研究ノート

The Development of Islamic Finance and Banking in Singapore

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Abstract

Singapore, since 2005, has joined the race to become a centre of Islamic finance and banking in Asia in an effort to complement its' already eminent position as among the top ten sophisticated financial markets in the world. The paper discusses how Singapore is positioning itself in the Islamic market place by implementing fiscal policies that help create a level playing field for Islamic capital to flow into the country. In addition, the paper discusses the responses of the private sector financial industry in response to government policies. These included the creation of Islamic windows and products in conventional banks, the creation of an Islamic bank, and responses in non-governmental community sectors. The paper concludes with the twin challenges faced by Singapore, namely that of the absence of internationally standardized rules of engagement for Islamic finance and banking and the shortage of talented personnel. As Singapore is incorporating Islamic finance and banking into its financial architecture, it might create a new brand for offering alternative products to the financial world.

Key words: Singapore; Islamic finance; Islamic banking; Islamic bonds; financial policy.

Singapore may be the most unlikely place in the world for becoming a centre of Islamic finance and banking. It's secular approach to religion but enshrining the practice of Islam under the government administered Majlis Ugama Islam Singapore (MUIS or the Islamic Council of Singapore), its rigorous approach to deter Islamic based terrorism, its promotion of casinos within integrated resorts are signs that it is not an Islamic state. At the same time, Singapore remains attractive to large sections of investors and Muslims as an investment haven with an efficient government, high levels of security for all investors and above all a place with excellent financial and banking rules. Having created a balance in its investment outlook to be closely aligned to the two Asia giants, namely China and India, Singapore is now looking beyond these two countries to the middle-east. As Middle Eastern countries divest their investments away from the United States and Europe, Singapore is positioning itself as a hub for Islamic finance, wealth management, infrastructure finance and health care to take advantage of the shift.

Islamic finance in Asia became a popular theme only since 2003. It is partly a consequence of new money being created in the middle-east. Middle-East stock markets too have performed well. In 2004 and 2005, for instance, the stock markets in the middle-east and the Gulf region showed good performance. Further, oil prices doubled in 2006. All these have led some countries to position themselves to attract the money from the middle-east to be invested in Asian destinations.

The aim of the paper is to explain a number of questions that arise in the analysis of the development of Islamic finance and banking in Singapore. The question of why Singapore is moving to position itself as a centre of Islamic finance and banking is analysed in the first section of the paper. The question of how Singapore is moving to be a centre of Islamic finance and banking is described by the analysis of policy decisions initiated by the government in the second part of the paper. The third section of the paper analyses the consequences of government policy on the financial and other sectors in Singapore.

Ⅰ. Positioning Singapore in the Islamic market place

Singapore, since its independence in 1965, has become an international financial centre. More than 700 local and foreign financial institutions are located in Singapore offering a wide range of financial products and services. Singapore has evolved an excellent way of attracting foreign funds. By 2002, 43 per cent of assets managed in Singapore were sourced from Europe and North America, with 30 percent of assets invested in Singapore, 52 percent in Japan and 18 per cent in the rest of the Asia Pacific (Angelo M. Verandon, 2006 : 197). By 2004, the World Economic Forum Global Competitiveness Report ranked Singapore among the top ten most sophisticated financial markets in the world. By 2003, assets managed by Singapore based financial institutions grew by 35 percent to S$465.2 billion. Daily trading activity reached US$153 million in 2004, a 51 percent growth over 2001. It is also a leading forex centre. In the Bank of International Settlement Triennial Survey of forex, Singapore was ranked the fourth largest forex centre in the world and second largest in Asia after Tokyo. Thus, Singapore's strategy of establishing itself as a centre of Islamic finance and banking was an additional effort to remain relevant in global finance and banking.

Asia is flushed with funds at two geographical locations. With the large trading surpluses experienced by China, East Asia has experienced increasing funds for investments. Similarly, the ever increasing petroleum prices have increased the cash flow into the Persian Gulf region. While the former are being invested worldwide, the latter funds are conditioned by Islamic ethical codes for investment. Asia with the greatest population of Muslims in the world is attractive to such funds. It is estimated that US$1 trillion in investible funds are in search of investment places. The banking sector in the oil-rich Islamic countries has US$306 billion industry with 15 percent annual growth.

The participation of Singapore in the Islamic financial market is not an unexpected phenomenon. Singapore's attempt to capitalize on Singapore's wealth management expertise to attract and service Islamic financial markets is facilitated by its gate-way status to East Asia for Middle East and North African investors. Singapore started its effort in becoming a centre of Islamic finance and banking (IFB) only recently. Brunei Darussalam, Indonesia and Malaysia had already launched Islamic finance and banking much earlier. Despite its late entry, Singapore shares the credibility of being like London and Zurich as a centre of international financial services.

