



AN INTERNATIONAL ISLAMIC FINANCIAL
CENTRE: A COMPARATIVE FUNCTIONAL
PERSPECTIVE BETWEEN MALAYSIA AND
SINGAPORE

BY

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ABSTRACT

In the formation of an international financial centre (IFC) literature, the government's role is recognised as imperative in ensuring that several initiatives are implemented to achieve the objective as an IFC. Writers and researchers alike have adopted several approaches in gaining insights to this area of research varying from the historical, teleological and geographical to the functional perspectives. This exploratory study employed ideas and thoughts based on the functional perspective that has identified four functions of an IFC such as Payment and Settlement, International Financial Intermediation, Risk Management and Fund Management. These four functions were then measured together with four other functions to resemble an Islamic character of an IFC, namely, *Shari'ah* Advisory Supervision, Financial Regulation, Credit Worthiness Management and Human Capital Management. Empirical results of the data obtained from the survey of questionnaires on perception of senior executives and managers working in financial institutions in Malaysia and Singapore showed that the factor analysis has reduced the data from eight functions to only six reliable and valid functions. Data obtained from these six functions were used for hypotheses testing and statistically significant results of the hypothesis testing were then verified and affirmed with qualitative analysis from the investigation of documentary sources and secondary statistical data obtained from reliable and relevant bodies in Malaysia and Singapore. Most importantly, results of the data analysis have revealed two most significant research findings. The first finding suggests that the six functions reduced from the factor analysis were reliable and valid to be the underlying functions that an IIFC must provide. The second finding suggests that Malaysia was perceived by senior executives and managers to be more competitive than Singapore as the centre of Islamic finance. Therefore, these research findings can be used as an impetus for future research on the possibility of introducing a new International Islamic Financial Centres Index (IIFCI) that is highly tenable to attain the same status of credibility and reputation of the mainstream Global Financial Centres Index (GFCI).

ملخص البحث

بناءً على دراسات مستفيضة عُرف مركز التمويل الإسلامي على أنه موسوعة للمنشآت المالية تتضمن مصارف وشركات استثمارية كبرى تنضوي تحتها الأسواق المالية التي تدير التدفق النقدي للإتجار والإستثمار بين مختلف الدول وفق الأسس الشرعية. عملياً يظهر فحوى هذا التعريف في مقارنة الوظائف الرئيسية والشروط الأساسية التي يجب استيفائها من قبل الدول المعنية بتطبيق فكرة إنشاء مركز التمويل الإسلامي الذي لا يزال في طور النقاش. أستمّت الدراسة من أفكار ومجهودات بعض الباحثين المختصين و التي تتعلق بوظائف مركز التمويل العالمي متمثلة في المصطلحات الآتية: السداد والتسوية، الوساطة التمويلية الدولية، وإدارة المخاطر، وإدارة الصناديق المالية، والتي أضيفت إليها أربعة خصائص أخرى للحصول على السُلاف الذي يخدم غرض الصيرفة الإسلامية لمركز التمويل العالمي؛ ألا وهي الإشراف على الإستثمارات، النظم المالية، إدارة القدرة على الإقتراض، والثروة البشرية. تتمحور منهجية الدراسة على منهجين: الكمي والوصفي لتحديد الوظائف الثمانية وفعاليتها، بحيث تم تحليل هذه الوظائف في نطاق التحليل الكمي إستناداً على البيانات الأولية التي تم الحصول عليها بواسطة الإستبيانات في كلٍ من ماليزيا وسنغافورة. تمخضت الوظائف الثمانية بعد التحليل إلى ستة وظائف فقط وهي التي إجتازت اختبار الثقة حيث يمكن الإعتماد عليها وفحص الفرضيات الأساسية. لاسيما أن نطاق التحليل الكمي اختبر البيانات الثانوية التي جمعت من المصادر الوثائقية والمعلومات الإحصائية عن ماليزيا وسنغافورة. أهم النتائج التي توصلت إليها الدراسة كالتالي: الوظائف الستة الناتجة من التحليل الكمي جديرة بأن تعتمد وصالحة للتطبيق في مشروع التمويل الإسلامي العالمي نظراً لمطابقتها للأهداف المنشودة، في حين أن التحليل الكيفي يشير إلى أن ماليزيا أكثر قابلية وملائمة لهذا المشروع مقارنة بسنغافورة. تتجلى فاعلية هذه الدراسة وأهميتها في أنها حجر الزاوية للدراسات المستقبلية في هذا المجال الحيوي، وتساعد على اتساع نطاق الصيرفة الإسلامية، ومن ثم بلورة وتطبيق فكرة التمويل الإسلامي العالمي.

