

Islamic Finance *news*

ROUNDTABLE



Islamic Finance for CFOs

Panelists:

- **Badlisyah Abdul Ghani** – Chief Executive Officer, CIMB Islamic
- **Khalid Howladar** – Global Head, Islamic Finance, Moody's Investor Service
- **Mohd Radzuan A Tajuddin** – Deputy General Manager & Head of Islamic Capital Market, Securities Commission Malaysia
- **Nicholas Edmondes** – Partner, Trowers & Hamlins
- **Rafiza Ghazali** – Chief Financial Officer, Cagamas
- **Wasim Akhtar Saifi** – Global Head of Islamic Banking, Consumer Banking & Chief Executive Officer, Standard Chartered Saadiq, Malaysia

Moderator

- **Lauren McAughtry** – Managing Editor, Islamic Finance *news*

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Badlisyah Abdul Ghani
Chief Executive Officer, CIMB Islamic



Wasim Akhtar Saifi
Global Head of Islamic Banking, Consumer Banking & Chief Executive Officer, Standard Chartered Saadiq, Malaysia



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Rafiza Ghazali
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CIMB Roundtable: Islamic Finance for CFOs

On the 26th May 2014, in conjunction with the IFN Asia Forum 2014, *Islamic Finance news* held the first in a new series of Islamic finance-focused Roundtable discussions, sponsored by CIMB Islamic.

A group of leading industry experts gathered together in a closed-door session to discuss the first in a series of broad yet crucial concepts designed to promote inclusion and participation in the wider industry. 'Islamic Finance for CFOs' aimed to create a roadmap for encouraging more corporates to tap the Islamic markets by identifying the key barriers, answering the key questions, addressing the primary concerns and suggesting the best methods for inclusion and awareness-building.

Islamic Finance news was delighted to bring together Badlisyah Abdul Ghani, Wasim Akhtar Saifi, Mohd Radzuan Tajuddin, Nicholas Edmondson, Khalid Howladar and Rafiza Ghazali in an illustrious debate representing the leaders across all fields of Islamic finance. The result was a fascinating and wide-ranging debate that covered every crucial concern and is an invaluable read for anyone seeking to encourage inclusion in the Islamic capital markets.

IFN: Can we start off perhaps by identifying the biggest barriers that CFOs might encounter that prevent them accessing the Islamic market?

Badlisyah: I think in general, a lot of CFOs in the market today simply don't have full awareness of what is available in Islamic finance, and as a result they don't actively pursue the options available. That is one of the main reasons why they are reluctant. Those who know, come very actively to

pursue it, and those who really know actually insist on doing Islamic finance, especially in Malaysia, as they do see that Islamic finance provides a significant value proposition that sometimes can even be better than conventional finance. I think it is good that CFOs actually explore beyond what they are comfortable with, in managing what is best for their organization. Islamic finance does provide certain things that can allow them to better manage the finances of their organization. If they understand that Islamic finance is actually comprised of the same elements or components as conventional finance - the traditional banking sector, the capital market, both equity and debt, and also the non-banking financial institutions – when they look deeper into each component they will find that Islamic finance has effectively similar offerings across all the different financial needs they may have.

IFN: Wasim, would you agree? Has that been your experience?

Wasim: I think it depends on which part of the world you are in – in Malaysia there is clearly a far greater understanding and knowledge of Islamic finance than we see in other parts of the world, including in the Middle East. There, you have limited pockets of understanding, especially at the CFO level, and people are more used to looking at conventional than Islamic. But even where that knowledge is there, there are still misconceptions in people's minds about what Islamic



transactions mean, and all the issues and hassles that might entail. New documents with new implications and new terminologies – that intimidates them. Others feel that the regulatory framework might have different implications between Islamic and conventional. Then the additional issue of religious sentiment itself – “If I don’t do it properly, it could do a lot of damage to my reputation, so better not to venture into that area at all.” Other parts of the world we do struggle when we talk to CFOs. The most common response is: “Is it cheaper?” If it is cheaper then they are willing to overlook all the other obstacles. But if it is not then they will just stick with the conventional.

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IFN: So is that the biggest barrier – the assumption of greater expense?

Wasim: Not necessarily more expensive – what it comes down to is that they are willing to take that move ONLY if it is cheaper, because if it is the same economic price as attached to conventional, then why bother when they are used to doing it the conventional way. That becomes very important.

