

Speech

Speech by SFST at Islamic Banking and Finance Forum (English only)

Monday, May 19, 2008

Following is the speech by the Secretary for Financial Services and the Treasury, Professor K C Chan, at the Islamic Banking and Finance Forum today (May 19):

Professor Poon, ladies and gentlemen,

Good afternoon. It is my great pleasure to speak at the Islamic Banking and Finance Forum today. First of all, I wish to thank the Hong Kong Polytechnic University for organising this event, which provides a platform for exchange of ideas about developing Islamic finance in Hong Kong. You will be hearing from several distinguished speakers on the subject of Islamic banking and finance later. To kick off the discussion this afternoon, I would like to share with you Hong Kong's strengths in developing itself as an Islamic financial market and what we are doing to facilitate such a development.

Islamic Finance

The Islamic financial services industry has experienced tremendous growth in recent years. Not long ago, Islamic finance was very much confined to countries with significant Muslim population. Thanks to the strong economic growth in the Middle East countries and the high level of accumulation of wealth and resource in the region, the Islamic financial sector is currently estimated to value beyond US\$1 trillion. That is about five times the magnitude five years ago, and is growing more than 20% annually. The pace of expansion of the global Islamic financial sector has been steady and rapid. And the industry is a strong potential for future growth.

The structure of Islamic finance products which emphasises the principle of risk-sharing and partnership, has made them increasingly popular among

non-Muslim investors. Many leading global financial institutions have been expanding their Islamic financial product portfolio to meet the growing demand. Financial centres, such as London, Singapore and Hong Kong, are adopting various measures to accommodate Islamic finance in their existing financial regimes.

Hong Kong's Strengths

The Chief Executive highlighted in his 2007 Policy Address the potential of introducing Islamic finance and encouraged the development of an Islamic bond (sukuk) market in our city.

Hong Kong is indeed well placed for the development of Islamic finance. We have a well developed financial services sector and deep and liquid markets. As at the end of February 2008, our stock market ranked 7th in the world and 3rd in Asia in terms of market capitalisation. We are one of the world's largest banking centres, with the presence of about 70 out of the 100 largest banks in the world. We are also one of the largest asset management centres in Asia.

We are blessed with our proximity, linguistic and cultural affinities and increasingly close economic co-operation with the Mainland, which allow us to provide an ideal platform for Mainland enterprises to reach out on one hand, and facilitate foreign enterprises, to explore and tap into the Mainland market on the other hand. Hong Kong is currently the most preferred platform for the listing of Chinese Mainland enterprises outside the Mainland. There are now more than 440 Mainland enterprises listed on the Hong Kong Stock Exchange, which cover a wide spectrum of businesses such as financial institutions, telecommunications, coal and gold mining, oil, gas, automobile manufacturing and supermarkets, etc. In addition, Hong Kong remains the only jurisdiction outside the Mainland in which banks may transact business using the Renminbi (RMB). We also became the first place outside the Mainland to operate a RMB bond market. All of the above show that Hong Kong is capable of offering unique market opportunities for overseas investors and Mainland issuers.

Added to our financial credentials are our political stability, heritage of rule of law, highly cost-effective business environment, open and transparent

regulatory regime, large pool of experienced financial professionals, free flow of information and capital and freedom of religion.

Our market liquidity is deep for conventional financial instruments and we have a pool of experienced finance professionals with expertise in wealth management, capital markets and insurance. And our policy is welcoming to financial innovations. Our experience in market development, and our success in tapping Mainland investment opportunities suggest that we have an opportunity to develop wholesale markets in Shariah-compliant instruments for Mainland-based issuers. And Middle Eastern financial institutions will find that Hong Kong offers a lot of strength as an international financial centre to help them directly enter the Mainland markets.

Hong Kong's Initiatives

With a view to putting in place an Islamic financial platform in Hong Kong, we are actively reviewing our legal, taxation and regulatory regimes for accommodating a sukuk market in our existing system and framework. The objective of our review is to bring about a level playing field for Islamic financial transactions vis-à-vis conventional financial transactions.

Our findings thus far suggest that there is no fundamental obstacle to the issue and transactions of sukuk in Hong Kong. Such transactions could be accommodated in our current regimes upon certain technical modifications, in particular to our taxation regime. On the taxation front, we note that sukuk tends to attract more tax than its conventional counterpart. A typical Shariah-compliant sukuk structure usually involves sale, repurchase and lease of assets between the sukuk originator, sukuk issuer/special purpose vehicle created for the sukuk purpose and investors. This gives rise to implications on stamp duty and profits tax obligations and liabilities. The additional tax implications cause complications in the sukuk contractual structures and are considered key impediments in developing a sukuk market in Hong Kong.

Drawing reference from the practices and experience of other jurisdictions which have taken steps in developing Islamic finance, we are proactively considering removal of multiple stamp duties for those Islamic financial transactions involving real estate, which is a common feature under typical

sukuk contracts. In addition, in-depth examination is being conducted on the nature and direction of the flows of periodic payments arising from sukuk transactions, which usually take the form of periodic rental payments for the use of the underlying assets, with a view to ascertaining the most appropriate tax treatment for such incomes. The ultimate objective is to ensure a level playing field for Islamic financial transactions. We believe that no substantial amendment to the current legal and taxation frameworks should be required for this purpose.

Apart from working on the taxation treatment on Islamic financial transactions, we are also encouraging market players to make use of our market structure and services to develop and launch Islamic financial products, promoting education on Islamic finance among industry participants and market players, and forging closer ties with various Middle Eastern as well as other Islamic financial markets and international standard-setting bodies.

Conclusion

Ladies and gentlemen, we are working hard to put in place a conducive platform for the development of Islamic finance in Hong Kong. We are pleased to note that the market response has been very encouraging. For instance, a major local bank launched the first retail Islamic fund in Hong Kong in November 2007. The fund is an index that tracks the Dow Jones Islamic Market China/Hong Kong Titans Index. Its fund size reached US\$51 million as at end March 2008, up by more than 10 times since its launch. Besides, Khazanah Nasional Berhad, the investment holding arm of the Government of Malaysia, issued a US\$550 million exchangeable sukuk listed on the Hong Kong Stock Exchange in March 2008. This is the first sukuk offering exposure to China's growth through Chinese equities listed on the Hong Kong Stock Exchange. The sukuk received good response from Middle East investors and was over-subscribed by 10 times.

Islamic finance is no doubt an area with ample room for expansion. Being an international financial centre, we believe that Hong Kong possesses the required credentials to offer a suite of Shariah-compliant products and services and become an Islamic financial hub. We shall work closely with the financial services sector and other relevant stakeholders to continue to promote our

strengths to investors.

Capacity building is also a key to success. We need to build up Islamic finance expertise to support the development of this important government initiative. In this regard, we look to our education sector to organise more relevant courses and training for our local financial personnel. Forums of the sort we have today are definitely conducive to Hong Kong's development in Islamic finance.

On this note, may I wish you fruitful discussions and a successful forum today. Thank you.