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DECLARATION

I hereby declare that this thesis is the result of my own investigations, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

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To My Parents and My Family

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In the name of Allah, The Most Beneficent, The Most Merciful

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LIST OF ABBREVIATIONS

AAOIFI	Accounting and Auditing Organisation for Islamic
ABM	Association of Banks in Malaysia
ACIFP	Association of Chartered Islamic Finance Professional
ADM	Asian Dollar Market
BCBS	Basel Committee on Banking Supervision
BIMB	Bank Islam Malaysia Berhad
BIRT	BIMB Institute of Research and Training
BIS	Bank of International Settlement
BNM	Bank Negara Malaysia
CMP	Capital Market Master Plan
CPSS	Committee on Payment and Settlement
CRA	Credit Rating Agency
DBS	Development Bank of Singapore
EMEAP	Executives' Meeting of East Asia-Pacific Central Banks and Monetary Authorities
ETF	Exchange Traded Fund
FSMP	Financial Sector Master Plan
FTS	Family Takaful Scheme
GFCI	Global Financial Centre Index
HNWI	High Net Worth Individual
IAIS	International Association of Insurance Supervisors
IBA	Islamic Banking Act
IBF	Islamic Banking and Finance
ICD	Islamic Corporation for the Development of the Private Sector
ICM	Islamic Capital Market
IDB	Islamic Development Bank
IFC	International Financial Centre
IFI	Islamic Financial Institution
IFSB	Islamic Financial Services Board
IFTDP	Islamic Finance Talent Development Program
IIBU	Islamic Investment Banking Unit
IIFC	International Islamic Financial Centre
IIFM	International Islamic Financial Market
IILM	International Islamic Liquidity Management
IIMM	Islamic Inter-bank Money Market
IUM	International Islamic University Malaysia
IMF	International Monetary Fund
IOFC	International Offshore Financial Centre
IOSCO	International Organisation of Securities Commissions
IRTI	Islamic Research and Training Institute
ISRA	International <i>Shari'ah</i> Research Academy for Islamic Finance
IT	Information Technology
MARC	Malaysia Rating Corporation Berhad

LIST OF ABBREVIATIONS (cont.)

MAS	Monetary Authority of Singapore
MIFC	Malaysia International Islamic Financial Centre
MSA	Measure of Sampling Adequacy
MUIS	Majlis Ugama Islam Singapura
NBFI	Non-Bank Financial Institution
NEG	New Economic Geography
OECD	Organisation of Economic Cooperation and Development
OPP	Outline Prospective Plan
PBUH	Peace Be Upon Him
PBUH	Peace Be Upon Him
PNB	Permodalan Malaysia Berhad
RAM	Rating Agency Malaysia
REIT	Real Estate Investment Trust
S&P	Standard and Poor's
SAC	<i>Shari'ah</i> Advisory Council
SC	Securities Commission
SFEMC	Singapore Foreign Exchange Market Committee
SGF	<i>Shari'ah</i> Governance Framework
SGX	Singapore Exchange
SSB	<i>Shari'ah</i> Supervisory Board
SWT	Subhanahu Wa Ta'ala
SWT	Subhanallah Wa Ta'ala
WIEF	World Islamic Economic Forum
WTO	World Trade Organisation

CHAPTER 1

INTRODUCTION

1.0 BACKGROUND OF THE STUDY

Ever since the Malaysian government's decision to cease Singapore as a state of Malaysia on August 9, 1965, Malaysia and Singapore have been competing head on in all sectors (Wan Hamidi, 2007), including in the financial sector. The latest bout of competition is on establishing themselves as hubs or centres of Islamic finance. In 2004, Singapore announced its intention to be the hub of Islamic finance and Malaysia welcomed the move.