In Malaysia there is a counter argument to that, on the basis that there is a large Islamic liquidity pool available, which would not go into the conventional space. So if you need to tap that, then really you have to go through the Islamic path

- so there is an additional economic incentive. The Middle East is very different, because there is no dedicated Islamic liquidity available – so you’ve got the liquidity of the Islamic banks, but that is only one part of the funding flows that go into issuances. Everything else comes under the conventional space. So there is no Tanjung Haji, there is no equivalent of Amanah Raya. In the Gulf everything can go into conventional or Islamic. So what is really the compelling argument to encourage them to go down the Islamic route?

IFN: Rafiza, as the only CFO in the room, what would persuade you to make that choice?

Rafiza: Cagamas is somewhat unique because the reason that we issue Sukuk is because of the underlying assets that we purchase – because they are Islamic mortgages or Islamic financing and therefore we raise Sukuk to buy these Islamic assets. If it were not for that, it would be very tough for me, going to my board, to insist we raise a Sukuk if there were no other compelling reason. To give you an example – we are now in the process of doing a multicurrency program, and because of the nature of the business, we have to have the Islamic and the conventional versions. Now suddenly I am seeing my costs double, because I have to have two ratings, I have to have an SPV here, I have to pay double to the reporting accountant, I have to pay a lot of money to the legal advisors... because I need to have an Islamic and a conventional version. Now, if I did not have to raise Islamically by mandate, then how would I be able to convince my stakeholders to go for that? Even if we had an affinity towards it, it comes to commercial viability of the transaction.

Pricing would not be the only consideration, in the decision. We would also consider the indirect costs and processes associated with the financing. At the end of the day, we have to take a commercial perspective, because it comes down to the returns to the shareholders.

Khalid: We [Moody's] work a lot with corporates, and all three of you have mentioned the term 'value proposition'. Being an Islamic bank is core to your franchise – actually it helps grows your franchise, as there is a customer base that will bank with you because you're Islamic. But if you are an Islamic real estate firm or an Islamic manufacturing company, it doesn't really add a lot of visible value to your customers. So you go to a CFO, who has been getting his funding from conventional banks for 20 years. Why would they want to go through the extra documentation, costs – all these additional steps? Necessity is the mother of invention – if they don't need it, they won't do it. However, if this end-to-end Halal concept comes into play, that might become a differentiating factor. If a Halal business that uses Halal financing can charge a better premium on its products then other firms might start thinking that they can pass on the additional costs incurred, as it is now part of their 'Islamic' value proposition. But at the moment this concept doesn't really exist anywhere outside of banking.

“ At the end of the day, we have to take a commercial perspective, because it comes down to the returns to the shareholders ”

Wasim: Rafiza is in a peculiar situation. Ideally what Badlisyah and I would be trying to do is convince her not to bother with a dual tranche, but just go for Islamic. The problem in her case, which is what a lot of CFOs face, is that she needs conventional money because she is buying conventional assets! And she cannot raise Islamic debt and then use that to buy conventional assets, nor can she use conventional financing to buy Islamic mortgages. So that raises a very peculiar situation where your costs basically double compared to a single program.

For customers and corporates who don't have that issue, who have no restrictions – that is where the real challenge comes in. Because there is no compulsion, no driver from their portfolio.

IFN: So how could the issues of cost be reduced?

Nicholas: There is an inherent cost to Islamic finance in a lot of jurisdictions; not just because of lack of familiarity and taking longer to explain the documentation to a client, but also because in some jurisdictions you have tax issues, legal issues which create further hurdles. All those legal frameworks have been set up to suit conventional finance, and it is very easy to raise conventional finance, to enforce it, without additional costs through tax etc. Whereas if in the UK for example you try to raise Islamic finance, there will be an additional cost. So there is an element of documentation to overcome a problem that is not of the Islamic finance



*Badlisyah
Abdul Ghani*

industry's making; it is just that it's there and you have to get past it.

Malaysia is lucky in the sense that it has achieved standardization. Having worked in the Gulf for many years, we could do a job for one Islamic institution, on a particular structure, spend all the R&D putting this structure in place, documenting it, and then taking it to the next Islamic bank, who would then say oh no, that doesn't work for our Shariah committee, we have to do it a different way. And that is also a big issue in that market - you end up fiddling around doing additional work just to make one thing work for one institution that doesn't work for a different one.

