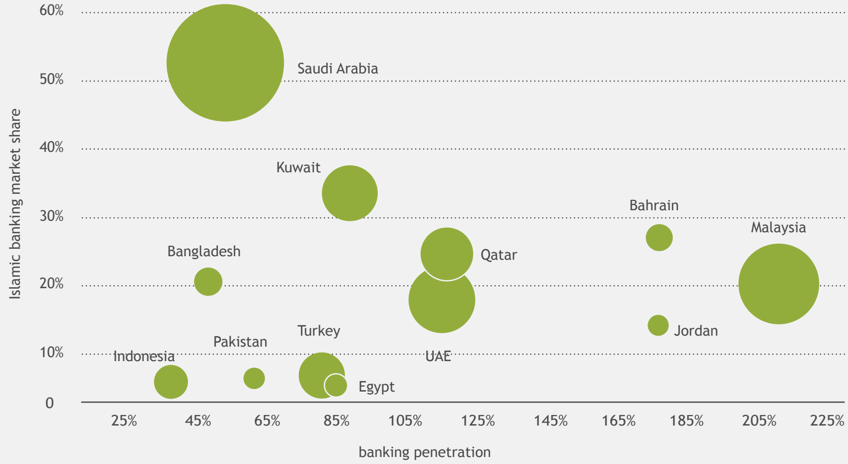
Moreover, IF institutions have limited access to quality customers as they are mainly start-

1. GLOBAL GROSS TAKAFUL CONTRIBUTIONS BY REGION 2009-2014



Source: EY's Global Takaful Insights 2014

2. BANKING PENETRATION AND ISLAMIC MARKET SHARE



Analysis includes domestic banking assets where data was available and excludes Iran, which has a unique domestic industry

Source: Central Banks, BMI, Pew Research Centre, EY Analysis

ups or small players that tend to concentrate on the retail segment. The dearth of acquisition targets in key markets further exacerbates the problem, leaving organic growth as the only viable option to increase scale.

Although IF institutions have made significant improvements in their product offerings, differentiation from conventional products is still a challenge, especially in new markets. Product innovation will therefore be key to ensure profitable and sustainable growth of IF institutions. In addition, the average product holding for Islamic banks is 2.1 per customer, which is significantly lower than the average of 4.9 on the conventional side. This is mainly due to the lack of customer segmentation and cross-selling on the part of the IF institutions. A rise in average product holding to 4.9 could increase profitability by 40 per cent, as well as improving the return on equity for some IF institutions by an additional 5 per cent.

Finally, the implementation of solvency and capital requirements will hinder the competitiveness of the smaller players, while better-capitalised institutions may not be able to provide the required shareholders' returns and profitability in the short to medium term. Based on an analysis of Islamic banks in the Middle East, it is estimated that capital ratios will reduce by approximately 3 per cent following the adoption of the Basel III requirements. Without any prospects of being able to provide better returns to shareholders, the Islamic banks will face a significant challenge to raise the required capital.

LACK OF REGULATORY CLARITY AND STANDARDISATION

The IF industry requires a conducive regulatory environment that supports its intricacies. Moreover, acting in their role as intermediaries between investors, businesses and customers, IF institutions require flexibility and clarity in executing their transactions. Accordingly, a more complete Islamic financial regulatory framework is necessary to accelerate growth.

Islamic financial institutions have voiced significant concerns regarding this regulatory challenge. The lack of uniformity across current regulatory frameworks results in reporting challenges for those who operate in different jurisdictions. For example, standards set by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) have been adopted by a number of countries in the Middle East, but have yet to gain worldwide acceptance, increasing uncertainty among investors.

Furthermore, in many jurisdictions IF is subject to tax treatment similar to that of conventional finance. This generally has adverse affects on the attractiveness and competitiveness of IF products, as typically applying the local tax rules to IF transactions, such as murabaha for example, can result in double taxation. Although regulatory agencies in many countries are seeking to address this issue through double tax agreements or treaties, a significant effort is still required from policy makers and industry players to engender a comprehensive framework in this field.

Although divergent views on a number of Sharia issues have reduced over the years, certain technical issues lack a standardised approach. Whilst it is often argued that these differences in opinion reflect the uniqueness of IF and offer a platform for development by stimulating innovation, a certain level of standardisation is desirable in order to expand the reach of the product offerings internationally.

SCARCITY OF TALENT

Talent development continues to be a significant challenge for the industry. The focus is not only on the numbers required to support the predicted growth of IF, but also on the deficiency in qualified experts in Sharia jurisprudence, as well as those with an appreciation of the complexities of the banking, takaful or fund management industries.

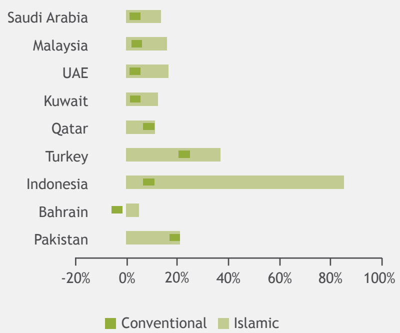
Due to the lack of talent development and consequent scarcity of qualified human capital, a culture of talent poaching has become ubiquitous not just between Islamic institutions in the national sphere, but also on an international level. Clearly, the necessary changes cannot be addressed without substantial planning and should ensure every level of talent development is included from tertiary-level education to those in the existing workforce.

To this end, further development of an internationally accredited qualification framework for IF is crucial, as the institutions that currently offer such qualifications have yet to attain the desired level of global recognition.

OPPORTUNITIES

A predicted increase in competition is expected to encourage the growth of larger and better-capitalised IF institutions. This, in turn, should stimulate the development of regional institutional champions and strengthen the industry's credibility on the international stage. By adopting technology-based, customer-centric solutions and improving regulation standards and talent development, the IF industry can further reduce its profitability gap.

3. GROWTH RATE OF ASSETS YOY 2013 (IN LOCAL CURRENCY)



Source: Central Banks, EY analysis

SIZE MATTERS

There are certain key requisites for achieving scale and growth; connectivity will become increasingly important. Bahrain and the Rapid Growth Markets (RGMs) – Qatar, Indonesia, Saudi Arabia, Malaysia, UAE and Turkey – account for 82 per cent of the international Islamic banking assets and are key to the sustainable development and internationalisation of the IF industry. They are expected to increase at a cumulative average rate of 19.7 per cent in the next five years and, as their growth rate is significantly faster than the rest of the IF world, must position themselves to take advantage of shifts in global trade and capital flows, which represent critical business opportunities for IF.

The enhancement of markets, customers and products is another important factor. Rapid growth also presents greater complexities for IF industry players. Currently, it is estimated that IF institutions serve up to 40 million customers globally, two-thirds of which reside in RGMs. However, leading IF institutions are doubling in size every four years and, as a result, are currently facing capability constraints.

An important agenda issue for IF institutions in this rapidly transforming sector is fostering a greater connection with their customers, and offering products that cater to the changing needs of the clients and the under-served segments of the market. Thus, detailed analysis is required to develop products tailored to the individual needs of the customer. In order to achieve these goals it has been posited that an ongoing programme focused on the evaluation of user experience should be implemented to help the IF institutions understand and analyse changing customer patterns, better anticipate their needs and encourage certain preferred behaviours.

TECHNOLOGICAL DEVELOPMENT

Greater penetration is necessary in core IF hubs. A catalyst for this penetration is technological enablement, which can increase engagement with new customers, as well as reduce operating costs. Distribution channels to be considered should include new branches, telephone and online sales, mobile, direct sales force, bancatakaful and partnerships.

Accordingly, operational transformation has continued to accelerate in recent years and produce results by addressing the various, ongoing paradigm shifts from a predilection for cash payments to a digital economy, and from using technology to comply with market changes to deploying digital technology, such as mobile banking, for revenue generation.

Along with the digital and technological advancements, an increasing amount of clients using financial services expect the institutions with whom they do business to provide solutions through social media. Therefore, it is no longer sufficient for IF institutions to merely have social media presence. Instead, they must be able to engage and deliver services and customised financial solutions in a faster and more efficient way via these channels. Moreover, leading banks are now using social media to engage with the market and social media analytics to gauge client expectations, satisfaction levels and relevant client perceptions.

EFFORTS TO IMPROVE TALENT DEVELOPMENT

To maintain growth and sustainability of IF, the industry needs to develop a comprehensive talent development programme, generating a pool of specialised, competent and high-calibre human capital. Malaysia continues to play a leading role in this respect, looking at different development platforms at the various stages of the talent fostering process.

For example, at the entry level, the Financial Sector Talent Enrichment Programme (FSTEP), organised by Bank Negara Malaysia, was introduced with the aim of training and providing top graduates with an adequate foundational knowledge of the financial services industry. The initiatives under FSTEP are required to meet the standards set by the globally recognised Association of Chartered Islamic Finance Professionals (ACIFP) and include collaborations between the industry and institutions of higher education.

Market participants deem these kinds of programmes essential for talent generation and believe they should be replicated in other countries with a growing IF industry, but adapted to address local requirements in each particular jurisdiction.

ENHANCING REGULATORY CLARITY

To ensure the growth potential of the industry is fulfilled, IF market actors must collaborate to develop an appropriate legal, regulatory and supervisory framework that can effectively cater for the special characteristics of the industry and ensure tax neutrality.

While standardisation of regulations across different jurisdictions is not yet a reality, new regulatory developments are shaping the industry. For example, the Islamic Financial Services Act 2013 (IFSA), introduced in Malaysia, provides industry players with greater clarity regarding prudential and legal requirements underpinned by Sharia principles. Importantly, the IFSA now governs the IF institutions, while a separate regulation, the Financial Services Act 2013, governs conventional financial institutions. In Qatar, the regulatory authority introduced the Islamic Finance Amendments Rules in 2012, which required onshore conventional firms to close their Islamic window operations with only limited exceptions in order to create a level playing field for Islamic banks to compete with conventional banks and foster financial stability.

Internationally, various bodies have been established that aim to lead efforts for global standardisation across the different fields within IF. These include the Islamic Financial Services Board (IFSB), the International Islamic Liquidity Management Corporation (IILM), the International Islamic Rating Agency (IIRA) and the International Islamic Financial Market (IIFM).

Although significant progress has been made in gaining global acceptance, these institutions will need to increase their capacity and reach in order to keep abreast of the dynamic IF landscape and ensure the standards being promulgated remain relevant to all IF stakeholders.

CONCLUSION

Major improvements in product offerings, brand recognition and revenues have allowed the industry to grow at a global level and further establish itself as a viable alternative to conventional finance. To maintain this impressive growth path and attract a wider global audience, industry stakeholders must focus on further expansion and unification of the regulatory framework across IF jurisdictions. One potential route to sustainable growth, technological improvements and effective international talent development programmes relies on key Islamic financial centres working in collaboration to achieve common goals and facilitate the environment and scale to push the industry to the next level. If the challenges are met, the IF industry will foster its popularity in rapidly growing Muslim markets, and simultaneously gain ground in other global markets, as it breaks into the mainstream.

➡ This feature was produced in conjunction with Syarizal Rahim, Partner in Islamic Financial Services at EY Malaysia.

ROUNDTABLE: RISING TO THE CHALLENGE OF GLOBALISATION

The Islamic finance sector is expanding in core markets, broadening its mainstream appeal and, as conventional finance and non-Muslim nations take notice of the opportunities and value propositions presented, it is moving towards a truly global scenario. Notwithstanding the landmarks already achieved, certain challenges must be addressed in order to sustain momentum.

AGENDA

- Islamic finance: scale and globalisation
  - The evolution of the IF industry
  - Perspectives on the mainstreaming of IF
    - Buy-side: pushing the agenda
      - Supporting 'Brand Malaysia'
      - Benefits of Sharia-based structures
    - Sell-side: broadening horizons
      - Expansion readiness of Malaysian IF market actors
      - Opportunities and challenges for purveyors of IF in the global arena
      - From a multi-domestic to a global market
    - Human capital challenges
  - Driving internationalisation forward
    - Developing IF jurisdictions
    - Malaysia: cross-border engagement
    - Barriers to global take-up
    - Building on the existing framework
  - The sustainability of the Malaysian IF model
- Islamic capital markets
  - Global sukuk market: meeting demand
    - Diversifying the product range
      - Short-term and variable rate instruments
    - Adopting financial technology
  - New frontiers
  - Attracting foreign Investors and Issuers
- Selling the IF story worldwide

PARTICIPANTS

ASHAR NAZIM
Global Head of Islamic Banking
EY

Ashar has 20 years of professional experience, primarily in the Islamic finance industry. He has been involved in a number of strategic initiatives across Europe, the Middle East, Asia Pacific and Africa, advising boards and senior management of clients on Islamic financial services-related matters. He is also a regular speaker at industry forums and has directed several thought leadership investigations on Islamic banking, takaful and wealth management.

RAJA TEH MAIMUNAH
Managing Director and Chief Executive Officer
Hong Leong Islamic Bank

Raja Teh holds an a Bachelor of Laws degree (Hons) and an Honorary Doctorate of Laws from University of East London. She has over 20 years' experience in banking and finance focusing on Islamic finance and investment banking. Raja Teh also sits on the Board of Hong Leong MSIG Takaful and holds the position of COO for Digital Innovation & Transactional Banking of Hong Leong Bank Berhad, where she spearheads digital initiatives for the banking group.

DAUD VICARY ABDULLAH
President and Chief Executive Officer
International Centre for Education in Islamic Finance (INCEIF)

Daud has been in the financial services industry for more than 41 years, with significant experience in Asia, Europe, Latin America and the Middle East. He has set up and managed two Islamic banks. Prior to that, he was a Global Islamic Finance Leader with Deloitte Currently, he is the President and CEO of INCEIF. Daud holds an Economic and Social History honours degree from the University of Bristol in England. In 2013, he co-authored the book 'Islamic Finance: Why It Makes Sense'.

MOHD. IZANI GHANI
Chief Financial Officer
Khazanah Nasional Berhad

At Khazanah, Mohd. Izani was instrumental in establishing Ringgit Malaysia-denominated sukuk programmes for the company and issuances of landmark sukuk in various currencies. The most recent cross-border deal he executed was the US $500 million exchangeable sukuk into Tenaga Nasional Berhad shares, in September 2014. Mohd. Izani graduated from the London School of Economics and Political Science and is a fellow of the Association of Chartered Certified Accountants.

CHUNG CHEE LEONG
President and Chief Executive Officer
Cagamas

Chee Leong is currently the President, CEO and an Executive Director of Cagamas Berhad, a post he has held since April 2012. He has over 29 years of central banking experience, focusing mainly on financial system stability and the financial sector. Prior to joining Cagamas he served as Director of Bank Negara Malaysia's (BNM) Banking Supervision Department and the Risk Management Department. Chee Leong has also carried out various assignments for the International Monetary Fund and the Islamic Financial Services Board.

BADLISYAH ABDUL GHANI
Chief Executive Officer
CIMB Islamic Bank

Badlisyah has 17 years of domestic, regional and global banking experience in various capacities including structured finance, capital markets and syndications. He holds a Bachelor of Laws degree from the University of Leeds, United Kingdom and currently holds positions within the Islamic Capital Market Consultative Panel of Bursa Malaysia, the Association of Islamic Banks in Malaysia, the Malaysian Accounting Standards Board and the Malaysian Investment Banking Association, among others.

PARTICIPANTS

PROF. RIFAAT AHMED ABDEL KARIM
Chief Executive Officer
International Islamic Liquidity Management Corporation (IILM)

Professor Datuk Rifaat is a leader in the Islamic financial services industry at both at the professional and the academic level. He served as the inaugural Secretary-General at both the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) and the Islamic Financial Services Board (IFSB). His contributions to the IFSI have been recognised by the many prestigious international awards he has received throughout his career, which spans over three decades.

RICHARD THOMAS
Chief Representative Malaysia
Gatehouse Bank

After a career of 35 years in merchant and investment banking, 30 of which were dedicated entirely to Islamic finance, Richard recently relinquished his role as CEO of Gatehouse Bank to focus on expanding its business model in Southeast Asia and linking the Islamic financial hub to the UK and GCC region. In 2010 he received his Order of the British Empire, bestowed by Her Majesty Queen Elizabeth II, in recognition of his contribution to the growth of the UK Islamic Financial Services Industry.

ANGELIA CHIN-SHARPE
Chief Executive Officer and Country Head
BNP Paribas Investment Partners Malaysia

Angelia is the CEO of BNP Paribas Investment Partners Malaysia and the Global Head of Islamic Segment for BNP Paribas Investment Partners. She has over 17 years of experience in banking, capital markets and asset management. She was responsible for the successful set up of the firm's operations in Malaysia and Brunei. She graduated with a Bachelors of Commerce degree in Accounting from Curtin University of Technology, Western Australia.

HERI AKHYAR
Vice President of Investor Relations
Garuda Indonesia

Heri began his career in 1997 at PT Satelit Palapa Indonesia and has held several key positions related to investor relations. Prior to joining Garuda in 2014, he was the Head of Investor Relations of Indonesian logistics giant PT AKR Corporindo Tbk. He completed his undergraduate degree in finance at Sydney Institute of Technology, New South Wales, Australia. Heri received his masters degree in finance from the Amsterdam Institute of Finance.

ROUNDTABLE PARTNERS

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MALAYSIA WORLD'S ISLAMIC FINANCE MARKETPLACE

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GLOSSARY

SHARIA
Often referred to as Islamic law, it encompasses the rulings contained in and derived from The Quran and the Sunnah, which are the sayings and living example of the Prophet Muhammad. It is primarily concerned with a set of values that are essential to Islam and governs not only religious rituals, but also all aspects of daily life. There is extreme variation in how Sharia is interpreted and implemented among and within Muslim societies today. This is especially prevalent for its financial laws.

SUKUK
A sukuk is a financial certificate that represents the holder's proportionate, beneficial ownership of an undivided part of an underlying tangible asset relating to particular projects or investment activities. In this structure, the holder assumes all rights and obligations to the asset. In contrast to a conventional interest-bearing bond structure with a contractual obligation to pay bondholders interest and principal on particular dates, the issuer of sukuk sells an investor the certificate and the asset is then leased back to the issuer for a predetermined return in the form of rental charges. The issuer also makes a contractual promise to return the principal at a future date at par value by buying their share of the asset. Sukuk must be able to link the returns and cash flows of the financing to the assets purchased, or returns generated from an asset purchased.

RIBA
Riba generally refers to charged interest, but can be translated in many ways to mean interest rate, excess, increase or addition. Technically, it refers to any increase or addition to capital obtained by the lender as a condition of a loan. Simply put, it covers earning money on money. Riba, in all forms, is strictly prohibited under Sharia law, as it is considered an unjust return that leads to unjust enrichment. This, in part, is due to the fact there is no productive or trade activity to create the additional wealth. In Islam, money is seen as only a medium of exchange, it has not value in and of itself and should not give rise to more money.

IJARA
A type of contract that refers to an agreement made by an institution offering IF services to lease a particular client an asset specified by the client for an agreed period against specified instalments of lease rental. Neither party may alter the contract without dual consent.
Ijara is classified into 'operating ijara', which does not include a commitment to transfer the legal title of the leased asset to the lessee at the end of the lease, and 'ijara muntahia bittamleek', which is completed by passing the legal title of the leased asset to the lessee.

MUSHARAKA
A type of contract that stipulates an investment partnership between two or more parties, for example an institution offering IF services and its clients. All parties contribute capital towards the financing of a particular business activity in equal or varying amounts to establish a new project or share in an existing one.The partners share the profits according to a pre-agreed ratio, while losses are shared in proportion to each partner's share of capital. Musharaka is often used by Islamic banks to finance large projects.

MURABAHA
A type of IF structure in which the institution offering IF services sells a specified kind of asset to a customer that is already in the possession of the institution, or buys a product on behalf of the client and resells the product to the same client, at cost plus an agreed profit margin.

WAKALA
A contract of agency in which the customer appoints the institution or other party to perform a certain task or undertake business on their behalf, usually for payment of a fee or commission. This kind of arrangement, without provision for payment of a fee, cannot be considered irrevocable, thus allowing an agent the right to terminate the agency at any time. Also known as al-wakala.

Ashar Nazim, EY: Today, we have convened to deliberate issues relating to Islamic Finance. The objective is to discuss the progress of Islamic Finance (IF) in the global context, as well as its implications for Malaysia's economy and the country as a whole. I would like to encourage candid opinions not only regarding the success of IF so far, but also relating to where the general approach must be refined in order to achieve industry-wide goals.

Currently, we are seeing the mainstreaming of the IF industry in a number of core markets, like Malaysia, Saudi Arabia, UAE, Bahrain, Qatar, Kuwait, as well as Sudan. In these countries the market share of the Islamic banking system is now in excess of 20 per cent. This offers new opportunities, but also challenges in terms of customer engagement. So, what is going well in terms of mainstreaming of industry and are there any changes in approach needed? Professor Rifaat, do you want to put some context to the evolution of the industry?

Prof. Rifaat Ahmed Abdel Karim, International Islamic Liquidity Management Corporation (IILM): The creation of certain infrastructure institutions has underpinned the development of Islamic Finance. The evolution of the IF industry really began with the founding of the Accounting and Auditing Organisation for Islamic Finance Institutions (AAOIFI) in 1991, which was the first organisation to look at the industry from an overall perspective. A recommendation from a committee established by the Islamic Development Bank (IDB), of which I was a member, concluded that in order to facilitate growth it was important that Islamic banks had comparable financial statements. Hence, it was recommended that a body be established to facilitate the standardisation of accounting reporting by Islamic banks. To grow across borders, some basic issues should be comparable and AAOIFI was, therefore, an important first step.

The second important step was considering the need for harmonised cross-border prudential regulations. In 2000, at an AAOIFI conference on regulation in Islamic banking that was facilitated by the IMF, it was recommended that a board be established within the AAOFI that would promulgate prudential standards. This meant that AAOIFI would be developed into a single standard setting body covering accounting, auditing and regulation, as well as Sharia, for which a board was established within AAOIFI in 1998. However, not all stakeholders were pleased with this recommendation and national interests had to be balanced. After some lengthy and hard negotiations, it was decided to establish a separate body to promulgate regulatory standards. Accordingly, the Islamic Financial Services Board (IFSB) was established and based in Malaysia.

> *“We are seeing the mainstreaming of the IF industry in a number of core markets”*

Finally, another major cornerstone facilitating the industry's growth was the creation of the International Islamic Liquidity Management Corporation (IILM). The IILM's mission is to facilitate liquidity management for institutions that offer Islamic financial services. Thus, we have a very broad scope to support the industry and this is underpinned by strong governance, with a governing board currently comprising nine central bank governors, as well as the president of the IDB Group.

The idea for this organisation was conceived in 2007, before the financial crisis, by a high-level IFSB task force chaired by the Governor of Bank Negara Malaysia. Although it was a truly visionary proposal, other central banks had to be convinced of the IILM's viability. However, the chairperson of the high-level task force, the governor of Bank Negara Malaysia, continued to advocate the need for such an innovative organisation and the IILM was established in 2010.

It should be noted that the financial crisis underlined the importance of liquidity and its risks. Increasingly, the financial community looks to central banks for guidance on these issues because they are the ones managing the crises.

AN, EY: That is an interesting narration of how the industry has shaped up over the decades. Let's get the perspective of Islamic financial services users. Mohd Izani, Khazanah Nasional has been leading the way in terms of Islamic finance endorsement. With 60 portfolio companies and a presence in numerous international

Ashar Nazim
Global Islamic Finance leader
EY

Mohd. Izani Ghani
Executive Director and
Chief Financial Officer
Khazanah Nasional

markets, what is your perspective on this mainstreaming phenomenon?

Mohd Izani Ghani, Khazanah Nasional: Some years ago, Khazanah Nasional was a mere custodian holding government shares. However, in 2004, we were given a new mandate, part of which was to transform our portfolio companies to become profitable, efficient and provide dividends that could be used to re-invest. We were also directed to establish a global presence.

In 2005, we took the decision that Islamic transactions and financing should be our mainstream and, consequently, we had to make it happen. In Malaysia, the push for IF use came from both the bottom and the top, so we had a commitment from major institutions, such as the Central Bank and the Bursa Malaysia, which helped us greatly.

“Going forward, our wish is to move beyond the local market and increase cross-border deals”

The decision has manifested itself in various ways. As part of the Government-Linked Companies (GLC) transformation programme, launched in mid-2005, we issued books setting out guidelines for different aspects of business. The capital management book, which all GLC CFOs have to know from cover to cover, has a special section devoted to IF that advises companies to adopt IF transactions if possible, provided there is no extra cost to the company. We have made our expectations very clear to all Khazanah-owned companies.

Moreover, our role administering the secretariat for the GLC programme, which is chaired by the prime minister, provided us with a platform to push this agenda further and reinforces the high-level commitment here. Outside this, we engage quite seriously with our companies regarding IF. We offer assistance related to usage and strongly support the investment agenda.

In 2006, Khazanah launched its first, and the world’s first, exchangeable sukuk at US$750 million, which was exchangeable for Telekom Malaysia Bhd shares. The idea was conceived in 2005, but it was a gradual process and there was significant groundwork required before the launch. Primarily, Telekom Malaysia had to be made Sharia-compliant and, because it was an international transaction, the company’s debt ratio had to be less than 33 per cent to comply with the prudential ratio under Sharia guidance. Thus, we had to ensure the company did the work to be ready for the launch, while we were preparing the structure.

It took 18 months to get to a point where we could launch and it was a difficult process. Nevertheless, we did it and, in the end, the demand was huge. We had made a deliberate decision to target Middle East investors and the oil money in the market at that time. This required a significant effort to educate the investors there because nobody had seen this structure before. We really needed to pull them along with us, really hand-holding them.

Going forward, our wish is to move beyond the local market and increase cross-border deals. For example, we want to see more and more of our companies go out, especially if they have a real need for foreign currency.

In 2011, we issued our inaugural renminbi denominated sukuk of RMB500 million. Again, it had not been seen before and required an educative effort on the roadshow. As a consequence of this issuance, when Axiata Group Bhd issued a renminbi sukuk in 2012, it was far easier for them to sell the structure. My broader point here is that we have already created a pathway and we expect others to follow in our footsteps. We will continue this leadership role, but for us to be successful in this endeavour, each and every stakeholder needs to play their role and really push the agenda.

AN, EY: Clearly, you have provided leadership throughout the segment and have carried ‘Brand Malaysia’ with you. Let’s get an outsiders’ perspective now. Heri, Garuda Indonesia is an active user of Islamic financial instruments and Indonesia has always been a great market, but the country’s take-up of IF has been rather gradual from an international perspective. Clearly, you are a success story; can you give us an assessment of your experience?

Heri Akhyar, Garuda Indonesia: We started to use IF in 2013, so we are relatively new to the market. From

our perspective, these Sharia-based structures are more flexible compared to conventional finance. As you may know, Garuda Indonesia uses IF to obtain the funds necessary to acquire aircraft on a leasing basis. Most IF transactions revolve around an asset and, in our case, we can use the aircraft, so it makes a lot of sense for us.

"There are, undoubtedly, opportunities for purveyors of IF to go after new markets"

Our evaluation is that conventional finance is far more rigid and Sharia-based structures can be customised to better meet our needs. Due to the internal conditions of the company, it can be tough to obtain financing, but we have certainly found it easier to go down the IF route and Garuda has come to the IF marketplace for three major transactions so far. We have successfully dealt with various IF vehicles like musharaka, ijara and wakala, and it has worked very well for us. The first time we dealt with the ALAFCO Aviation Lease and Finance Company KSCC from Kuwait, our second piece of Islamic financing was placed with a unit of Maybank and our third was with Emirates NBD.

One issue is that Sharia-based financing has not been adapted to every business sector in Indonesia. However, due to its customisable model and the fact that the Indonesian Financial Accounting Standards Board has also issued policies to facilitate and adapt to these IF concepts, it is becoming easier for companies to obtain Islamic financing in the country.

AN, EY: That is interesting. Is there an opportunity here for Malaysian Islamic banks to internationalise? Indonesia, for example, is a big market and companies like Garuda are becoming more familiar with IF. Badlisyah, do you see this as a challenge or a real opportunity?

Badlisyah Abdul Ghani, CIMB Islamic: Whether it is Malaysian Islamic banks or an Islamic bank from any other country, there are, undoubtedly, opportunities for purveyors of IF to go after new markets. We all want to see IF grow beyond where it is today. There are many jurisdictions with the capacity to do that and we want to see them jump on the bandwagon and facilitate Islamic finance, so that we can do business and, most importantly, the consumer can get what they want in terms of a better and greater choice of financial solutions.

Due to the proximity of Indonesia, naturally it is our first port of call, but there is also Singapore, and perhaps even Thailand. Beyond the Association of Southeast Asian Nations (ASEAN) markets, there is Hong Kong, India and Pakistan, then you have the Gulf Cooperation Council (GCC) countries, the Commonwealth of Independent states (CIS) in the north, and even China.

There are a couple of Islamic banks in Malaysia that are fully geared up to go out and take these opportunities. They may be ready, but whether or not they want to go out is a different matter altogether. It is unwise to rush into these things, especially when doing business in a new jurisdiction and undertaking totally new activities that are unfamiliar to the population. Of course, you can always be a niche player in your own jurisdiction and still be profitable.

AN, EY: It is a matter of strategy, but it is also a matter of balance sheet and then connectivity across financial markets. Undoubtedly, size matters, especially in the domestic market where it is going very well for Malaysia, but looking beyond there are very different dynamics.

Richard, you are in a unique position in that your bank has a representative office in Malaysia, as well as dealing with the conventional market in the UK. Coming back to the topic of the mainstreaming of Islamic finance, do you think the industry is ready?