For Singapore a large pool of petrodollars looking to invest in suitable Islamic products that is in compliance with Islamic principles, thus becomes another pool of funds to tap into. It will help banks in Singapore to create innovative financial products for the market. Assets held by Muslims in oil exporting countries, led by Arabs in the Persian Gulf, at both conventional as well as at Islamic banks are worth US$1.5 trillions and estimated to be growing at 15 percent a year. Singapore aims to get a bigger piece of this growing fund. According to Standard Chartered Plc., the oil producers of the middle-east would get US$250 billion in 2007 (*Financial Express*, 28 June 2007). The region has 300,000 millionaires while their financial assets are growing by 9 percent annually.

Fund management is an integral part of Singapore's financial industry. Singapore based fund managers oversee more than US$285 billions of assets. Singapore government is keen to add to that pool by tapping investors from the middle-east. Accordingly Singapore's Senior Minister and former Prime Minister Goh Chok Tong has promoted the move to have Islamic finance and banking by arguing that Singapore is not complete 'as a financial centre' if it does not offer Islamic financial services (*Financial Express*, 28 June 2007).

There are about a billion Muslims in the world with the middle-east having about 15 percent. Of the 250 Islamic banks in the world 90 of them are located in the middle-east. Conventional banks, through their Islamic units (or windows) in the United Kingdom (UK), Germany, Switzerland, Luxemburg and other countries also promote Islamic banking.

Islamic banks manage over $250 billion of assets with another $200 to $300 million managed by Islamic windows and subsidiaries of international banks. The Gulf Cooperation Council (GCC) region has been the hotbed of activity with 41 Islamic institutions (18 are banks). Qatar and Bahrain are the leaders and hold 70 percent share of the assets, while United Arab Emirates (UAE) account for 19 percent of assets. According to the Council for Islamic Banks, there are now more than 300 Islamic financial institutions in more than 40 countries. Thus, as it will become evident later in this paper, Singapore would concentrate its efforts to link up with the GCC region to attract the funds for its efforts in becoming a centre of Islamic finance.

Islamic banking reflects a re-assertion of traditional Islamic principles and the increasing tendency among many Muslim businesses to use their funds according to the principles of Islam. According to Ibrahim Warde (2000 : 5) the 'definition goes beyond simply equating Islamic finance with interest-free banking. It allows to take into account operations that may or may not be interest-free, but are nonetheless imbued with certain Islamic principles : the avoidance of *riba* (in the broad sense of unjustified increase) and *gharar* (uncertainty, risk, speculation); the focus on *halal* (religiously permissible) activities; and more generally the quest for justice, and other ethical and religious goals'. The first modern experiment with Islamic banking took place in the Egyptian town of Mit Ghamr in 1963. The bank had initiated a simple savings account based on profit-sharing and lasted less than four years. Despite the early failure, Islamic banks in the seven Emirates that make up the UAE outperformed the conventional account in the first half of 2006. Their profits rose by 62 percent from the same period in 2005.

With the rise in global competition for oil-profits, the middle-east region is now facing increasing competition from western banks as well as from the Southeast Asian region. Some of the better organized countries in Southeast Asia are not only aspiring but have become able to take control of leadership in Islamic finance and banking. Southeast Asia, with about a third of the world's Muslim population and a savings rate of 35 to 40 percent of gross-domestic product, has emerged as the attractive centre for Islamic finance and banking. Within Southeast Asia, Malaysia and Singapore are competing to become either jointly or individually the global hub for Islamic finance. Islamic banking already accounts for 23 percent of the banking activities in Malaysia. Singapore too manages around US$2 billion of *Shari'ah* compliant capital market funds and is seeking to grow rapidly in the fields of wealth management, capital markets and reinsurance within the Islamic banking sector.

II. Government Policy Formulations

This section discusses the views, responses and policy formulations of the Singapore government in its effort to position itself as a centre of Islamic finance and banking in Asia.

As the Middle-East, India, Southeast Asia and China represent the fastest growing regions in Asia today, Singapore is restructuring its financial architecture to attract the Islamic funds that are rapidly accumulating in the GCC region. Singapore has accepted the view that Islamic financial services will become globally accepted form of financing. As a financial centre, it sees the opportunity to offer Islamic financial services as another capability in its range of financial services. The Singapore government wanted to capitalize on the growing Islamic finance market by leveraging upon its existing expertise as a world financial market. The Monetary Authority of Singapore (MAS) as the central banker and the Singapore Stock Exchange (SGX) were two institutions that played key roles in the creation of conditions amenable to attracting Islamic funds to Singapore. Both the institutions created policies and instruments that were to allow the commercial banks to expand Islamic investments in finance and banking.