Radzuan: Malaysia has a fairly long history in developing Islamic finance. We have done a lot in terms of developing the ecosystem – supply side, demand side, financial market infrastructure. To the extent that today, we have achieved scale. And as a result of that scale, we have come to a point where the issuance process is efficient. The legal, documentation process is very efficient.

So from a cost standpoint, I think Islamic finance today, in Malaysia, now supports a very efficient and sustainable fundraising mechanism within the Islamic financial system. But unfortunately globally, you just don't have the same ecosystem. The main challenge today is the tax framework, from country to country. It is clearly an issue. We have seen progress, there are steps being taken, but I do not think at the moment that they are sufficient to develop a comprehensive ecosystem to support the development of the industry globally.

Badlisyah: To respond to the issue of cost. I have handled a lot of transactions in jurisdictions that do not have what we have in Malaysia – where obstacles occur in stamp duty, in tax, etc. At the end of the day, arrangers such as CIMB or Standard Chartered will make sure that the cost of a particular transaction, whether it is a banking transaction or a capital markets transaction, will be at minimum the same as a conventional transaction – if not better.

You can always work out a solution to give the best deal to a customer. For example Rafiza, in your case when you are doing a conventional bond and an Islamic tranche: one solution to that would be to have an interchangeable facility – both conventional and Islamic under the same facility – and therefore your costs are lower. There are many ways of getting customers the best deal, and Islamic finance can accommodate that. And that has been seen in Malaysia and it can be seen in other jurisdictions as well. I think that is what we want to convey to the marketplace.

Nicholas: I think the issue of cost is not purely to do with lawyers. We are talking about how CFOs look at Islamic finance versus conventional, and the hidden cost for them is the lack of familiarity and awareness of the product. So they may be paying exactly the same cost to banks, lawyers, accountants for the issuance of Sukuk or for any Islamic financing they are undertaking but the internal costs for them and their staff, with the perception they have that it is unfamiliar to them, makes them think that they are going to incur a lot more internal costs in terms of running that financing. I don't think it actually is as big a deal as they perceive it to be. Part of the challenge is the education of those people to realize that actually running Islamic financing through its lifetime is really no more expensive than any other financing.

“ We are talking about how CFOs look at Islamic finance versus conventional, and the hidden cost for them is the lack of familiarity and awareness of the product ”

IFN: So how would you respond if a CFO came to you and said: I want to issue an Islamic product, I want to raise financing in that manner, but I don't know how to go about it, what do I need to do?

Rafiza: Today Badlisyah has been talking about the branding of Islamic financing, people see a Sukuk as a religious need. You see other conventional structures that are a lot more complicated, that are maybe not as cost efficient, but people don't see it that way. They just see: Islamic finance = Shariah = extra cost. It is all about perception. But it is just another structure that just so happens to abide by Shariah principles.

IFN: So what would you say to a CFO to explain the advantages or attraction of a Sukuk structure over something else?

Wasim: When it comes now to a question of doing a standard issuance, the costs are no different than doing conventional



Wasim Akhtar Saifi

issuance. Today any bank - CIMB Islamic, Standard Chartered Saadiq, HSBC Amanah - will be able to do any normal Sukuk issuance at no extra cost. The documentation is all there, the structures are all there, the issuance is not going to be any different than on the conventional side. So what is it getting you additionally? If cost is not an issue, and let's assume that your pricing is probably going to be similar to the conventional too - although there is a possibility that you might be able to tighten the spread slightly more on the Islamic side because of the lack of opportunity for Islamic liquidity itself so obviously more people are chasing whatever is going around. The whole issue comes down to being able to tap an additional source of funding which conventionally you are not able to tap. I think that is the argument we have found works best with CFOs.

To give you an example, last year we did an issuance for a company that has nothing to do with Islamic finance - a mid-sized, publicly quoted corporate and their banking facilities were all entirely conventional. And we convinced them that we could tap the Islamic market and help them raise enough money to settle all their conventional debt, at a substantial saving to bank debt. So it's not as if you have Sukuk competing with bonds - it's just that nobody else on the conventional side had been able to take that proposition to them. So now the CFO thinks wow, Islamic finance is fantastic for me because I am able to shave 75bps off my funding costs.