Richard Thomas, Gatehouse Bank: In the recent mid-term review of the IFSB-IRTI Ten-Year Framework and Strategies for Islamic Financial Services Industry Development, two of the obstacles identified were related to the trust and relevance of the market going forward. More specifically, whether the potential client base found IF relevant to its business and whether the client base trusted Islamic finance in various different aspects. In terms of becoming a global industry, building trust and building relevance is critical to the future of IF.

Badlisyah Abdul Ghani
Chief Executive Officer
CIMB Islamic Bank

Richard Thomas
Chief Representative Malaysia
Gatehouse Bank

Taking up the issue of scale and globalisation, Michael Porter, the Harvard Business School professor and author, developed a fairly clear model to determine what is a global industry and what is a multi-domestic industry. If we shoehorn the IF market into this model, it is clear that it is not yet a global market. While there are substantial players, they participate in multi-domestic markets and the development of products is multinational rather than global. Thus, the overarching challenge for IF is to take these multi-domestic projects and globalise them.

The type of actions currently being undertaken by Khazanah Nasional and Garuda are critical for the world to see a product that can potentially be globalised. I think the importance of Khazanah's renminbi sukuk was underplayed in the market and had global, rather than just national, significance. It certainly made an impression in London, which has also been looking at the renminbi market.

When Islamic finance developed in London, it developed as a bilateral relationship between London and the GCC states. However, we reached out to Malaysia in the late 1980s, when it was still very much a domestic market. Now, Malaysia has developed substantial strength by focusing on building a solid, national identify for IF, far outreaching anything that any other country has achieved. The Gulf markets have been more international, but have not built the infrastructure Malaysia has developed and, as a result, it is now in a position to internationalise. Certainly, everybody around this table has a significant success story to tell, but these stories need to become global.

In order to build on this, we have to overcome the notion that issues relating to standardisation and harmonisation inhibit international growth. I think this is overplayed. However, the perception has an affect and, consequently, these issues must be resolved in order to develop trust on an international basis. Moreover, it is imperative that Malaysia takes the knowledge that is built around the national IF infrastructure and internationalises it, so it can be adopted in other markets.

AN, EY: Clearly, another factor that will be instrumental to IF becoming a mainstream phenomenon and facilitating this move towards a global market is the human capital issue. Daud, as the CEO of the International Centre of Education in Islamic Finance (INCEIF), can you give us some context here? What is the crux of this challenge and what more needs to be done to produce the necessary workforce to sustain the development of the IF industry?

Daud Vicary Abdullah, International Centre of Education in Islamic Finance (INCEIF): Approximately nine years ago, when I was managing director of Hong Leong Islamic Bank, I remember talking to several people around this table about the human resources situation in the sector. Contrary to the view in the marketplace at that time, we were generally of the opinion that the volume of quality human capital was slightly lacking. To cut a long story short, INCEIF was one initiative born out of those assessments.

Initially, the institution was looking at securing the domestic market, but when I took the post three years ago, my mandate was to build the organisation in terms of international recognition. We now have over 2,000 students from 80 countries, 60 per cent of which are online, and we are growing. It has been a tremendous success. We are actively engaged with key stakeholders around the world, such as the World Bank, the Islamic Development Bank (IDB) and the UK Government, and these organisations have actually approached us, which shows the value and relevance of developing resources in this sector.

Looking to the future, there are some significant challenges. I disagree slightly with Richard in that within this idea of increased standardisation is the area of professional standards, which is important. Professional industries, such as law or accounting, all have internationally recognised standards and a model by which students can attend a variety of institutions and undertake tertiary-level degrees that satisfy many of the requirements of those qualifications. In the IF industry, we do not have that yet, although we are working on it.

Additionally, we need to devise a methodology whereby we can predict realistic estimates in terms of job numbers and opportunities available in the industry. Currently, there are some fairly disparate numbers being banded about and a more accurate assessment

Raja Teh Maimunah
Managing Director and
Chief Executive Officer
Hong Leong Islamic Bank

must be undertaken. There are 11,000 actual jobs in IF financial institutions here in Malaysia and that may be stretching it.

Accordingly, the biggest challenge is the disconnect between the standard of people we are producing and ensuring that there is a marketplace in which these people can work. In fact, UK universities offering undergraduate IF programmes have begun to shut them down due to insufficient numbers of graduate jobs. As a result, in that market there has been a focus shift to research and executive programmes, which is something INCEIF is undertaking in partnership with universities in the UK and the City of London.

Ensuring the continued development of human capital has to be broken down into manageable components. There is no doubt the market is growing, but I am not quite sure it is growing on a global basis. Each country has different educational standards and accreditation standards and, therefore, the globality of professional standards will set the tone for the future.

Raja Teh Maimunah, Hong Leong Islamic Bank: It is not easy to find someone straight out of an institution who is 'Sharia ready'. Many people working in the industry, especially in the CEO positions, are conventional bankers who take it up and it comes on the job. However, my personal view is that those who do better are the ones who have passion and the belief that it is more that just a job.

Coming back to the internationalisation of the business, Hong Leong bank is a family-owned, Chinese organisation, so we are driven by very different objectives than CIMB Islamic or Khazanah. It is solely a commercial objective for us. We are ready to internationalise in terms of capital and resources, but, unlike conventional banks, I cannot open shop in all the ten ASEAN countries because the legal infrastructure is not in place. Furthermore, it takes significant endurance to approach a new market and have the necessary conversations with regulators that convince them it is worth the effort.

It comes back to how to drive this internationalisation. The work of Khazanah is very important because it provides comfort to these new markets, but Malaysia is the only country doing IF that has an internationalised agenda. However, whilst we have gone out of our way to push that agenda and done a great job to sell the notion that this is a global business, it is still a challenge to bring foreign issuers and investors here.

One problem is that foreign issuers have struggled to get competitive pricing when they come onshore and after two or three failed foreign issues they stop coming. Mohd. Izani explained that he is mandating CFOs to use IF where possible, as long as the cost is not greater. If he is saying that, the rest of the world will not see it any differently. Potential users will not do IF for the sake of it; it has to make sense. If it is going to cost you 100 basis points more from your benchmark issue in Europe, foreign issuers will not come here. There has to be extra benefits, like access to a new pool of investors or something more diversified.

> *“Potential users will not do IF for the sake of it; it has to make sense. If it is going to cost you 100 basis points more from your benchmark issue in Europe, foreign issuers will not come here”*

All of us, personally and within our institutions, do our bit to promote the industry, but I think we need some huge financial hubs, like London, really taking it up and running with it. Malaysia's aspiration is a good start, but we want to start internationalising IF in the international financial markets and for that we need assistance.

MIG, Khazanah Nasional: I want to make two points relating to Raja Teh's comments. One is regarding cost: the environment for IF in Malaysia allows us to impose conditions for the adoption of this type of financing because, when comparing sukuk transactions with conventional finance, the former is often better. There are savings there for the issuer, which can be up to five basis points.

The second is that when we issued our Singapore dollar sukuk in 2010, we were willing to sacrifice tighter pricing in order to further our internationalising mandate. It was good for us just to go to Singapore and

make it happen and, importantly, we had the support of Bank Negara.

If you market sukuk issuance well enough and engage with investors you can get finer pricing and, in this case, we did so. The size and tenor of that sukuk was unheard of in Singapore and it has proven a point. In 2015, it will be the first maturity of the first tranche and investors have already started to ask about a repeat issue because they need to replenish. So it is doable, but we will have to take bold steps to ensure this process keeps moving forward.

AN, EY: So, we need to take bold steps. Cagamas, the National Mortgage Corporation, an institution that has been promoting growth and facilitating liquidity in the secondary mortgage market for many years and has great potential for the IF industry in Malaysia, but also globally. All eyes are on you.

Chung Chee Leong, Cagamas: In the last 27 years, we have only issued in Malaysian Ringgit, whether it be conventional bonds or sukuk. Our first sukuk issuance was in 1994 and, since then, we have issued sukuk totalling RM43 billion; this included the first Islamic residential mortgage-backed securities. Currently, we are seeing greater demand for sukuk issuance and the pricing has compressed simply because there is a bigger investor base looking at sukuk.

"Sukuk structure should be guided by an understanding of the issuers' needs and through interaction with investors"

Moving forward, we are looking at embarking on a multi-currency programme for both conventional and Islamic finance. The US$2.5 billion conventional programme has already been approved by the various authorities and we also expect the US$2.5 billion sukuk programme to be completed very soon.

Even though we have huge local demand, we want to move into the international market not only to diversify the investor base, but also to mitigate our over-reliance on a single benchmark for pricing. At this moment, we rely solely on the Malaysian Government Securities (MGS) and we need to look at our diversity in terms of measuring our issuance against different yield curves and other issuances.

Generally speaking, to forward the IF agenda, nationally and internationally, the industry's human capital must understand the needs of the various institutions to a greater extent in order to structure the sukuk better. Sukuk structure should be guided by an understanding of the issuers' needs and through interaction with investors. Clearly, different types of investors have different perspectives and requirements. For example, GCC investors may be very focused on Sharia compliance, whilst other Asian investors may be more concerned with the issuing organisation or yield differential.

For Cagamas, the choice of whether to issue conventional bonds or sukuk depends on the underlying assets we are purchasing. For example, if we are purchasing a portfolio of Islamic financing from an Islamic Bank, we have to issue sukuk. It is not dictated by choice or pricing.

Moving forward, in terms of Cagamas' role, if there are sufficient assets to be purchased, the plan would be to continue developing the bond market, as well as the sukuk market. Furthermore, over the years, we have come up with various new structures to stimulate the sukuk market, which have evolved over time to meet the demands and requirements of investors. I see this continuing.

AN, EY: Angelia, you are from an asset management background and you talk to a lot of investors. How do you see this mainstreaming potential of IF, in terms of the opportunities and challenges, from a global banking, asset management perspective?

Angelia Chin-Sharpe, BNP Paribas Investment Partners: Most of the money we manage is for global institutional investors and their key requirements are investment grade issuance and ratings. With Khazanah moving to issue dim sum bonds, as well as Singapore dollar sukuk, and potentially Turkish lira sukuk, it will provide further encouragement to global corporations, as well as Sovereign Wealth Funds (SWFs), to start looking at IF fundraising opportunities. It is an excellent development

Chung Chee Leong
President and
Chief Executive Officer
Cagamas

Angelia Chin-Sharpe
Chief Executive Officer
BNP Paribas Investment Partners

and I think, with the right pricing, we will be able to see more of these kinds of issuance coming up in the market.

In the global sukuk market, we are seeing further concentration between Malaysia and the GCC markets. However, most of the issuance in Malaysia are still domestic, rather than global, so as the IF industry internationalises and increases its interactions with global institutions, like central banks and global pension funds, there will be greater demand for U.S. dollar issuance, which must be met.

> *"It is likely that we will see more global issuance. This will help to create more depth in the market, and increase the liquidity"*

Thus, it is fantastic that international finance hubs like London and Hong Kong are issuing their first sukuk. This is what we need to see and, as a consequence of the London issuance, it is likely that we will see more global issuance. This will help to create more depth in the market, and increase the liquidity and the opportunities for asset managers, like us, to manage risk and diversification within the portfolio of our clients.

BAG, CIMB Islamic: In terms of this idea of mainstreaming, IF in Malaysia is already mainstream. Clearly, you have to split the different segments of the market to get the full picture, but as far as the Islamic capital market sector is concerned it is fully mainstream; sukuk issuance is bigger than conventional bonds. In the consumer segment, the market share is about 21 per cent and that does not include the Development Financial Institutions (DFIs) in Malaysia, which are either already 100 per cent Sharia-compliant or are currently converting and would raise the market share to 25 per cent. Over the next few years Islamic banking will certainly increase its market share.

The conservative estimate from the Malaysian Central Bank is that IF penetration will reach 40 per cent by 2020. This will occur if we carry on business as usual, throw the product in the market and don't shout about it. Thus, IF is mainstreaming on its own and it is happening purely on a commercial basis, as there is no other incentive for banks to do IF in the consumer space.

However, the agenda of mainstreaming is very critical to develop outside of Malaysia. These other jurisdictions have IF, but it is fairly superficial in most areas. Many foreign institutions are implementing platforms from a product perspective in these jurisdictions, rather than a business perspective. Therefore, if the product is not making a good enough return on equity (ROE) or assets (ROA), they simply drop the product offering and that is the end of IF in that particular institution or, even worse, the end of the offering in the particular jurisdiction.

To me, mainstreaming means you have to look at IF beyond the product. Each product will go through a cycle and there will be ups and downs. Accordingly, when one product does not deliver as much, another product becomes more popular and covers the shortfall in revenue. However, it is important to remember that the one that drops in revenue is still bringing in the clients whom you can cross-sell. The moment you approach it from solely a product basis, you cannot see the full ecosystem that IF can offer.

RT, Gatehouse Bank: To my mind, the problem this creates is that, if you have sustainable domestic business and you achieve 40 per cent Sharia-compliant business, it will affect your international and regional competitiveness, as a company, if the countries around you are not themselves developing the ability to interact in this manner. I think that will surely drive the need to engage internationally, even if you are successful domestically.

BAG, CIMB Islamic: We have been implementing this kind of engagement since the 1980s to foster the development of IF in other markets. In many jurisdictions we helped build IF from scratch; in fact, we wrote the law for them. It is naturally in our interest to make sure that other jurisdictions are very successful. We need to have counterparties if we are to have cross-border engagement or do business internationally.

RTM, Hong Leong Islamic Bank: It is difficult. We have, literally, invited other jurisdictions to 'copy paste' our own product manuals, just to move this forward.

However, you have to appreciate the distinct political landscapes and also the cultural aversions.

When I was working with Bank Negara, significant work was done with Korea to bring the IF agenda along. However, it was rejected in the courts because, culturally, the people were not comfortable. A similar situation occurred in France, and in Hong Kong it took 10 years to pass the law relating to sukuk law and even then it was extremely proscriptive – excluding the practice of any other part of IF other than sukuk.

DVA, INCIEF: Malaysia relishes competition in IF because it needs places to go and to expand. However, seven or eight years ago there were too many market actors trying to just parachute the Malaysian model into other jurisdictions.

Luckily, there were good thinkers who realised it requires more that just a parachuted-in model to sustain a new market; you have to understand the model already in existence and adapt accordingly. INCEIF also works on an education and awareness platform, so we get asked for advice relating to our experience in setting up IF education. In the last 12 months, we have been in Turkey and Kenya, working with the central banks and the regulatory authorities, and in Senegal, with the West African Economic Monetary Union, to help set up initiatives.

"It requires more that just a parachuted-in model to sustain a new market; you have to understand the model already in existence and adapt accordingly"

All of this is indicative that the IF world is advancing. There are some very good things in the Malaysian model, but new markets want a model which uses the best part of it, whilst simultaneously helping them to understand the aspects that need adapting. The persistence is there and Malaysia will continue to lead the way.

AN, EY: Hearing those comments, I want to bring an outside perspective. I would characterise the Malaysian effort to internationalise Islamic finance by highlighting the tremendous work of Bank Negara, which is everywhere, and the great presence and visibility in different markets from the infrastructure institutions. My question is, beyond sukuk: why is it that 'Brand Malaysia' is not as visible in the top 15 Islamic banks as some of the 'multi-domestic' GCC banks? Where is 'Brand Malaysia' in that private sector space?

RTM, Hong Leong Islamic Bank: From Hong Leong Islamic's perspective, when you talk about presence in a multi-domestic capacity, essentially that means having a presence in the GCC. Of course, we assessed this option, but they are very small markets, so the decision not to go is largely a commercial one. For me, the more interesting opportunity is the ASEAN countries and the rest of Asia, but, again, we cannot expand into these markets for regulatory reasons. Even in Indonesia, where we have an Islamic presence, you are not allowed to use the conventional parent branch infrastructure freely, as we can in Malaysia.

You talk about 'Brand Malaysia', but when you want to export something commercially it has to be commercially viable. The GCC Islamic banks have gone to markets where this is not the case. Kuwait Finance House (KFH) was in Turkey for a very long time before they could put their money anywhere because the Turkish government did not issue its first sovereign sukuk until 2012. Instead they had to place their money with the foreign banks, like HSBC and Citibank, in murabaha placements. It certainly was not a money-spinner, but I assume, for KFH, there was an element of what Khazanah is trying to do in terms of creating a pathway. You ask about the private sector, but it is very different. It has to be commercially driven.

AN, EY: So, essentially, what you are saying is that conventional markets do not have the regulatory infrastructure and more populous Muslim countries, like Indonesia, Egypt, Turkey, Pakistan and Bangladesh have political issues or economic issues which prevent entry being commercially viable.

BAG, CIMB Islamic: Malaysia did the right thing in being very focussed on building and developing the national

Daud Vicary Abdullah
President and
Chief Executive Officer
INCEIF

Prof. Rifaat Ahmed Abdel Karim
Chief Executive Officer
International Islamic Liquidity Management Corporation

market and putting in place all the necessary parts of the IF ecosystem before considering the internationalisation of the business.

New markets or IF jurisdictions do not have the luxury of building a domestic market before being forced to consider internationalisation because of the growth of the industry in the global market, but, to my mind, they must be given the space to develop their domestic market with a focus on establishing the right ecosystem. If not, they may be handicapped in their capacity to do business.

For example, CIMB Islamic was the last bank to undertake Islamic banking balance sheet business in Malaysia because the ecosystem was incomplete. In 2002, there was no formal Islamic derivative market in existence, so we could not manage our risk effectively and efficiently. Consequently, we focussed on actually building a formal Islamic derivative market, which took four years, and only then, in 2006, did we go into the market aggressively, becoming one of the fastest growing Islamic banks by balance sheet between 2006 and 2011.

From CIMB Islamic's perspective, before we could even consider going into other markets, like Indonesia, Singapore or the UK, to do balance sheet business, we would want an adequate ecosystem to be present. So, when you ask where 'Brand Malaysia' is in the private sector space, my answer is that I will not bring 'Brand Malaysia' to other markets if a complete ecosystem for IF is not available there for me to do business in a commercially viable manner.

RAAK, IILM: We have to continue to concentrate on the framework, so we can achieve growth in the IF industry and sustain that growth. I think the answer relates to initiatives, whether these are taken by regulators in individual countries, at the infrastructure level, or even at the national level, like INCEIF and Cagamas.

In Malaysia, initiatives to form national institutions have made a significant contribution to the growth of Islamic banking and even conventional banking. For example, Cagamas has provided a mechanism for banks to offload receivables from their balance sheets by buying those receivables, securitising them and selling them as sukuk. This has helped the fundamental development of the IF market, in this particular case regarding the sale of debt.

Another example is the initiative by Bank Negara Malaysia to establish one single Sharia committee at the central bank level. I believe the purpose was to give the financial industry a greater sense of certainty, as it was echoed by many respectable international organisations. Indeed, enabling regulatory initiatives seems to have ensured the growth of IF and attracted others to come to this country and do business. These kind of actions have enhanced Malaysia's competitive advantage and helped it to remain at the leading edge. It has also encouraged market players to embrace IF.

An enabling climate is an important factor to achieve success and has ensured those nations that have fostered these environments have gained competitive advantage. The nations that did not embrace these kinds of initiatives seem to be in decline. This is a very important lesson to remember.

RTM, Hong Leong Islamic Bank: I would say Malaysia's one defining initiative is the introduction of the Islamic interbank money market. The lack of such a market in the GCC markets meant we could not operate in those markets. We had money, but we did not have anyone to give it to, we had no one to borrow from and we became expensive. This is the one aspect that all Islamic markets must embrace, especially the UK.

RT, Gatehouse Bank: Touching on that point, in my view, the biggest single risk for Islamic banks relates to where the control of the payment system lies. In the UK, when a money centre bank pulled out of Sharia-compliant nostro relationships with Islamic banks, they shut nostro relations accounts down and we had to act quickly to avoid a significant nostro risk. Standard Chartered was there, but now, after Standard Chartered, the choice for compliant solutions is severely limited.

You are absolutely right about the importance of the interbank market, but that will only succeed when it has a payment system. The question remains how IF, on a global scale, can create a global payment system that supports it. One of the few negatives of a multi-domestic business is the difficulty in building an

Heri Akhyar
Vice President of Investor Relations
Garuda Indonesia

international payment system upon it. Therefore, the industry will always be in the hands of somebody else and that is an incredibly big risk.

AN, EY: There is also a serious risk that, with all the sanctions and penalties that are being meted out as a result of the step up in supervision stemming from the financial crisis, conventional banks are actually pulling out of IF markets. Some international banks have refused to do business with some of the larger Islamic banks because they are not willing to take the risk at the moment.

DVA, INCIEF: We are getting closer to that reality. If you are looking at this from a global financial stability perspective, as Richard noted, Standard Chartered is the only Sharia-compliant bank and without them there would be a very significant problem. Essentially, the Islamic stand-alone banks would shut and we would just be left with Islamic window banks.

ACS, BNP Paribas Investment Partners: This issue affects our asset management business as well. When we trade with counterparties, official institutions have minimum requirements regarding the institutions with whom we trade. There have been incidents relating to the jurisdiction of our client's institution because some international banks are not willing to take on board the client for us and that means we cannot trade. It is difficult.

RTM, Hong Leong Islamic Bank: I think this all comes back to the importance of the UK taking up the IF torch on a grander scale. If some of the UK's national debt was moved in this direction, you would start to see the whole benchmark yield curve in effect. Clearly, it is a Bank of England decision, but it would really make a difference because the big banks are all British.

RT, Gatehouse Bank: Now the UK government have issued sukuk, the genie is out of the bottle and more will inevitably come. Currently, the UK Treasury and the Foreign and Commonwealth Office are working hard to encourage the infrastructure and green sukuk-related business, which is government backed.

Gatehouse Bank is completing the first phase of our national housing PRS programme, which is also UK government-backed. The UK is making very big strides very quickly, it may not be that evident, but it is happening. Moreover, at least three of the UK's six Islamic banks are profitable, which is a good sign.

AN, EY: I want to return to Malaysia and talk about the users of IF. I asked a taxi driver here, a non-Muslim, about IF. He had heard of the term and knew that it was available, but his perception was that IF was the same as conventional finance under a different name.

So, the question is whether the current template in place is sustainable, beyond the market share perspective? Is the model meeting its objectives or is a change required?

RTM, Hong Leong Islamic Bank: I think it is sustainable. The governor of Bank Negara Malaysia has highlighted the need to move from a credit intermediation market to an investment intermediation market. That is crucial, but it is an evolution as the market matures, not a replacement of the model.

In terms of the 'taxi driver question', conventional banking is so ingrained in collective perception that it is difficult to sell 'different' products that are not fully understood by the consumer, as they will not buy them. There are accusations of IF using conventional products and wrapping around them, but in some ways the pit was by design. For example, selling IF products to Malaysians who do not speak Arabic or understand sharika or murabaha is very hard. In fact, we have dropped all the Arabic names from our products.

DVA, INCIEF: I think it is about posing the question: why not Islamic Finance? It is about creating that awareness. I do not think we have to change the template. We have to increase the intensity, but it is not about trying to explain the intricacies of how Riba works, but rather showing why IF is good for business; how it helps the liquidity profile of your client; or how it helps their risk management profile, for example. We should focus on communicating the value proposition to the broader world and demonstrate it. It then becomes reasonably straightforward.


BAG, CIMB Islamic: Islamic banks in Malaysia have always approached Islamic finance from a purely commercial perspective, the religious element goes without saying. We have been very focussed about that. It is the conventional banking industry that keeps suggesting to the market at large that IF is the same as conventional finance because it is the only way they can push IF's competitive value proposition back.

AN, EY: In Turkey, they are calling it 'participation banking' to give it more mainstream appeal. Is there any discussion underway in Malaysia regarding keeping or dropping the term 'Islamic' from the title?

RTM, Hong Leong Islamic Bank: No, there is no initiative to rebrand. Sophisticated users, like Khazanah, clearly understand how it works, but in the retail market it is very different. However, Hong Leong Islamic has 50 per cent more non-Muslims buying our mortgages. The reason for this is that Malaysian Chinese are largely investors who trade heavily in properties and they know they do not have to pay a penalty for early redemption on Islamic mortgages. Under Sharia law, we cannot penalise them like the conventional banks. So, I get the buy-in.

AN, EY: That is very interesting because in many of the conventional markets the word 'Islamic' immediately creates a psychological barrier. Then you have to explain and justify before you start talking business. Perhaps the model should follow the example of companies like Emirates or Al Jazeera, who respect the culture, but do not explicitly refer to the Islamic nature of the business. They compete purely on the quality of service: for example, Emirates serves halal food on flights, which everyone enjoys and so no one is bothered.

RTM, Hong Leong Islamic Bank: I think there should be substance over form. It is true the word 'Islamic' does not sit well in some jurisdictions. You have to sell the philosophy behind it and the inherent participatory nature. Interestingly, the China Banking Regulatory Commission (CBRC) has set up a committee to look at alternative banking models in order to avoid the problems that lead to the financial crisis. The CBRC engaged Hong Leong Bank because we have a branch in Chengdu and I now have a team of Sharia scholars who are assisting the Chinese government in launching what they call a 'leasing house'. We advised them not to call it Sharia-compliant banking or ijara and our scholars set out that the basis of the structure for Muslims is riba-free, which is what we try to promote. So, the result is an institution largely based on the principles of ijara – zero interest. Clearly, there is appeal for these kinds of structures.

DVA, INCIEF: When I am in London I spend more time in heated discussion with fellow Muslims on the justification for IF than I do talking about the value propositions with non-Muslims. Part of the problem is that non-Muslims considering using IF notice that there are significant differences of opinion regarding what is correct in terms of Sharia justification. You get this complete distortion of the reality and the people who you want to persuade in terms of creating awareness are dissuaded because of this level of uncertainty. I have had this experience all over the world.

ACS, BNP Paribas Investment Partners: From an asset management perspective, in order to show the opportunities in Islamic asset management and promote the Islamic process to our colleagues working in other markets, we first needed to help them understand how we actually make the investments. Then they see there is no real difference from managing conventional portfolio, apart from the selection of securities and, maybe, the financial universe, so to speak. Importantly, we need to demonstrate the performance we can contribute, even with this rather smaller universe.

After eight years of trying to promote that with the global sales force, this year I am gaining traction with colleagues in Europe and the Middle East. I think this is partly due to the global financial crisis, and the resilience the sukuk market showed during that time. With global bond yields at negligible levels, investors are seeing opportunities in the sukuk market to get better yields and improve their portfolio diversification as, essentially, you can see it as another asset class.

CCL, Cagamas: Recently, we have had some interactions with fund managers in a number of non-Muslim financial centres. We found that although they had some

mandates for sukuk in the market, they reported that the demand is not really there. When we dug deeper, we found the reason was the complexity: essentially, investors do not understand the instruments. As such, there is a need to create awareness and understanding.

Now that the Hong Kong and UK governments have issued their first sukuk, corporate entities will be able to evaluate the sukuk structures and gain a better understanding, which should translate into more demand. Another reason for this lack of demand is that there are not adequate sukuk benchmark indices, unlike in the conventional market. The creation of more benchmarks to measure performance of investment portfolios would help spur the sukuk market forward.

AN, EY: That seems like a cue to move on to Islamic capital markets and, more specifically, debt capital markets. The sukuk market has been the darling of the media, as well as the IF industry, and this love affair looks like it will continue for a good few years.

"The creation of more benchmarks to measure performance of investment portfolios would help spur the sukuk market forward"

However, recently, a number of studies have highlighted significant issues relating to the supply side. Part of the problem here is that, by some estimates, demand is four times greater than supply and, clearly, this gap must be narrowed. Malaysia is a leader when it comes to the Islamic debt capital market, so my question is: what is the next frontier for this market and how do we arrive there? Professor Rifaat, could you outline the IILM platform?

RAAK, IILM: I think it is important that we diversify the available products. Until recently, only long-term sukuk have existed in the market. As a consequence, it was a challenge to lay the groundwork for our first short-term sukuk in 2013. The market needs to be made aware of these types of instruments. There are important differences between long- and short-term sukuk and, during the preparation for our inaugural issuance, we realised that most users assumed that sukuk were only long-term. Indeed, there was a severe dearth of understanding of short-term instruments. This must change.

The IILM has adapted the financial technology of Asset Backed Commercial Papers Program to the specificities of IF. Currently, this kind of financial technology is hardly used in emerging markets. However, this was not achieved without having to overcome challenges. For example, it was challenging to have and maintain the human resources that possess the necessary expertise to offer these products. Moreover, there are a catalogue of other products and instruments that must be rolled out to ensure the development of the IF capital markets.

It will require an impetus and concerted effort from the sector to generate a wider acceptance for these products. For example, if a product has been widely booked it indicates a broad approval from a Sharia perspective, which will aid take-up.

CCL, Cagamas: In Malaysia, Cagamas has already issued Islamic commercial paper (ICP) in Ringgit in order to allow Islamic banks to hedge their position for liquidity purposes. This ICP has been available since 2007 and, similarly, we have developed variable rate types of instruments, like variable rate sukuk Commodity Murabaha, which can be re-priced every three months to further meet the needs of Islamic banks. Clearly, there is still more that can be done in terms of product innovation, but we will be driven by the market in this area.

In terms of frontiers for Malaysia, it is very important that we increase our efforts to attract foreign funds to invest in Malaysian government Islamic papers. Of course, the last 10 years have seen a large increase in investors from the GCC and elsewhere, but if you compare the foreign participation in Malaysian Government Securities (MGS) to the Government Investment Issues (GII), the Islamic equivalent of MGS, it differs greatly – 48 per cent as opposed to 3 per cent. Similarly, the yield for GII is about 10 to 30 basis points higher than MGS.

There are many reasons for this, but the main one is certainly related to index inclusion. Investors need to

benchmark their portfolio and GII are not included in a few important indices of which MGS is a component. Accordingly, it would certainly make a difference if GII were to be included in the Citibank World Government Bond Index, for example. However, GII may need to be rebranded to really improve this situation. The name GII does not automatically create an association with Malaysian government securities or indicate it has an IF component; perhaps it could be rebranded as MGS-I, for example, to reinforce the connection and increase demand from foreign investors.