MAS undertook review of the financial and banking regulations to explore whether a separate financial framework is needed to promote Islamic finance and banking. This was followed by a review of the tax framework so that Islamic finance and banking products are not disadvantaged by the conventional finance and banking practices in Singapore. Beyond

Singapore, it must be noted that Switzerland, France, The Netherlands and Spain too have promoted Islamic finance in response to the oil-money searching for investment. Singapore has been exceptional in enacting specific legislation to facilitate Islamic finance. The legislation being pursued in Singapore has certain similarities with that enacted in the United Kingdom. As Islamic investments are based on *Shari'ah* law that forbids Muslims from receiving or paying interest, the Singapore government introduced policy formulations to not only attract middle-east funds but also compete with Malaysia and Indonesia in becoming a centre of Islamic finance in East Asia.

The Singapore government and the finance community in Singapore are already competent in making Singapore the fourth largest financial management centre in the world and the second largest Forex centre in Asia after Tokyo. As Muslims form 16 percent of Singapore's 4.2 million people, the idea of using the local community to neither launch Islamic banking nor attract investments was given less priority. As Singapore's investor base for Islamic banking is very small, the government laid emphasis on attracting Islamic finance from outside in formulating its policy strategies. Specific policies were created to offer products as well as attract more investors.

The Singapore government through its two major institutions, namely MAS and SGX, was aware that policy formulations must be accompanied by financial products that follow the *Shari'ah* law. As Singapore's banking laws were attuned to conventional banking, the government set about to harmonize Islamic principles with the existing laws, and remove those laws that prevented the spread of Islamic banking. From February 2006, the Singapore government concerned itself with a series of financial measures that specifically targeted the incorporation of Islamic principles. The question of compromising 'profit sharing' *(Shari'ah* law) with 'interest' (conventional law) was taken up in the Singapore Budget on 7 February 2006. The government proposed to treat profits and expenses on *Murabaha*, *Mudarabah* and *Ijara wa Iqtina* products as interest earned, and therefore be eligible for tax deduction. This was an attempt to harmonize the two banking principles than adapt conventional banking to Islamic banking. The removal of double taxation or lowered taxes on some Islamic transactions and products was to help the Islamic capital market grow in Singapore. On 20 February 2006, the government announced it plan to tax Islamic debt products in the same way as conventional bank products. MAS reviewed its policies to ensure that Islamic finance is not disadvantaged vis - à - vis conventional finance. It waived the double imposition of stamp duties on real estate financing which have been structured under Shari'ah law. Concessionary tax treatment for *Sukuks* (Islamic bond) was also made similar to conventional bonds. The effects were expected to be twin fold in that it will help attract wealthy investors from the Middle-East as well as encourage local banks to develop alternate financing to the conventional practices.

Following the changes initiated by MAS, the SGX launched Asia's first *Shari'ah* compliant index on 22 February 2006. Known as the 'FTSE SGX Asia *Shari'ah* 100 Index', the index was the combined effort of the Fleet Street Stock Exchange (FTSE) in London and Yasaar Research. The index was to be the first in the series of FTSE SGX Shari'ah Index to be launched in Singapore. It is made up of 100 *Shari'ah* compliant stocks. The US dollar denominated index comprised of stocks from Japan, Korea, Taiwan, Singapore and Hong Kong. SGX planned to use the first Shari'ah index for creating products such as 'Exchange Traded Funds' (ETFs) and over-the-counter (OTC) trading instruments. The index is calculated in real time and published in United States Dollar (USD) value. It can be used as the basis of index-linked funds, ETFs, and OTC products.

In order to ensure that the FTSE SGX Index was in agreement with the *Shari'ah*, all the stocks were put to a vigorous screening process and were approved by a panel of Islamic scholars. It deliberately excluded stocks of companies dealing in activities such as the sale of pork or pork-based products, liquor, gambling and pornography. The stocks were screened using Yassar Researcher's proprietary screening methodology which is backed by a panel of Islamic scholars. As an index, it allowed middle-east investors access to the East Asian markets. According to the SGX, 'the Index itself may not be listed on the Stock Exchange. They can be licensed by any financial institutions and these institutitons can produce structured products to meet customer's needs' (Linus Koh, Executive Vice-President, Head of Products and Services at SGX, *Business Times*, 21 February 2006). The launching of the index was a significant attempt to develop Islamic finance and investment in Singapore. It created more opportunities for Islamic investors, especially from the Middle East to invest in Asian markets.