Khalid: I have heard that for Gulf issuances, Islamic liquidity adds an extra 10-15% of demand in terms of available investment funds. For Malaysian issuers, is it the same? Does it add an extra 50% of investor demand? Can you dimension that?

Badlisyah: It provides a lower cost of borrowing. Between 15-20bps depending on tenor.

Khalid: But in terms of absolute demand - does making it a Sukuk issuance increase the investor demand?

Wasim: For local issuance I would say it adds if not double, then at least 25-30% additional availability for local issuers. For international issuances then I think it normalizes a little

more. But local issuances - there is not enough available liquidity for the funds over here. So you have enough Islamic liquidity - with the likes of Tabung Haji, the Islamic funds, some of the large fund managers. That money can't go into conventional.

Khalid: And that is missing in the Gulf - the institutional investors.

Wasim: That was the biggest issue when I was on the other side of the table, running Tamweel. We were pushing the government to promote the Sukuk market – to say they should allocate a percentage of their pension fund, their sovereign wealth fund to develop the Islamic fixed income market. Unless and until you do that, for a Gulf CFO there is really no incentive to go Islamic because he is going to have the same banks coming in for conventional and Islamic it is the same players. So why go the Islamic route when you are not really getting any additional liquidity coming in from it?

“ The whole issue comes down to being able to tap an additional source of funding which conventionally you are not able to tap. I think that is the argument we have found works best with CFOs ”

Badlisyah: But there is some rationality to that. In the Gulf, traditional fixed income investors are very familiar with the bond market and the pricing there is rational thinking behind their investment. Islamic investors in the GCC are fairly new to the bond market in general, in terms of Sukuk, and over time we have seen rationality coming into that space, and the spreads that are demanded by Islamic investors are getting smaller and smaller, and coming into line with the rest of the investors in the market. I think that given time, you will find the market in the GCC behaving in the same manner as we have seen in Malaysia.

But having said that, definitely it would be great to have a large pool of funds as are available in sovereign wealth funds and pension funds, to be dedicated to Islamic finance, in the same manner that exists here. Once you have that, then you really have an Islamic market for a CFO for any corporate to look at. And for me, I believe CFOs of any corporate today should prepare their organization for that eventuality, because the market is heading in that direction.

Radzuan: From a global standpoint we do need that liquidity base, and that is what we in Malaysia can offer in terms of Islamic finance capability that banks in the GCC do not. You



need that liquidity from the Islamic sovereign wealth funds and central banks - it is very important in terms of providing a framework for developing Islamic finance, and opportunities for CFOs to tap the liquidity. The Saudi and UAE sovereign funds alone handle about US\$1.3 trillion in assets. Imagine if tomorrow they decided to allocate 20% of this for the purposes of conducting business and transactions but through Islamic finance - imagine the global impact that it would have on the value chain of Islamic finance in the Gulf, and beyond.

Wasim: The other factor that affects CFOs is this concern that people have about the liquidity of the Islamic instruments themselves. That is a challenge - if an Islamic investor in the Middle East wants to buy US\$25 million of Sukuk, his banks or wealth managers are not going to be able to get that all in one stroke. They will be hunting around every day trying to gather US\$1 million here today, US\$1.5 million there tomorrow. This is something that also concerns CFOs - that when you have an issuance, you want to see your issuance traded actively in the secondary market. Unfortunately what happens is that because the Islamic banks are so hungry for assets - when an Islamic bank subscribes US\$20 million to the ICD Sukuk, that is not coming onto its trading book, it will hold onto that until maturity. Somehow we need to make sure that there is a lot more trading in Islamic instruments themselves as that liquidity will then convince people that there is an active secondary market.

Khalid: It's sort of a catch 22. You need a lot more issuance to generate liquidity.

Badlisyah: When I deal with CFOs I remind them that when the conventional bond market started it was in a similar situation - there was not a sufficient number of issuances in the market for active trading to occur. As more and more issuances happened, coming into the market because CFOs decided they wanted to do it - then you will see that concern moving out. At the end of the day people have to be fair when they make comparisons with the conventional market - they

must remember that conventional bonds started the same way, and we need to do the same thing as the bond market did to encourage that active trading in the future.