At the moment, outstanding debt from MGS in the market is about RM300 billion and from GII it is about RM200 billion, a difference of RM100 billion. In view of that, the need for rebranding is further amplified if we overlay the foreign participation, as I highlighted previously.

AN, EY: Khazanah has been a trailblazer in the sukuk market and the Islamic debt capital market, but now others are catching up, what is the next game-changing initiative that you are looking for?

MIG, Khazanah Nasional: We have a few principles when we use sukuk. One of which is that we will do it in the currency in which we invest, whether it be the renminbi or Singapore dollars or whichever. Recently I have been thinking seriously about a Turkish lira sukuk. We have assets in the country, so it is quite natural for us to undertake this in terms of matching the assets and the liabilities. However, the current environment there is not quite conducive, so we will continue to monitor market conditions.

In a way, we use the details to push the boundary a little bit. We priced our exchangeable U.S. dollar sukuk in September and, if you remember, we looked to do a five-year sukuk with no put, but for investors that is pushing too hard. So, to soften the terms slightly, we agreed internally to do seven years with a put for investors after four. With those terms, we were able to finalise the deal and get what we wanted in terms of a zero coupon, negative yield, and the size of US$500 million minimum.

Thus, we are pushing certain key principles, so we can achieve our goals and move forward. However, the climate has to be conducive to progress and that is true for development inside and outside of Malaysia. For us, to go outside Malaysia, the target market must be ready to accommodate our requirements. Patently, we are commercial entities and returns are very important. If they are serious about it, they must prepare the ground and then we can play our role as well.

HA, Garuda Indonesia: From Indonesia's perspective, in terms of the role of Sharia-compliant products in the market, the government has done a lot of things to lay a foundation, but it is not yet enough. It takes a significant amount of effort to educate corporations in this area and it takes time; notwithstanding, IF is very popular in Indonesia currently and we have the same kind of ecosystem surrounding the market. However, when we come to the domestic fundraising, of course Sharia is there, but I think there is less clarity regarding its application. Furthermore, as we discussed previously, Garuda raised finance through Islamic means last year, but there is significant complexity behind this choice relating to Indonesia being the jurisdiction and other issues like currency and interest options – Indonesian IDR interest is very costly compared to other denominations.

"As IF use increases, it will stimulate a snowball effect, but this will be a gradual process"

On top of that, I think part of the problem is that market actors do not know where to start. From my point of view, it all comes back to education. It is vitally important that the population, the market and, particularly, the corporations gain a more complete understanding of this sphere. I am sure that many of my peers working for other corporations have not used this kind of financing. Thus, as IF use increases, it will stimulate a snowball effect, but this will be a gradual process.

AN, EY: OK, from Malaysia's perspective, what would be the definition of success in terms of Islamic capital markets, let's say in five years time?

RTM, Hong Leong Islamic Bank: We need to create an environment where foreign issuers can receive the same kind of competitive pricing that they can get outside. Currently, domestic issuances achieve better pricing because the issuers are known to domestic investors and foreign issuers, regardless of their name outside, always tend to have a premium put on their issuance because they are unknown. This certainly dissuades foreign investors from coming.

We therefore need to bring foreign investors here, so that we really become a marketplace in that we have both foreign and domestic investors and foreign and domestic issuers operating within the market.

ACS, BNP Paribas Investment Partners: I agree. Attracting foreign investors is a problem that we have faced in terms of managing the sukuk market. In fact, this year has been quite challenging for us because, even though we have the funds to buy, there is not enough foreign paper available in the market. Moreover, liquidity is an issue.

In terms of the global Islamic assets that BNP Paribas Investment Partners manage, almost 80 per cent of these assets are actually owned by Malaysian clients. This comes back to the fact that there is not enough push from other Organisation of Islamic Cooperation (OIC) countries to provide the Sharia mandate for Sharia investable assets. If this occurs and there is an increase in these kinds of assets available for management, it will help develop the Islamic capital market.

The development of the Islamic capital market will ensure an increase in innovation, enhanced liquidity and we will also see more issuances from other countries. Additionally, if we have respected, legitimate institutions providing this kind of mandate, other market actors will be confident the market is there for this kind of paper. Thus, you will see important corporate entities and SWFs starting to look at issuing, which will also help the pricing concerns previously mentioned.

BAG, CIMB Islamic: Looking at the broader view, the biggest challenge for Malaysia's IF industry is to build the full ecosystem for the non-ringgit IF business. That is to say, whatever we have delivered in the domestic market we need to replicate for the international market. As has been posited, we need to cultivate a large, robust investor base and provide non-ringgit investable assets. Additionally, we must encourage and foster a space in which intermediaries and advisors can come and facilitate these kinds of activities, not only banks, but also lawyers, accountants and tax advisers, for example. Lastly, we must galvanise corporate entities and high net-worth individuals so they are prepared to get involved and do business in, through and out of Malaysia.

> *"The biggest challenge for Malaysia's IF industry is to build the full ecosystem for the non-ringgit IF business"*

This is the ecosystem we require and it has been developing well in the last few years. Whatever problems we are currently facing are actually good problems because identified problems require solutions and when the solutions are implemented it will bring us closer to our goal.

RT, Gatehouse Bank: From a UK perspective, we have seen a huge increase in bilateral business between Malaysia and the United Kingdom in the last three years. Clearly, we have benchmarked examples like the redevelopment of Battersea Power Station, but there are dozens of other similar investment initiatives going on in a number of sectors.

As a result, there has been a rise in the number of Malaysian institutions now active cross-border in the UK and this will bring both asset and liability opportunities for which Malaysian Islamic banks can act as intermediaries. Furthermore, the SWFs who have been buying and financing commercial real estate in the UK will have a tremendous opportunity to turn what is currently debt bank finance into sukuk.

Gatehouse Bank regularly issues small, unrated sukuk backing our real estate business, which we place privately in the private wealth management market (PWM). This market will certainly grow in Malaysia and as it does so the possibilities to place sukuk privately, without some of the constraints discussed today, will

undoubtedly be augmented. Thus, there is an inevitable connection with London in terms of capital markets and an inevitable growth and depth of the Malaysian capital market. What still remains to be seen is whether the Malaysian market can absorb this upsurge in volume.

In order to fully capitalise on the opportunities here, Malaysia must find a sustainable way of creating an international capital market linked with London, Dubai or Shanghai, or even a combination of all three. Creating an international capital market with an international currency, like the renminbi for example, has great potential and would help sustainability.

DVA, INCIEF: I think there are many reasons to be optimistic, but it is realism we need, rather than optimism. Malaysia is well-positioned, it has the infrastructure in place and there is a wealth of exceptionally talented people at all levels working for Malaysia's IF goals.

> *"Malaysia must find a sustainable way of creating an international capital market linked with London, Dubai or Shanghai"*

In terms of challenges, looking at the situation from an education perspective, which can often lead the way, there is no doubt that research drives us towards thought leadership and innovation, which is incredibly important. However, we must ensure we are producing the people to keep the industry going. Therefore, it is vital that INCEIF continues to receive intellectual and business-related support from IF thought leaders from all over the globe: discussing ideas, probing us, goading us, and helping us devise the strategy.

As we grow a greater and more international alumni base, who have been educated to a high standard, we will begin to see these influences in other countries. We have a solid platform from which we can grow and develop, but it needs to be on the basis of sustainability and quality, rather than just sheer volume.

ACS, BNP Paribas Investment Partners: It is certainly very tough to move the industry forward, but you have to keep going. Certainly, Sharia assets are a smaller part of our larger conventional assets. We need to demonstrate the opportunities provided by current Sharia assets to our management to get the necessary support to develop new Sharia products.

AN, EY: I will second that point. Selling the IF story is not easy and many times it revolves around a few individuals. However, once the idea gets rooted in an important multinational, such as an EY or another large consultancy, the impact is huge because there it provides the global presence and the credibility in the market necessary to encourage much greater development.

DVA, INCIEF: That is the differentiator. When I tried to set up a Global Centre of Excellence for IF at Deloitte in 2002, it was rejected four times. I had to fly to New York to present to the managing Board at my own expense and convince them it was good for business. It is persistence, passion and knowledge that make the difference. Moreover, we must not lose the collective knowledge that has been built up through the years. We have to document it and take it into case studies to further the development of the industry.

RAAK, IILM: In the Malaysian Central Bank's year 2000 annual report there was only one paragraph on Islamic banking, but in the latest report there is a whole chapter. That shows you the progress; it is evidence of how far we have come. Now, there are a huge number of aspects of Islamic finance, all of which require investigation, research and dialogue. I agree with Daud in that development has largely been due to perseverance and that must be continued.

AN, EY: OK, I would like to thank all participants for their input and frank opinions today. Every time I come to Malaysia and engage with the industry at large, I am always pleasantly surprised in terms of the aura and the momentum that is here. At times, I think more should be done to take the 'Brand Malaysia' story outside the country. A lot of information about these successes, and consequently the prestige, stays within Malaysia. There is great potential to disseminate what has occurred here to further the global development of Islamic Finance.

JASEEM AHMED

ISLAMIC FINANCIAL SERVICES BOARD (IFSB)

Secretary-General

INTERNATIONAL INVESTOR: How has the IFSB developed its role in relation to global financial stability in the IF space?

JASEEM AHMED: The IFSB was established in 2003 to promote the stability and resilience of the global Islamic financial services industry through the issuance of standards for prudential regulation and supervision of Islamic finance (IF). According to our mandate, those standards must be benchmarked against existing standards, whilst also recognising the specificities of IF. This requires a close working relationship with global counterparts, such as the Basel Committee on Banking Supervision (BCBS), the International Organisation of Securities Commission (IOSCO) and the International Association of Insurance Supervisors (IAIS).

Additionally, we promote cooperation and awareness about stability and resilience issues in IF on an international level. This is underpinned by the yearly IFSB Summit, during which regulators, thought leaders and practitioners are brought together and we announce the core results of our annual Stability Report. We also conduct surveys to assess the progress and implementation of our standards and to identify pertinent challenges. So far, the results have shown that regulators and policymakers are becoming increasingly aware they must adopt IFSB standards in a more proactive way.

As a result of the global financial crisis and the subsequent introduction of the Basel III Capital and Liquidity Framework, we had to develop an additional work programme to address our concerns that this industry-defining, global framework may have ramifications for IF. Thus, we outlined a set of IFSB standards to level the playing field for IF institutions in relation to Basel III.

Can IF potentially minimise the impact of economic crises?

In an ideal world, IF institutions operate using principles that stipulate their instruments must be directly linked to the real economy, there should be a one-to-one correspondence between the funding and liability side on the one hand, and the real assets they support on the other. A contraction in asset values will be closely related to a contraction of liabilities. Thus, an Islamic economic system certainly has the potential to insulate the wider economy from crises, especially of the type that we have seen in which highly indebted over-leveraged banks have seen their asset values wiped out.

Regarding the recent global financial crisis, Sharia principles actually led to an avoidance of toxic assets and protected Islamic banks from a major contributor to the collapse. Moreover, Islamic banks usually have a high ratio of core equity, so they are inherently more loss-absorbent. However, many lack a comprehensive risk management framework that is integrated with bank-wide risk management capabilities and linked to stress-testing structures. These things are happening, but it is a work in progress.

> ***CAREER DEFINING MOMENT***
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> *In 2003, I was sent to Thailand on a difficult assignment to open a new office for the Asian Development Bank, which had announced its opening in 1998. In order to successfully implement policy you must understand the importance of process and come up with a solution that considers the different perspectives on the issue. We obtained the approval to open in 2004.*
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> ***LESSON IN BUSINESS***
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> *In modern business, the 'command and control' framework that previously held sway in terms of employee management is no longer relevant. As a leader, my role is to protect my staff from stress and not pass it down. Accountability is important, of course, but you hold your staff to the fire, only because you hold yourself to the fire on their account. This facilitates a more productive work environment.*

What are your thoughts on liquidity management and Islamic interbank markets?

Interbank markets are absolutely vital in providing liquidity to banks and assisting the regulator in its monetary policy operations. Globally speaking, compared to the conventional sphere, the IF industry is still some way from developing deep interbank markets and they are difficult to establish on similar principles due to Sharia prohibitions on the use of interest rates. However, Malaysia is leading the way in this area with a deep and liquid Sharia-compliant market and also secondary trading on Sharia-compliant securities. Other countries, especially in the Gulf, are also making inroads.

The IFSB established a taskforce to address this challenge culminating in a technical note on liquidity management. We posited that governments should assist the private sector in developing Sharia-compliant financing instruments or securities that can be integrated into the public expenditure framework for the purpose of short-term liquidity management. In conventional markets, governments have played a crucial role providing financing instruments for the corporate sector and allowing the development of a yield curve, which facilitates capital market growth. We want to see something similar in IF.

Can the principles that underpin IF help to expedite broader global take-up?

The sector is still in early stage development, so there is tremendous scope for further progress. There is certainly potential for significant overlap between the governing principles of IF and the surging interest in sustainable practices and investments in the non-Muslim world. However, there is a relative scarcity of instruments that can satisfy their sustainable, green or ethical requirements.

Concrete actions are already being taken across the globe in this vein. For example, the World Bank has recently managed the issuance of a sukuk for the International Finance Facility for Immunisation (IFFIm), which was an example of innovative financing that is Sharia-compliant and directed towards a global public good.

Furthermore, the idea that investments must be screened to ensure they do not contradict the principles of Sharia is fundamental to IF, which is a strength of this approach. The next stage is to implement additional layers of screening and consider how we can build goals that relate to climate change or social development, for instance, into these financing structures.

PROF. RIFAAT AHMED ABDEL KARIM

INTERNATIONAL ISLAMIC LIQUIDITY MANAGEMENT CORPORATION (IILM)

Chief Executive Officer

INTERNATIONAL INVESTOR: Could you outline the importance of the IILM in the Islamic Finance space?

PROFESSOR RIFAAT AHMED ABDEL KARIM: The IILM was established on 25 October 2010 by central banks, monetary authorities and a multilateral organisation to develop and issue short-term, high quality Sharia-compliant financial instruments denominated in international reserve currency in order to facilitate effective cross-border liquidity management for institutions that offer Islamic financial services.

I would like to posit that the IILM should already be considered a success story. It has adapted the financial technology of Asset-Backed Commercial Paper (ABCP) to the specificities of IF. Usually the ABCP is undertaken in some Western markets, but, to the best of my knowledge, it has not been used in emerging markets and certainly not in jurisdictions that host Islamic finance. Thus, this was a definate breakthrough and according to Standard & Poor's (S&P) 2015 Outlook for Islamic Finance, the IILM is a 'landmark institution'.

However, as we are bringing an advanced instrument to the industry, this type of conduit management has certain challenges. For example, you need to enlist high-level, highly skilled human capital to run it, which the IILM has done. Moreover, in the IILM's case, it had to cater to the needs of its primary dealers. In terms of credit rating, the IILM is not a rated institution; however, it has managed to obtain a rating of A-1 for its programme from S&P. This rating has enabled the IILM to issue its high quality, short-term, tradable, U.S. dollar-denominated sukuk.

In August 2013, the IILM issued its inaugural sukuk for US$490 million. The IILM only issues sukuk in international reserve currencies and, so far, in U.S. dollar denomination. From its first issuance until January 2015, the IILM has issued sukuk amounting to US$1.85 billion. However, the actual amount issued is much higher due to the reissuance of sukuk. As of January 2015, the sukuk that have been issued and reissued amount to US$7.64 billion.

IILM sukuk are the only available short-term high-quality, tradable, Sharia-compliant financial instrument that meets the Basel III high-quality liquid asset (HQLA) requirements. The only liquidity instrument comparable is the 3-month U.S. Treasury Bill, which is not Sharia-compliant, and, hence, not acceptable in IF.

Furthermore, sukuk issued by central banks are not tradable in many IF jurisdictions, as they are based on debt. The IILM sukuk are the only short-term, high-quality, Sharia-compliant financial instruments that are widely considered to be tradable.

> ***CAREER DEFINING MOMENT***
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> *The decision to concentrate on Islamic finance has fulfilled me from an academic and professional perspective. While I started my career as an academic, in 1991 I moved to AAOFI and, later, spearheaded the establishment of the IFSB and the IILM. Academically, I have published extensively in peer-reviewed journals and shared my knowledge by writing books.*
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> ***LESSON IN BUSINESS***
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> *You must show perseverance in everything that you do. What we have achieved at the IILM has been very significant to the Islamic finance industry in particular and the financial services industry in general. Though the beginning was very difficult and challenging, we had to persevere to achieve our goals and objectives i.e. to be where we are today.*

How have you been able to promote cross-border liquidity with your programme?

The IILM ABCP is meant for cross-border transactions to enhance cross-border liquidity flows. For example, a Malaysian bank would buy a financial instrument from its central bank to meet domestic liquidity requirements. However, for a cross-border transaction, the bank would need a financial instrument in an international reserve currency. In this context, the IILM would serve as a link to meet the bank's cross-border liquidity requirements.

If you want to promote cross-border investment, you have to have a currency that others can tap into. For example, if you issue sukuk in a local currency you would struggle with take-up, as the issuance would be concentrating on the domestic market only. However, if we issue sukuk in an international currency we can elicit wider acceptance from investors in various jurisdictions.

Furthermore, the short-term tenure of the IILM sukuk meets the market needs and demands, as opposed to long-term sukuk. Long-term sukuk are very unlikely to meet the Basel III HQLA requirements due to price volatility. The Islamic Development Bank (IDB), for example, issues Sharia-compliant, long-term sukuk, which has a higher rating than the IILM's sukuk programme, but its sukuk would not qualify as a HQLA.

How have you ensured your issuance is so widely accepted from a Sharia perspective?

Although the IILM has its own Sharia Board, the IILM sukuk must also be assessed by the Sharia Board of the primary dealer to enable them to buy and sell the sukuk in the IF space.

The IILM designed its asset portfolio structure in such a way that it would be widely accepted from Sharia perspective. For example, the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) standard on sukuk requires that sukuk should have a minimum asset ratio of 30 per cent tangible assets and 70 per cent financial assets. The IILM's asset portfolio level must have a minimum of 51 per cent tangible assets and 49 per cent financial assets, which is based on the Sharia ruling that was promulgated by the Islamic Fiqh Academy of the Organisation of Islamic Countries. In addition, the IILM is allowed by its governing board to only have sovereign assets to back its sukuk. As a result, the IILM sukuk are widely accepted by Islamic banks in various jurisdictions.

Why has Malaysia been so successful in promoting the growth of IF?

The country has been very committed and has taken a leadership role at the level of the central bank. There is certainly a shared vision at the top level and all leaders have shown great perseverance. Moreover, they have been very pragmatic in pushing the agenda. For example, in order to win the bids for important institutions, they have established new legislation to meet all international standards. Thus, Malaysia has shown it has the capacity to attract and host both conventional and Islamic international financial organisations.

MOHD. IZANI GHANI

KHAZANAH NASIONAL

Chief Financial Officer

INTERNATIONAL INVESTOR: What are the objectives behind Khazanah's exchangeable sukuk programme?

MOHD. IZANI GHANI: The exchangeable structure allows investors to exchange sukuk into shares after a certain period, once the stock reaches a certain target price, and allows us to fulfil certain objectives. One is as a divestment-cum-funding tool. We manage our assets by limiting our holdings in our portfolio companies, so excess holdings are divested after they reach a certain level of value creation. Accordingly, these actions allow us to plough back the money into new investments. It also helps us to realise the call by the government to reduce our non-core holdings in the government-linked companies (GLCs) and leave them in the hands of private investors.

Khazanah pioneered this structure, launching the world's first exchangeable sukuk in 2006, exchangeable into Telekom Malaysia shares. It was very well received by the investment community because it was Sharia-compliant, equity-linked and backed by Khazanah credit, essentially a new asset class for them. We have gone on to launch similar offerings in other sectors. Most recently, in September 2014, we issued a US$500 million sukuk exchangeable into Tenaga Nasional shares.

Our success in the sukuk market has provided us with some useful lessons. Primarily, you must identify the most appropriate sukuk structure because particular jurisdictions have differing interpretations of Sharia principles. To overcome this, we organise our Sharia Committee to include well-respected Islamic scholars that represent the most important jurisdictions to endorse our structure. Thus, investors can see these names and recognise our coverage of all jurisdictions, so they feel more comfortable with it.

Next, we realised the importance of spending time educating investors. In Malaysia, it is not so necessary, but in the Middle East a thorough discussion about the structure and the companies in our portfolio is required. This is true for both conventional and Islamic investors.

Finally, other front-end preparation must be carried out meticulously. For example, the stock must also be Sharia-compliant and it is not based on the activity alone. Some scholars even stipulate certain ratios, like conventional debt to market capitalisation or total assets, and in order to market the product outside of Malaysia, we must comply. So we spent a lot of time and effort getting it ready.

CAREER DEFINING MOMENT

For me, every moment spent at Khazanah is a defining one. No matter how small the task at hand, I do it with the knowledge that I am contributing to the growth of the Malaysian economy.

LESSON IN BUSINESS

The most important lesson is ensuring that you have dedicated enough time for thorough planning.

Can you elaborate on Khazanah's strategy in relation to Islamic financing?

We have opted for Islamic financing as our mainstream since 2005 and regarded conventional financing only as an alternative, the opposite of many other organisations. Our general strategy is to try to match the currency of the assets that we acquire with that of its financing. For example, in 2010, Khazanah wanted to acquire Parkway Hospital Group in Singapore. In order to do this, we had to raise Singapore dollars because the settlement was in the local currency. It is these kinds of situations that allow us to fully implement our strategy and so we decided to issue a Singapore dollar sukuk.

It was a challenge to raise the S$1.5 billion required to fund the acquisition. Another key parameter was to match the duration of the asset with the maturity date, which was relatively long at 5 to 10 years. The banks were unwilling to assist us because the product was untested, so we turned to investors in Singapore, especially insurance companies and long-dated funds. They were positive about the sukuk as they had allocations for long-tenure products and wanted to match their own assets. The sukuk had a good order size, we had fine pricing and it was a good experience. Currently, we are considering a reissue when it reaches maturity.

Our broader goal is to keep pushing the boundaries, as we did with the aforementioned sukuk. Increasing launches of long-dated assets is another step towards making the asset class more attractive to investors and completely fits with our strategy. Importantly, if other issuers follow suit, it will create much-needed depth in the market.

How else is Khazanah stimulating foreign investor participation in the Islamic finance (IF) market?

Clearly, foreign currency issuance is the best way to encourage foreign investors to look at IF. After the success of our Singapore dollar sukuk, we wanted to continue to help grow the IF industry, alongside Bank Negara and MIFC, and we saw the potential to issue other foreign-denominated sukuk. Recognising the importance of picking a stable currency, I suggested that offshore renminbi (CNH) could be a good candidate, as Khazanah has some investments in China.

Importantly, we had previously established a RM10 billion Multi-Currency Islamic Securities programme through an SPV that facilitated the process, so after conversations with investors and diligent planning, we issued our inaugural renminbi sukuk. Due to significant interest, it was upsized from CNH300 million to CNH500 million. This led the way for others to undertake these kinds of issuance.

To attract more foreign issuers to Malaysia, there has to be more effort in marketing the local IF industry. Malaysia is one of most advanced jurisdictions regarding its infrastructure and offers a complete framework for sukuk issuances. We just have to make others aware of our capabilities.

Additionally, we must encourage more participation from the private sector. We spoke earlier about educating investors on Sharia structures, but we must also include corporate leaders in this effort. If companies decide to use Sharia-compliant transactions, they expand their investor base to both conventional and Islamic investors. Moreover, research has indicated that companies can get better pricing issuing sukuk over conventional bonds. That has to be an incentive. Again, creating awareness is key in this respect.

PERSPECTIVE: THE WORLD BANK

The World Bank has successfully issued a US$500 million landmark sukuk through the International Finance Facility for Immunisation (IFFIm), and aims for further convergence of sustainable investing and Islamic finance on the global level.

The 'Vaccine Sukuk', a US$500 million, three-year issue, pays a variable profit rate and is based on the Sharia principle of murabaha

THE WORLD BANK AND ISLAMIC FINANCE

The World Bank is the world's largest multilateral development institution with the primary objectives of ending extreme poverty and promoting shared prosperity. It has 188 member countries and a lending portfolio of approximately US$150 billion. In addition to providing loans and guarantees, the World Bank supports its member governments by providing technical assistance and promoting the exchange of information among members.

Although the World Bank operates primarily as a conventional financial institution, it strongly supports the growth of Islamic finance (IF). The fundamental purpose of IF is to create more inclusive, resilient and fair financial systems as well as to expand access to finance to all – goals that are clearly in line with the objectives of the World Bank.

Equitable economic development in many countries, including in the Islamic world, is hindered by the limited access of households and small and medium-sized businesses to financial services. When individuals and businesses do not have sufficient access to credit, savings and insurance products, they are unable to achieve their wealth potential and are left economically vulnerable. As a result, both those affected parties and the economy as a whole suffer.

In some cases, people would like to access financial services, but are unable to do so because of factors such as prohibitive cost or a lack of financial institutions in the area where they live. In other cases, people affirmatively choose not to make use of the financial services that are available to them. Such a choice could be driven by a lack of trust in financial institutions or by the fact that financial services are incompatible with the person's religious or other beliefs. This latter factor explains why many Muslims around the world refrain from accessing conventional financial products. It is estimated, for example, that less than 20 per cent of approximately 1.6 billion Muslims around the globe use conventional banks.

IF promotes financial inclusion by offering Muslims the choice of financial products that are structured to comply with the tenets of Islam. There are Islamic equivalents for all major financial products, including deposits, mortgages, mutual funds and insurance. Making these products more widely available helps to foster greater economic activity and create more inclusive financial systems.

Much of the World Bank's work in IF has focused on capacity building for its member governments, including facilitating the exchange of information and best practices among its members. In addition, the World Bank has entered into or arranged a number of IF transactions. The first such transaction was in 2005 when the World Bank issued a Malaysian ringgit 760 million, five-year Islamic debt security, based on the Sharia principle of bai bithaman ajil, in the Malaysian domestic market. More recently, the World Bank arranged a landmark US$500 million sukuk for the International Finance Facility for Immunisation (IFFIm).

IFFIM'S 'VACCINE SUKUK'

The World Bank serves as the treasury manager for IFFIm, an international organisation that was established in 2006 to finance immunisation, vaccine procurement and related health system strengthening programmes in many of the poorest countries in the world. IFFIm's financial base consists of legally binding, long-dated pledges from nine sovereign donors (the United Kingdom, France, Italy, Norway, Australia, Spain, The Netherlands, Sweden and South Africa) for an aggregate nominal value of over US$6 billion. Based on the strength of these pledges, IFFIm raises funds in the international capital markets and uses the proceeds to support its life-saving work. The World Bank handles the capital markets fundraising activities under the direction of IFFIm's board of directors, as one of several treasury manager roles.

In 2014, the World Bank arranged a sukuk transaction for IFFIm. The sukuk, a US$500 million, three-year issue that pays a variable profit rate and is based on the Sharia principle of murabaha, has been referred to as a 'Vaccine Sukuk' because the proceeds will principally go towards procuring vaccines to immunise children in poor countries, through GAVI, the Vaccine Alliance. The World Bank worked with a group of joint lead managers to structure and distribute the Vaccine Sukuk that represented most of the major IF jurisdictions, including Standard Chartered Bank, Barwa Bank of Qatar, CIMB of Malaysia, National Bank of Abu Dhabi, and NCB Capital of Saudi Arabia, as well as two co-lead managers, Bank Islam Brunei Darussalam and Union National Bank of Abu Dhabi.

The transaction represented certain important landmarks for both IFFIm and the sukuk market. It was IFFIm's first venture into the IF market and first transaction sold largely to Middle Eastern and Southeast Asian investors. Previously, IFFIm's investor base was located mainly in the United States, Europe and Japan. Moreover, it was the largest debut sukuk ever issued by a supranational entity, an especially impressive achievement given that IFFIm is one of the smallest and newest supranationals in the world. Finally, it was the first international sukuk for a charitable purpose.

SUSTAINABLE INVESTING AND ISLAMIC FINANCE

'Sustainable investing' means investing money to promote activities or businesses that the investor believes promote sustainable economic growth or achieve specific social or environmental goals. Over the past decade, this investment philosophy has grown in popularity at a rapid rate. A large and growing number of individual and institutional investors, including asset managers, pension funds and university endowments, now include achieving certain social, environmental and/or corporate governance objectives as a part of their money management process. In making investment decisions, these investors overlay a qualitative analysis of a company's policies or practices in the specific area or areas of concern to the investor onto their quantitative analysis of the company's financial condition and prospects.

As a sukuk with a charitable purpose, IFFIm's Vaccine Sukuk has brought the concept of sustainable investing to the international sukuk market for the first time. While sukuk investors similarly screen their investments for qualitative factors, in their case, compliance with the tenets of Islam, they have traditionally relied on 'negative screens' in respect of the use of proceeds for a sukuk. In other words, they have required that the proceeds not be used to finance any haram activities, such as alcohol or pork production or conventional banking activities. The more positive type of screening employed by sustainable investors, who invest to try to achieve specific economic, social or environmental objectives, has not been a prominent feature of IF as yet.

IFFIm's Vaccine Sukuk, for which the proceeds go to finance a socially valuable cause, was the first transaction to bring the sustainable investing 'positive screening' philosophy to the international sukuk market. In order to build on this success, the World Bank is looking to support further convergence of sustainable investing and IF. For example, the World Bank has signed an agreement with the Dubai Supreme Council of Energy to partner together to design a funding strategy for Dubai's ambitious program of investment in climate and environmentally friendly projects. One element of this funding program may be issuance of 'green sukuk', and issuance that finance environmentally beneficial projects.