Singapore government realised that unlike in Malaysia and Indonesia, it does not have a very large critical mass of consumers who will help it establish a retail banking sector as in the conventional banking sector. As such, from the inception, Islamic finance and banking was viewed more as wholesale banking for fund management institutions and for capital markets. Singapore wants to be a financial centre by having *Shari'ah* compliant products as one of many choices for investors. It does not 'aim to be a purely Islamic financial centre … Singapore is going about setting up structures that accommodate Islamic finance products' (Teo Swee Lian, Deputy Managing Director of MAS, *International Herald Tribune*, 18 May 2007). In the process, Singapore sees itself as the 'gateway' for Asian investors looking for opportunities in the middle-east and vice-versa.

In order to attract funds from the Middle-East, Singapore forged closer ties with banks and regulators in the GCC region. MAS worked closely with UAE Securities and Commodities Authority as well as Qatar's Financial Centre Regulatory Authority to provide training to Singapore. This was also to enable Singapore cooperate with the GCC region in supervisory and regulatory matters.

From 2005, MAS allowed banks in Singapore to offer *Murabaha* financing in Singapore. It is commonly used as short-term financing and in trade finance. With the exemption of *Murabaha* financing from the restriction in the Banking Act against non-financial activities, banks can offer *Murabaha* financing by purchasing goods on behalf of a client and selling the goods to the customer at a marked-up price to be paid at a later date.

"MAS recognises that Islamic finance is gaining global importance. It is an

> important complement to the suite of products and services that Singapore as an international financial centre can offer. MAS is open to introducing refinements, such as this to our regulations to ensure that our framework is conducive to the development of Islamic financial services".
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> [Heng Swee Kiat, Managing Director, MAS, *Islamic banking News*, 28 September, 2006]

The New Regulation allows banks to carry out purchasing and selling an asset provided that the purchase is requested by a customer. The customer, thus, is legally obligated to take delivery of the asset.

MAS also became a full member of the Islamic Financial Services Board (IFSB) and later a part of the IFSB Supervisory Review Process Working Group as well as the IFSB Islamic Money Market Task force. These international affiliations of MAS together with Singapore's open markets, efficient infrastructure and transparent regulations is to allow Singapore to further develop itself as an international financial centre offering Islamic finance possibilities.

While the MAS is attuned to promote Islamic finance and banking, it has not set up a distinct banking regulatory framework for Islamic banking in Singapore. The existing regulatory framework is being adjusted to promote Islamic financing. It has been argued that a separate regulatory framework may be more a burden for Islamic banks to set up establishments in Singapore.

> "As many of the supervisory processes and prudential measures are common to both conventional and Islamic banking activities, MAS's assessment is that there is no need to create a separate Islamic banking supervisory framework in Singapore. Hence, MAS is open to admitting Islamic banks on prudential criteria for admission". [Cited in Islamic Banking News, Singapore, 1 September, 2006]

The Singapore government, thus, through its policy formulations has arrived at the position of promoting Islamic finance and banking within the existing financial architecture. Having done that, it has reformed the tax structure to encourage the private sector to initiate the promotion of Islamic finance and banking in Singapore. The current adaptation was achieved in a time frame of two years beginning from 2005.

Ⅲ. Private sector responses

This section of the paper analyses the responses in the finance and banking sector to the policy and market changes with regard to the growing significance of capital formation in the middle-east. It will comment on the various Islam based products and processes that the non-governmental sector initiated in order to best service the increasing Islamic wealth flowing into Singapore. The non-governmental sector responses can be divided into the establishment of banks specifically aimed at Islam based financial practices, the Islamic banking windows and products started by conventional banks, and the community based responses to use Islamic financial practices to promote fund-raising for projects. All these responses were possible owing to the fundamental changes made to financial and banking rules by MAS.

Islamic windows and products

MAS has been fine-tuning the rules and regulations to facilitate the introduction of Islamic finance products. But private sector is expected to create products that comply with Islamic principles. Singapore, thus, is encouraging companies to introduce more products that comply with Islamic law to increase its share of the market.

The growth of Islamic finance in Singapore hinges on the commercial viability of such products. As there are different interpretations of *Shari'ah* products in the industry, MAS decided early to leave it to the internal *Shari'ah* boards of the various banks to make the decision of how they will market their products. It also became clear that Islamic funds alone were not looking for Islamic products. Many conventional fund managers were also looking for any asset that offers them diversification. Islamic financial products in Singapore are offered by banks that have a presence in the Middle-East and Malaysia. Hong Kong and Shanghai Banking Corporation (HSBC) and Standard Chartered Bank (SCB), for instance, having presence in the Middle-East and Malaysia, are transferring their expertise to Singapore in the form of insurance products.