Rafiza: Specifically for Cagamas we saw a sudden demand for our issues once we manage to get our bond onto an index. For most issuers, the chances for a Sukuk to get onto the Sukuk index are far greater than for a conventional to get onto the conventional fixed income index given the size of the global fixed income market for hard currency issues.

“ I think there is a misconception in people’s minds that if they do an Islamic transaction they need to have Shariah capabilities within their organization and an understanding of Islamic laws. That is something we continuously tell CFOs - you don’t need that. That is our job, as the arranger ”

IFN: What kind of timeframe are we looking at? What direction are we moving towards in terms of tradability?

Wasim: We have certainly made progress. Five years ago, the amount of issuances that were available were far fewer than today. If we continue with the current momentum, than five years now the situation will look very different. We just need more issuances, so that people feel that they don’t have to sit on what they subscribe, because they can always trade on it and book some profit today, and put some money in the next issuance instead.

Khalid: In terms of the timeline it is a bit of a moving target, because as the Islamic banks are growing very fast, they consume all the available Sukuk supply. So you need the actual dynamic to change - for supply to grow faster than the growth of the Islamic banks, otherwise you will never actually catch up. That is where supranationals come in - you need the governments, the IDB, the IILM to pump out paper, to satisfy the excess demand to the extent that banks know that if they sell a sukuk, they can buy it again tomorrow if they need some again. It’s that top-down drive that you need to catalyze that growth.



Nicholas Edmondson

Again, it is not going to happen just with the banks and the corporates - the sovereigns and supranationals have to issue as a matter of public policy, like they did in Malaysia. Left to its own devices the private sector is more competitive over pricing. And unlike when the conventional market was developing, the CFO today does have a choice. And which CFO really wants to be a pioneer? There’s no point being the first to jump off a cliff.

IFN: Is there anything else on the supranational level that could encourage CFOs to issue? We are seeing more non-Muslim nations moving towards issuance - what impact might this have?

Nicholas: Going back to the point of supranational support. Until governments really embrace the idea of truly supporting Islamic finance to get it off the ground, it is going to be very difficult for some of these markets. Malaysia is very, very different from most of these non-Muslim markets.

Wasim: Malaysia is very different even from many of the other Muslim countries. In fairness to the others - if you look at the Malaysian aspect, and not to say that Malaysia does not have a genuine dedication to Islamic finance, but there is a very strong economic reason for doing so. In Malaysia there is no opportunity to make a mark on the conventional space - you have Singapore down the road, you have Hong Kong up the road - so whatever Malaysia does in the conventional space it will struggle to be noticed in the global economy.

Dubai, on the other hand, has a different challenge. It already is a regional conventional center for finance. Now it is trying to create something on the Islamic side, because it sees the opportunity. But for Malaysia, Islamic finance really is the one

Khalid
Howladar



opportunity it has to stand up and be noticed on the global stage. Everyone around the world now, when they want to get started in Islamic finance, talks to Malaysia. In the rest of the world, they do not have that positioning incentive.

Khalid: You have a 15-year headstart in Malaysia. As long as upon serious mistakes are made, it's easy to maintain that lead, because your domestic base is so strong. Dubai is still a very small country - it doesn't have the same domestic population so Malaysia does have some natural advantages that it can sustain going forward.

Badlisyah: That positioning that Malaysia has been able to benefit from is to a large degree also available to corporates. So CFOs who want to position their organization in the international marketplace can use Islamic finance to do so. I have dealt with many new-to-market corporates who purposely came to see us wanting to do an Islamic finance transaction in order to be noticed. They say they want to go and expand their business in the GCC for example, and they want to make sure that when they go there they profile themselves effectively and they identify Islamic finance as the best way to enhance their profiling in those markets.

Khalid: When you have foreign companies raising funds domestically within Malaysia - that's a huge step. It is not just Malaysian companies borrowing from Malaysian investors, when you have foreign companies coming here, that is actually a landmark event that shows you are really a place for regional corporates to raise capital here.

Badlisyah: There are a lot of jurisdictions around the world that are not yet fully ready to support the needs of CFOs to get the best benefits from Islamic finance, and when they

look around they see Malaysia as providing them with the best platform for them to achieve this. So a lot of companies have come to the Malaysian market to raise funds. And they have either used the funds within the Malaysian market itself for their own investment, or they have swapped it back to whatever currencies they are looking for to be used elsewhere. As a marketplace for Islamic finance, Malaysia has proven that it can give CFOs anywhere in the world what they want. I only hope that other jurisdictions can achieve the kind of framework that we already have in Malaysia.