CONCLUSION

As a conventional financial institution, the World Bank recognises that it will not be a primary player in IF. However, given the complementarity of its objectives with the goals of IF, the World Bank is working to support its further development on many different fronts. Promoting information sharing and the adoption of best practices among its members as well as deepening knowledge about IF, for example through the establishment of the Global Centre for Islamic Finance in Istanbul, are all part of the World Bank's work in this area. Importantly, the institution also seeks to engage in or arrange Sharia-compliant transactions, such as the Vaccine Sukuk for IFFIm, whenever such transactions are both financially efficient and an opportunity to have a meaningful impact on the market.

➥ This feature was produced in conjunction with Michael Bennett, Head of Derivatives and Structured Finance, Capital Markets Department, World Bank. Photo credit Gavi 2012 Amira Al-Sharif

A growing number of investors now include social, environmental and corporate governance objectives as a part of their money management process

RAJA TEH MAIMUNAH

HONG LEONG ISLAMIC BANK

Managing Director and Chief Executive Officer

INTERNATIONAL INVESTOR: To begin, please outline your views on the development of Islamic Finance (IF)?

RAJA TEH MAIMUNAH: I honestly believe that if the world embraced or adopted the principles behind Islamic banking it would eliminate occurrences of recession or inflation. The concept of financing within Islam is about supporting community and performing actions to promote real economic activity.

However, certain barriers to the growth of IF have become clear. A common accusation is that IF is a wolf in sheep's clothing: that the products are only different to conventional ones in name. This is categorically false: the underlying contracts used in IF are fundamentally different when comparing product to product. However, while IF practitioners, including me, consistently expound this point, there does seem to be a certain amount of duplication and instances in which IF products are just wrapped around a pre-existing conventional offering.

Due to the complexity of the current financial system and the degree to which its design is ingrained in the global economy, combined with the current scale of IF, the industry cannot make the changes required to extricate itself from the behemoth that is conventional finance and realise the potential it has to contribute to the greater good.

For example, regarding liquidity, most Islamic banks are funded largely through conventional money markets. This is due to the difficulty in finding Islamic interbank lending or corresponding banking lines, which stems from the lack of sizeable and rated Islamic institutions. As a result, they end up dealing with the Islamic desks of global banks. This means they become price takers because they are dependent on liquidity or funds from the conventional side and negatively affects their competitiveness. When you talk about liquidity, the money is always sitting in the conventional space.

CAREER DEFINING MOMENT

I started out as an investment banker and changed to Islamic banking, which caused some scepticism. So, when I was asked to set up the Islamic Commodity Exchange on the Bursa Malaysia it was career-defining because I had gone away to learn about Islamic banking and this was my first appointment on my return. Moreover, the concept was viewed with cynicism from all sides, as we were effectively competing with the London Metal Exchange and people could not see the added value. However, it was very successful and the exchange trades about US$5 billion a day now.

LESSON IN BUSINESS

Never look at things short-term. Decisions taken with a short-term perspective will come back at you like a boomerang.

Is there enough liquidity within the Islamic financial industry to break away from the conventional space?

The problem here is related to structural issues. According to the new Basel III requirements, liquidity is measured using kappa ratios: one is the Liquidity Coverage Ratio (LCR) and another is the Net Stable Funding ratio. These ratios are generally covered by retail money, but the majority of Islamic banks in Malaysia are funded largely with wholesale money, which is not regarded as stable according to Basel III.

Moreover, globally speaking, most Islamic banks are funded through inter-bank deposits, so I would postulate that the new Basel Accord will impact a large number because, from a funding perspective, they do not have the necessary retail reach. Certainly, there must be an extensive retail expansion for most entities before there is any talk of moving towards an advanced infrastructure mechanism, like an Islamic payment system, for example.

Yet, importantly, an Islamic payment system would bring players to the market, so largely the whole idea of wanting an independent payment system is to be able to pool liquidity and allow Islamic institutions to reduce their dependence on conventional liquidity. However, a key reason why the industry does not have its own payment system is due to the lack of liquidity, so it is a vicious circle.

Nevertheless, the volume of liquidity currently available within the IF industry is not sufficient to establish a money market. Total Islamic banking assets are approximately US$1.2 trillion and, to give that some context, HSBC's banking assets are over US$2.5 trillion. So, a single global bank has over double the assets of the entire Islamic banking system.

Can you elaborate on the issues preventing the growth of the IF Industry?

We need more people to buy in at the retail level. This means the focus must be switched slightly. The industry has been concentrating on wholesale, but on the consumer side, unless a customer is moved to use services out of faith, it has to be a proposition that would really make a difference. Thus, we have to pay greater attention to product innovation.

However, the problem here relates back to my initial point. As most Islamic financial institutions are subsidiaries of conventional banks, with regard to risk management or the approval of products there is a rigidness concomitant with conventional finance that favours a product based on pre-existing options and prevents the development of innovative Islamic products. This is due to the fact that, philosophically and theoretically, they are too different for conventional practitioners to comprehend.

Whereas conventional products are based on credit or, essentially, risk transfer, Islamic banking products are based on risk-sharing. A pure musharaka does not transfer risk; it is a contract whereby the partners share the profit and loss of the business venture. Philosophically, that is the fundamental difference between conventional and Islamic banking and, because the decision-makers and the prudential regulators are all on the conventional side, it makes it very difficult for the Islamic banking industry to do things differently.

In fact, the whole concept of doing things differently has certain implications. For example, imagine how risk-sharing is viewed from a consumer perspective. If their money is not guaranteed in an Islamic bank, but is with a conventional bank and the returns are the same, the decision is straightforward. Other problems stem from the difficult balance between innovative product development and revenue concerns. In Malaysia, there is a high uptake of Islamic loans by non-Muslims because there are no penalty or redemption fees. Now, while these sorts of gems should, quite rightly, be identified and promoted as a selling point, it is problematic because, as well as upsetting the conventional parent bank, it raises difficult questions for Islamic banks regarding revenue generation.

These are very difficult conversations to undertake and, even though we are making traction, I am not sure how much further we can go, globally speaking. Personally, in order to initiate true global growth, I think Islamic banks need to divorce from their parent and go it alone as as separate institutions. The industry needs to have a debate about this. The fundamental principles of both sides differ so substantially and the Islamic banks can only go so far under a conventional parent. There is only so far the experiment will be allowed to go.

In Malaysia, steps are being taken to ensure there is a level playing field and Islamic institutions can stand alone. However, industry stakeholders must take the initiative and demonstrate the sustainability of the model. In order to do this, at least in Malaysia, Islamic banks must show they can expand outside their home jurisdiction.

What must happen to aid the expansion of Islamic Banks regionally and globally?
Global expansion is difficult, as the law in target markets must be changed to facilitate the entry of Islamic institutions. This is especially true in relation to tax laws and when you start talking about the neutralisation of tax, which is a basic requirement for the introduction of IF products, it already creates a climate of suspicion. Even in Asia Hong Leong Bank is in a number of markets that our Islamic bank cannot enter because they do not have conducive regulatory frameworks in place. You have to make a commercial justification to go to a market: if it is not a facilitative environment and it will be difficult to make money, you cannot go.

In a similar way, as open and welcoming as London has been, the UK enacted the laws and thought that would be enough, but it is not. I cannot set up an entity because I do not have the liquidity management tools. Thus, the financial infrastructure to make IF commercially viable is still not there. HSBC decided to shut down nearly its entire Amanah business and focus its Islamic operations in Malaysia because it is the only jurisdiction that is facilitating the industry and where it is possible to make money. From the perspective of a global bank, there are no other grounds. They have no vested interest. So, expansion requires the provision of an environment in which IF can be commercially viable.

Currently, even Malaysian Islamic banks are some way off from being able to go out and it is by no means a forgone conclusion that it will happen. Furthermore, and above all, the industry must address the fact that 'brand Islam' is a hard sell in the current global climate.

Can the principles of IF that point towards social responsibility and sustainability stimulate greater interest in the industry?
In 2014, The World Bank arranged a sukuk transaction for the International Finance Facility for Immunisation (IIFIm); the funding will go towards vaccinating children in developing countries. These kinds of initiatives are completely aligned with the philosophy and fundamental principles of Sharia banking.

However, the majority of the Islamic countries cannot promote many causes that aim to develop sustainability or green issues, as they lack the wealth to invest adequately. Essentially, in a developing country these issues are 'luxury items'. Therefore, they have to be promoted by developed markets.

In truth, many Islamic countries are not in a position to promote IF in general; however, this is not the case for all of the Organisation of Islamic Cooperation (OIC) countries. The ICD Thomson Reuters Islamic Development Report stated total Islamic banking assets as of 2013 stood at US$1.214 trillion. They provide a breakdown of the numbers and, if you do the calculation, it reveals that 91.6 per cent of these assets sit in eight countries. A substantial chunk is held in Iran and, consequently, if Iran is excluded, the total looks rather meagre and the pack is being lead by Saudi Arabia and Malaysia. Two countries that, with a population of approximately 30 million each, do not even enter the top ten countries with the largest Muslim population globally.

The last time I checked there were 57 member countries in the OIC. Indonesia, Pakistan and Bangladesh, the countries with the largest Muslim populations in the organisation, are not represented in these eight countries with the vast majority of IF banking assets. Yet, if they decided to adopt IF as mainstream, the industry would be changed in an instant.

Therefore, as I posited, it falls on the developed markets, like Singapore, Hong Kong and London, to move things forward, and I am extremely heartened by recent events. However, developed markets engage with IF from a very different perspective. It is about visibility of capital markets and being a financial centre, rather than pursuing it for the good of the people.

So, in terms of sustainability and social responsibility, I am very encouraged by The World Bank initiative, as it is in line with the idea developed markets should take the lead. IF has a lot to offer in this respect: it has tools to address the inequality in the distribution of wealth and facilitate real economic growth and development. Sustainability is an issue that is becoming increasingly important to an increasing number of the global population. From that perspective, it can be commercialised. This is important because, while I am very proud of what Malaysia has achieved for the global IF industry, the reality is we need global banking institutions to push IF forward because they have bigger muscles.

What is your opinion on the convergence of IF with the greater halal economy?
It is certainly an interesting possibility. I am always encouraged when I look at global brands, like Nestlé and Kraft, which have decided to implement halalisation throughout their entire business. It is a simple and cogent argument: you can sell more products if you decide not to exclude a third of the world's population.

Curiously, it seems to be a lot easier to pitch and sell the concept of halal to global entities within the food industry, as opposed to the global banks. For some reason, there is not the same level of aversion to brand 'halal' as there is to brand 'Islamic finance'. It could be something as simple as a connotation of the word 'Islamic'; however, it also may be down to the ease with which halal food production can be undertaken under existing legislation in many countries. Banking is slightly more complex from a regulatory perspective.

However, these multinational food companies do not feel compelled to adopt IF and become totally halal because for them it is about the consumption of the product; the rest of the value chain is irrelevant. Importantly, this is within the ambit of Sharia permissibility. It does not stipulate that non-Muslims are prohibited from preparing halal food, and forcing the issue of end-to-end Sharia compliance is also problematic because it is not explicitly supported.

Of course, being end-to-end halal is a great story from a market perspective, but, in my view, it is not as important to the forward progress of the industry as convincing world governments that IF is a defence mechanism against economic and financial crises. In fact, the Chinese government stumbled upon Islamic banking because they were looking for alternatives to conventional banking. They have engaged serious academics to undertake substantial research related to the fundamental principles of the industry and have embraced the concepts that underpin IF, like risk- and profit-sharing. It is interesting to them because it is sustainable and, importantly, more equitable. It is a development such as this that can really give IF some forward momentum.

CHUNG CHEE LEONG

CAGAMAS

President and Chief Executive Officer

INTERNATIONAL INVESTOR: Could you provide a brief overview of Cagamas and its national importance?

CHUNG CHEE LEONG: Cagamas Berhad, the National Mortgage Corporation of Malaysia, was established in 1986 to promote home ownership and growth of the secondary mortgage market, as well as to develop and promote the private debt securities market and Islamic finance in Malaysia. It issues debt securities to finance the purchase of loans from financial and non-financial institutions.

Cagamas plays a key role in the nation's financial system as a provider of liquidity to promote financial stability and sustainable growth. Our funding model has also enabled us to contribute significantly to the development of the domestic private debt securities market by creating the much-needed benchmark yield curve for credit pricing of other issuers as well as through the introduction of debt securities structures, particularly in the sukuk space.

Today, the Cagamas model is globally recognised and well regarded by multi-lateral institutions including the World Bank and the Asian Development Bank. Cagamas was assigned a triple-A rating by RAM Rating Services (RAM) and the Malaysian Rating Corporation (MARC). In 2013, Moody's Investor Services assigned an A3 rating to Cagamas, equalling Malaysia's sovereign rating.

Could you elaborate on how the organisation structures its operations and how Islamic products have grown as part of your business?

Cagamas issues bonds and sukuk to fund the purchase of housing loans or other types of loans on a match-funded basis i.e. they are balanced in terms of tenure, duration and amount. Hence we are able to reduce and mitigate significantly any exposure to liquidity or interest rate risk. Moreover, we do not leverage in order to increase returns and our asset liability gap, which currently stands at approximately two months, is well within our risk management policy duration limit.

CAREER DEFINING MOMENT

As a central banker with 29 years' experience, I have been exposed to the full spectrum of the banking industry, particularly supervision of islamic banks and financial stability. Becoming the President and CEO of Cagamas has afforded me the chance to delve into the industry from a commercial point of view and put into practice my knowledge and experience.

LESSON IN BUSINESS

At Cagamas, we recognise that it is important to meet the needs of the counterparties and clients in providing solutions as opposed to selling products that they may not require. We are committed to customising our products: as in today's evolving environment, businesses must be able to adapt and innovate to meet the needs of the industry.

Our Islamic business started in 1994 and currently constitutes approximately 52 per cent of our business. There is a lack of opportunities in the market to hedge the Islamic banks' predominantly fixed rate assets and Cagamas provides this option.

There has been considerable progress in our sukuk offerings resulting in greater uptake by investors. In 1994, Cagamas offered Malaysia's first sukuk udharabah and we went on to offer the bai bithaman ajil Islamic securities in 2005 as well as the sukuk murabaha in 2007. We have since issued the sukuk al-smanah li al-istithmar (ALIm) and sukuk wakala bil itithmar as they are more acceptable to investors from the Gulf Cooperation Council (GCC) countries.

Our single largest sukuk issuance in the domestic market was the RM4.2 billion sukuk murabaha in October 2013.

Why is Cagamas looking towards the international capital market?

Essentially, while local investors remain an integral component of our funding operations, we want to expand and diversify our investor base by sharing our credit profile and strength as a strong value proposition for international investors to widen and diversify their portfolio. Additionally, these new funding avenues would also mitigate any potential over-reliance on one particular yield curve by Cagamas.

From the national perspective, we are fully supportive of the government, Bank Negara Malaysia and the Securities Commission of Malaysia's initiatives to promote higher foreign participation in the domestic bond and sukuk market. From our observation, foreign investors are looking at yields and liquidity, hence we hope to attract more foreign interest in Malaysian corporate issuances by exposing them to the liquidity and depth of Malaysia's capital market.

To this end and in the interest of diversification, we have also developed two Multi-Currency Medium Term Note (EMTN) programmes – both conventional and Islamic. Our Islamic EMTN programme, which is based on the principle of wakala, is widely acceptable to Islamic investors, particularly from the GCC countries, underscoring our developmental role. The Islamic EMTN will be used to fund the purchase of Islamic assets from the financial system.

From an Islamic finance (IF) perspective, what must be done to facilitate financial integration among ASEAN states?

We are of the view that in order to facilitate financial integration among ASEAN states, an IF ecosystem should be established across the ASEAN region. Due to significant differences in the tax and legal systems among the member countries it would be challenging to have ultimate integration, hence it is important to have mutual recognition in order to facilitate cross-border issuances. Achieving total harmonisation of IF standards throughout the ASEAN economies will require a multi-national effort but we are confident that the value proposition offered by IF will provide the impetus needed to transcend national objectives.

Cagamas is actively looking at ways to improve regional integration. Towards this end, we co-organised the ASEAN Fixed Income Summit in 2014 that focused on issues and challenges related to ASEAN integration, cross-border issuance and infrastructure financing, the latter being an important regional challenge.

On that note, Goldman Sachs estimated that infrastructure needs in the region may reach US$550 billion by 2020. As such, increased private investors' participation is needed for an efficient and integrated regional economy. In Malaysia we have already seen successful instances, such as the DanaInfra issued exchange-listed sukuk fund the construction of the Mass Rapid Transit (MRT).

BADLISYAH ABDUL GHANI

CIMB ISLAMIC

Chief Executive Officer

INTERNATIONAL INVESTOR: Could you talk about CIMB Islamic and its role in the Islamic Finance (IF) ecosystem?

BADLISYAH ABDUL GHANI: CIMB Islamic is a Southeast Asian bank based in Malaysia with operations in 18 countries and universal banking offerings in Malaysia, Indonesia and Singapore, as well as wholesale banking services in the other countries. It was established in 2002 as the Islamic banking and finance franchise of CIMB Group. Over the years, the bank has evolved from a boutique Islamic investment banking house to a universal Islamic bank with offerings across consumer banking, investment banking, corporate, treasury markets, as well as asset management.

Since its formation, the bank has played a significant role in the evolution of the IF ecosystem through initiatives in key areas ranging from regulations to commercial banking. We are proud to have assisted in the formulation and formation of new legislation and Sharia governance frameworks in many of the jurisdictions we serve.

Looking at the IF industry, CIMB Islamic is the largest sukuk arranger in the world on a year-on-year and cumulative basis, undertaking innovative structures including the Musyarakah sukuk structure and the Islamic mortgage-backed securities. We also developed the complete yield curve for the sukuk market by helping customers issue longer tenures. Our far-reaching involvement in the global IF marketplace includes the broadening of the issuing currency base through issuances denominated in Japanese yen, renminbi, and Singapore dollar, among others. The bank has been part of many important non-ringgit notes, including the UK government's GBP200 million inaugural sukuk, Hong Kong's US$1 billion inaugural sovereign sukuk, and Malaysia's sovereign wealth fund Khazanah Nasional's US$500 million exchangeable sukuk. The latter is exchangeable into shares of Tenaga Nasional Bhd.

CAREER DEFINING MOMENT

I have two defining moments; it is hard to choose between them. The first was when I led the issuance of the first global U.S. dollar-denominated sukuk for Kumpulan Guthrie Bhd in 2001. The other defining moment was when I was asked to establish CIMB Islamic under the CIMB Group at just 28 years old.

LESSON IN BUSINESS

The greatest lesson I learnt was to think fast, talk less and do more. If we think too much, we run the risk of losing an opportunity. If we talk too much, we run the risk of losing momentum. If we do less, we risk not achieving anything in business.

CIMB Islamic has also contributed to the development of a formal Islamic derivatives market in collaboration with the International Swaps and Derivatives Association. Our efforts have led to new products such as the Islamic Profit Rate Swap, which allows the market to better manage risk. In the asset management space, we are one of the pioneering Islamic fund managers in Southeast Asia and the most diversified. Our areas of expertise include, but are not limited to, mutual funds, private equity funds, property funds, infrastructure funds and structured funds. Most of our products are market leaders.

The commercial and retail banking space is also a stronghold of CIMB Islamic. When we entered the market in 2006, we rolled out products that had never been seen before, such as the commodity Murabaha deposit for retail depositors. Today, CIMB Islamic is the largest Islamic commercial bank in the world by branch network with over 1,000 branches across Southeast Asia and other major financial hubs. We also have more Islamic products than any other Islamic bank in the world.

How can IF become mainstream globally?

For IF to achieve this goal we have to first understand how IF becomes mainstream at the national level, and we can use Malaysia as an example. Malaysia is considered a key region for IF because the country's lawmakers have put in place a comprehensive, enabling infrastructure and framework for the industry to operate effectively. This has served to increase the certainty of doing business for various stakeholders and has provided a high degree of assurance to consumers and investors that their rights will be protected.

For such an environment to exist on a global level, more jurisdictions must follow Malaysia's example. While they certainly need not replicate the Malaysian blueprint for IF, their efforts should lead to the same outcome: a market that is conducive to Sharia-compliant business. However, I must stress that the objective should not be to position IF as the only way forward for everyone; the world should not be made to choose between IF or conventional finance. What is more important is people having more choices of financial solutions, Islamic or conventional, that best serve their financial needs.

Which established IF jurisdictions are part of the bank's international strategy?

Looking at the global IF marketplace, jurisdictions such as Indonesia, Singapore, Brunei, Turkey, Bahrain, Qatar, Kuwait, Oman, Hong Kong, UK and Saudi Arabia have all established a substantial domestic IF ecosystem, albeit with room for improvement. I would add that many other countries are attempting to enter the IF industry. However, most of them lack fundamental prerequisites to facilitate a successful undertaking of IF business. CIMB Islamic's focus will be to strengthen our position in Southeast Asian countries, but we recognise the potential of the other jurisdictions and pay close attention to developments in global IF industries.

What is the best strategy to increase non-ringgit notes in Malaysia?

The best strategy is to continuously market to both issuers and investors. Many tend to focus solely on issuers. Of course, non-ringgit based issuances in Malaysia would not have been possible if it were not for the proactive initiative of various issuers to diversify their funding avenues. By leveraging the available Sharia-compliant liquidity via raising sukuk, they aid the increase of foreign currency notes. However, we also need a growing investor base in order to strengthen the IF marketplace.

At CIMB Islamic, we continue to play an important and valuable role by communicating the value of tapping the non-ringgit market in and through Malaysia to both new and repeat issuers, as well as new and repeat investors.

DAUD VICARY ABDULLAH

INTERNATIONAL CENTRE FOR EDUCATION IN ISLAMIC FINANCE (INCEIF)

President and Chief Executive Officer

CAREER DEFINING MOMENT

After being made redundant in 1991, I set up my own business focusing on what I knew best: process re-engineering. The second job I got was in Malaysia and I was exposed to Islamic finance for the first time. Within a year I was married and specialised in IF. The path has been clear for me ever since I decided to become independent.

LESSON IN BUSINESS

I would like to echo the advice I give to my four sons: be passionate about your work and if you cannot be, move on. That is what I have learned; love your work and everything will be fine. If you cannot be passionate about it, you are in the wrong place.

INTERNATIONAL INVESTOR: Could you elaborate on the progress and the strategic developments of the institution?

DAUD VICARY ABDULLAH: In 2007 we set up our first Master's programme, which was joined by 33 students from 7 countries. Currently, INCEIF has close to 2000 students from over 80 countries and about 830 graduates at master's and doctoral levels, an achievement that fills me with pride.

At present, we are the only university fully dedicated to Islamic finance (IF) at a post-graduate level. We have strong strategic relationships with the World Bank and the Islamic Financial Services Board (IFSB), and we advise the Government of the United Kingdom on finance education. Notably, the UK government was the first country outside the Islamic world to issue sovereign sukuk.

In terms of plans for the future, it is important to maintain our focus and continue building momentum. We aim to obtain an accreditation set by the Association to Advance Collegiate Schools of Business (AACSB), which establishes accreditation standards for institutes such as the Harvard Business School, INSEAD and the London Business School. The AACSB not only looks very rigorously at academic standards and programmes, but also at the quality of the faculties, research output, interactions and the value an institution provides to the industry.

How can conventional industries and regulators be convinced to use IF?

In the early days, around 20 years ago, we were grateful for anyone who was prepared to listen. Fortunately, we have moved beyond that point, but we still face challenges related to getting the message across that IF is for everyone, instead of just a religious solution for followers of Islam.

A substantial amount of customers in the retail market in Malaysia are non-Muslims and they take part because IF offers a better value proposition. Moreover, corporate financiers and treasurers know a great deal about raising funds through sukuk and base their investment judgement on competitiveness and attractive pricing.

In Japan, IF has been skilfully adopted, albeit not in a direct way. Banks in Japan are not allowed to own assets other than their own buildings, so onshore IF is constitutionally not possible. Consequently, Japanese corporations have ended up in the Gulf region, followed by the bankers.

In the U.S. there is still a climate of suspicion regarding IF, since many people are not well informed about the concept. Americans have constructed the largest private equity market in the world, so in order to familiarise them with IF it is important to appeal to their business sense and explain the differences between a real economy and a financial economy.

A real economy creates jobs, assets and working capital that actually increase economic growth. The deregulated, post-Reagan financial economy is based on derivative trading without underlying assets. People are engineering financial instruments and generating huge trade volumes, which have very little impact on the economy. Simply put, IF is about efficient and effective mobilisation of capital for the benefit of the real economy, which, in order to grow, needs to be able to tap into cross-border liquidity flows.

Could the successful Malaysian IF model be adopted globally?

Malaysia is certainly successful and has been recognised by many outside the country, including the latest Thomson-Reuters report on IF, as the most advanced Islamic financial system.

I think Malaysia has a very thorough, robust and detailed model. However, it was built for this country. If you want to implement IF in a certain country, you need to be aware of your starting position vis-à-vis IF and look at the current frameworks regarding Sharia, taxes, accounting, regulations and professional standards. Once you have defined a starting point, you can outline a destination: implementing full-service IF, or just focused on retail, wholesale or asset management.

Only after these two steps can you start making comparisons to the Malaysian model and seeing which parts may fit in to the model developing in the particular jurisdiction. For example, the legal system in Malaysia is based on English common law. This generates a level of flexibility that allows Sharia to be adopted quite easily. Indonesia, on the other hand, has a legal system based on the Dutch civil code, which is constitutionally bound and does not tolerate the same level of legal flexibility.

Given the remarkable progress of sukuk issuance, what is the next frontier for IF?

Overall, I think IF needs a greater level of understanding and acceptability, but it is not just about the banking aspect. At the moment, we are hampered by our ability to locate funds that are most needed. There is a lot that can be done in terms of raising capital for the benefit of the real economy and increasing cross-border liquidity. For example, in IF, there are almost no equivalents to liquidity management tools such as U.S. Treasury bills. The International Islamic Liquidity Management Corporation (IILM) is one of the institutions that have been established to start creating these instruments.

Moreover, IF could certainly play a significant role in terms of financing small and medium-sized enterprises (SMEs), yet this needs to be put on the agenda, so that the regulators are actually comfortable with it.

Finally, research on IF is an important growth area. Together with our sister organisation the International Sharia Research Academy (ISRA), INCEIF actively engages with the industry, doing valuable research that helps to expand the IF marketplace.

A number of supranational entities have highlighted large infrastructure gaps in developed and developing nations

FOCUS: FINANCING DEVELOPMENT

The sukuk market is the most publicised segment of the Islamic finance industry, yet significant development is still required and its compatibility with infrastructure financing could be a major spur to push sukuk into the mainstream.

Recent developments in the sukuk market have been spectacular. In 2014 a record number of jurisdictions tapped the market, which saw significant first-time sovereign issuances from non-Organisation of Islamic Cooperation countries, such as the United Kingdom, Luxembourg, South Africa and Hong Kong, as well as issuances from global institutions, Goldman Sachs and Bank of Tokyo-Mitsubishi, ostensibly clearing the way for the growth of this financing tool.

With approximately 15 per cent of total global Sharia-complaint assets in the form of sukuk and a slew of new markets working to build the necessary frameworks for issuance to take place, the future development of the asset class, which offers important opportunities for more diversified financing, looks particularly bright. However, the challenges to sukuk development are not insignificant and must be adequately addressed if the potential of sukuk is to be fully realised.

Due to the obvious imbalance between the scope of this piece and the complexity of the sukuk landscape, it is pertinent to highlight one important potential growth driver, which also exemplifies some of the major challenges affecting sukuk development in general and the growth of the Islamic finance (IF) industry as a whole.

BUILDING SUKUK GROWTH

Infrastructure development is an important global growth driver. Numerous analyses posit infrastructure spending requirements in the coming years. Significant funds are already invested in global infrastructure globally, but supranational organisations, such as the OECD and the IMF, have published reports pointing to large infrastructure gaps in both developing and developed nations. The OECD cited a figure of US$70 trillion for ports, roads, power and communications until 2030 and the World Bank estimates that US$1 to US$1.5 trillion per year, on top of current spending, will be needed until 2020 in order to meet growth targets in emerging and developing economies alone.

This reality presents interesting opportunities for sukuk development. As sukuk structures must be linked to tangible assets, it provides a natural funding match for infrastructure projects, which offer the kind of long-term stable cash flows required for the transaction. Additionally, the risk-sharing aspect of sukuk further cements the relationship, with sukuk providing the necessary flexibility to deal with the uncertainty of projects.

The infrastructure gap has increased, directly or indirectly, due to reverberations from the 2008 Financial Crisis. Commercial banks have become less inclined to finance large infrastructure as they nurse damaged balance sheets and the Third Basel Accord has made long-term financing less attractive for traditional providers.

Thus, the responsibility for infrastructure finance is being relocated to the bond markets and the huge increase in visibility of global sukuk has demarcated the funding tool as an attractive and, importantly, eminently possible alternative to conventional debt financing.

There are obvious opportunities within the countries that are leading the IF push. Malaysia has already demonstrated a successful track record for appropriately-structured sukuk for infrastructure upgrades and market actors are citing large projects in the pipeline, like the Mass Rapid Transit development, as growth drivers. Meanwhile, the Gulf Cooperation Council countries are continuing with significant infrastructure spending plans that may be affected by sustained low oil prices, resulting in a surge in issuance to meet planned expenditure.

Yet it is perhaps in the oil-importing and developing MENAP and CCA economies where sukuk will prove to be the most useful mechanism to meet the infrastructure gap. Supranational entities and several IF thought leaders suggest that closing the gaps would address the limited growth prospects and unemployment challenges in these regions in the short term and build a better growth platform for the medium term.

In most cases, the required assertive infrastructure programme cannot be fully funded because state resources are not adequate and borrowing from domestic markets is becoming decidedly more difficult. Project-based infrastructure sukuk is, therefore, likely to be a vital tool in advancing an economic development agenda. What is more, many countries in the two regions have significant Muslim populations, which will expedite the uptake of Islamic financing.