Maybank, Malaysia's largest Islamic bank, launched Islamic deposit products in Singapore. It is the first foreign bank in Singapore to introduce deposit accounts in compliance with the *Shari'ah*. It has introduced two deposit products in the form of an online savings account called 'iSAVvy Savings Account' with Automated Teller Machine (ATM) access plus a special dividend-on-dividend feature and a savings-cum-checking account known as 'Premier One Account'. These accounts are based on the Islamic concept of *Al-Wadiah Yad Dhamanah* or guaranteed safe custody. The bank guarantees the principal, but the returns are based on its investments. Maybank has allowed the Islamic accounts to be opened at any one of its seven specified branches in Singapore, while the accounts can be operated at any of Maybank's twenty-two branches in Singapore. The *hibah* or token on the accounts may be declared in the form of dividends. Maybank has assured that the dividends offered to depositors will be at competitive rates. The bulk of the deposits received is to be invested in Singapore itself, as investment overseas will involve exposure to foreign exchange risk, something which is not allowed under the *Shari'ah* form of financial management. Maybank plans to use the products to test the potential of the market in Singapore for Islamic banking and financial services. It will consider whether the *Murabaha* concept of profit sharing will allow the expansion of Islamic retail banking, term deposits, wealth management, trade financing and project financing. Maybank being the largest Islamic banking operator in the Southeast Asian region believes that despite the small Muslim population in Singapore, their experience so far indicates that Islamic finance and banking can be expanded. According to Agil Natt, Deputy President of Maybank,

> "Islamic banking is not just for Muslims. It is a universal product. In fact in Malaysia, 45 percent of our Islamic banking customers are non-Muslims. So you can see there is widespread acceptability among non-Muslims as well".
> [Channelnewsasia. com, 25 November, 2005, 1713]

Maybank believes that retail banking and other Islamic banking products will become popular in Singapore despite the small Muslim population.

The Overseas Chinese Banking Corporation (OCBC) was the first bank in Singapore to launch Islamic deposit products in 1998. The *Al-Wadi'ah* account was to serve a special market and customers in Singapore. Serving a special group of Muslim customers in Singapore, the *Al-Wadi'ah* account is based on one of the more common Islamic banking concepts. *Al-Wadi'ah* basically means guaranteed safe custody. In this concept, the bank acts as a trustee of funds and in line with Islamic law, customers deposit the money not for profits in the form of interest but rather for safe keeping. Under this concept, no returns are promised to customers. The bank gives the customers *hiba* or gifts as dividends for customers. The *Al-Wadi'ah* saving and current accounts serve both individual and corporate customers. This was followed by the introduction of the OCBC *Al-Wadi'ah* Monthly Savings Account and the *Zakat* Auto-Deduction Facility, a first in Singapore that provides Muslim customers with a convenient and disciplined way to save and also pay their obligatory tithe or *zakat* from their OCBC Bank accounts to the Islamic Religious Council of Singapore (MUIS).

In 2002, HSBC bought the Keppel Insurance Company in Singapore, and inherited a *Takaful* platform that the latter had built to actively service the Muslim community. The products offered included *Takaful* family care, *Takaful* Home Care, *Takaful* Motor Care, *Takaful Umrah* Travel Package and *Takaful* Mosque Package.

In September 2006, OCBC announced another first in Islamic Banking in Singapore with a launch of the OCBC Treasury *Mudharabah* Account (OTMA), a new *Shari'ah* approved product that is based on the concept of *Mudharah* or profit sharing. OTMA was specially developed to address an increasing need for more Islamic treasury products among Muslim corporate customers, Islamic financial institutions, non-profit organizations, mosques, and other Islamic bodies in Singapore and the region. It is designed to remain flexible by offering a shorter investment term starting from one month to a wider range of investment amounts and denominated currencies which include the Singapore dollar (SGD), American dollar (USD), the European dollar (EURO), Australian dollar (AUD) and the British pound (GBP). Haji Ismail bin Syed Ahmad, Head of Islamic Banking Unit, Group Treasury, OCBC Bank, reiterated that the Bank is constantly seeking to understand the Muslim banking community better. OCBC Bank aspires to be the fore-runner in the development of relevant *shari'ah* compliant products for the Muslim community in Singapore and the region. As the first bank in Singapore to launch Islamic depository products and facilities, such as the OCBC Islamic

Treasury Facility (OITF) and OCBC *Ijarah* Participating Facility (OIPF), it is constantly reviewing its role to promote Islamic finance and banking. OCBC has its own *Shari'ah* Advisory Council to approve its products so that customers are assured that their funds are strictly invested only in protected *Shari'ah* compliant assets.