According to Thomas (2005), Malaysia, with well over two decades of experience in establishing and developing a sophisticated Islamic banking and finance (IBF) infrastructure and a fully integrated Islamic capital market (ICM) offering virtually all of the capital markets resources found in highly developed conventional markets, has always emphasised on complementing and sharing its expertise with its neighbours that can bring about mutual benefits to both countries. In 2006, Malaysia announced its intention to position herself as the "Islamic Finance Gateway" through the establishment of the Malaysia International Islamic Financial Centre (MIFC) initiative (Mohd Razif, 2007). Zeti Akhtar, the Governor of Malaysian Central Bank (Bank Negara Malaysia or BNM) reiterated in 2006 that to step up Malaysia's effort in strengthening its position as the centre of Islamic finance and developing Islamic finance to new heights, Malaysia was tapping the global business opportunities through the MIFC initiative with the objectives, viz; to encourage a vibrant fund and

wealth management industry; acting as the origination, issuance and trading of Islamic financial instruments; and to carry out international Islamic financial business.

On the contrary, Singapore has gained a strong foothold as an established financial centre in the Asia Pacific region and the Chairman of the Monetary Authority of Singapore (MAS), Goh Chok Tong, underscored Singapore's latest foray into IBF as helping Singapore to enhance its reputation as a financial centre (Chia, 2004). This statement was echoed by MAS Deputy Chairman, Lim Hng Kiang that Singapore was working with the industry to ensure that the country had a full suite of financial products and services, including Islamic products and services (Choo, 2007). Thereafter in May 2007, the establishment of the first Islamic bank in Singapore called Islamic Bank of Asia by South-East Asia's biggest lender, Development Bank of Singapore (DBS), and 22 prominent investors from the Middle East Gulf region marked an important milestone in Singapore's efforts to tap increased demand for investments that comply with Islamic principles. (Ng, 2007).

In the global scene, the result of the evolution of Islamic financial markets, the swell of oil money in the Gulf, and the Gulf governments looking to diversify their countries' economic base from the oil industry, has placed Islamic financial services to the fore. At the end of 2007, the size of the global Islamic financial services industry was estimated ranging between US\$700 billion and US\$1 trillion, with an annual growth rate of 15% to 20%, in *Shari'ah*-complaint manner covering 300 institutions in over 65 jurisdictions managing the assets (IRTI, 2006; Oakley, Bond, O'Murchu and Jones, 2008). However, according to the Global Islamic Finance Report 2011, the key findings from the report showed that in 2010, the Islamic finance industry was valued at US\$1.14 trillion and was growing at a rate of 10% (BMB Islamic, 2012). The remarkable achievement registered by the Islamic finance industry

indicates that the industry is gradually building the depth, quality and quantity of its product portfolio (BMB Islamic, 2011). Extending further the prospect for growth of IBF, Tai Boon Leong, the executive director of MAS, quoted Standard and Poor's (S&P) estimation of reaching US\$4 trillion (Tai, 2008).

The past three decades have witnessed many great challenges to the world economy at large. With the onset of information technology (IT) explosion, nations across the globe are caught struggling to keep up with the pace of technological development of the new era that leaves no country spared of its consequences if they choose to remain lackadaisical. Unfortunately, the development of a country is very much related to and measured against its reaction and attitude towards the dynamic and rapidly-changing information technology.

The IT explosion has caused tidal waves that change the ways governments, institutions and businesses are run. It started a chain reaction in the financial economy and affected the trend towards globalisation. Both governments have adopted a positive approach in facing challenges of the IT, globalisation and most recently, financial liberalisation, in their respective financial markets. In tandem with this transformation, Shayerah (2009) noted that the resilience of the Islamic banks to the economic downturn and the international financial crisis as compared to its counterparts in the conventional banks was largely due to the avoidance of speculative investments such as derivatives. Shayerah's (2009) analysis suggests that Islamic finance is capable of becoming a vehicle of recovery from the international crisis. Shayerah (2009) is also implying that the position of the Islamic banking industry will be strengthened in the international market. This new surge of interest will put Islamic banking and finance in the radar screen of investors and companies who are sourcing for alternative funds for financing (Shayerah, 2009).

The attention given to IBF has brought to the forefront the long standing topic of interest in the formation of international financial centres (IFC) (Peter, 2007). Before this study attempt to examine the factors that have led to the formation of an international Islamic financial centre (IIFC), it is apt to reflect on the strands of literature that have propounded on the formation and development of IFC.