Many of the same arguments apply to Sub-Saharan Africa, which has long been lauded as a new frontier for IF and, particularly, infrastructure sukuk; yet, like other emerging economies, it has faced significant barriers in terms of legal framework and capital market development. However, along with the South African sukuk, 2014 also saw Senegal launch a successful programme and it is looking to tap the market again, specifically to finance infrastructure. This could signal the opening up of the whole region, paving the way for project-based sukuk, with a number of other African nations being mooted as the next in line to issue.

BROADER IMPLICATIONS

As stated, infrastructure sukuk is just one potential driver in a very complex sukuk landscape, yet the potential benefits in developing this particular segment have significant implications for the growth of the asset class in general and IF as a whole.

Primarily, an economic development agenda underpinned by infrastructure sukuk has enormous capacity to draw global investors into the fold. The G20 group of major nations has already included a discussion of sukuk as an infrastructure financing tool on its annual agenda, and the issue will be pushed by the group's Muslim-majority countries, especially Turkey and Indonesia, who currently hold important economic policy positions.

Moreover, the Asian Infrastructure Investment Bank proposed by the government of China, which has already adopted IF structures in other areas, could be another significant avenue of growth, as a number of the founding members are Muslim countries that have issued, or have plans to issue, sovereign sukuk.

Additionally, as has been posited by Michael Bennett of the World Bank, trends in the global financial markets may be converging to highlight infrastructure sukuk as a viable form of finance for green or environmentally sustainable investing. As outlined above, capital markets investors are taking on the infrastructure funding mantel; consequently, those interested in green investments may be attracted by, among other factors, the opportunity to invest in projects with pre-determined criteria in line with their values, and a greater degree of certainty with regard to where their money is going. With the shift towards renewable energy in the MENA region offering significant opportunities, green sukuk is only a matter of timing and not feasibility.

Furthermore, in this report, Richard Thomas, Chief Representative for Gatehouse Bank in Malaysia, has highlighted the importance of infrastructure sukuk in generating the scale necessary to entice institutional investors and sovereign wealth funds that have so far been unable to contribute significantly to the development of IF due to shallow Islamic capital markets. This will be further magnified by the shift in infrastructure funding to the bond markets, as a result of Basel III.

The wider implications of these developments are that they will serve to increase the acceptance of sukuk by global investors and could provide the conclusive push into the mainstream. Moreover, the instrument not only has the potential to contribute to key industry challenges, such as scale and Islamic capital market development, but also to bridge another important gap between the conventional and Islamic financial worlds.

For sukuk to meet its potential, a robust domestic market infrastructure must be developed and access to international markets facilitated using a holistic approach. IF jurisdictions can achieve this by taking advantage of the vast knowledge and experience available through international development agencies and technical assistance providers that have previously fostered conventional domestic bond markets and can, therefore, help deploy well-established frameworks, assess constraints and build an agenda of reforms to support policy makers foster the ecosystem required for growth. It is under the banner of development and social responsibility that global institutions can increase their mandate to push the sukuk, and in turn the IF, agenda.

The growth of infrastructure sukuk will also increase the cross-border reach of sukuk markets and could further advance the adoption of commonly acceptable structures, a significant factor that, historically, has retarded sukuk growth. Concomitant efforts must also be made to promote securitisation, tradable structures, a deepening of secondary and money markets and centralised Sharia boards. Again, it is striking how important these developments are for IF industry growth as a whole.

Along similar lines, the expansion of infrastructure sukuk has the capacity to create greater geographical diversification and, importantly, build on the growing number of sovereign issuances from Europe, Africa and Asia, providing stimulation for issuances from non-sovereign entities. This would engender a greater range of risk profiles and more opportunities for diversification, appealing to a wider pool of investors and positively affecting liquidity concerns.

Infrastructure sukuk is on the cusp of significant growth. It is the right instrument at the right time for IF and for the world. Moreover, the developmental challenges this financing tool faces are the same as those hindering the broader growth of IF. Thus, the growth of infrastructure sukuk will bolster industry-wide development.

MUZAFFAR HISHAM

MAYBANK ISLAMIC

Chief Executive Officer

INTERNATIONAL INVESTOR: Which developments in Islamic finance (IF) offer the most exciting opportunities for growth?

MUZAFFAR HISHAM: Maybank began offering Islamic banking in 1993 and Maybank Islamic was established as a subsidiary in 2008. Since then, it has grown to become the market leader. The industry itself has grown tremendously well and has reached a compound annual growth rate of 10 to 15 per cent.

Until recently, due to the pragmatic approach of regulators in Malaysia, Islamic banking has coexisted with conventional banking. However, importantly, we have come to the crossroads with the introduction of the new Islamic Financial Service Act (IFSA), which will engender the elevation of Islamic banking to a new level. Updated regulations have afforded greater importance to Sharia governance and the various Sharia concepts. This allows Islamic financial institutions to move beyond the conventional wisdom, acting as credit intermediary, to become an investment intermediary. This change will enable the industry to break through another level of glass ceiling and positively differentiate our offering from conventional finance.

Accordingly, Maybank Islamic has formulated initial plans that we believe might be interesting to the industry regarding product development and risk management. As a financial institution, risk management is our key business and if we develop an effective and robust framework, innovation and value – in terms of shareholder returns, value for our customers, and to the community as a whole – will be produced as a result.

In terms of product development, we are eager to push this market. The key challenge for the industry is to get the regulations right, as they have a significant impact on development. They must be clear, merit-based, market-led and allow for innovation and growth.

When we develop these products, we must have our overall risk management tools in place and the regulations must support what we want to take to market. We have learned from the Asian and global financial crises that, in terms of regulation, we cannot make knee-jerk decisions based on short-termism. The market will always be there and it will correct itself. Accordingly, it is important to develop a long-term vision that creates a level playing field.

CAREER DEFINING MOMENT

There is no specific moment, but I feel happy and blessed that during my career I have been able to gain experience in the Islamic banking industry, first at Amanah Merchant Bank, and later the CIMB Group, and now at Maybank Islamic, which is an exciting organisation with excellent leadership.

LESSON IN BUSINESS

It is important to have clear objectives and noble intentions. If your intention is just to make profit at any cost, you will eventually go down, but if you focus on serving the community profit is a given.

Finally, looking at the financial ecosystem and its values from an Islamic perspective, we must make an effort to find opportunities that can breach inequality by serving and elevating communities.

What are the major challenges in terms of developing the IF ecosystem?

Malaysia has a great ecosystem in place; the main challenge is ensuring the regulation that comes out of the IFSA is appropriate. Regulators in other IF jurisdictions should recognise the success and pragmatism of the model here and use it as a blueprint for growth.

Regionally speaking, the challenge is to promote cross-border business. Thus, in the ASEAN region, and even linking to Gulf Cooperation Council (GCC) countries, policymakers must emphasise the importance of reciprocal policy structures. For example, all regional Islamic banks should find clear rules if they want to establish their institution within another regional jurisdiction. ASEAN is the future, this is where our market will be, and a pragmatic approach to regional regulation will benefit all the parties and foster the growth of IF.

Additionally, in terms of Sharia-compliant cross-border payments, IF is a young industry and there are challenges regarding the lack of infrastructure for these transactions. Established players, such as Maybank Islamic, can take advantage of our existing systems, but for new entrants the capital investment can be quite high. Thus, the industry needs to invest in payment systems and build infrastructure. The existing system can be used, but it will require an innovative approach and diligent work with Sharia councils.

There are further challenges regarding clarity in anti-money-laundering guidelines and related currency trading policy. This will require a frank debate with the regulator to ensure there is an agreed threshold restricting speculative trades because many financial institutions took on too much leverage trading currencies, as opposed to using the payment system for the purposes of trade and the real economy. So, policy needs to be looked at, but I am confident that technology and innovation will facilitate growth in this segment.

How are you implementing your strategy in Singaporean and Indonesian markets?

We have had successes in both markets. In Singapore, the retail market is very competitive, but we have made good inroads there by focusing on serving the community and facilitating cross-border transactions. The IF market in Singapore is relatively small, but as long as it continues to provide good returns and we create value for our customers, we will keep growing this market.

Indonesia is an important market for the development of IF, it has about 5 to 6 per cent of the banking market, but being a majority Muslim country, there is potential for significant expansion. In fact, Indonesia's U.S. dollar sukuk is currently outpacing returns from both Malaysia and Dubai. Maybank Islamic is currently in the top three in terms of growth there, but, again, the regulation needs to be clarified and we have put forward some proposals regarding the facilitation of growth.

We can certainly add value in this market to corporate entities, and we have proved this through our work with Garuda, the national airline of Indonesia, with whom we undertook a large bilateral transaction in May 2014. However, interestingly, there is a certain proportion of the population that are not yet bancarised, thus, introducing a Sharia platform that offers this group non-riba products could really grow a new set of liquidity and promote growth not just for Islamic banking, but also for their banking system as a whole.

ASHAR NAZIM

EY

Global Head of Islamic Banking

INTERNATIONAL INVESTOR: What is your outlook for the global Islamic finance (IF) industry?

ASHAR NAZIM: These are exciting times for IF, as the industry is transitioning into a mature phase. Across the globe, we are witnessing some key trends that will shape the future of the industry. The first trend is the rebalancing of the global economy and we are seeing a shift in trade and GDP growth towards the east. The primary beneficiaries of this eastward shift are emerging markets, which include major IF players. Importantly, many of these IF markets are underpinned by positive demographics, including a younger population that is upwardly mobile in terms of wealth.

Another important trend is the mainstreaming of IF in many key markets. The industry already has close to a 50 per cent market share in Saudi Arabia and, going forward, IF will continue to capture conventional banking market share.

The third, and most important, trend is that the industry is growing beyond the narrow spectrum of finance. Today, the focus is on the broader halal ecosystem and we are seeing new initiatives, by both the public and private sectors, to further expand the halal economy in many jurisdictions. With over 1.6 billion Muslims around the world, there is enormous demand and economic potential in developing all aspects of the Sharia-compliant lifestyle.

As a result there is a visible shift in the branding of IF. What was previously known as 'Islamic' banking has been repositioned as a more neutral entity. For example, Noor Islamic Bank has dropped the word 'Islamic' and is now known as Noor Bank. Islamic banks are increasingly targeting mainstream markets, in both the retail and corporate sectors.

Apart from these trends, two other factors will certainly shape the future of IF. One is the value proposition of IF over conventional financing. Industry leaders need to leverage on the principles of IF, which are fundamentally linked to social responsibility, to attract more customers. The other factor is the evolution of digital banking, which will have a significant impact on how financial transactions are conducted. However, both conventional and Islamic banks are struggling to keep up with the current pace of digitisation and, if they cannot implement efficacious digital frameworks, they face being outclassed by non-traditional players, such as PayPal and other start-ups.

CAREER DEFINING MOMENT

When I ventured out to be an entrepreneur in the IF space, I was able to gain a clearer understanding of the industry structure, critical viewpoints and the disconnect between the users and providers of Islamic financing.

LESSON IN BUSINESS

Always be honest. In the long run, what really matters is being honest with yourself, your clients, your employers and your people.

Please elaborate on the challenges currently faced by the IF industry?

One of the key hurdles that can limit the growth of IF is political instability, which we have seen in some major IF markets and has had a severe impact on business environments in these jurisdictions. In countries like Iraq, Egypt and Turkey, the ongoing political volatility has undoubtly impacted the local IF industry, despite the size of these domestic markets. When looking at this issue from a global perspective, the aggregate economic losses in these countries will have an adverse impact on the entire Islamic banking industry.

Another challenge is the quality of the available infrastructure, such as regulatory frameworks and accounting standards. While the industry's infrastructure has evolved over the last 20 years, it is unable to keep pace with the growth and complexity of IF. This should be addressed as soon as possible.

The third challenge is achieving adequate scale for Islamic banks. While there are a handful of large Islamic banks, like Al Rajhi Bank, the size and growth of the industry in general is rather limited. However, there has been an important realisation among key players and IF thought leaders that there is an urgent need to build scale in order to reach critical mass. If this growth is undertaken in a systematic manner, Islamic banks will become more competitive and relevant.

What are your thoughts on the growth of the takaful industry?

The takaful industry is still in the process of establishing its footprint and is riding on the growth of IF in various markets. To accelerate growth, there has to be a regulatory convergence between different markets. At the moment everything is very fragmented. For instance, Saudi Arabia and Malaysia use different definitions of Islamic insurance. The regulatory disconnect has confused the industry, made investors nervous and impeded growth.

We also need to establish mega takaful operators to drive the industry in the right direction. These entities need to be able to absorb initial shocks as they experiment and innovate, as well as potentially influencing the convergence of regulations.

Lastly, there has to be strong leadership and insightful dialogue within the industry. IF industry leaders, directly or indirectly related to the takaful industry, need to come together for unilateral discussions on key issues at global forums. These forums will foster the development of the industry from both business and regulatory perspectives; currently it resembles an orphan industry with no proper direction.

How can Malaysia strengthen its place as the global IF leader?

Primarily, the Malaysian Islamic banks have to reposition themselves as autonomous, independent banks. Currently, most banks are subsidiaries or windows of conventional banks and their respective boards tend to focus on conventional operations. With more autonomy, the Malaysian Islamic banks will be able to venture beyond their current market segments.

Besides autonomy, Malaysian Islamic banks need to create a more holistic service offering. The next frontier, for example, could be wealth management. Yet, while some initiatives are underway in this area, there is much work to be done to develop Sharia-compliant pension schemes and family wealth planning.

Furthermore, Islamic banks could make significant contributions in developing the country's SME sector and increasing the efficiency of zakat – obligatory almsgiving in the Muslim faith – by ensuring funds are more effectively channelled to good causes.

PERSPECTIVE: DUBAI CHAMBER OF COMMERCE AND INDUSTRY

The Dubai Chamber is creating a favourable environment for the Islamic economy by actively supporting initiatives that have been launched to foster growth of halal industries and unlock opportunities to further drive the global expansion of Islamic finance.

H.E. Abdul Rahman Saif Al Ghurair, Chairman of the Dubai Chamber of Commerce and Industry, reflects upon initiatives fostering the development of the halal economy

DRIVING GROWTH

The Dubai Chamber of Commerce and Industry has organised a number of major international events to draw attention to and provide a platform for discussion about the Islamic economy. In 2013, we held the first Global Islamic Economy Summit in cooperation with Thomson Reuters, aimed at bringing together the different elements of the Islamic economy under one forum. The event successfully managed to engage the region's decision-makers and business leaders who drive growth in the halal industries. Subsequently, in 2014, we organised the 10th World Islamic Economic Forum in Dubai, the largest in its history, which was attended by 3,215 people from 108 different countries.

Dubai's Islamic banking industry began to emerge in the 1970s, when the Dubai Islamic Bank, the first Islamic commercial bank, was founded. Over the past decade, Dubai's economy has grown considerably and has diversified into several expanding sectors. This has helped drive growth in Islamic economies, such as Islamic finance (IF), halal food manufacturing and halal tourism. Looking at the growth figures in the different sectors of the Islamic economy, it becomes clear that there are untapped opportunities and potential for these industries to further drive economic growth in Dubai, especially because the halal economy reaches beyond just the financial sector, covering a wide range of areas such as food, lifestyle, consumer products, education, standardisation, the development of small and medium-sized enterprises (SMEs) and Islamic business frameworks.

THE HALAL ECONOMY

In 2013, important elements relating to scale and competitiveness were addressed when His Highness Sheikh Mohammed bin Rashid Al Maktoum, Vice President of the United Arab Emirates and Prime Minister and Ruler of Dubai, formalised the initiative to promote and foster growth of the halal economy, named 'Dubai: Capital of the Islamic Economy'. This marked a turning point for IF in Dubai and was followed by several other initiatives promoting the expansion of the halal economy.

The Dubai Islamic Economy Development Centre (DIEDC) aims to facilitate, engage, and empower the city to become the global capital of the Islamic economy by forging a cooperation framework with stakeholders and implementing a comprehensive strategy with practical programs and initiatives. DIEDC has built its strategy around seven focus areas spanning key economic sectors: Islamic finance (IF), halal products, family tourism, the digital Islamic economy, knowledge and information, Islamic design and standards and certification.

In 2013, NASDAQ Dubai successfully launched the Global Sukuk Centre, which enhances Dubai's credibility as a global financial hub and aims to attract new investment opportunities. Additionally, the Dubai Silicon Oasis Authority (DSOA) has launched the Dubai Technology Entrepreneurship Centre (DTEC) to build on the success of DSOA's current technology incubation centre 'Silicon Oasis Founders' (SOF), which was set up to promote local entrepreneurial talent in the IT sector. The 3,600 square metre centre will provide a nurturing business environment for start-ups offering solutions that cater to the requirements of an Islamic economy, particularly initiatives that focus on digital and online Arabic content.

There are several other initiatives that aim to create a space for and facilitate the further emergence of the Islamic economy. For example, TECOM Investments has launched a dedicated cluster to foster the establishment and growth of halal industries focused on manufacturing and logistics companies in the food and beverage, cosmetics and fragrances and personal care sectors within Dubai Industrial City; TECOM Business Parks has propounded the need for a 'business incubator' for entrepreneurs and SMEs working in the digital Islamic economy domain; and Economic Zones World (EZW) has allocated over 1.5 million square metres for the establishment of halal zones in the Jebel Ali Free Zone (JAFZA) and TechnoPark, specifically designed to cater to the regional and international halal product markets and create an enabling environment for halal industries.

Finally, His Highness Sheikh Mohammed bin Rashid Al Maktoum, Vice President of the UAE and Prime Minister and Ruler of Dubai, has launched the Salma emergency food relief programme, a partnership between DIEDC, Awqaf & Minors Affairs Foundation and Noor Endowments. The international humanitarian aid and relief project provides preserved halal food to people in crisis-hit locations and complements the Sharia principles that promote Islamic ethical values and business ethics aiming to increase and improve social welfare.

GLOBALISATION AND HUMAN CAPITAL

The global IF industry is certainly growing. According to the State of the Islamic Economy 2014-2015 Report, published by Thomson Reuters in collaboration with

DinarStandard, Islamic finance assets were valued at US$1.66 trillion. The strong industry growth was led by Islamic funds and sukuk, which increased by 14 per cent and 11 per cent, respectively.

The arrival of sukuk in Western markets such as the UK, Luxembourg and Hong Kong marks an important turning point for the industry with respect to its global exposure, and in core Muslim-majority markets the share of Islamic assets continues to rise. For example, Islamic assets in Saudi Arabia have reached 52 per cent. Moreover, there is strong potential for future growth as many of these core markets, such as Pakistan, Indonesia and Turkey, have large populations that are not as yet bancarised.

Concerted steps are being taken to tackle the fragmentation and uneven development of the IF industry. New or emerging markets have established or are in the process of establishing central Sharia boards at the national level and are making significant efforts to adopt the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) guidelines for Sharia governance.

In the GCC, calls for greater cross-border cooperation have been growing. However, each market must address its priority areas before moving towards an increased harmonisation of regulation and practices.

Importantly, the success of the IF industry will depend on the availability of qualified and high-quality human capital. Experienced professionals in the IF sector are in demand and, due to the sustained growth of the sector, this will only increase in the coming years. According to research by the Alhuda Centre of Islamic Banking and Economics, 38 universities worldwide are producing 5,000 IF graduates per year; however, by some estimates, this is not enough to meet industry requirements.

In Dubai, efforts are being undertaken to address the skills gap apparent in the country's finance professionals and increase knowledge relating to Sharia-compliant banking instruments. As part of this push, the Hamdan bin Mohammed Smart University, the first e-University in the United Arab Emirates, was launched by the Dubai Centre for Excellence in Islamic Banking and Finance in 2013. The institution aims to support the ongoing efforts to establish Dubai as the world's Islamic economy capital, in line with the ambitious vision and directives of the emirate's leadership. The centre offers academic programmes based on three premises: human capital development, research, and community service. Moreover, Dubai's banks have been given the responsibility of investing in graduates to educate them on the principles of IF and help attract new talent to the industry.

THE DIGITAL ISLAMIC ECONOMY

The halal economy has yet to fully leverage on the potential of technology to drive it forward. However, the Dubai Smart City initiative is one of the most important projects in the GCC that will, through the use of advanced technology, facilitate the growth of an Islamic economy in Dubai and the GCC. The Government of Dubai, under the directives of His Highness Sheikh Mohammed bin Rashid Al Maktoum, Vice-President and Prime Minister of the UAE and Ruler of Dubai, has already implemented several measures to transform the emirate into a smart city.

There has been a major shift in recent years towards business and institutions offering online services and mobile applications to increase stakeholder satisfaction and engagement. The Dubai Chamber anticipated this, moving with the radical change, and now has 47 per cent of its services available online or through mobile applications, with more coming on stream in the near future. Developing the Islamic digital economy is a hugely important aspect of expanding this broad smart city concept.

Additionally, mobile banking is becoming increasingly important for today's retail customers. If implemented properly, applying best international practices, this can be a major growth driver for Islamic banks. Meanwhile, thousands of digital mobile applications with Islamic-themed content continue to come online. For example, during Ramadan 2010, the Singapore-based mobile application developer Bitsmedia released an application that provides accurate prayer times and Qibla directions based on the user's location. By 2014, the application had been downloaded more than 10 million times across 216 countries worldwide. This is evidence of the abundant opportunities available in Islamic mobile technology and shows the halal economy's potential for future growth, which can easily be tapped by Islamic banks if they continue to adapt the technology to suit their customer bases.

The arrival of sukuk in Western markets such as the UK, Luxembourg and Hong Kong marks an important turning point for the industry with respect to its global exposure

RICHARD THOMAS

GATEHOUSE BANK

Chief Representative Malaysia

CAREER DEFINING MOMENT

Certainly, my decision to focus exclusively on the nascent Islamic finance industry in the early 1980s. Increasing unease about the practices arriving in international finance with deregulation and the big bang in the City of London gave way to greater trust and confidence in the value propositions underpinning my career choice.

LESSON IN BUSINESS

Primarily, never assume anything in banking. It sounds too simple, but as soon as you start to challenge norms, opportunities to improve and lead immediately appear. The lesson that took much longer to learn was: work with a team that can build absolute trust and integrity among its members, do not bother to be part of a team that cannot.

INTERNATIONAL INVESTOR: Could the convergence of the halal economy with Islamic finance (IF) push the industry forward?

RICHARD THOMAS: I am never more aware of the unrealised potential in IF than when I look at the lack of connectivity between the halal economy and Islamic banks. However, there are many factors that have contributed to this gap, which are related to scale on both sides, competitive advantage and the absence of the required financing tools.

Regarding scale, until recently, halal industries have mainly been SME activity centred on food production. Apart from notable exceptions, like Bank Al Baraka, the development of tools for SME businesses and the ability to look at both equity and debt financing for SMEs has been difficult for the IF industry.

Essentially, halal businessmen are generally focused on the compliance of their actual business. In terms of funding, they have grown to accept that there is no viable Islamic alternative and have used conventional finance because it has been their only choice.

Even though IF is now developing the required tools, Halal entrepreneurs still see it is a move towards the unknown. I believe many are yet to be convinced about its trustworthiness and whether the service provision is adequate. Furthermore, IF market actors are finding that lack of scale is making it very difficult to reach across a globally diverse range of SME businesses to get the message across.

These barriers are being overcome, but there is a change coming that will redefine the financing model for emerging businesses, whether conventional or Islamic. We are currently witnessing the rapid growth of crowdfunding and peer-to-peer finance. In fact, there are already a number of Sharia-compliant initiatives, happening outside of the banking network, providing financing tools directly aimed at halal business people. Furthermore, the recent introduction of the Investment Account Platform (IAP) has profound implications and should be a focus of welcome change.

Clearly, the largest halal businesses are being served by Islamic banks, but the emerging halal industry, which is still at the core, particularly in developing markets, will be well served by these alternative, non-traditional providers of finance. It was a significant discussion topic at the World Islamic Economic Forum (WIEF) 2014 and some of these crowdfunding platforms are already multimillion pound operations. In fact, the Malaysian Securities Commission are actively setting up what they call a 'safe haven' for crowdfunding in Malaysia, which includes a specific focus on Sharia-compliant crowdfunding.

As I mentioned in the *International Investor* Islamic Finance Roundtable, the Midterm Review of the IDB-IRTI 20-year plan for the development of IF suggested the two biggest threats to progress were trust and relevance. This goes to the heart of the issues relating to halal industries: whether IF is relevant to the real economy and whether it is trusted. I think the jury is still out regarding those questions.

However, Islamic institutions are better positioned to capitalise on opportunities related to this type of funding because IF is based on fundamental principals that offer a better proposition in terms of trust, integrity and ethics. It is certainly a good moment to demonstrate the possibilities of IF, but it will take a tremendous communicative effort.

How can IF leverage off Sharia principles that highlight social responsibility and sustainability?

The nature of IF is greatly to do with avoiding harmful activities; it is socially responsible at its core, which also draws it naturally into the sphere of sustainability. In conventional economies, the average citizen is not convinced that financial services have 'reformed' after the recent financial crisis. IF is a practical demonstration that things can be better.

Eradicating or avoiding harm is a key concept that elucidates IF in an important way. There are some common misperceptions about Islam that colour an understanding of IF. For example, it is perceived to solely be about the absence of interest, but actually that is just a very small part. Another misperception is that Islam is just a series of prohibitions. However, it should be looked at from the opposite point of view, i.e. what is unethical or unsustainable should not be done and everything else should be done. Thus, there is no issue with making profits or doing business.

I recently heard a prominent economist lecture on his concerns about the unsustainable nature of economics in an applied sense and the extent to which conventional finance contributes to unsustainable practices. For example, how the entrenched interests in financial circles are prone to finance more dangerous nuclear options, over better, more sustainable ones. It was suggested that 'global finance' was responsible for the lack of change in commercial industry and that IF could be part of the solution to this problem.

While it is critically important for conventional finance to take sustainability seriously, my position is that the financial practices that contribute to unsustainability will not be fixed, as the self-interest involved in conventional finance is so embedded in the culture. It is logical that those who share these views are drawn towards an Islamic economic model.

Unfair distribution of wealth is a significant contributor to social unease and, arguably, it is currently more starkly evident than ever before. The Islamic economic practice offers models of risk and reward distribution that can be studied to assist in necessary adjustments in more globalised financial systems.

There is the suggestion that Islamic economics is not actually different to conventional, but I think that in the pure and applied sense there are significant differences, and sustainability is one area where this is abundantly clear. It may not be fundamentally Islamic in origin, but Islamic economics has a greater affinity with the concept of a sustainable economic model than that which is currently in place.

The economic sustainability factor could be an important driver to bring IF into the mainstream, globally speaking; however, again, a lot of communication work needs to be done to expedite this. Importantly, in the absence of conventional finance moving towards a sustainable and socially responsible model, IF can get there first, stimulating growth in local markets and providing a demonstration effect to the world, which conventional finance would then be able to follow.

How can IF institutions build the scale needed to facilitate a sustainable economic model?

It is not easy to build scale from scratch through the SME market or halal industry. Moreover, the Islamic asset management market is currently very small. This is partly because the ratio of Islamic assets under management (AUM) is 80 per cent from retail and 20 per cent from institutional, almost the exact opposite of the conventional asset management market.

One way it could be achieved is through the development of infrastructure. There is a huge amount of new and regeneration infrastructure development required globally and infrastructure products can meet the needs of substantial institutional, pension and sovereign wealth funds (SWFs), which, as evidenced by the Islamic AUM ratio above, have so far been unable to contribute significantly to the development of IF because the Islamic capital markets lack depth.

In fact, part of the reason the UK Government decided to engage in IF with such zeal was due to their interest in financing infrastructure. The country has already shown an interest in encouraging social responsibility through initiatives with institutions like the Green Investment Bank. They are keen to continue this and will work with other interested parties, like Malaysia for example, to see if they can bring in Sharia-compliant products to complement their objectives.

Investors are beginning to develop an appetite for Sharia-compliant infrastructure and engage with the concept for the first time. In fact, I do not think that substantial conventional investors discriminate; they are quite comfortable because they have already made the link between Socially Responsible Investing (SRI) and IF at a basic level.

The argument that goes down very well at the sponsor level is that non-Sharia-compliant projects can only be financed by conventional means, but Sharia-compliant projects can be financed with conventional and Islamic money, doubling the fund pool. Historically, that argument has been important in real estate and smaller ticket markets, but as IF gains scale, infrastructure market actors will begin to realise the importance of demonstrating the product is Sharia-compliant in order to attract funds.

In reality, if the big money, like SWFs, pensions funds and endowments, throw their weight behind IF, that will be the deciding factor. Encouragingly, this is beginning to happen. The attitudes of the Middle East SWFs are changing towards a more Sharia-compliant model of investing, but it comes back, again, to the issue of trust and relevance and whether they believe that, legitimately, the IF industry truly represents those values.

All things considered, there is a very reasonable, achievable growth path to get the industry from where it is today to the scale that is needed to achieve a level playing field with conventional finance. Things are happening very quickly now. Interestingly, at WIEF 2014, it was announced that UK Export Finance (UKEF) will issue an Export Credit Agency backed sukuk, in support of an Airbus customer. This is a substantial transaction that the scale of the industry would not have supported five or ten years ago.

Is greater standardisation required to foster greater fund participation?

For me, the answer to this question is related to the changing nature of equity and debt, and the realisation that standardisation is not always necessarily a good thing. On the conventional side, we have seen that the move towards standardising products can have the potential to limit development because it stifles innovation.

Importantly, IF is not yet at a sufficiently developed and diverse stage to welcome standardisation beyond the avoidance of clashing ideologies, which essentially means resolving differences relating to the tradability of debt, something that has been deemed permissible in Malaysia and Asia, but not in the Middle East.