In April 2006, the Malaysian banking group Commerce International Merchant Bankers Berhad (CIMB) announced that it will launch an Islamic Unit Trust in Singapore. CIMB branches in Singapore have planned to offer Islamic deposits and financing products as well as 'commodity *murabahah*', that involves mark-ups on product price in place of interest. The kinds of products it hopes to promote in Singapore will depend on the stages it is in (Badlisyah Abdul Ghani, Head of CIMB Islamic, *International Herald Tribune*, Monday, June 12, 2006). CIMB's effort to start a finance business in Singapore was a consequence of the government's revision of its banking framework to accommodate Islamic compliant financial efforts.

By 2006, the Standard Chartered Bank became the first bank to bring a deal to the market — a US$96 million Islamic finance facility (*Murabaha*) for Baitak Asian Real Estate Fund. Singapore has become the establishment centre for about S$2 billion Shari'ah compliant real estate funds managed out of Singapore.

Maybank Singapore is also offering a *Shari'ah* compliant twelve month structured deposit linked to commodities, the first in the region. It offered retail investors exposure to the commodities marked with 100 percent principal guarantee if held till maturity. In June 2007, the Kuwait Finance House (Malaysia) concluded a deal with the Pacific Healthcare Group in Singapore. As the leading Islamic banking group from the GCC region, it came into the Southeast Asian market by establishing a new base in Labuan, Malaysia, in 2006. Barclays Capital and others are in the process of launching an Exchange Traded Fund (ETF) off the FTSE-SGX Asia Shariah 100 Index and SGX. Progress has been slow because of the unfamiliarity of Islamic institutional investors with ETFs.

An Islamic Bank

Singapore wants to attract large funds and high net-worth individuals from overseas through Islamic equity instruments such as *sukuks* (Islamic bonds) as its own investor base of about four million people is too small.

DBS Group Holdings, Southeast Asia's largest bank, announced the establishment of Singapore's first Islamic bank in May 2007. It was done together with twenty-two Middle Eastern investors. Known as the Islamic Bank of Asia (IB Asia) it will offer corporate, capital market and private banking services. Abdulla Hasan Saif, the advisor to the Bahraini Prime Minister for economic affairs, has been appointed as the scholar advisor to DBS. DBS has been in Dubai since 2006, to be a key player in the Islamic financial sector. With its active participation in Middle Eastern markets, DBS has already participated in landmark equity IPOs (Introductory Public Offers) and securitization in the ME.

The Islamic Bank of Asia (IB Asia) is to be at the forefront of new market-based ideas to structure and introduce opportunities in Asia that uphold Islamic banking principles. It will focus on commercial banking, corporate finance, capital market and private banking services. Thus, it aims to complement MAS's vision of attracting Middle Eastern capital to Singapore and promote trade. IB Asia has enlisted four prominent Muslim scholars to guide its operations. With an initial paid up capital of US$418 million, 22 investors from prominent families and industrial groups from the Gulf countries make up the majority of the bank's founding shareholders. Eventually, DBS will continue to hold slightly more than fifty percent of the bank's shares. The new bank is to develop and distribute *Shari'ah* compliant financial instruments. IB Asia will continue to be a subsidiary of DBS based in Singapore and will operate from separate ground floor offices in DBS's headquarter facilities.

Community responses

Since 2005, awareness of Islamic finance and banking practices became widespread in Singapore's non-governmental sectors. In this part of the paper two public institutions are commented upon to illustrate the responses in these two organizations, namely a secular educational institution and an Islamic organization. Beyond these two organisations, Singapore's financial landscape is now familiar with the many seminars and international conferences organized by consultancies and financial institutions.

The Singapore Polytechnic (SP) was the earliest education institution to respond to incorporating training of expertise for Islamic finance and banking. The School of Business at the Singapore Polytechnic launched the Training and Research Centre for Islamic Finance (TRIC). Prior to the establishment of the centre, it had conducted training programmes with a consulting company, the Glohex Groups Private Limited and the Singapore Business Federation. The Centre plans to become a knowledge centre for Islamic finance in the region. It will help create a knowledge database and compile the opinion from various schools of thoughts on Islamic finance issues to provide valuable information for Islamic practitioners. The School of Business at the Singapore Polytechnic is also planning to incorporate Islamic Finance into its curriculum by offering elective modules in its academic programme from 2008.