Wasim: We have seen a lot of issuances happening for overseas companies. The interesting thing is that with a conventional company - like Mumtalakat or Taka - they could raise anywhere if they wanted. In the case of Taka I remember that the fully swapped pricing was about 35bps tighter than their secondary market conventional bonds were quoting at - so they were able to come to Malaysia, raise ringgit, swap it into dollars, all at a price lower than their secondary market issuances were trading at. That doesn't happen all the time but it does happen, and that opens the doors because the other CFOs in those jurisdictions realize that if someone else has done it maybe they can do it too.

“ I tell CFOs to forget about this terminology and just look at the substance. Islamic financial transactions in the form of Sukuk are simply indebtedness arising from trade activities. It is still indebtedness - you owe this money to someone ”

Nicholas: The domestic markets here are quite mature, in that sense. But one of the frustrations we have is that the service infrastructure is still lacking here. As an international CFO coming into Malaysia to talk to a Malaysian bank about issuing in Malaysia, the first thing they are going to say is where is my support structure? Where is my Clifford Chance, my Allen & Overy? They are not here. Little things like that can stop people from viewing this as a mature market.

Khalid: That's the only reason why London can even maintain any pretense of being an Islamic center - because they have everything else. That shouldn't be overlooked, that critical mass of human capital, of support elements. In Kuala Lumpur you have the foundations, but you have to build up the international aspect.

Radzuan: There are impediments. Change should be coming, but it is a work in progress. Liberalization is certainly being

discussed and it is on-going. Hopefully this year we might see something happening.

Nicholas: If you have a restricted market, even if it is service lines, you won't attract that international talent. You have the liquidity, you have the banks, who are leaders in their fields - but the issuers and clients who want to come to Malaysia will see the absence of an international service industry as a hurdle - they won't see the familiar faces they are used to seeing in the DIFC or Singapore - and that gives those places an advantage.

Khalid: It is something that Malaysia is giving up when it doesn't need to - they are just leaving it lying on the table for other financial centers to pick up.

“ CFOs need to understand that when they do an Islamic financial transaction, the decision on the Shariah, once made, does not change. It remains Shariah compliant until maturity ”

IFN: What about from the CFO perspective - is there any element of compliance or financial reporting or accounting complexity that might also put them off?

Wasim: I think there is a misconception in people's minds that if they do an Islamic transaction they need to have Shariah capabilities within their organization and an understanding of Islamic laws. That is something we continuously tell CFOs - you don't need that. That is our job, as the arranger. We have the expertise so you don't need to have that understanding. You don't need to set up a whole internal Islamic infrastructure just to do an Islamic transaction.

Badlisyah: When it comes to financial reporting, accounting, credit rating - at the end of the day it is all one and the same. There is no such thing as Islamic accounting, there is just accounting for Islamic financial transactions, and it is the same IFRS standards that you apply to conventional finance. And all CFOs are very familiar with IFRS so this should not be an impediment - they can apply that same knowledge to Islamic transactions.

Nicholas: When we talk at the conferences about Wakalah, Murabahah and we use these long words - if a CFO was sitting there he would have no idea what we were talking about - but when you look at the legal documentation you won't find those words there. It is completely English law-governed financing documentation. We don't use Islamic terms. So there is this slight misconception - we differentiate ourselves brand-wise by saying we have these Islamic rules,



we give them names, and that can mystify CFOs, but when you get to the documentation it is just plain English.

Badlisyah: I tell CFOs to forget about this terminology and just look at the substance. Islamic financial transactions in the form of Sukuk are simply indebtedness arising from trade activities. It is still indebtedness - you owe this money to someone.

Radzuan: I think the clarity in terms of documentation has improved substantially. This has allowed the risk premium for Sukuk issuances to narrow from an international perspective.

IFN: You mentioned ratings - does this impact issuance or would issuance impact their rating?

Khalid: Absolutely not. From our perspective - and it should be everyone's perspective - we look at substance over form. If you have a Shariah compliant financing - I wouldn't say that I don't care, per se, but I just look at the contractual obligations and the overall indebtedness, whether it's a bank, sovereign or a corporate.