In fact, the market in Malaysia, led by the regulators, has been making a significant effort to bring the two positions together. Many major Islamic banks have been under pressure to ensure their products are more in line with practices in the Middle East, which they are finding difficult. Yet, the benefit from eliminating a major conflict may be outweighed by the detriment that rigid standards bring and could come at the expense of new product development, which IF needs for the next growth phase.

This all comes back to the changing economic relationship between debt and equity, which is rising up the global agenda. I have been following the debate, which centres around the imbalance in the treatment of debt and equity. In the current financial system, debt has advantages over equity, especially in the areas of tax and accounting.

In order to remediate this difference, some European governments have introduced a version of the Allowance for Corporate Equity (ACE) with the intention of making it easier to raise equity without having to rely on raising debt. ACE is not a new product, and its potential to be very expensive in terms of forgone tax revenue has not made it popular. Nevertheless, both the current UK Government and the opposition chancellor have at least mooted its implementation, which reveals the depth of intention to address the problems created by institutionalised preferences granted to debt and the breadth of interest in this concept.

It is in the areas of taxation and accounting, and remediating the balance between debt and equity, that IF can play a significant global role. IF market actors must undertake the required actions to make their offerings viable on a conventional level. This will increase competitiveness and, hopefully, lead to the introduction of a whole range of new products, particularly into the capital markets, as well as facilitate the emergence and legitimacy of the Islamic equity capital market.

Currently, Islamic capital markets are debt driven and corporations have not engaged with them because it is challenging to undertake fully asset-backed type structures. However, if the IF industry can take the lead and change the nature of accounting for equity and assets, and if non-Islamic bodies, like the UK Treasury, are at least studying products like ACE, it is clear this is a realistic direction, an opportunity to fix what is badly broken in the conventional model and another opportunity for IF to grow both its scale and market share.

Furthermore, this illustrates a gap that must be filled. Historically, IF has needed people who kicked on and made it work. Now, the industry needs applied economists and thought leadership to move it to a different level. The need to be able to connect the dots is critical. It is happening in Malaysia, there are encouraging signs in the UK and, if these kinds of discussions continue, it will draw in the GCC countries. There are plenty of clever people involved in IF, but they do not have anything around which to coalesce. Institutions like INCIEF and the IFSB offer a platform for IF market actors to be involved and integrated into discussions relating to the actual dynamics of economic development.

DR. MOHD. DAUD BAKAR

AMANIE HOLDINGS

Founder and Group Chairman

CAREER DEFINING MOMENT

The moment came when I decided to leave my post as deputy vice-chancellor of the International Islamic University of Malaysia and start my own company. Venturing out on my own and being responsible for the income of my employees was not easy. However, my nerves helped me as it motivated me to work harder.

LESSON IN BUSINESS

The greatest lesson is to be long-term "greedy" and not short-term "greedy". When we are short-term "greedy", we tend to cut corners; when we favour the long term, we can slowly build a strong foundation and credentials.

INTERNATIONAL INVESTOR: Could you provide us with a brief overview of the Amanie Group?

DR. MOHD. DAUD BAKAR: In 2005, I founded Amanie Advisors in Kuala Lumpur. The company has certainly expanded since then and now the Amanie Group consists of a number of Sharia-compliant companies focusing on distinct business areas such as advisory, IT, big data analytics, private equity, and commodity trading platforms. Currently, we have offices in Dubai, Luxembourg, Cairo, Astana, Seoul, Muscat, Dublin and Melbourne, and we are active in numerous other markets.

The key to the group's success has been the ability to position ourselves between the supply and demand sides of the broader Islamic finance (IF) market, and our business has been structured to complement the differences and strengths we have identified in each IF market. For instance, in cities like Kuala Lumpur and Dubai we provide more extensive services due to the holistic landscape of both the Islamic finance and the Halal economy. Our Luxembourg office was opened to take advantage of the country's position as the asset and fund management capital in the Eurozone. Seoul was selected, not because of its IF industry per se but due to the available funds in South Korea, and we are currently working on connecting South Korean organisations with new IF markets that are in need of their capital and technology. We are even operating in Afghanistan, in collaboration with their Central Bank, to establish the regulatory infrastructure for IF.

What are your thoughts of Sharia entrepreneurship in Malaysia?

Malaysia has seen unparalleled development in the IF space. However, there are two main challenges that must be overcome in order to progress. First, the potential of Sharia entrepreneurship must be realised and promulgated. Professionals from fields like medicine and engineering do not limit themselves in terms of business ventures, but you rarely hear of a Sharia-trained graduate starting their own company. This brings us to the second challenge, which is to convince others of the value of Sharia-compliant ventures. Many see them as a compliment to growth and not a driver; I started Amanie to prove that Sharia principles can be at the forefront of a successful venture.

The primary solution to these issues is to focus on educating the younger generation regarding the possibilities of Sharia entrepreneurship. Each year Malaysia produces thousands of graduates, with and without Sharia-related degrees. They need to find jobs, but are not informed about entrepreneurship in general, let alone Sharia entrepreneurship. Therefore, they cannot assess or benefit from its potential.

Importantly, articulation of the scope of Sharia entrepreneurship has not been clear and has led to the perception that it is limited to the banking and finance sector. Frankly, this is absurd, as it covers everything from tourism to food. We must work to reframe the understanding of this area.

How can IF grow beyond the current global financial hubs?

There are numerous opportunities across the globe to grow IF and the Halal economy in general. To capitalise on them, IF market actors wanting to engage new markets must first understand the market and then adapt their approach according to the varying levels of knowledge of Sharia-compliant business in each particular country.

For example, in the Republic of Ireland, austerity measures have recently come to an end and they are looking to borrow in order to finance further growth. Thus, they could opt for conventional sources of funding or choose alternative sources, including Islamic financing. The important step is to build a relationship through education, which in turn fosters confidence in the IF industry. Accordingly, Amanie Group met with representatives of the Irish government and brought them to Malaysia to educate them on the abundance of Islamic liquidity and the benefits of using IF. All IF actors should strive to spread the programme to new markets.

What more can Malaysia do to increase its global footprint in IF?

In my opinion, we have to improve the risk appetite of the local Islamic banks. The primary hurdle is convincing risk-averse shareholders, who lack the confidence to venture beyond Malaysia and Southeast Asia, to explore overseas opportunities. In Africa, 40 per cent of the population is Muslim and most areas require investment in infrastructure; very few Malaysian banks have ventured into these markets. In some cases, this has to do with the publicly listed status of many Malaysian banks, which means they are not comfortable taking on new risks. Furthermore, the risk management strategies currently in use are no longer relevant to Islamic banking and finance. Success in IF is about capitalising on niches, not already crowded markets, and there are many new markets in developing countries.

A significant part of my job concerns meeting people. During a conversation with an investment banker from a mid-sized Turkish bank, I was surprised when he informed me of their numerous and successful activities in difficult new markets, like Kazakhstan and Bosnia. You expect big Western or Asian banks to be there, but they had gone in to these markets and laid important foundations by providing technical systems and services. Consequently, they have built a presence and a reputation, which leads to repeat business.

This shows there are opportunities to thrive in new markets and Malaysian banks should be prepared to take them by investing overseas and exporting infrastructure well beyond Southeast Asia. Many emerging markets are aware of Malaysia's capabilities; so local business leaders should take the first step and diversify their catchment area.

IDCORP
INNOVATION & DEVELOPMENT

TECHNOLOGY, BANKING AND ANALYTICS

With the convergence of technology, banking and analytics, IDCorp strives to bridge the gap between these three worlds and unlock their combined potential.

IDCorp provides cutting-edge Sharia-compliant financial technology and banking systems for the growing Islamic financial industry.

IDCORP

Innovation & Development Sdn. Bhd. (IDCorp) specialises in end-to-end software solutions for the financial industry that encompass all major components of the banking and payment process systems. The corporate vision is to stay at the forefront of the financial technology industry. Accordingly, the company continues to invest in human capital and research and development, which enables a consistent offering of relevant, high-quality banking solutions for both the conventional and Islamic banking sectors.

IDCorp has installed its Banco® product suites in many institutions and provided the concomitant services, all of which are supported by the following system solutions:

BANCO® SOCIAL NETWORK-MEDIA BANKING SYSTEM

IDCorp's flagship Banco® Global Core Banking System serves all major banking segments, namely retail, corporate, private, Islamic, and microfinance and community banking. However, with the increasing amount of time consumers spend online, specifically on social media, there is an opportunity for banks to increase their interaction with customers through this platform. Seeing this market potential, IDCorp has developed the Banco® Social Network-Media Banking System. The system helps banking institutions reap significant benefits from carefully planned social media engagement programmes, which focus on improving corporate reputation, creating a better customer experience and using social media platforms as easily accessible news distribution channels.

By engaging customers in this manner, through various social media platforms, banks have the opportunity to strengthen their brand. Furthermore, effective social media engagement differentiates a brand, making it more relevant to customers. The sheer reach and effectiveness of social media also enables a cost decrease. For instance, sites like Facebook serve as a low-cost channel to send notifications, provide customer service, identify dissatisfied customers and host conversations. Moreover, social media platforms allow banking institutions to create better, more innovative products and services that reflect real-time consumer demand.

However, to get the most from social networks, financial services firms need the software tools to engage with customers rapidly, and monitor and analyse messages on social networks effectively. Thus, within this system, IDCorp has included a built-in Social Media Banking Intelligence (BI) solution that customers can leverage. The BI solution allows users to run social media analytics to get a more accurate, real time understanding of market needs and trends, quantify customer perceptions about products and competitors, and effectively track brand success. The state-of-the-art BI engine also produces the highest levels of accuracy by analysing linguistic relationships and relaying this valuable data regarding the specific opinions, emotions and behaviours the customer is expressing directly to the bank's management team.

The trove of data obtained from the BI solution enables banks to get valuable customer, market, and competitive insights from the social web for a more comprehensive picture of their brand's performance, and to identify areas for improvement.

WEB-BASED VIRTUAL BANKING AND CHANNELS DELIVERY SYSTEM

IDCorp has brought together a collection of banking services to be accessed via the Internet, smartphone and mobile SMS. The mobile banking solutions include SMS mobile banking, mobile web banking, mobile banking with unstructured supplementary service data (USSD) across a GSM network, and mobile payments services. Users of the Banco® Virtual Banking solutions will have real-time access to all their accounts, obtain mini bank statements, perform fund transfers, check account balances and change their passwords. Once activated, Virtual Bank will be available anywhere in the world, at any time of the day.

IDCorp offers a number of different systems solutions

The company's electronic banking channels are connected to the channel management, which links all other banking systems, including the centralised banking, payment switching and credit card systems. The quality of the systems and channels is such that users will not experience a decline in performance, efficiency, usability, reliability, safety or privacy.

END-TO-END PAYMENTS SYSTEM AND INFRASTRUCTURE

IDCorp's signature SIPA® payments solution is an expandable, parametric and peer-to-peer system. It handles card life cycle stages, namely issuance, extension, renewal and replacement, and is based on MasterCard, Visa and the Payment Card Industry Data Security standards (PCIDSS). The SIPA® payments solution is part of IDCorp's comprehensive payments solution architecture.

The front office modules within this solution enable customer connectivity with payment services through electronic channels and payment terminals. They also provide connections with other key components of the payment system including national switches, payment service providers and banks.

The popularity and success of IDCorp's payments infrastructure is demonstrated by the company's market share in Iran's banking sector and payments industry. IDCorp has a 75 per cent market share in the Iranian private banking industry and 75 per cent market share with state banks. We also manage 60 per cent of the point of service (POS) terminals in the country and perform 60 per cent of transactions on the National Switch, which processes credit card and ATM operations.

SHARIA-COMPLIANT CREDIT CARD SOLUTION

IDCorp's Islamic Credit Card Solution is a combination of the company's Sharia-compliant financing and card management system. It provides a fully dynamic and parametric relation between the card and the loan system, enabling banking systems to determine the type of lending based on the characteristics of the purchase. Banks are also able to automatically debit accounts and handle automatic branch payments, thus improving their credit management, bill settlement and instalment collection. Furthermore, IDCorp's solution allows banks to introduce fees and profit rates more efficiently.

For cardholders, the Islamic Credit Card Solution helps them to better manage their Sharia-based credit financing. They can also use credit companies as credit suppliers. To ensure the privacy of customers, all cardholder data is secured based on PCIDSS standards.

MICROPAYMENTS AND AUTOMATED FARE COLLECTION FOR PUBLIC TRANSPORTATION

IDCorp's Automated Fare Collection System (AFCS) has a modular architecture model with interoperable and integrated modules using a centralised database system platform. The fare payment system architecture has both data and service-oriented components for ultra-light contactless cards used in public transportation. AFCS also comes with fare collection, e-ticketing and ticketing office solutions that enable workflow, ticket and credit card management and ticket personalisation solutions. Clients will also be able to impose tariffs and setup zonal controls.

Moreover, AFCS' clearing and settlement capabilities include members-operators settlement rules management, reconciliation and fund transfer payment gateways. In terms of security, the system's security access modules provide defences for multiple service points, payment networks and credit management centres. AFCS's back office operations include business intelligence, fraud detection, operational intelligence, mobile business intelligence and management information systems reporting.

BIG DATA MANAGEMENT AND SOCIAL NETWORK INTELLIGENCE SYSTEMS

IDCorp's Banco® Big Data and Intelligence Systems focus on business intelligence, fraud detection, operations, user loyalty and social networks. The highlight of the intelligence systems falls under social intelligence in the form of two solutions. The first is the Social Network Crawler Engine that enables analytics, web intelligence and sentiment analysis. The engine is a software system that investigates the content of social networks, by employing state-of-the-art techniques to extract data related to a specific subject. The software mainly belongs to the trend analysis or sentiment mining family of technologies, which has emerged in recent years. The primary focus is on the largest social network site – Facebook. However, the engine also caters for other sources of trend analysis including Twitter, blogs, news sites, and internet forums, among others.

The second social network intelligence solution is called the Government Internet Filtering and Sniffer Engine. This engine employs the latest techniques to control the Internet access on the Internet backbone of a country. IDCorp's successful implementation and support of the Islamic Republic of Iran's national filtering system for over 6 years highlights both the knowledge and experience of IDCorp in completing projects of that scale. The primary focus of the engine is a central carrier-class filtering system that performs access control on web sites. It enables the authority to enforce access policies on web sites, URLs and keywords. Moreover, it brings fine-grained access control on Internet usage and helps the authorities in mitigating various threats to individuals and the general population.

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HANDRITO HARDJONO
GARUDA INDONESIA
Former Chief Financial Officer

INTERNATIONAL INVESTOR: What is your outlook for the global Islamic finance (IF) industry?

HANDRITO HARDJONO: Garuda secured US$100 million in Islamic financing from the Indonesian unit of Malaysia's Maybank, PT Bank Internasional Indonesia Tbk. The loan has a tenure of three years and is based on the musyarakah structure. It will be used to finance the expansion of our aircraft fleet, growing both our domestic and international networks. Part of the loan will be used to finance our Hajj and Umrah flights, which are flights for Muslims making the pilgrimage to Mecca, throughout its three year period. This is not the first time Garuda has turned to IF: in the past we have secured an ijara-based loan to finance aircraft purchases, and used wakala and musyarakah-structured loans for working capital and other general purposes.

I must stress that we have faced some challenges when trying to determine the best loan structure that matches our needs. This is primarily due to the exclusion of aircraft on our balance sheet. Garuda does not own most of its fleet; many aircraft have been acquired under an operating lease arrangement with the respective vendors. This, coupled with the fact that our equity is smaller than other airlines, does not require us to include those aircraft on our balance sheet. Thus, the airline is unable to use certain structures and methods of Islamic financing, as they require underlying assets that are reflected in the company's financial statements. The same hurdle has also prevented us from issuing sukuk.

What are some of the market challenges that Garuda faces and how can the airline overcome them?

The primary challenge for us is the weak Indonesian economy. Growth has not been as strong as we had hoped and this has caused the Indonesian rupiah to depreciate more than 13 per cent against the US dollar in 2014. With Garuda's accounting and business transactions carried out in US dollars, the effects of the weakening rupiah have been clearly reflected in our financial statements. Garuda's recent investments have also yet to return a profit, as they must contend with increased competition from other domestic and international airlines.

To overcome these hurdles, we have undertaken three initiatives as part of a broader strategy implemented in 2014: we have joined the SkyTeam Alliance to strengthen and grow our international network; we have opened a new international route to London to bolster our presence in the European market; and, to enhance Garuda's global brand, the airline has become the official kit sponsor of English football giants Liverpool F.C. To turnaround our financials, we have consolidated non-performing routes, such as closing our Jakarta-Taipei route and reducing flights to Sydney. Instead, we will shift our focus to more profitable destinations.

CAREER DEFINING MOMENT

The greatest period of my career was between 2005 to 2010, when we had to restructure Garuda's debt of more than US$1billion and avoid filing for bankruptcy. At the end of 2010, we finally signed the debt restructuring agreement. In early 2011, Garuda successfully launched its IPO and was listed on the Jakarta Stock Exchange, marking a new beginning in the company's history.

LESSON IN BUSINESS

The most important lesson is choosing the right people and managing them well. They have to be able to adapt to changes within a short period of time. Moreover, in order for the company to survive, they have to be strong in the face of competition..

What are some of the benefits Garuda has identified in using Islamic financing?

The primary benefit that we have experienced is the diversification of our funding sources with the broadening of our investor base. Before, most of our investors came from Europe and other western societies, countries where the aircraft manufacturers were based. By using IF, we are receiving a lot of attention from investors based in regions like the Middle East and Malaysia. Sharia-compliant funding is key in order to purchase underlying assets that are required to undertake other forms of Sharia financing and sukuk issuances.

Islamic financing has also allowed the airline to lower prices for certain flights to more competitive levels. This is partly due to the lower loan rates set by Islamic banks. Another benefit is the increased marketing opportunities for Garuda, especially in new markets. For instance, through our financing partnerships with banks in the Middle East, we can market the Garuda brand to customers in the region. With the added exposure and recognition, we can then obtain more financing to further expand our operations.

What initiatives are being undertaken to promote IF in Indonesia?

The government is playing a huge role in developing the domestic industry by issuing sukuk and legislators have stated their intention to continue doing so. Since 2011, the country has sold over US$5 billion of global sukuk. The government's latest sukuk, launched in September 2014 with a tenure of 10 years, was worth US$1.5 billion. The order book totalled over US$10 billion, easily making it Southeast Asia's largest order book for a sovereign sukuk.

By issuing sovereign sukuk, the government will definitely stimulate the participation of both the banks and investors, perhaps even contributing to the growth of IF in the region. In the third quarter (Q3) of 2014, the Islamic banking market share reached 4.9 per cent of the local banking space. Sharia-compliant mutual funds captured 4.5 per cent of the local market, while sukuk issuances represented 3.2 per cent of global issuances as of Q3 2014. Indonesian lawmakers are also working on improving the legislative and regulatory frameworks together with the National Sharia Board. As of November 2014, the board has 95 standards related to IF.

Certainly, one area of the local IF industry that needs more resources and attention is human capital. Many companies, from banks to airlines, lack individuals with the skills needed to carry IF use forward in the country. Thus, companies are unable to implement Islamic financial transactions efficiently. Moreover, the general public needs to be educated about IF as well. To do so, banks can use their commercial Islamic banking branches as a venue to market the benefits of this type of financing.

PERSPECTIVE: CENTRAL BANK OF THE PHILIPPINES

Encouraged by favourable macroeconomic conditions, the Philippines has seen a sustained increase in infrastructure projects, as well as an accelerated rollout of projects under public-private partnerships (PPP). This has provided fertile ground for Islamic Finance (IF) to further develop.

Amando M.Tetangco Jr., Governor of Bangko Sentral ng Pilipinas (BSP), reflects on the development of IF and the outlook for infrastructure projects

Despite the millions of Muslims in the Philippines the availability of Sharia-compliant financial products in the country is very limited. However, the Philippines has long been open to accommodating IF. In fact, the government-owned Al-Amanah Islamic Investment Bank of the Philippines (AAIIBP) was established in 1973. However, the growth of AAIIBP has been hampered by certain legal constraints, as the General Banking Law, established in 2000, stipulates that Islamic banking explicitly pertains to Al-Amanah Bank only and does not provide for the creation of other Islamic banks. Thus, AAIIBP lacks the necessary counterparties to grow the industry. For this reason, the BSP is supportive of the initiative to introduce appropriate amendments in order to address this issue.

DEVELOPING A FRAMEWORK FOR ISLAMIC FINANCE

To develop Islamic banking and finance in the Philippines, the country needs to establish an appropriate legal framework where the Islamic banking system can operate side-by-side with the conventional banking system and where conventional banks can operate Islamic banking windows. Additionally, certain taxation laws and regulations need to be adjusted to accommodate IF products and services. In the absence of an enabling law governing the establishment and operation of new Islamic banks, the BSP cannot issue regulations to govern their establishment and operation.

To this end, the BSP has been collaborating with government agencies, such as the Securities and Exchange Commission, the Philippine Deposit Insurance Corporation, the Insurance Commission and the Department of Finance, to explore the ways in which Islamic banking can be developed and promoted. The BSP has also rolled out a perception survey to gauge the interest of banks in the area of IF. The results will be an important consideration in determining the appropriate regulatory framework for Islamic banking.

Another crucial step is the need to build a pool of manpower that understands IF, which is critical to the success of all the initiatives. BSP has been working with multilateral agencies and other jurisdictions that are more advanced in the field to address this need.

Importantly, the development of IF can be utilised as a means of improving financial inclusion, particularly in the Autonomous Region in Muslim Mindanao. In fact, the BSP has recently become more actively involved in issues relating to IF in light of the proposed Bangsamoro Basic Law, which includes some provisions on Islamic banking. The draft law calls for coordination between all public sector stakeholders concerned with determining an appropriate approach for the further development and promotion of IF not only in Mindanao region, but also in the Philippines as a whole.

FINANCING INFRASTRUCTURE DEVELOPMENT

Growing urbanisation in emerging markets and increasing prosperity are expected to boost spending on transportation, communication, water, power and even manufacturing. IF can play an important role in these infrastructure developments given its ideological commitment to serving the community and emphasis on equity-based and asset-backed financing.

Currently, the industry is growing beyond predominantly-Muslim markets and this trend is expected to contribute to greater cross-border flows in terms of increased trade and investment transactions, including cross-border Sharia investment and financing, which could reinforce economic linkages and foster financial security. These developments highlight the need for a strengthened IF infrastructure, comprehensive cross-sectoral standards and a common platform enhancing dialogue among the regulators in different jurisdictions.

As the IF industry grows, the Philippines is taking a more committed stance to enable its accommodation. Accordingly, the country is looking to increase its attractiveness as an investor destination by establishing a stable and transparent policy environment and reducing the cost of doing business.

The Philippines current market indicators show an optimistic outlook, with a sustained increase in projects leading to higher production volumes, business expansion and enhanced business strategies and processes. This outlook is driven by the expected acceleration in the rollout of infrastructure and other projects under the PPP program, as well as the favorable macroeconomic conditions, such as stable inflation and low interest rates, sustained foreign investment inflows, and the steady stream of overseas Filipinos' remittances.

However, the private sector will only participate if a conducive business environment and the right incentives are in place, and laws that protect the interests of the different stakeholders are established. Thus, to be able to use IF as a funding source for infrastructure projects, it is imperative an adequate regulatory framework is established.

MOHD. SHARIFF KHAMIS

IDCORP

Executive Chairman

INTERNATIONAL INVESTOR:Could you provide us with a brief overview of IDCorp and its products and services?

MOHD. SHARIFF KHAMIS: IDCorp stands for Innovation & Development. We are a Malaysian company providing global banking software to banks throughout the globe, focusing on the markets of Malaysia, Vietnam, Myanmar and Indonesia in Asia and Iran in the Middle East.

In terms of our current Islamic banking footprint, in Asia the Indonesian market is rapidly growing, not only regarding technology, but also in the detailed aspects of Sharia compliance. Malaysia, of course, is way ahead in terms of take-up, being a global leader in Islamic finance (IF). In Iran we have a very strong market presence in banking applications, payment systems and fare collection for the transportation system. Interestingly, I have just returned from North Africa, as we are trying to assess the development of Islamic banking in Algeria, Morocco and Mauritania. The Tunisian capital, Tunis, will be our base on that continent.

Our core business has always been global banking, focused on IF, and we also provide conventional banking solutions. We are very proud of the Banco Social Network-Media Banking System, which has been developed to offer a better customer experience and to improve corporate reputation via social media platforms. We are specialists in loyalty intelligence, which means that based on the data provided on the amount of transactions, we are able to instantly reward customers at the very moment they perform a transaction.

We also offer solutions for automated fare collection in transportation systems. We have supplied systems to the Tehran Municipality for public transport infrastructure (MRT and BRT) in the Iranian capital, Tehran Metro.

Finally, we offer fraud detection solutions, which is operational intelligence that actually traces transactions and reports to the operators if there is something suspicious about a particular transaction, such as potential fraud or money laundering.

CAREER DEFINING MOMENT

I was trained as an accountant, sponsored by the Bank Bumiputra. I started work for the bank in the credit department and I had computing on my mind. Then a vacancy opened up in the IT department, and I never looked back. I have been designing, consulting and running businesses related to computer systems since that moment.

LESSON IN BUSINESS

Even though I work with computers, I focus on the people with whom I work. When I interact with fellow workers or customers, I always keep in mind how to relate to them and adapt myself to generate the best outcome. In my field, it is essential to know how to relate to people from different cultures.

Do you see potential for IF in China?

China has a large Muslim population and, given the fact that some banks in the country have customer bases of up to 300 million, there is definitely potential. However, there are some hindrances in terms of laws and regulations. Nevertheless, if IF can bring in funding from abroad, governments may be more flexible in adjusting the regulations.

Given the obstacles, I think it is unlikely that we will see standalone Islamic banks, so they could learn from the Malaysian model and acquire banks or obtain majority or equity shareholdings in order to set up Islamic banking in China.

How can technology support and facilitate the growth of the IF market?

I am convinced that the implementation of technology is essential to developing a successful business. At IDCorp, our aim is to use cutting-edge technology to implement Islamic banking and develop products on par with conventional banking systems, if not better, such as Sharia-compliant ATMs, Points of Sale (POS) and telephone banking services.

It is also important to identify technology that is beneficial for particular segments. For example, we have been proposing that relatively small Sharia banks should take advantage of cloud computing, instead of designing customised banking software and systems.

In my experience, any bank that implements cloud computing can save up to 40 per cent on initial costs. IDCorp has offered Application Service Providers (ASPs) and cloud computing to various Islamic banks in Indonesia, and I forsee us selling a great number of licences in the future, as it is technically and economically attractive for small banks.

In terms of adopting Islamic banking solutions, it is important to realise you cannot turn an existing conventional banking system into an Islamic system, as they are completely different. It is challenging to pull banks out of their comfort zone, as they are usually content with their existing systems. My experience has taught me that when the management of a bank changes, there are more opportunities to integrate new technologies. The human factor generally slows down innovation processes, especially at large banks.

Are there any barriers to the further development of IF in Malaysia?

Malaysia is recognised as a leading country in IF and has successfully propagated Islamic banking. At conferences I have attended, many speakers are Malaysian or they refer to Malaysia as their case study, which is a great accomplishment. However, it has been very successful in promoting IF to the corporate world, but less so to the general public. This should be addressed, as it a growth barrier.

Furthermore, the tendency of increasing profits rather than adopting musharaka or profit sharing is something that worries me. Sharing profits and losses is one of the main principles of Islamic banking and this should not be forgotten, so I hope new scholars will re-evaluate the IF standards in Malaysia and provide another road map, putting more weight on other Sharia-compliant products instead of mainly focusing on sukuk.

For example, there is an Islamic trade finance system, which we developed, incorporating Sharia-compliant structures. We received customers from Tehran in Kuala Lumpur who came all the way to Malaysia to compare what they had and what Malaysia was doing in this field. We took their interest as a signal that there was a market for developing trade systems for IF. Thus, we started investigating this segment and have now developed an Islamic trade finance application, which has been increasingly successful since its implementation about two years ago.

ANGELIA CHIN-SHARPE

BNP PARIBAS INVESTMENT PARTNERS MALAYSIA

Chief Executive Officer and Country Head

CAREER DEFINING MOMENT

It was during the Asian financial crisis, while I was working for an entrepreneurial stockbroking company. Our credit lines were cut, and margin calls were barely met. However, with perseverance, our efforts paid off.

LESSON IN BUSINESS

You have to recognise that your people are the true assets, but also acknowledge the challenges in managing them. You have to listen to your team and motivate them in a way that ensures your objective can be achieved.

INTERNATIONAL INVESTOR: Could you give us your views on the development of the asset management industry and the sukuk market?

ANGELIA CHIN-SHARPE: It has been challenging for the broader asset management industry since late 2013 because investors have preferred to hold cash due to price and volume fluctuations in the market. As the markets begin to stabilise, especially on the U.S. front, most investors are now returning and seeking new opportunities.

However, despite the high levels of uncertainty experienced recently, the demand for sukuk has continued to stay strong, especially in Malaysia, Indonesia and the Gulf Cooperation Council (GCC) nations. Even when the U.S. Federal Reserve began discussions on tapering, the negative price action of sukuk was less intense than conventional bonds.

In fact, the demand for sukuk is so strong that every time an issuance takes place it will almost certainly be oversubscribed. The main factors behind this phenomenon are the increased recognition of sukuk's stability by investors, as well as the presence of big investors in the market. Such investors include cash-rich GCC banks and pension funds.

An analysis of the sukuk issuing currency shows another facet of Islamic finance (IF). Malaysia, for example, harbours ambitions to become an Islamic financial hub, as demonstrated by the depth of its investor pool. However, because of the sheer size of this pool, most issuing entities in Malaysia have little incentive to issue in a foreign, more recognised currency like the U.S. dollar. Thus, companies do not to look for opportunities outside their comfort zone and this greatly inhibits the growth of IF.

