
Bridging Islamic capital markets around the world

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Classes of *shariah* compliant securities

- *Sukuk*
 - Based on *shariah* compliant structures
 - Financial characteristics similar to conventional bonds and floating rate notes
 - HM Treasury plans to treat them as equivalent to conventional instruments
 - Equities
 - No *shariah* compliant equivalents
 - Distinct from *mudarabah* and *musharakah* from an investment perspective
 - Focus on capital gains and dividends, not profit and loss sharing
 - Permissible under *shariah*, but subject to sector and financial screens
 - Having a portfolio of equities in a fund facilitates *shariah* compliance
 - Fund assets based on commodities, leasing, and REITs
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Islamic capital markets?

- Is a separate market needed?
 - Trading of *sukuk* and *shariah* compliant equities in conventional markets
 - If designated Islamic markets capital flows and arbitrage with conventional markets likely
 - Dubai Financial Market re-branded as the world's first Islamic stock exchange in November 2006
 - *Shariah* compliance in conventional markets
 - Dow Jones and FTSE Islamic indices demonstrate compliance
 - The LSE, Tokyo and Wall Street mostly compliant
 - Emerging markets of Muslim countries often less compliant as conventional bank equity accounts for a higher proportion of market capitalisation
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An international Islamic capital market?

- Cross border *shariah* compliant capital flows
 - Might be enhanced if a single Islamic capital market
 - Where would market be located?
 - How would it be regulated?
 - Whose *shariah* rulings would apply?
 - Alternative is cross listings in national markets
 - The International Islamic Financial Market
 - Established in Bahrain in 2002
 - Founding members IDB, Central Bank of Bahrain, Labuan Offshore Authority, Bank Indonesia, State Bank of Pakistan, Finance Ministry of Brunei
 - Administratively rather than market driven
 - Not a market, rather it simply endorses *sukuk*
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Competing Islamic financial centres

- Gulf region
 - Market proliferation: Kuwait, Bahrain, Doha, Abu Dhabi, Dubai, Muscat & Riyadh
 - Bahrain
 - Islamic banking centre with 27 Islamic banks and 12 *takaful* companies
 - Over 70 *sukuk* but little trading
 - Informative regulatory rulebooks
 - Trust law for Islamic REITS
 - Riyadh
 - King Abdullah Financial District
 - Headquarters for Capital Markets Authority, Tadawul and a commodity market
 - Plans for 43,000 financial jobs including accountants, commercial lawyers, financial analysts, consultants etc (8,200 in Bahrain)
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Bridging Indian Ocean capital markets

- Kuala Lumpur
 - Largest number of corporate *sukuk* internationally
 - Over 40% of global *sukuk* issuance by value
 - Long experience of *shariah* compliant funds
 - *Shariah* compliant FDI flows
 - Al Rajhi Bank and Kuwait Finance House have a significant presence in Malaysia
 - Malaysian International Islamic Financial Centre
 - *Shariah* compliant securities and funds offered in any currency
 - Tax breaks for *sukuk* SPVs, management fees from fund administration and Islamic REITS
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Regulation of *shariah* compliant funds

- Cross border portfolio investment
 - Regulation in jurisdiction where registered, but offered to foreign investors
 - Regulatory differences
 - Disclosure requirements for open ended funds sold to retail investors most stringent
 - Less formal disclosure to institutional and high net worth individual investors in closed end funds
 - Information provided on minimal initial subscription, purchase fees, annual management charges and redemption terms
 - For equity funds information on major holdings and performance relative to Islamic indices
 - *Shariah* monitoring
 - Communication and surveillance issues when fund managers in a different country to where fund domiciled
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Cross border arbitration & dispute resolution

■ English law

- Most cross border Islamic funding operations conducted under English law
- Case of Shamil Bank versus Beximco and ruling of High Court and Court of Appeal in London
- Parties bound by *shariah* contracts they have signed

■ Civil law jurisdictions

- Appeal against terms of contract with default
 - Challenge to contracts as being unfair questions *shariah* validation
 - *Gharar*, contractual uncertainty, more likely under civil law
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The way forward for Islamic capital markets

- **Shariah compliant investment flows**
 - *Islamic Financial Services Industry Development: Ten-Year Framework* (2006, IRTI and IFSB)
 - FDI flows > portfolio investment flows
 - **Multilateralism versus bilateralism**
 - Cross border agreements between national regulators versus international agreement on regulation and *shariah* standards
 - **Empirical evidence**
 - Little indication that different regulatory regimes and *shariah* standards have constrained *shariah* compliant capital movement
 - No evidence of regulatory or *shariah* arbitrage by Islamic investors
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