MUIS, though a government statutory body, also used the expansion of Islamic Finance in Singapore to launch a *Musyarakah* bond. In order to develop its *wakaf* properties, it launched an *ijara 'sukuk'* worth S$60 million in 2001. Being the first of its kind in the world, it not only placed Singapore in the world map, but has become accepted as a new form of product innovation in the Islamic finance industry. The *sukuk* was issued to develop two of its *wakaf* properties, which consists of a service apartment with 107 rooms, a four-storey commercial complex and a mosque. The cost of the project came to S$35 million and was financed by an *ijarah* issuance. The service apartment managed by a specialist management company is running close to full occupancy. The second project was the purchase and refurbishment of a six-storey office building at 11 Beach Road, which is currently fully tenanted. A S$25 million *ijarah sukuk* was launched to finance the acquisition of the property as the sale of *wakaf* properties in non-prime areas did not generate adequate funds. Both properties are currently valued at more than S$100 million. By this process the Muslim community in Singapore has managed to achieve both financial and social gains from the development. For its innovative solutions in Islamic Finance, MUIS was conferred the prestigious Shaikh Mohamed Bin Rashid Al-Maktoum Award at the International Islamic Finance Forum (IIFF) in March 2006 at Dubai.

Ⅳ. Conclusion

The pursuit of Islamic finance and banking in Singapore has been gathering increased attention since 2005. In November 2006, while Minister Mentor Lee Kuan Yew was visiting the GCC, he called on Singapore to seize the opportunities in Islamic finance and banking 'before the window closes' (December 1, 2006, Reuters News). Statements like these pushed MAS to design rules of engagement within the financial architecture of Singapore to attract middle-east funds. But then the devout Muslims in GCC will not purchase assets that derive profits from alcohol, pornography, pork, gambling, armaments, tobacco, prostitution and other activities considered non-*Shari'ah* compliant. Singapore government's efforts so far has tried to create a level playing field between Islamic and conventional investments, although other measures will be needed if it wants to make further inroads into the fast-developing market.

Islamic finance and banking not only compete among themselves but also with a mature conventional banking industry in Singapore. In comparison to Malaysia and Dubai, Singapore is rather late in its efforts to develop an Islamic Finance industry, but it has moved rapidly to catch up. The Chief Executive of DBS, Jackson Tai, for instance has summarized the challenge as follows:-

> "In the short term, I believe the population of Singapore is probably not geared towards Islamic Financing but that may take time to develop. The population of Muslims is smaller than in other countries. But in the long term, it can expand in places like Indonesia with a large Muslim population".
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> [April 8, 2007, Radio Singapore International]

Islamic banking requires an ethical practice not to charge interest as in conventional banking. Islamic practice only encourages interest free loans. Even in *Qard Hasanah* (benevolent loan) practice, the bank can only impose service charge, not exceeding the actual administrative cost of such loans. This practice will make conventional banks that have Islamic windows and products to avoid retail loans that will not give profits as in conventional loans with either high fixed interests or variable interests. Thus, bulk of financing by Islamic banks or windows would be equity oriented to confine themselves to practices such as *Murabaha* (cost plus sale), *bay mu'ajjal* (deferred payment sale), *bay 'salam* (purchase with deferred delivery), *bay' istis'na* (made to order), *ijara* (leasing) and *ju'ala* (loans with a service charge).

Two of the more crucial issues facing the Islamic finance industry in Singapore are regarding *shari'ah* compliance rules and new product development. The first problem pertains to an accepted regime of international rules for Islamic finance and banking that Singapore can adopt. Institutions such as the Islamic Financial Services Board (IFSB)[1] and the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) have made great progress in developing standards including rules for *shari'ah* compliance. MAS, the central bank of Singapore, is a full member of IFSB.

The other problem is the need for talented people learned in both the conventional banking practices and the rigour of *Shari'ah* laws. Finding such talent is a problem for many financial institutions in Singapore. MUIS[2] has launched postgraduate scholarships to create a dynamic breed of *Shari'ah* trained persons in Singapore to meet the needs of the increasingly complex Islamic finance industry.

The spread of Islamic finance and banking does not face a challenge in Muslims forming only sixteen percent of the population in Singapore. Southeast Asia's Islamic finance industry is acknowledging that most of its assets do not belong to Muslims. Global bank HSBC's Islamic operations HSBC Amanah, says that more than 70 percent of its customers in mainly Muslim Malaysia are ethnic Chinese. If Islamic finance and banking is truly ethical banking that guarantees transparency, then most Singaporeans may switch to using those facilities.