The decision to issue sukuk in a foreign currency is certainly affected by the business objectives of the particular entity. Khazanah Nasional, the Malaysian government's strategic investment arm, took the lead with Singapore dollar and U.S. dollar issuances, but the decision to do so was tied to their international portfolio, which includes investments in both the U.S. and Singapore.

At the international level, we have witnessed several governments issue their first sovereign sukuk, namely the UK, Hong Kong, Luxembourg, and South Africa. Again, the currency used for each issue was different, and this can also be explained by the issuing entities' objectives. The UK's sukuk was denominated in British pounds to tap the potential of the local Islamic banks; Luxembourg decided to issue their maiden sukuk in Euro to leverage the European investor base; and South Africa chose to use the U.S. dollar to diversify its funding sources and tap into wealth in the Arab countries. However, a crucial factor behind the international success of these issuances was that they were denominated in more globally recognised currencies.

What are some insights into Sharia investing that you have identified?

The preferences of investors have indicated that financial innovation is a key factor in their decisions, which is currently lacking in Sharia-compliant products. The lack of innovation is due to the low demand for such products. In the private banking space, research has shown that some Muslim investors are more comfortable opting for conventional products that are more innovative and sophisticated. If they choose to adhere to Sharia principles, they usually invest in sukuk or Sharia-compliant equities.

As such, Sharia-compliant products have not taken on the same asset volume as conventional products. Thus, the biggest challenge for the asset management industry is actually gathering the assets that are Sharia-compliant. Most of the industry's assets are from institutional investors rather than high-net-worth individuals.

What must be done to develop the Islamic wealth management sector in Malaysia?

Malaysia has the ambition to become an Islamic private banking hub, but the market has not been fully opened yet. Currently, there are restrictions that limit the introduction of new products from entering the market. However, the lawmakers have had active discussions with all stakeholders in the market, including BNP Paribas, to resolve this situation.

Currently, certain initiatives are being undertaken to build an adequate infrastructure framework to grow the Islamic private banking market. One example would be the liberalisation of Malaysia's unit trust industry by allowing foreign firms to establish wholly-owned unit trust companies in Malaysia. Such efforts would then allow both foreign players and products to be easily registered in Malaysia, thus meeting the investors' demand.

What is the primary challenge in increasing investor participation in IF?

The main obstacle is to convince global investors that Islamic investment products are not exclusive to Muslims and that they are able meet the requirements of investors at large. At the heart of the issue is a gap in understanding Sharia-compliant products and the challenge is aggravated when investors choose to ignore such products because of the Sharia label. Even BNP Paribas Investment Partners, despite being a global financial institution, has faced this issue. When we wanted to promote our Islamic product capabilities in places like Europe, investors chose to neither listen nor understand simply because of the word 'Sharia'.

We are currently discussing the possibilities of removing the Sharia label and promoting our products in a way that fosters understanding of the processes involved in structuring them. Part of the learning curve includes educating investors of the real selling point of IF, which is the need for investments and financing to be backed by real assets. This underlying principle makes IF well suited for socially responsible investing (SRI) and sustainability initiatives.

DR. NUNGSARI AHMAD RADHI

DANAINFRA NASIONAL

Principal Officer

INTERNATIONAL INVESTOR: Could you talk about DanaInfra's mandate as a fully-owned government subsidiary?

DR. NUNGSARI AHMAD RADHI: DanaInfra Nasional Berhad is a Special Purpose Vehicle (SPV) set up as a fully-owned subsidiary of the Ministry of Finance of Malaysia in March 2011. Its main role is to advise and undertake funding for future major infrastructure projects on behalf of the Malaysian government. The founding objectives are to separate fundraising activity from infrastructure construction and develop the most cost-competitive, efficient and sustainable financing models, whilst maintaining the government's fiscal position. The model in use currently allows the treasury department to be flexible in terms of managing cash flow and to take advantage of the liquid capital market in Malaysia.

As a quasi-government issuer, the primary mandate is a fundraising exercise for the construction of Malaysia's first Mass Rapit Transit (MRT) project, the Sungai Buloh-Kajang Line, which spans 51 kilometres and serves 31 stations across the Klang Valley. The project was begun in 2012 and costs have been estimated at about RM30 billion with construction and funding projected over a period of six years.

Accordingly, DanaInfra has implemented a RM8 billion financing programme guaranteed by the government, comprising an Islamic Medium Term Note (IMTN) programme and an Islamic Syndicated Islamic Revolving Credit Facility as a backstop mechanism.

The first sukuk issuance under the IMTN programme took place in July 2012. Upon the exhaustion of the RM8 billion financing limit, we obtained a second Government Guarantee in April 2014, bringing the total guaranteed amount to up to RM21 billion.

To develop and facilitate greater retail participation in the bond and sukuk market, we presented a new investment product, the Exchange Traded Bond / Sukuk (ETBS). As the first sukuk to be offered to retail investors,

CAREER DEFINING MOMENT

I am a traveller. During my professional life I have obtained too many relevant experiences to choose just one particular moment that defines my career.

LESSON IN BUSINESS

Having free cash flow is essential when you are setting up a business project; I am old-fashioned in that sense. Before selling your business idea and having other people on board, it is essential to be able to demonstrate you have cash flow.

DanaInfra ETBS is listed on Bursa Malaysia to allow primary issuance and secondary trading akin to listed equities.

How do you plan to raise awareness about DanaInfra's evolution from a MRT funding vehicle to an infrastructure-funding vehicle?

We aim to develop global awareness about the role that DanaInfra has played to date as one of the strategic components of the Malaysian government's infrastructure efforts. The challenge going forward is that we cannot afford to slow down in the fundraising efforts. Timeliness is crucial in adhering to the funding schedule of any public infrastructure project.

The main drivers for DanaInfra to innovate are the needs to tap a wider investor base and reduce reliance on full government guarantee. Therefore, we are exploring a move towards equity-like structures and optimising the public infrastructure assets. In order to attract foreign investors, we need to factor in the discomfort among certain investors regarding debt instruments, as Islamic scholars differ on the acceptability of such instruments.

Executing this, however, will require having the infrastructure assets to back the structures, which leads to the pooling of public infrastructure assets for this purpose. Additionally, consolidating these assets will allow more flexibility in assets monetisation in the long-term.

What is the advantage of finance (IF) over conventional finance in terms of infrastructure development?

Conventional development financing has played a major role in global infrastructure investments, but has failed to fulfil all financing needs over the last three decades. Based on estimates by the Organisation of Economic Cooperation and Development (OECD), US$71 trillion investments would be required by 2030 for road, rail, telecommunications, electricity and water infrastructure, or approximately 2.5 per cent of global GDP.

The potential of IF in infrastructure projects has already been demonstrated. In Malaysia, 71 per cent of sukuk issued in 2013 was to fund infrastructure projects, and 41 per cent in the case of the Gulf Cooperation Council (GCC) countries.

One of the attractive aspects of IF is the high degree of certainty it provides with regard to the utilisation of funds. Additionally, IF transactions are supported by sound business ethics, as Sharia advisory and supervisory entities serve to ensure that the transactions are in compliance with Sharia standards. The underlying principle of IF is that transactions should benefit both lenders and borrowers, while risks and returns are properly apportioned.

What initiatives could attract more foreign investors for Malaysian issues?

As an emerging country with an active and sophisticated capital market, Malaysia is already high on the radar of international investors focusing on sovereign debt. As of June 2014, 45 per cent of Malaysian sovereign debt was in foreign hands, compared to Indonesia's 32.5 per cent and India's 2 per cent.

Moreover, DanaInfra has already established its name among fund managers domestically, as evidenced by the oversubscribed books during the last six sukuk issuances amounting to RM14.1 billion. In order to reproduce these successes at a global scale, we plan to engage investment banks with worldwide distribution channels and reach out to potential investors via targeted media presence.

To ensure familiarity for foreign investors, Malaysian issuers looking to expand their investor base should be flexible. For example, they may consider an issuance denominated in foreign currencies, or a fundraising programme rooted under American, European or Japanese securities laws.

It is also crucial for issuers going the route of Islamic investment instruments such as sukuk to select an underlying Islamic principle, which is universally accepted by Islamic scholars, and to communicate the principle properly to investors who may not be familiar with such principles.

PERSPECTIVE: UK GOVERNMENT

The UK has much to offer the fast-growing IF market and has strongly stated its ambition of maintaining and expanding the position it currently holds as the Western hub and a leading global centre for Islamic Finance.

The UK must build hundreds of thousands more housing units per year, which creates enormous opportunities for Islamic banks

EXCELLENCE IN ISLAMIC FINANCE

The UK Treasury has consistantly expounded its policy of open, willing engagement with fast-growing economies, such as those in the Islamic world, and the global market for Islamic finance (IF) is expanding rapidly, enjoying year-on-year growth of 40 per cent since 2005, with global Islamic assets totalling close to US$2 trillion.

The are a number of factors that distinguish the UK as an ideal place to do business for the IF market. The primary factor relates to its position, due to the time zone, at the centre of global capital markets. Additionally, the country offers world-class academic institutions that provide specialised training courses and qualifications, such as world-renowned MBA courses, and has recently introduced scholarships that pertain to IF. The professional services industry in the UK has significant expertise in IF, including more than 25 law firms, and the country benefits from a highly-educated, multicultural and multilingual workforce. Developing IF is an important part of the UK Government's long-term economic plan to diversify its economy, working with new markets and taking advantage of emerging trends.

The UK Government has also taken a number of policy decisions to reinforce and cement its position as a global partner and destination of choice for IF. In October 2013, London hosted the first World Islamic Economic Forum (WIEF) held outside of the Islamic world. Over the course of the forum a number of important commitments were made, which have since been implemented, including launches of both an Islamic Index on the London Stock Exchange, and the first Islamic underwriting agency, Cobalt Underwriting; and the establishment of certain groups to promote the development of IF, such as the Islamic Insurance Association, and Global Islamic Finance and Investment Group (GIFIG), which brings together high-level, public and private market actors and regulators to examine the key global opportunities and barriers facing IF.

However, the most signifcant indicator of the UK's commitment to IF came in June 2014, when it became the first country outside the Islamic world to issue sovereign sukuk. The UK issued a £200 million sukuk maturing in July 2019, the largest ever issuance of sterling sukuk. It uses the common ijara structure, with rental payments on central government property providing the income for investors, was nearly 12 times oversubscribed, receiving orders totalling around £2.3 billion and allocations were made to a wide range of investors based both in the UK and in major IF around the world. The profit rate was set in line with the yield on gilts of similar maturity.

The success of this issuance should encourage further private sector issuances in the UK and was the culmination of signifcant work undertaken over a number of years to create a tax and regulatory environment that puts IF on a par with conventional finance in the country.

MARKET DEVELOPMENTS

There are certain areas of development investors can expect in the UK market. 2015 has seen the UK's credit export agency, UKEF, bringing a guaranteed sukuk to market in support of an Airbus customer. The government-backed agency provided cover for a US$913 million sukuk issued to Dubai's Emirates Airline to fund the acquisition of four aircraft. The issue marks the world's first sukuk supported by UKEF and the largest ever capital markets offering for an ECA-backed aviation transaction. Given the confidence the market has in both the strength of the UKEF guarantee and the principles of Sharia financing, the landmark transaction saw strong and diversified demand from global investors.

The second area of development in the British market is infrastructure. The UK has already seen some major infrastructure projects in recent years that have been funded or part-funded by IF, such as Qatari Diar's investment in Chelsea Barracks, The Shard and the Battersea Power Station development, and will certainly be seeking significant further inward investment in this area in the coming years. The UK must build hundreds of thousands more housing units per year than are currently being constructed, which creates enormous opportunities for Islamic banks. Gatehouse Bank, which is fully Sharia-compliant, has already made a significant investment that could reach £700 million to construct 6,600 units in the North West and Midlands regions.

The third area is Sharia-compliant facilities. The Bank of England (BoE) has acknowledged the very real difficulties Islamic banks currently face in meeting their liquidity requirements, as the BoE's existing facilities involve interest-bearing activity and are, therefore, not Sharia-compliant. To address this, in 2015, the BoE will begin feasibility work on establishing a Sharia-compliant facility. Although this will be a project for the medium term, it is nevertheless a step in the right direction, and it is another vote of confidence from the UK in bringing IF into the mainstream.

RAMLIE KAMSARI

CIMB-PRINCIPAL ISLAMIC ASSET MANAGEMENT

Chief Executive Officer

INTERNATIONAL INVESTOR: Could you provide an overview of your strategic objectives?

RAMLIE KAMSARI: Our overriding mission is to be a market leader in Islamic asset management, providing customised solutions to institutional investors using an end-to-end Sharia platform. We aim to shape our processes in a manner that supports our objectives and plans to increasingly promulgate our achievements in this sector. One accomplishment that we are particularly proud of is our success as a sub-investment manager for the Al Hilal Global Sukuk Fund, which already has US$55 million assets under management (AUM) only two and a half years after its inception.

Internally, our principal objective is to foster a client-centred approach. Therefore, we have implemented the Total Customer Experience (TCX) programme, which focuses on procuring feedback from our clients. Annual client surveys looking at key deliverables, such as investment returns, turnaround time on queries and research reports, enable us to benchmark ourselves against industry peers and evaluate the client expectations very accurately.

These questionnaires are also aligned with our key priorities and the deliverables expected by the customers. For example, regarding investment returns, we assess the return target looking at the different mandates and asset classes. We engage with our clients using qualitative and quantitative parameters in order to deliver an evaluation that is not only measureable, but also realistic for both parties.

In this process, we try not to be prescriptive but use a holistic approach in which we actively focus on the operational and back office functions rather the front-line areas. Since many companies do not prioritise these areas, our internal stakeholders are very pleased with this method. As we are operating on a shared service model, it is imperative that employees in supporting roles feel part of a larger team. The implementation has been smooth so far, so I think the next step is to live up to the expectations.

CAREER DEFINING MOMENT

For good or bad, and I have always been consistent about this, it was between 1994 and 1995. When the Kobe earthquake shattered the world markets, I was working at Barings Bank and had a front-seat view at the epicentre of the debacle surrounding the bank's collapse. The repercussions of those events provided clear lessons to me and have shaped my career.

LESSON IN BUSINESS

Witnessing the collapse of the Barings Bank taught me that integrity is a key virtue in this industry. Moreover, the experience forced me to develop resilience and self-belief. Events like these, however distressing they may be, also present opportunities to learn and grow.

What are your expectations regarding your expansion plans?

The United Arab Emirates (UAE) is our main priority because of an existing mandate and the strong pipeline we are seeing. In order to capitalise on all available opportunities, we need to be close to the epicentre of sukuk issuance, which is in Abu Dhabi and Dubai.

As we are strengthening our presence in the Gulf Cooperation Council (GCC), we have reinforced our investment team in Kuala Lumpur, and homogenised our credit evaluation process, particularly for GCC credits, ensuring our market leadership role for global sukuk. It has been estimated that issuances in 2015 will total up to US$100 billion, 40 per cent of which will originate from the GCC. That gives us a lot of confidence and substantiates our decision to focus on that market.

In total, we are looking to raise US$100 million in the GCC, predominantly from global sukuk mandates. Despite the inherent challenges, we are continuing to expand our sales distribution network in UAE, and potentially Saudi Arabia as well, as it creates a visible platform to entrench our leading position in the Islamic asset management space.

What trends have you observed within the local and regional investor community?

Over the past few years, we have seen an increasing amount of non-Muslim investors becoming interested in our products, which is an exciting development. From a geographic point of view, investors are seeking opportunities in GCC countries in order to diversify and to enter an emerging market.

The majority of this new group of investors have an agnostic approach, so they see the region as a burgeoning area of growth, especially Dubai. It is also seen as a safe haven in the region, considering the geopolitical events in the neighbouring countries. Certainly, leading these investors down this path has required an educative process, and we have had to deal with many misperceptions, not only relating to asset classes, but also regarding the market in general.

In fact, investors are surprised when they see the advancements and liquidity in some of these economies. When they realise opportunities are equal in terms of exposure, they become more confident.

Additionally, investors are gradually moving away from a benchmark or relative return strategy and are looking at absolute returns to maximise the return potential. There is an increasing appetite for unconstrained portfolios, which allows us to look for the best risk-return reward. Furthermore, albeit a cyclical trend, investors are increasingly interested in emerging markets. We also see many more requests for frontier market exposure and, currently, Latin America has come to the fore. It has a wealth of commodities, which are generally Sharia-compliant, and a very strong trade flow.

Could you tell us more about your Islamic Global REITs product offering?

This market has great potential. We are looking at Islamic Global Real Estate Investment Trusts (REITs) as an extension of our product offering, as we see demand from local institutions. Specifically, local pension funds have increased limits on allocation for both international exposure and alternative investments. Our partner, Principal Global Investors, has a very strong capability and track record in conventional REITs in the US, so there will be a path to globalising the local REIT market. At this moment, we are analysing how to move forward in terms of coming up with a Sharia-compliant offering.

Sharia-compliant investing is growing rapidly as an alternative to conventional financing.

FOCUS: ISLAMIC ASSET MANAGEMENT

The Sharia-compliant asset market opens up opportunities for equitable wealth distribution and competitive investment returns. The case for Islamic asset management set out below elaborates on the benefits of this investment approach.

The development of Islamic asset management has been driven by a rising demand for Sharia-compliant investments from the global Muslim population, which will reach an estimated 2.2 billion by 2030, approximately 26 per cent of the world's total projected population at that time. The relevance of Islamic asset management as an alternative investment class for both Muslims and non-Muslims has significantly increased with the growing conscientiousness relating to business ethics and fiscal conservatism, an interest which has been further stimulated by the global financial crisis and its aftermath.

UNDERSTANDING ISLAMIC FINANCE AND ASSET MANAGEMENT

Islamic asset management is grounded in principles that express an explicit intention to meet the financial needs of participants with integrity and in a manner that is tangible, fair and honest, while ensuring a more equitable wealth distribution. All Sharia-compliant assets embrace materiality and the validity of transactions, while investment must be based on social and moral values.

Islamic finance (IF) encourages investing in real, productive or trade-related activities, and the generation of fair and legitimate profit. Ensuring a close link between the financial and productive flows that underpin IF, funds must be invested in real assets and companies, rather than exotic investments, such as conventional derivatives, that are not directly linked to underlying assets. This has the effect of insulating the Islamic financial system from risks associated with excessive financial leverage and speculative activities.

A central feature of the IF system is the belief that money is perceived only as a medium of exchange, a store of value and unit of measurement, with no intrinsic value. Therefore, the payment and receipt of riba, or interest, is not allowed, as it leads to an increase or excess that accrues to the owner in an exchange or sale of a commodity or by virtue of a loan arrangement, without providing any equivalent value to the other party.

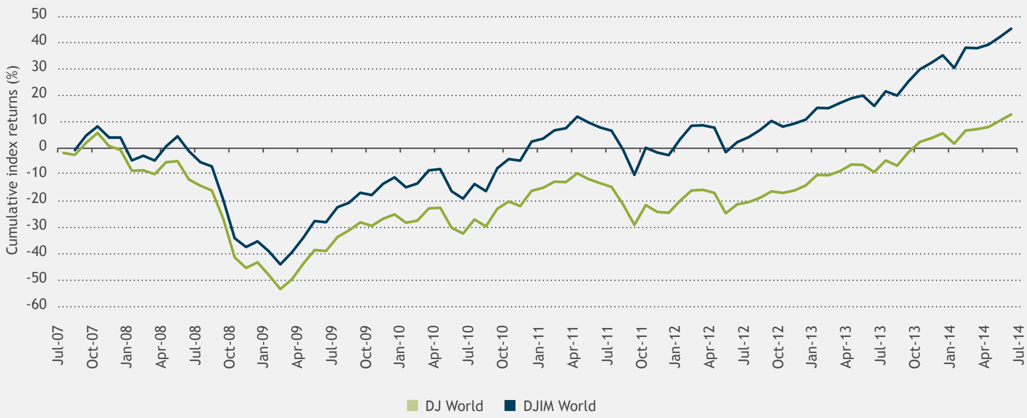
Accordingly, Islamic bonds or sukuk do not pay interest rates like conventional bonds, which are based on the exchange of paper for money with interest imposed to measure returns and liabilities. Sukuk pay coupons in a different manner, such as rent or profit, serving as trust certificates or participation securities that grant investors a share of an asset along with the cash flow or profit and risks that are commensurate with such ownership.

Moreover, this is the essence of a Sharia principle that stipulates there should be no profit sharing without risk sharing, which also implies that the only legitimate means of earning profit is through engagement in an economic venture that contributes to the real economy.

The risk- and profit-sharing characteristics must be clearly defined at the onset of a Sharia-compliant transaction, and serve as built-in mechanisms that promote the adoption of sound risk management practices by financial institutions engaged in IF.

Contracts must be honestly and clearly laid out, as ambiguity or uncertainty could lead to interpretational differences that may provide and advantage to one party over another. Additionally, appropriate due dili-

1. 7-YEAR CUMULATIVE INDEX RETURNS* (DJ WORLD VS. DJIM WORLD, JUL 2007 - JUL 2014)



* Returns are for price levels of the Dow Jones indexes only and do not include dividend reinvestments

Source: Bloomberg

gence and higher standards of disclosure enforce market discipline and minimise informational asymmetries.

BENEFITS OF ISLAMIC ASSET MANAGEMENT

Even though it is still developing, the global Islamic fund management industry is currently one of the fastest-growing sectors within the worldwide financial system. In fact, the industry expanded by 2.8 per cent in 2014, reaching US$75.8 billion in Sharia-compliant assets under management, attracting investors of all stripes, both Muslims and non-Muslims, who are drawn to value-based investing opportunities. Importantly, investments are not limited to Islamic companies, but any company that engages in activities that are not considered to be harmful. In addition to this socially responsible aspect, there are many reasons for non-Islamic investors to invest in line with Sharia principles.

Primarily, although they may outperform or under-perform against conventional investments over shorter periods, Sharia-compliant investments generate returns comparable to conventional investments over longer periods (see fig. 1). In fact, over the last seven years, the Dow Jones Islamic Market World Index (DJIM World) outpaced the Dow Jones World Index (DJ World) by an average of 3.74 per cent per year, returning 45.32 per cent and 12.83 per cent respectively (see fig. 2). Moreover, the same can be said for the period between October 2007 and March 2009, the worst bear market in decades, during which the DJIM World reported -43.21 per cent compared to -50.48 per cent for the DJ World (see fig. 2).

Furthermore, investing in line with Sharia principles offers greater stablility of returns. Sharia-compliant equites are less volatile than their conventional counterparts, both during times of financial crisis and financial stability, due, at least in part, to the fact that excessive financial leverage is prohibited. This is evidenced by comparing the annualised volatility of the DJIM World with that of the DJ World (see fig. 2).

The Islamic choice also provides the benefit of embedded risk management. In order to be considered Sharia-compliant, equities must pass through a rigorous screening process, which ascertains whether the underlying companies are sufficiently capitalised to weather difficult times and liquid enough to meet short-term obligations. This process sets strict limits for various financial ratios, such as debt to total market capitalisation or debt to total assets, in order to limit leverage; and cash to market capitalisation or cash to total assets, in order to ensure sufficient liquidity and the productive use of cash.

During the 2008 global financial crisis, due to the punctilious nature of the screening, the companies underlying the Sharia-compliant equities were generally better capitalised and more liquid than their conventional peers. Thus, they were less exposed to the deleveraging, solvency issues, liquidity concerns and the consequent sharp price declines experienced by conventional counterparts during this period.

Another advantage is that Islamic bonds are backed by real assets. Sukuk are asset-based or asset-backed

2. COMPARATIVE RETURNS* AND VOLATILITY

	18-month bear market (Oct 2007 - Mar 2009)			7-year market (Jun 2007 - Jun 2014)		
	DJ World	DJIM World	Difference	DJ World	DJIM World	Difference
Total Return	-50.48%	-43.21%	7.27%	12.83%	45.32%	32.48%
Annualised Total Return	-37.87%	-31.83%	6.04%	1.74%	5.48%	3.74%
Annualised Volatility	34.08%	32.47%	-1.62%	19.02%	18.02%	-1.00%

* Returns are for price levels of the Dow Jones indexes only and do not include dividend reinvestments

Source: Bloomberg

in that there is an asset or a pool of assets underlying every transaction, and the ownership of that asset or pool of assets is transferred to the investors. Thus, investors enjoy all the rights and obligations of ownership. Moreover, in asset-backed structures, sukuk holders have recourse to the underlying assets.

As transactions and contracts must be free of uncertainty, with terms and conditions clearly defined at the outset, Sharia-compliant investments have greater transparency and, therefore, may produce more predictable results.

Lastly, Sharia-compliant investments offer significant opportunities for diversification. While displaying a high correlation with conventional investments, they have the potential to limit downside risk. During the bear market between October 2007 and March 2009 referred to previously, Islamic funds fared better than conventional portfolios, declining less, experiencing lower volatility and regaining losses as the markets recovered.

HOLISTIC ISLAMIC ASSET MANAGEMENT IN PRACTICE

The popular definition of Islamic asset management deems that an investment manager is mandated to invest only in Sharia-compliant securities. CIMB-Principal Islamic advocates for a more expansive definition of Sharia-compliance, going beyond the investment screening process and ensuring that all aspects of the investment management operations are Sharia-compliant.

ISLAMIC INVESTMENT SCREENING PROCESS

To ensure the business qualifies as Sharia-compliant, the screening of Islamic equities takes place on the operational level, based on industry type, financial ratios and tolerable benchmarks. In turn, sukuk are qualified as Sharia-compliant predominantly based on their financing structure. Furthermore, proceeds from sukuk issuance must equally be used in a Sharia-compliant manner.

VALUE-ADDED OPTIMISATION OF ISLAMIC PORTFOLIOS

In addition to optimising the portfolio based on the qualified Islamic equity and sukuk investment universe, the investment manager may add further value by being able to understand a client’s Islamic needs and then structuring an optimal asset allocation based on various capabilities, coupled with a disciplined investment process yielding sustainable investment returns over the longer term.

Specifically, the investment manager should evaluate whether major market changes are due to Sharia concerns, market concerns or perhaps both. Equally, it should be estimated whether pricing differentiations between conventional and Sharia securities are due to Sharia differences, market dynamics or imbalances, regulatory requirements, or government initiatives.

Additionally, to properly advise clients on potential benchmarks for their portfolios, and for these to be optimised, market trends that could affect the securities universe must be anticipated and risks peculiar to Islamic securities and markets identified and mitigated properly.

INVESTMENT MANAGEMENT OPERATIONS

Holistic Islamic investment management services refer to the operations of the investment manager. In Malaysia, the first country in the world to have a fully-fledged Islamic capital market operating in parallel to the conventional banking system, the Securities Commission have mandated a number of requirements that ensure the legitamacy of investment management operations. They stipulate that Sharia advisors must be appointed at a company level and, if retail products are being offered, at a fund level. In case of irregularities, designated Sharia-compliance officers must report to the Sharia adviser and board of directors for consideration or immediate remedial action. Although guidelines currently vary between jurisdications, these particular guidelines are being viewed as a benchmark for the global industry.

Additionally, investment managers must have processes in place to handle investment securities that may turn non-compliant, called the Purification Process. Whilst Malaysia has clear guidelines regarding this, in various other countries income generated by the non-Sharia portion can even be divested at the dividend level, that of interest-bearing bonds or securities, and given to charity.

ISLAMIC ADVISORY

One of the key success factors of Islamic asset management is the investment manager’s appointed Sharia adviser. The Sharia adviser must have a robust and institutionalised advisory process in place to enhance the integrity of its decisions regarding Sharia-compliance.

To ensure interpretations are practicable, advisers must have experience with traditional capital markets, investment and product development. They must also be familiar with the differences in Sharia interpretation by jurisdiction. Moreover, to ensure the universal acceptability of its decisions across the various regions, the Sharia adviser must select Islamic scholars from diverse backgrounds and various jurisdictions.

CONCLUSION

Sharia-compliant investing is growing rapidly as an alternative investment class. It is attracting a broad spectrum of investors, both Muslim and non-Muslim, due to its foundation in ethical business practices, social responsibility and fiscal conservatism. While Islamic clients may be mandated to invest only in a Sharia-compliant manner, other investors do so for the benefits they derive, including greater stability of returns, transparency and diversification.

➥ This feature was produced in conjunction with CIMB-Principal Islamic Asset Management.

ZUKRI SAMAT

BANK ISLAM

Managing Director

INTERNATIONAL INVESTOR: Could you elaborate on the significant progress made by Bank Islam in recent years?

ZUKRI SAMAT: I joined Bank Islam in 2006. At the time the bank required significant improvements and, consequently, we launched the Turnaround Plan. Internally, we faced a certain amount of resistance in our efforts to transform the work environment and the mindset of our staff into a culture driven by performance. Externally, we had to address the general public's false perception that Islamic finance (IF) is exclusive to Muslims, which necessitated a rigorous rebranding exercise.

We also undertook a restructuring of the business in order to refocus on areas in which Bank Islam had an advantage and play to our strengths, particularly in retail banking. The hard work and perseverance paid off as we completed the turnaround within a year and we were able to regain the confidence of our employees. Additionally, between July 2009 and December 2012, we implemented the Sustainable Growth Plan, to strengthen Bank Islam's position in the industry. Today, the bank is valued at almost MYR6 billion.

How do you manage and foster leadership and talent development at Bank Islam?

I have always believed that leaders influence others by ensuring their actions are consistent with their statements. More importantly, leaders need to build a good rapport with the rest of their team through effective communication and continuous engagement. In the case of Bank Islam, we have implemented processes that allow us to easily obtain first-hand information from our branches and the space to take that information into consideration. There must always be an open channel for discussion and feedback from employees and customers, as well as other stakeholders.

