



*~Address by YBhg Datuk C. Rajandram,
Executive Deputy Chairman, RAM~*

PROMOTING THE GROWTH OF GLOBALLY ACCEPTED ISLAMIC PRODUCTS

The issue of promoting the growth of globally accepted Islamic products is certainly a topic that is relevant to the current environment within the Islamic finance industry, as reflected by the increasing number of global sukuk issues that have come into the market in the past few years. As we are all aware, “globalisation” is now one of the most popular buzzwords with reference to business and economics. Indeed, globalisation has influenced many aspects of our daily lives, and is certainly becoming the trend in our fast-paced world.

I will focus on issues relating to the sukuk market, as well as the development of credit ratings within this arena.



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It is important to note that sukuk issuance in Malaysia has consistently outperformed conventional bonds since 2002. In 2006, about 70% of the domestic market's rated corporate bonds were sukuk issues. Most of the sukuk proceeds had been used to fund new investments, acquisitions or business expansion, as opposed to refinancing.

What is more interesting is that there was a notable shift in the profile of sukuk contracts in 2006, from the traditional debt-based contracts to equity-based ones (i.e. mudharabah and musyarakah). This change may have been partly influenced by the desire to distribute such sukuk outside their established home market, particularly the Gulf States. There is also now a tendency for Syariah boards to include prominent scholars from both the



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national and international arena, thus qualifying them to address issues and operate within different schools of thought. The arrival of foreign Islamic banks on Malaysian shores is also a positive step towards expediting the transfer of knowledge vis-à-vis application of Islamic products from other regions.

The recent success of the Khazanah's Exchangeable Bonds further highlights Malaysia's desire to become a leader in Islamic finance. It is even more encouraging that these international transactions had been originated from banks based in Malaysia. This is very much in line with the objective of the Malaysian Government to put Malaysia at the forefront of the Islamic financial market.

To propel the global sukuk market to greater heights, more of such innovative products need to be introduced. However, it is



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important that at the end of the day, Islamic financial products must remain competitive against their conventional counterparts, regardless of how innovative such offerings may be.

In addition to Khazanah's recent issue, the other global sukuk have been mainly sovereign-backed issues. Given this, as far as the final paymaster is concerned, the credit risk basically hinges on the Government's payment aptitude. We should ask ourselves: why stop at this level? How can we push the corporates to play a more active role in the global sukuk market?

If we depend on just sovereign-backed issues, there is only so much that can be raised. Therefore, the way to expand the global sukuk market is to create a wider variety of issuers. This is where the importance of a comprehensive framework comes in -



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encompassing legal, regulatory, tax and accounting, and also credit ratings. To create a vibrant global sukuk market, we must first ensure that all these factors are in line with international best practices.

RAM is mindful of the development of the Islamic financial market; we have refined our rating methodologies with respect to sukuks. We had started out with ratings for debt-based sukuks, and had later introduced new rating methodologies to reflect the partnership nature of equity-based contracts. As the sukuk market develops further in terms of innovativeness and the application of Islamic contracts, we must constantly upgrade and refine our rating methodologies to keep abreast with these changes.



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Nevertheless, I would like to highlight that RAM does not form opinions on whether a financial instrument is in accordance with Syariah principles. Instead, we analyse its creditworthiness in the context of a broad array of capabilities and incentives. Fundamentally, a credit rating is a common measure of creditworthiness, regardless of whether it is a conventional bond or a sukuk.

RAM defines credit rating as "an objective and impartial opinion on the ability and willingness of an issuer to make full and timely payments on financial obligations." This opinion is conveyed in a simple alphanumerical scale, for easy reference and comparability. Rating is essentially an opinion; it is an art as much as a science. Rating takes into consideration both qualitative and quantitative factors. Qualitative aspects include opinions on management



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quality, views on the future operating environment of the company and other soft factors. On the other hand, quantitative factors come into play when assessing a company's financial strength.

The growth of the country's sukuk market, at "break-neck" speed, has been nothing less than remarkable. As a pioneer in the Islamic finance industry, Malaysia has set the standard and led the way on many fronts; for example, the empowerment of a single regulatory body; a central Syariah advisory council, which facilitates shared understanding and uniformity on Syariah interpretation and permissible structures; a single documentation framework; a robust supervisory structure; established governance and disclosure standards for investor protection; and a progressive tax regime catering to the distinct requirements for sukuk issuance, to name but a few.



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Given the established and conducive infrastructure and system, coupled with increasing demand, there is considerable room for expansion into other segments of the Islamic financial industry, for instance the Syariah-compliant structured-product market and Islamic derivatives market, for better dispersion and management of risk – all of which should render the market more efficient and competitive. The market will also benefit from a shift in the trading mentality of investors, leading to even more dynamic secondary trading and a robust price-discovery device.

Another aspect to focus on is the need for a bigger pool of professional talents – different skill sets, resources and technology are required for the structuring and execution of more complex sukuk transactions. The establishment of the International Centre



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for Education in Islamic Finance, or “INCEIF” which aims to produce Islamic finance professionals with the necessary technical skills and knowledge in Islamic finance, should be applauded and supported by the market players.

Going forward, we envisage Syariah-compliant financial instruments, sukuks in particular, playing a catalytic role in advancing the growth and development of the global Islamic financial markets and also in promoting cross-border issuance and investments, especially the inter-regional flows between Asia and the Middle East.

A final point, the vital need for educational and information-dissemination activities in relation to the development of the Islamic capital market. Sharing knowledge is one way through



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which we can prepare and improve ourselves with regard to this task. In this respect, we should promote and encourage international dialogues and conferences where practitioners, Syariah scholars, regulators and other market participants can highlight issues and exchange ideas and solutions - a definite benefit to the advancement of the Islamic finance industry.