Although Singapore's domestic market is small, its finance industry has about S$600 billion under fund management. It has been growing 20 percent each year since 2001. The top 30 of the biggest fund managers in the world, and the top private bankers in the world are all based in Singapore and this creates a good base to develop Islamic finance and banking products. MAS, however, will have to continue to set clear industry standards and formalize legal frameworks.

Islamic finance is important for economic development and as a potential alternative financing route for projects. Islamic finance can be a catalyst for economic development and poverty reduction. Islamic banking is not just for conservative or radical Muslims. It has now become mainstream business. As a consequence every bank wants to be part of it. It has also broadened its appeal beyond the community of faithful Muslims. Nearly, a quarter of all Islamic banking business in Malaysia is being transacted by non-Muslims. Similarly in the middle-east, Indians and Europeans participate in using Islamic banking.

There is little awareness in Singapore, especially among the wider public that Islamic finance can exist in countries where Muslims do not form the majority. A survey of 400 Singaporean Malays in 2004 showed that only 37 percent had a grasp of Islamic finance (Cited in Siow Li Sen, 2004). Islamic finance still requires promotional and educational work. This is where Singapore can add value by channeling the money from the middle-east into Singapore before reaching East Asian and Pacific investments. Singapore can overcome its lack of a large Muslim population by working with neighboring countries like Indonesia. As Singapore is already a financial centre and regional hub to the world's major banks with growing strength in structuring and manufacturing derivatives and asset products, it is well placed to develop Islamic finance. Even though Singapore apparently faces rivalry from neighbors like Malaysia and Brunei in raising Islamic funds, these funds are often managed by large western financial institution like Citigroup, Deutsche Bank, HSBC and Union Bank of Switzerland (UBS). By fashioning appropriate financial policies, it can still be the hub through which these funds are managed by the global financial institutions. One area that Singapore can undertake is the *takaful* (insurance) aspect of Islamic finance. As the industry has the same lawyers, auditors and accountants as the conventional financial institutions, it will be much easier to promote Islamic financial institutions. *Takaful* generally caters to the middle-east customers and will be able to sustain itself. *Takaful* premiums have to be invested in a *Shari'ah* compliant and profitable manner. *Takaful* is both a leading product and a lagging product. They are sold behind some leading products such as home financing and car financing products. College fee planning programme and pension products are dependant on successful *Takaful* and *Retakaful* industry. *Takaful* is the goldmine that Singapore can nourish in the Islamic finance industry.

Singapore's challenge lies in promoting Islamic finance as a mainstream opportunity than an oddity of conventional banking. United Kingdom and Malaysia are far advanced in the promotion of Islamic finance and banking. Singapore joined the race only in 2005 and during the fourth decade of the industry elsewhere. Changes in the UK are very likely to be replicated in other countries including Singapore. As none of the countries have so far managed to create a brand, Singapore will have to create a brand of Islamic finance and banking with a global reach. Most have been adopting and adapting each others practices. Many of these institutions are not defining the *Shari'ah* concept of finance and banking but are following the flow of money. Singapore, in order to create its own international brands needs to overcome the conceptual differences. There are significant differences in the *Shari'ah* interpretation of *Fiqh Al-Muamalat* (Islamic law relating to financial transactions). Singapore, for the present, is using Islamic Advisory groups to overcome the lack of *Shari'ah* convergence on finance and banking.

The Islamic finance industry will be a feature to be actively developed as long as Singapore remains a part of the international financial architecture. Compared to the conventional financial system it is relatively young. Islamic finance and banking, in wanting to be part of a global financial system, would continue to adopt many of the innovative practices and products as long as they comply with the principles of *Fiqh-Al-Muamalat* (Islamic law relating to financial transactions). Singapore needs to continue to address the Islamic financial architecture. It needs to establish which model it would prefer to follow. Malaysia has shown the way for a dual banking model, where the Islamic system operates along side with the conventional system. Iran, Pakistan and Sudan have provided a model for the Islamization of the banking system. Singapore has, so far, avoided both models and appears to manage the Islamic finance and banking as part of the financial architecture that it has evolved.

Notes

1) IFSB, established in 2003, is the international-standard setting body of regulatory and supervis-

ory agencies to ensure soundness and stability of the Islamic banking, capital market and insurance industries.

2) MUIS, established in 1968, advises the President of Singapore in all matters relating to Singaporeans Muslims, numbering between 450,000 to 500,000 making around 14 to 15 percent of the population. It is the sole custodian of halal certification in Singapore.

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