A revision of our human capital policy was an essential part of Bank Islam's Turnaround Plan. In the effort to transform the bank's culture and keep employees motivated, I was reminded of the importance of attracting the right talent and not necessarily the best talent. Companies also need to invest in training and education for their employees. Accordingly, Bank Islam has taken the initiative to develop the Young Leaders Programme to grow its own pool of Islamic banking talent. The programme places high-performing graduates in structured job rotations across different business segments for one year.

CAREER DEFINING MOMENT

When I was asked to lead Bank Islam, my task was to convince all stakeholders of the management's strategies to save the bank. Implementing the strategies was challenging as we were closely monitored by regulators, shareholders and politicians. With persistence, Bank Islam returned from the brink of collapse to become the bank it is today.

LESSON IN BUSINESS

There will be times when we need to take risks, but they should be calculated risks. For banks, never venture into a business or provide credit without proper understanding. Instead, we should always make informed decisions.

How important are your strategic expansion plans to your overall vision for Bank Islam?

Regionalisation is a key pillar of our corporate blueprint and we are currently investigating how this expansion into foreign retail banking markets can be implemented. As the world's largest Muslim-populated country, with 240 million people, Indonesia is an obvious choice to assess initially. The country is expected to experience strong economic growth at more than 6 per cent per annum in the next few years and currently has an overall banking penetration rate of 20 per cent. Moreover, the cultural similarities and the relatively short distance between Malaysia and Indonesia, along with the latter's economic potential, makes Indonesia an excellent potential market. At this juncture, we would welcome conversations with Indonesian banks that are keen to partner with us.

Can you please give us an insight into your current customer base?

We have identified that there is as an increasing level of customer sophistication, but a low retention rate. Thus, delivering excellent service becomes crucial. We have emphasised both service excellence and Sharia-led innovation in our latest corporate blueprint.

To keep pace with this growing customer sophistication, we have put a sustained focus on product innovation, with the bank playing a pioneering role in the development of Islamic banking products, such as our TAP mobile banking and our UniDebit card. The implementation of the Islamic Financial Services Act (IFSA) supports our move towards developing globally accepted Sharia-based products.

Moreover, we can leverage on the increased awareness relating to ethical banking. As a standalone Islamic bank, it is possible to capitalise on the opportunities created by the growing number of customers who bank with the conviction that they do not want to compromise on the co-mingling of funds, operations, and marketing. Our efforts are paying off because we have experienced significant customer growth from two million in 2007 to five million in 2014.

What are your thoughts on the progress of Islamic banking and finance in Malaysia?

The primary developments revolve around tighter requirements on regulatory compliance and responsible financing. With the introduction of regulatory standards such as Basel III, banks are expected to manage risk more proactively and exercise robust capital management.

In the case of Malaysia, the country's central bank introduced the IFSA in 2013. A key agenda of the act is to achieve financial inclusion through risk sharing in line with Islamic financial principals, realising the projected growth of the Malaysian Islamic banking sector.

The Malaysian government is also taking significant steps to improve access to financial services, such as the introduction of the Sharia-compliant Investment Account Platform (IAP). The IAP, which will be implemented in 2015, allows Islamic financial institutions to act as an investment intermediary, through efficiently the funding and commercialisation of new and innovative financial products.

The platform is also expected to enable SMEs and new growth industries, such as eco-friendly and technology-related companies, to gain access to financing.

SANDEEP SINGH

FRANKLIN TEMPLETON INVESTMENTS

Country Head, Malaysia

INTERNATIONAL INVESTOR: Please share your views on the Malaysian investor base?

SANDEEP SINGH: We regularly undertake surveys to gauge investor sentiment and have identified a fairly strong home bias among Malaysian investors towards local equities and fixed income. Of course, this is no different from many other global markets, but it is slightly more prominent here.

As the Malaysian market matures, investors are broadening their investment scope and Asia is the natural investment destination, due to the scale of Malaysia's integration with other Asian nations and the fairly sizeable Chinese and Indian population here.

The growth of the Malaysian market has resulted in the introduction of non-ringgit denominated investment products and local investors are increasingly looking at products issued in Australian, U.S. and Singaporean currency share classes, demonstrating a growing openness to international offerings. Moreover, the last few years have created a level of awareness among investors that they should pay less attention to short-term volatility and focus more on achieving their long-term financial goals. Consequently, they now tend to require more information and are less likely to make rash decisions. This highlights the increasing maturity within the Malaysian investor base, which I think is further reflected in the high penetration rate of unit trusts compared to many other emerging markets.

Despite growing interest in offshore investments, there are only a handful of dedicated U.S. equity funds available in Malaysia, of which ours is one. This is surprising as over 45 per cent of global market capitalisation is in U.S. stocks; thus, Malaysian investors are missing out on a big regional exposure to diversify their portfolio.

Can you outline some of the key trends you have identified in the IF space?

The main trend is the increasing number of sukuk issuances. Investors are warming to the distinct characteristics of sukuk, such as less correlation with other asset categories and exposure to market segments not easily accessible on the conventional side. Moreover, recent sovereign issuances from countries such as the UK, South Africa and Luxembourg have raised the credibility of the industry.

To demonstrate its growing importance, out of approximately US$2 trillion total global IF assets, 80 per cent are in Islamic banks, 15 per cent is in sukuk issuance and the remaining 5 per cent is in the Islamic funds industry and takaful. We should stress, however, that we perceive the major source of growth, at present, to be through sukuk products that meet the medium- and long-term fixed income requirements of investors.

Sharia-compliant portfolios are generally more restricted than conventional ones, due to the investment universe being smaller. Thus, investors are incrementally moving towards global equity strategies to diversify their portfolio as they offer a portfolio manager a much wider choice of stocks, especially in the context of Sharia investing, than those that are more regional and local in scope.

Additionally, we have observed certain differences between investors in sukuk and investors in Sharia-compliant equities. Currently, sukuk attracts investors who recognise the merits of the asset category, not just the underlying faith-based principles. In contrast, Islamic equities currently attract more faith-based investors.

How can the Sharia-compliant asset management industry ensure sustained growth?

Most of the larger IF players are operating with a very local or regional focus and there is a need to broaden their reach. Clearly, Malaysia and Saudi Arabia are big markets, but to take the industry to the next level, the local and regional institutions need to have a global footprint.

Firms like Franklin Templeton are able to rapidly grow IF operations, as they already have an established network of clients and offices around the world. However, local entities can struggle initially to gain global recognition and economies of scale.

Globally, a large majority of Islamic fund managers have less than US$100 million assets under management. This limits Islamic fund managers in their ability to attract large institutional clients due to their lack of experience in managing big mandates.

Moreover, a fund must not only be domiciled in a global jurisdiction to offer easy passporting across regions, but it must also offer a certain minimum asset size. For example, a global private bank may be interested in marketing a product, but, if they have a limit of selling up to 20 per cent of a fund's assets under management, they are not going to engage in the process if they are going to hit the ceiling at US$1 million for a fund size of US$5 million.

All these issues are a bit of a chicken and egg situation – you need to get that initial scale by securing clients one by one and building a solid base to give you that strength and visibility. However, I think a collective and concerted effort by the industry players to raise awareness about the industry and products would be even more beneficial in the long run. Nevertheless, awareness of IF has certainly been on the rise, the assets are growing, more products are appearing, more global names are entering the market and the track record is being built over different market cycles.

Despite this, in order to ensure sustained IF growth, a culture of investing must be fostered among populations. In many Muslim-majority countries, the general penetration and awareness of investment products is low. Thus, Sharia investments can only be a fraction of an already meagre total. This is an issue in many emerging markets and it must be addressed.

CAREER DEFINING MOMENT

It was when I was relocated from India to set up Franklin Templeton's office in Malaysia. To come to a foreign country without prior knowledge of its culture and with practically negligible local support to help set up the office was certainly a challenging, but career-defining, endeavour.

LESSON IN BUSINESS

One must never forget the importance of trust in the field of investment management. Trust takes years to build, but it can be lost overnight. Always be transparent, honest and, most importantly, never lose sight of the interests of your clients.

PERSPECTIVE: BEYOND THE BRAND

The global banking crisis raised significant questions regarding the sustainability of the current financial system. Islamic finance can address these issues by promoting funding structures directly related to real economic activity. However, certain misconceptions surrounding 'brand Islam' still must be overcome.

Raja Teh Maimunah, Managing Director and Chief Executive Officer of Hong Leong Islamic Bank, reflects on the misconceptions surrounding Islamic finance as a brand

BANKING IN CRISIS

There has been a robust discourse about the 2008 financial crisis. Numerous theories have sought to accurately identify the causes, comprehensively delineate the repercussions and put forward proposals regarding how the crisis could have been averted. The debate has moved further to consider how the affects of future crises can be at least minimised, if not completely prevented.

Despite all the discussion and theorising, the after-effects of the crisis are still reverberating in parts of Europe; bailouts and repayment terms are still being negotiated. The general public distrust banks, authorities distrust bankers and, as a consequence, tighter regulations are being formulated. However, so far, the debate has failed to provide an adequate account of why the banks were able to go so far.

At the risk of oversimplifying, I posit that the answer is rooted in the business of lending money. Under scrutiny, the concept of making money from money seems rather bizarre. However, the commodification of money has occurred and yet, as a commodity, it has no intrinsic worth.

SHARIA-COMPLIANT FINANCE

The principles of Sharia forbid usury in banking. Adherents of Islam are prohibited from lending any amount of currency to be repaid over time with an unjustified increment above the amount of the loan. Simply put, you cannot lend a dollar to be repaid over time with a dollar plus ten cents. However, Sharia does permit trade and, thus, it is acceptable to purchase a good for a dollar and resell it for a dollar and ten cents, payable on the spot or over an agreed period. The difference in the actual amount and manner of payment is, ostensibly, minimal, but the fundamental distinction is that financial transactions using Islamic finance (IF) support a trade and, consequently, real economic activity.

Real economic activity is a vitally important concept, yet the growth of the derivatives market has precipitated a reality in which a substantial proportion of global financial transactions are not used to benefit the real economy. Although the derivatives market is difficult to accurately value, data released by the Bank of International Settlements (BIS) stated that the figure for the total outstanding notional amount of the OTC derivatives market in June 2014 was approximately US$691 trillion, which is almost ten times the estimated nominal Gross World Product. Moreover, it is not controversial to highlight that the exposure related to the bilateral trade of derivatives, especially in the OTC market, helped propagate and intensify the global financial crisis in 2008, which had significant ramifications for the global population.

The financial world is increasingly complex and it could be argued that the approach outlined above, distinguishing funding through interest and trade, is too simplistic to gain any traction. However, Sharia law provides for a variety of funding mechanisms that are more complex than the option outlined above and can be applied in a number of different instances.

The most compelling are those which embody profit- and risk-sharing structures. In conventional finance, banking products are based on a risk transfer concept, aptly known as credit risk. Thus, money is lent according to a measured risk, usually based on collateral or the borrower's net worth, and given a schedule of repayment. However, this arrangement is not apposite to certain business ventures, especially start-ups. As a consequence, conventional institutions rarely finance new entrepreneurs. Yet, under a profit- or risk-sharing arrangement, banks have an opportunity to invest in an enterprise with the possibility of a higher return. In addition, society at large benefits from the creation of new enterprises and the innovation climate that is stimulated concomitantly. These structures also have the potential to address issues relating to the distribution of wealth.

More importantly, the sharing of risk would elicit more judicious behaviour throughout the banking industry, so banks would be less likely to engage in high-risk activities and take on toxic assets. It was largely these activities that contributed to the financial crisis and, thus, had the banks employed the principles of Sharia in banking previous to 2008, it would have helped to mitigate the extent of the downturn.

BRAND ISLAM

The logical response to the latter proposition is to question why Islamic banking has not been embraced by the world. Over the years, there has been a rise in sentiment inimical to Islam, particularly among Western nations. The September 11 attack and various other terror events have perpetuated a fear of Islam and an increase in Islamophobia. Thus, by association, and due to its perceived proximity, Islamic banking is also viewed with suspicion.

As a consequence, numerous misconceptions about Islamic banking have been widely formed. Some prevalent ideas are that Islamic banking facilitates the funding of terrorism; that it is a covert means to promote Islamisation; that it is meant for Muslims only; that it is cheaper or more expensive; and that it does not adhere to best practice or that it is primitive. Although this list is not exhaustive, it is pertinent to provide a rebuttal to each.

Primarily, it should be noted that violence in any form is against the teachings of Islam. Furthermore, Islam does not advocate the imposition of Islamic values on others; there are several injunctions in Islamic sources that make this clear. Regrettably, it must also be emphasised that Islamic banking has nothing to do with terrorism carried out by radicals who have deviated from the fundamentals of Islam.

There is no hidden agenda in the pursuit of the promotion of Islamic banking. It is simply the promotion of equity and justness. Interestingly, the official newspaper of the Vatican, L'Osservatore Romano, advised the post-crisis conventional banking industry to look at the rules of IF in order to restore confidence among their clients, suggesting that the ethical principles that underlie IF are representative of the true spirit that should mark the financial services industry.

Moreover, without question, Islamic banks are subject to the same standards as other financial institutions. They must adhere to the banking regulations prescribed by the particular central bank governing the jurisdiction in which they operate, and conform to the regulatory architecture that is imposed worldwide.

The idea that Islamic banking is only meant for Muslims is categorically refuted by the fact that 50 per cent of the customers of Hong Leong Islamic Bank are non-Muslims. In addition, condemnations of usury are not only found in Islamic texts, but are also present in the writings of Christianity, Judaism, Buddhism and Hinduism. What is more, global institutions, such as Citigroup, HSBC and Standard Chartered, have been offering Islamic banking products and services to all their clients for quite some time. Undoubtedly, this is due to the interest and because it is a good proposition for all.

It is also not necessarily cheaper; even though the financial structures are interest free, there are still costs related to managing Islamic funds. However, nor is it necessarily more expensive. Returns must be commensurate with the risk taken by the capital provider.

Another unfounded belief is that IF does not adhere to best practices or that it is primitive. Multinationals across multiple jurisdictions have raised significant funds through the use of complex Islamic capital market instruments backed by legal documents adopting best practices and established arbitration centres. In fact, the first corporate Islamic bond was issued by the Malaysian subsidiary of Shell, the global oil company.

SIGNIFICANT OPPORTUNITIES

Non-Islamic countries, such as the United Kingdom, Singapore, Hong Kong and Luxembourg, are adopting IF in their financial systems and major financial centres, and have all introduced laws to facilitate IF. They have recognised that to remain relevant they must be able to offer a comprehensive suite of financial products that caters to changing global requirements.

There are some 1.6 billion Muslims worldwide. In 2013, a report produced by the Dubai Authorities and Thomson Reuters suggested that the global Islamic economy has a potential value of US$6.7 trillion, which is greater than the economies of every country in the world, except China and the United States. The report estimated that the global expenditure on the media, food and lifestyle sectors by Muslim consumers reached US$1.62 trillion last year and posits that figure will rise to US$2.47 trillion by 2018.

Islamic banking will continue to play an important role in the growth of the Islamic economies. It facilitates the financial inclusion of Muslims that, due to their religious beliefs, would not seek funding from, nor invest in, conventional banks. It also facilitates cross-border trade activities and provides businesses with access to multiple markets that were previously out of reach. IF can also serve investors as an alternative asset class, especially those seeking asset-backed and ethical investments.

However, the critical and most convincing argument for the furtherance of IF around the globe is that with which this piece began: financing using Islamic structures promotes the use of funds for real economic means, spurring real economic activity, and driving innovation and entrepreneurship. It serves to defend against profiteering by the few, which inevitably leads to loss bearing by the many. Far from being a sector that is just for Muslims, it is a vehicle for the enrichment of all.

In order for IF to achieve its full potential, the world must be actively encouraged to look beyond the misconceptions, beyond the brand, and see IF as it truly is.

There is no hidden agenda in the pursuit of the promotion of Islamic banking. It is simply the promotion of equity and justness

ROHANA ABDUL MUNIM

PATH SOLUTIONS

General Manager, Malaysia

INTERNATIONAL INVESTOR: Could you provide us with an overview of Path Solutions?

ROHANA ABDUL MUNIM: Path Solutions is based in Kuwait, and focuses on designing and developing software solutions to address the needs of the Islamic finance (IF) sector. We are present in thirty-three countries, spanning three continents. We serve fully-fledged Islamic banks, microfinance institutions and conventional banks looking to create an Islamic window or subsidiary.

Islamic financial services are increasingly integrating into the global financial markets. Therefore, we work tirelessly to provide clients with best-in-class Sharia-compliant software solutions that are in line with the best international practices and also ensure the security of the international banking system.

We differentiate ourselves through our Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI)-certified software solutions with a strong implementation track record. Furthermore, our technology partners include Microsoft, IBM and Oracle.

Our commitment and expertise in Islamic banking and finance are underlined by the fact that some of the world's largest Islamic banks are our clients. The company has also gained recognition from the industry's top analysts, including Gartner, Forrester, and TowerGroup.

What are your views on the progress of IF in Malaysia and Indonesia?

Malaysia and Indonesia offer tremendous opportunity for the development of IF, especially with both being Muslim-majority countries. Currently, Malaysian Islamic lenders have exceeded 20 per cent of total banking assets while their Indonesian counterparts hold 5 per cent respectively. Although we are seeing a higher growth rate in Indonesia, the growth has yet to achieve its market potential. The Financial Services Authority in Indonesia is targeting to achieve 20 per cent market share of total banking assets within the next 10 years.

CAREER DEFINING MOMENT

It was the opportunity to join Path Solutions, which introduced me to Islamic finance. I enjoy being an active player in the industry. I wish to continue to raise awareness and assist banks and Islamic financial institutions in the proliferation of knowledge through technology.

LESSON IN BUSINESS

We must recognise the importance of understanding clients' aspirations and needs. In the IT business, a continuous investment and improvement in technology, people, product and packaging are vital to ensure relevance, sustainability, and competitiveness. Technology is evolving rapidly, and so will the financial services industry in how it does business.

Malaysia's position as a leading Islamic banking centre is due to the relative liberalisation of its economy, the strengthening of its financial infrastructure and its openness to the world. These developments make the country well-poised to dominate Islamic banking.

The efforts of Malaysia's Central Bank, Bank Negara, must be commended as well. Since the 1970s, Malaysia has constructed a detailed plan to domestically develop IF with a vision that will transform the industry into a mainstream play by 2020. Bank Negara boosted the growth of the Malaysian IF industry with the implementation of new measures, a variety of Islamic financial products and a large number of participants. These initiatives, coupled with the development of the Islamic interbank system, provided the prerequisites for the viability of a domestic IF system in the country.

Indonesia's Central Bank has also developed the infrastructure, policy and roadmap for the development of the country's Islamic finance industry. However, the slower growth is partly due to implementation challenges including internal support, business competitiveness, product innovation and market awareness. Most banks run their Islamic business as a window and control the entire operations with the conventional system, limiting the growth and competitiveness of Islamic banking. Nevertheless, Indonesia has a great opportunity to become the next Islamic financial hub with 85 per cent of its 250 million-strong population being Muslim and an administration that promises much economic reform.

Indonesia's financial inclusion initiative, which aims to remove all constraints with price and non-price characteristics on public access to financial services, will also provide a boost to the domestic IF industry.

What are your thoughts on integrating technology with Islamic banking?

Looking at Islamic banking as a whole, there are several areas, including technology, which are still underdeveloped. We certainly foresee the demand for further development in integrating innovative technologies in the next couple of years.

As a start, Islamic banks need to invest in technologies that focus on advances in customer service. Banks will be able to better understand customers through successful implementations of Customer Relationship Management (CRM) systems, branchless banking and mobile banking, as well as advanced approaches in risk management.

Can you tell us more about your flagship product, iMAL?

iMAL is a multi-award winning, fully integrated front, middle and back office Islamic banking solution running 24/7 in real time. iMAL, where 'i' stands for Islamic and MAL means money in Arabic, was developed from scratch around AAOIFI guidelines and standards, and is geared to address both country and region-specific Islamic banking requirements.

All iMAL modules adhere to Islamic law and fully comply with International Accounting Standards. The system is based on Sharia guidelines for the purpose of financing related to murabaha, mudaraba, ijara, istisna, salam, project financing, real estate and others.

iMAL enables Islamic financial institutions to carry out essential tasks across retail, corporate, transaction and investment banking, as well as online and mobile payments, and financial messaging. The applications not only enable Islamic financial institutions to better serve their customers, but also to meet business needs in areas like streamlining operations, introducing new products, improving efficiencies and customer service, ultimately increasing revenues while reducing risk.

Today, over one hundred clients use our iMAL Islamic Banking & Investment System for their daily operations.

AZMI MOHD. ALI

AZMI & ASSOCIATES

Senior Partner

INTERNATIONAL INVESTOR: Could you elaborate on the initiatives that Azmi & Associates are taking to explore new markets?

AZMI MOHD. ALI: As a law firm, we recognise the importance of becoming global in our practice. We visited law firms in Belgium, Luxembourg, Italy, China, Kazakhstan, Kirghizstan, Sri Lanka, Nigeria and Kenya and plan to visit more European and American law firms in the future. Exploring new markets is undoubtedly part of our mission but we have also built a global network to market our firm. For instance, we are a member of several significant networks including TerraLex and First Law Network which are based in Florida and Brussels respectively. In 2012, Azmi & Associates also became an exclusive member of the Islamic Finance Lawyers Network (ISFIN).

We undertook these initiatives because it is vital that we position ourselves to be able to tap into Malaysia's growing status as a global player in commerce. Clearly, legal practice is closely intertwined with the growth of economies and this strategy will create numerous opportunities for us.

What are your views on the growth potential of Malaysia's economy?

Over the past five years there have been serious efforts to remove the barriers that hinder doing business in Malaysia. For instance, foreigners can now register a private company limited by shares in Malaysia with 100 per cent foreign equity in sectors like finance, IT, and oil and gas. Other sectors such as property are being opened up to foreign players as well. As a consequence, foreign investors will be more likely to look at Malaysia.

Projects to improve the country's infrastructure are well underway. The Klang Valley Mass Rail Transit (MRT) project has the potential to provide connectivity with a 20 kilometre radius from the city centre, thereby raising the proportion of journeys taken on public transport in the Klang Valley to 50 per cent. Furthermore, the proposed High Speed Rail (HSR) that connects five cities in Malaysia to Singapore is expected to give new impetus to the economic growth.

CAREER DEFINING MOMENT

My defining moment came when Azmi & Associates successfully secured the mandate to co-manage the listing of Felda Global Ventures Berhad, which was the second-largest global initial public offering in 2012. It achieved a market capitalisation of RM19.3 billion on its listing.

LESSON IN BUSINESS

Investment in infrastructure, human capital and technology should be made alongside the expansion of client base to ensure long-term sustainability. This will help a business to stay focused on consistent and long-term objectives. A business well endowed with these is likely to experience a high growth rate and more importantly achieve long-term sustainability.

Speaking of these two cities, I must point out that, while the cost of doing business is much lower in Malaysia than Singapore, the former's delivery system is lagging behind the latter's. If Malaysia can be more responsive to foreign investors, I think the gap between Malaysia and Singapore will diminish.

What do you think is lacking in the Malaysian Islamic finance (IF) ecosystem?

The Malaysian market is still small, but there are efforts to increase the size and number of transactions by turning Malaysia into a centre for Islamic banking. What is lacking here is the right asset base of Islamic banks, as they are not as strong as the larger conventional banks and cannot manage sizeable banking transactions.

Another problem is human capital. Unlike London and Singapore, we are suffering from the lack of competent human capital to improve the performance of the Islamic banking industry. For Malaysia to attract global talent, the IF sector must pursue domestic policies that favour a more open market and offer the right incentives. Besides, the banks and financial-related institutions must also be ready to pay wages that are on par with other developed markets.

What are your thoughts on IF institutions that simply make conventional products Sharia-compliant?

We need to see a fundamental change in the way financial products are presented and structured, starting with a base offering that is in line with Sharia principles. However, it is important to note that the current products, which have been adapted from the conventional market, are Sharia-compliant. It is a matter of meeting the clients' expectation. However, it is difficult to convince the clients who are used to the products that are similarly structured according to the conventional products to purchase totally different products. You have to educate the market slowly and gradually.

The fundamental challenge related to product innovation brings us back to the lack of human capital. There are not many lawyers who are capable of managing new and innovative products in the Malaysian market. Thus, law firms tend to focus more on what has been done before, rather than supporting innovative ideas. On the other hand, foreign firms are not interested in coming to Malaysia, even if the government decides to open up the Malaysian legal market, as the potential revenue is not attractive enough. Clearly, we need to open up the legal market, and also create bigger banks to handle large and complex Islamic financial transactions so that the market becomes more attractive.

How can we establish a truly universal Islamic financial market?

Firstly, we must harmonise the concept of IF amongst the regions before the creation of a universal framework. However, harmonisation itself is a challenge as there are different Islamic schools of thought and regulatory regimes among the banks.

The Malaysian model can be used by other jurisdictions to develop their Islamic banking industry because of its holistic nature. However, instruments issued in Malaysia cannot be sold in Dubai, for instance, because the global infrastructure is not in place. There must be a coordinated, collaborative approach between central banks to develop a framework that can integrate all processes, enabling instruments to be offered cross-border.

While harmonisation is the first step, eventually we will need a standardised regulatory framework. Because the legal foundations in all regions, including the IF hubs, are so different.

DR. AMAT TAAP MANSHOR

FINANCE ACCREDITATION AGENCY (FAA)

Chief Executive Officer

CAREER DEFINING MOMENT

Certainly, it would be my appointment as CEO of the FAA in 2012. When I took the position, the management was very risk-averse. Thus, I saw an opportunity to drive the agency and implement an expansion plan

LESSON IN BUSINESS

Ultimately, so long as you dare to drive the situation, and have consistency in your actions and have a clear vision, the rest will come as a result of experimentation to determine what works and what does not.

INTERNATIONAL INVESTOR: How is the FAA planning to expand its operations in the coming years?

DR. AMAT TAAP MANSHOR: The Finance Accreditation Agency (FAA) was established in August 2012 by Malaysia's central bank and the Securities Commission in Malaysia. Our mandate is to ensure quality and excellence in learning for the financial services industry both nationally and globally. Essentially, the FAA is an important cornerstone in the development effort focused on providing accreditation for learning programmes, individuals and institutions within the financial services industry.

To date, more than 100 modules from both local and international training providers have received accreditation from us, and our operations will continue to make a significant contribution in sustaining a strong talent pipeline for the financial sector in this dynamic and challenging environment.

Currently our focus is on Europe, the Middle East and Asia, and much of our work relates to reviewing applications for accreditation from global institutions. In 2013, we collaborated with a number of global institutions and organisations to further enhance the skills development and quality capacity of finance practitioners. Several programmes are already in place, and we have organised joint workshops with our counterparts in Bahrain and Pakistan to promote the importance of quality in training.

We are also engaged with key stakeholders in the Middle East to develop high performing professionals in the region's Islamic finance (IF) sector and we participated in the Dubai Islamic Economic Roundtable Series 2014. Moreover, we are assisting the government of Dubai in establishing a larger and more competent talent pool of trained Islamic professionals and increasing its market share in the region.

Could you provide us with an overview of the FAA's latest products?

Recently, we launched two products, which are the FAA Learning Standards (FLS) and the Finance Qualification Structure (FQS). The FLS is a comprehensive guide for industry stakeholders outlining the minimum requirements in the design, development and delivery of learning programmes. It outlines what is necessary from curriculum to assessment, effectively setting the benchmark for IF training as the number of users grows.

The FQS was developed in order to harmonise and integrate the professional qualifications in the financial sector into a single framework. Thus, it enables mutual recognition through different work and learning spheres and facilitates employee mobility across economies. It is an essential document for all stakeholders including: regulators, as it facilitates recognition of qualifications and certifications by quality assurance agencies and professional bodies; financial institutions, as it enables them to determine the competency levels of employees and take informed decisions about investments in learning and development; training providers, by assisting them in the design and development of relevant qualifications and certifications; and higher learning institutions, as it ensures the provision of industry-based curricula and facilitates the production of job-ready graduates for the industry.

How can the human capital issues in the IF industry be solved?

Primarily, it requires a more comprehensive approach and close collaboration between industry and academia. The main source of talent for this job market will come from universities and we must address the mismatch between the graduates produced and the skills required by the industry. To solve this, industry actors must have greater involvement in developing the curriculum and, ideally, our FLS product will be used to facilitate this process.

Furthermore, actual industry practitioners must work in or have interaction with university faculties, so they can share their applied knowledge and create a better balance between theory and practice in the learning environment. Finally, students must have opportunities to gain hands-on industry experience, so they can prepare for real work environments. The FAA is currently working on solutions to overcome these hurdles, but they are at an early stage.

Additionally, the IF industry needs to have globally recognised benchmark standards to identify, define, select, apply and improve the training programmes offered to industry practitioners. These standards should indicate the specifications necessary to ensure the training, products, methods and services meet a specific and recognised level. The absence of these protocols decreases the compatibility and interoperability of Islamic financial services training and hinders the development of the industry.

I would add that we also need to establish an international accreditation body. There is currently no setup that deals comprehensively with accreditation standards for industry-based learning programmes in IF that provides evidence that training programmes lead to the development of competencies needed in the marketplace. Accreditation is essential for the industry to ensure global practices are maintained across economies and jurisdictions.

How does Malaysia fare against other nations in terms of IF-related training?

There is a wide proliferation of courses related to IF worldwide. Certain studies have suggested that the top three countries providing such education programmes are Malaysia, the United Kingdom and Pakistan. However, due to the absence of international standards, it is difficult to make an adequate overall assessment. In Malaysia and the UK, there are a great number of advanced-level courses. In contrast, many other countries that provide a certain level of IF training lack the resources to make the jump to an advanced level. We hope our learning standards will quicken this process.