One of the issues is that a lot of these structures haven't been tested in a bankruptcy or insolvency scenario. Bankers put together a very innovative structure to get you back to the same place as an unsecured debt - but whereas tens of billions of eurobonds have defaulted so you know exactly how they behave in distress, one doesn't necessarily know how some of these structures will work in practice. Look at the example of The Investment Dar (TID) in Kuwait. There were a couple of times where they actually tried to use the Shariah compliant aspect as an excuse to default on their debts. That opportunity doesn't exist with a conventional bond.

Nicholas: There have been court judgments of a similar nature. This is why all the English law-governed Islamic documentation won't refer to Islamic words, so that it is enforceable as a contract exactly as is. You can take your Shariah conversation somewhere else - that is for you and your board to decide, but the enforcement of the payment is a legal obligation.

Wasim: The peculiar aspect of TID was that its Shariah board was actually of the view that the transaction was valid and

they should be paying. It was the management, with their backs against the wall, that tried to say otherwise.

Khalid: And this is where the disconnect comes in between governance and management. The company by its constitution is Islamic, their Shariah board was happy, but the management was trying to evade its payment obligations. That shows that even in an Islamic institution, the Shariah board doesn't have full control.

IFN: So for a CFO who has not issued before, this disconnect, this conflict between two legal systems - would that be an impediment?

“ One needs to be aware that compliance also goes beyond the point of issuance ”

Wasim: It is not something that we face. I have never come across it as a concern. Yes, we haven't seen this tested, but even in TID's case the court ruled that it should be treated the same way as a bond and had the same obligations of repayment.

Khalid: It's more of an investor/lender concern than a borrower concern.

Nicholas: It's really part of the bank's risk.

Wasim: And the CFO doesn't have to worry about that.

Radzuan: What is potentially comforting to CFOs is to show them a dedicated resolution platform. I think this is where international Islamic arbitration is another area that needs to be developed. The Kuala Lumpur Regional Arbitration Center is moving towards that to offer a dispute resolution platform, especially involving cross-border transaction. That is an area the industry needs to work on, to reduce uncertainty.

Nicholas: I am not so sure. In a pure financing transaction, a banking institution wants certainty, and arbitration doesn't give you that. Even cross-border. If you were doing a banking transaction you want it to be governed by a non-Shariah legal system such as English or Singapore, that you understand and that you trust. Islamic financing in the end is just a structured financing, which happens to comply with certain principles.

Badlisyah: Whether people choose arbitration over the court depends on the parties that have to make the decision. The point is that CFOs have a lot of choices and these are very similar to those they can see in the conventional space. That is the conclusion that we should draw.



Rafiza Ghazali

Khalid: From a ratings perspective we really look at the enforceability of a transaction and its banking documents, so we want to know what law it is under and how it works. If you introduce an element of subjectivity - if there was something that was dependent on Shariah compliance, which is a subjective foundation - we would probably find it unratable.

Badlisyah: I think CFOs need to understand that when they do an Islamic financial transaction, the decision on the Shariah, once made, does not change. It remains Shariah compliant until maturity.

Nicholas: So in terms of what CFOs need to think about in terms of principles - the best thing for the Islamic industry would be to be able to say - you don't have to think about that. That's our problem. We make sure it fits within the Shariah requirements. You as the issuer only need to know that you've done your bit. That makes life very simple, particularly for those from non-Islamic institutions.

IFN: Rafiza, do you agree?

Rafiza: Yes, to a certain extent. But a lot of times bankers don't really realize that there are compliance processes post-issuance which an issuer needs to take into consideration. It's not a major problem however it needs to be addressed. A system needs to be in place to make sure the assets don't commingle, that the proceeds arising from the Islamic transaction are invested accordingly. But when you hear discussions about compliance, one needs to be aware that compliance also goes beyond the point of issuance.



With regards to reporting though, there is nothing complex, it is just another classification in the balance sheet because you need to segregate the assets and especially the profit and loss segmentation. For any corporates - you have to make sure you don't use Islamic proceeds for non-compliant activities.