Kindleberger (1974) who lamented on the lack of scholarship on financial centres had initiated his study on the formation of IFC from the historical perspective. Cassis (2006) extended further Kindleberger's historical perspective but analysing it from a different angle. Presently, there is a renewed interest in this topic as witnessed in the role played by preeminent global financial centres such London and New York in the establishment of regional financial centres such as Hong Kong and Singapore to complement the cross-border capital flow to the rest of the world (Peter, 2007) . On the other side of the globe, the Arab world and other emerging economies were declaring themselves as financial centres or hubs and this phenomenon was seen as an attempt by these countries in seeking to establish an international presence (Peter, 2007).

Additionally, Xiaobin (2010) claimed that there was a series of factors contributed to the formation of the financial centers across the globe. Such factors include; scale of economies, economic development, international trade, history, transportations and communications that had contributed to the development of international financial centres (Kindleberger, 1974; Poon, 2003; Reed, 1980). Sassen (1999) asserted that the two most important factors were national consolidation of financial activities, market and financial liberalisation. Xiaobin (2010:3) also observed that factors and elements proposed by scholars “overlap and merely differ in rhetoric and varying degrees of generalization”. Beaverstock, Taylor and Smith (1999) argued

that world cities, global cities or producer services centres were categorised as the modern international financial centers.

Furthermore, in a study on London as an IFC, Clark (2002) attested to London's continued dominance over other IFCs because of its systematic approach to global connectivity, a deliberate plan to enhance the presence of skilled human capital, introducing denationalised and offshore platform, providing flexible regulation, introducing knowledge economy and having the capability to provide financial services. Analysing from another perspective, Laulajainen (2003) postulated that the three determinants for the formation of IFC were: (1) the geography of finance (related to the location of transactions instead of economic production (Gordon, 2002)); (2) a more sophisticated legal fundamentals and (3) time-zone theory - studies have shown that there is a positive relationship between the degree of sufferings and the number of time zone differences (Waterhouse, Reilly, Atkinson, and Edwards, 2007). Several findings from other studies conducted by Poon (2003), Poon, Eldredge and Yeung (2004) and Wójcik (2009) on the time-zone theory suggest that global financial services specialises in its own time zone and that inspite of stiff competition between IFCs, they cannot substitute each other's functions within respective time zones.

There are other strands of literature that may have claimed that their studies were related to the topic on the formation of IFCs but Cheung and Yeung (2007) had fittingly argued that "both macroeconomic and microeconomic/institutional factors", as well as financial market strength and efficiency were important in the formation of IFCs. Cheung and Yeung cited in their study two countries, Hong Kong and Singapore, which had outperformed regional economies as well as many other major economies, including Japan. This finding appears to explain, in part, by their favourable microeconomic and institutional environment and trade openness (Cheung

and Yeung, 2007). In sum, Kaminsky's (2009) reflections on the lesson that can be learnt from history in discussing the topic on the formation of IFC, pointed out that the long term government policies towards achieving the status of an IFC must be systematically planned, implemented as scheduled, monitored with proper enforcement procedure and government intervention when necessary. Singapore was singled out by Kaminsky as one of the countries that had adopted long term policies in their drive towards establishing themselves as an IFC and the chronology of policies are listed as follows: (1) in 1968 authorised the Bank of America to open an Asian currency unit to carry out foreign currency operations - the Asian dollar market was born; (2) the government also intervened directly to encourage the emergence of a bond market; (3) in 1984 the Singapore International Monetary Exchange was created and (4) by 1995, 185 foreign banks set branches in Singapore (Kaminsky, 2009). Hence, in its effort to establish itself internationally, several initiatives planned by the Singapore government had resulted in Singapore achieving among the top ten global financial centres in the ranking of the Global Financial Centre Index since 2007 (London City Corporation, 2010 cited in Xiaobin, 2010: 4).

Likewise, an examination on the strands of literature related to the formation of an International Islamic Financial Centre (IIFC) witnessed similar attempts by scholars to analyse factors that have led many countries to declare themselves as IIFCs or hubs of Islamic finance. As a nascent industry, IBF is seen as one the fastest growing industries and has become an important segment of the mainstream global financial market. However, strands of literature written on the topic on the formation of IIFC are scant. Nonetheless, through the analysis of policy speeches by government officials and regulators of the financial system who have embraced IBF, coupled with assembling of ideas from scholars who have dedicated their works on IBF, the author