Nicholas: That is true. We recently did a transaction with PNB Bank for a real estate investment in England. The asset is a big building, fully let to a law firm at the moment. But it is in the City of London. The risk of that whole building or its lease being assigned to a non-compliant tenant, such as a conventional bank, is an issue.

Khalid: But I am not sure all law firms are Halal either!
(Laughter)

Badlisyah: At the end of the day there are so many corporates that have gone through the same issuers though - and they have never had any problems. Solutions are there, and there are precedents that have been set up by many other corporates across the globe. CFOs really should have no worries about accessing Islamic finance.

IFN: **Is there anything that anyone would like to highlight that we have not yet discussed?**

Nicholas: We should mention the importance of awareness and education. I don't know how much work you as banks do on this side of things. Obviously conferences and forums are great, but most of the people who come to these things

are going to be people already in the industry - you are not getting the conventional CFOs. What do you do - or what can you do - or what can the government do - to improve that awareness? On our side, we spend a lot of time going round to institutions and explaining to them what Islamic finance is about.

IFN: **So what's going on at a similar level to demystify Islamic financing for CFOs - and what more can be done?**

Badlisyah: To my mind, CFOs simply need to open their minds and their horizons to the possibilities, and maximize options available to them by tapping Islamic finance. Over the years CIMB Islamic has engaged with many corporates not just in terms of a specific pitch to win a deal, but we go and offer the CFOs and finance divisions a full day of training on what the available options are in the Islamic finance space - not just Sukuk but everything else. We also engage with associations that the CFOs are members of, we participate in their events and present Islamic finance to them and then follow through with those who are interested. These things need to be done more, and not just in jurisdictions like Malaysia where Islamic finance already has a footing. It has to be done in new markets that do not yet have an enabling framework, because education will lead to awareness, and awareness will lead to CFOs demanding better access from their regulators.

Wasim: I fully agree. We also need to ensure that understanding permeates the organization all the way down the chain. Often you can get the president or the CFO



convinced, but the people who actually do the transactions on the ground are still unwilling or unsure. The second is that we need to be sharing best practices and best structures in the public domain. If you come across a good structure or a good transaction that works for your customer, share that with other people in the industry and use it as an example for other CFOs so that it gives them an opportunity to see concrete material benefits.

Nicholas: But in my experience, lawyers and bankers are very reluctant to tell other people what their structures are.

Wasim: It has changed a lot. There are no brownie points to be gained in having a unique structure anymore. Sooner or later the public will get to know about it - better they hear it from you, so you can take the credit. We are finding that a lot more transactions are multi-institutional anyway, which is opening up the market. CFOs are now relating to a specific deal and saying oh, maybe I could do that too.

Rafiza: As an issuer, when a corporate doesn't have any reason to issue, it is still a challenge. At the end of the day the bankers will have to come to us with a commercial structure that meets our financing requirements - whether it is Islamic or un-Islamic, The bankers need to understand that issuers have a list of targets that they need to address, and Shariah compliance (if not required by the shareholders) is not even in the top five for most, unfortunately.

Radzuan: In terms of education and awareness, we also need to reduce information asymmetry and ensure parity in terms of global access to information on Islamic Finance for CFOs. We need to identify platforms so that this is disseminated efficiently. The other element is not to focus just

on CFOs on the supply side, but also CFOs on the demand side. So liquidity is an important factor - look at the suppliers of the liquidity to ensure it matches the needs of the CFO on the supply side, so the two CFOs are working together.

Khalid: It really needs to come from the top-down. I would focus on the demand side, to the extent that you get sovereign wealth funds and central banks allocating a percentage towards Islamic financing to create that value proposition for CFOs so they can see that there is real demand from institutions.

Nicholas: I think we have to differentiate between those markets where we have a lot of Islamic liquidity, such as Malaysia, where pricing is not an issue and the opportunities already exist - and those markets where it is not so straightforward. You will only persuade the CFOs in those markets through education and through the availability of and access to liquidity.

But the demand is there. We are fed up of structuring Islamic deals in the UK using conventional banks. Tabung Haji asked us specifically to set up a Shariah client account in the UK - we finally managed to set one up with a UK clearing bank - and it only lasted a year before they closed it down.

Badlisyah: You should open with CIMB Islamic in London!

Nicholas: If you have a branch there, we would.

Badlisyah: We do!

IFN: Islamic Finance news, forging connections across the industry!⁽²⁾