

Biz Titans Roundtable with Professor Marti G. Subrahmanyam Repositioning Malaysia's International Financial Center Narrative

Roundtable Notes

Note: These notes follow the Chatham House Rule. Participants are free to use the information received, but neither the identity nor the affiliation of any speakers (other than references to Professor Marti G. Subrahmanyam (Keynote Speaker) and Professor Joseph Cherian (Moderator) may be revealed.

Opening and Context

The second Biz Titans Roundtable at Asia School of Business (ASB) convened senior leaders across business and finance to exchange views on Malaysia's international financial center (IFC) narrative.

The discussion followed the Chatham House Rule to encourage openness: the ideas may be used, but the identity or affiliation of speakers, apart from the Keynote Speaker and Moderator, is not to be disclosed.

The event was framed as a dialogue rather than a lecture. Participants were encouraged to raise questions and debate issues collectively, with Professor Marti G. Subrahmanyam, the Charles E. Merrill Professor of Finance, Economics and International Business at the Stern School of Business, New York University and Global Network Professor of Finance at NYU Shanghai, whose research over the years providing an anchor for discussions on Islamic finance in Malaysia and market dynamics.

Background: The IFC Landscape

IFCs have emerged as an area of interest in the past two decades. Currently, New York and London dominate the global financial landscape, with Singapore arguably joining their ranks.

An IFC serves multiple functions. Firstly, it acts as a platform for cross-border capital. These flows do not necessarily need to originate from or enter the country in which an IFC is located, but the IFC should facilitate such capital flows.

Secondly, an IFC houses multiple services, such as banking, financial markets, foreign exchange trading, and asset management. Ireland was highlighted as the sole country to do this well, hosting insurance, harmonized market and banking regulations all under one roof, and a prudent taxation system. This self-contained system provides Dublin with a unique competitive advantage in the European market post-Brexit. Conversely, the

fragmented regulatory system in the U.S. makes it hard to navigate between the different regulatory bodies.

Finally, an IFC facilitates price discovery, one of the most important functions of financial markets. However, price discovery can only occur when there is sufficient liquidity. As an example, it is challenging to decide the price of any **off-the-run** US Treasury bond because it is a highly illiquid security and not qualified by the futures market.

The challenge an emerging IFC faces is to break out of a chicken-and-egg problem: capital market infrastructure needs to be built to draw international financial traders, but oftentimes the infrastructure will only be built when there is sufficient demand or liquidity.

The 3 T's: Trust, Transaction, Talent

Broadly speaking, an IFC needs to be strong in three areas for success, described under the 3 T's framework: Trust, Transaction (in terms of liquidity and ease of trading), and Talent. Several aspects contributing to the success of an IFC were identified and can be classified under the 3 T's as follows:

- **Trust**

- The **rule of law** should be enforceable. English common law, which Malaysia follows, serves as an advantage, as demonstrated by adjudication commonly occurring in New York and London. This rule of law allows for the enforceability of contracts, such as whether a contract falls under the ISDA.
- **Efficient price discovery** is characterized by the rapid incorporation of information into asset prices. It serves as the hallmark of a fair, orderly, and well-functioning financial market.
- The **ability to withdraw money on short notice** underlies the trust an investor has in an IFC.

- **Transaction**

- **Capital account opening** was discussed through the examples of China and India, two countries with no substantial capital account opening, due to the lack of policies and regulatory support for this. Regulation in India assumes that people are untrustworthy, leading to policies that seek to control prevent financial activity. As such, India has a cumbersome investment process that requires investors to go through Mauritius, among

other steps, thus preventing the possibility of meaningful financial activity within India.

- **Deep, liquid markets** allow for price transparency. As an example, asking about exchange rates is easy because currency markets are extremely liquid, whereas **off-the-run** Treasury bonds are significantly more illiquid and therefore harder to price.
- IFCs need to have **infrastructure for payments and clearing**. Euroclear was highlighted as an example of a clearing system in Europe, playing an important role due to the power of the Euro globally. It was suggested that Asia should have an equivalent clearing system with a global focus.
- **Talent**
 - IFCs require a **skilled global workforce**, especially one that is freely mobile.
 - The **language** an IFC uses matters, especially as nearly all contracts are written in English.
 - IFCs should also be located in environments with **urban livability** in order to attract a global workforce. GIFT City in India was highlighted as an IFC that was established in a remote area with undesirable living conditions; as such, it has become a booking center to which people neither travel nor move to.

Several of Kuala Lumpur's strengths and areas for improvement were identified, which can again be classified under the 3 T's:

- **Trust:** Kuala Lumpur has an effective legal system and strong regulatory systems.
- **Transaction:** Kuala Lumpur has well-functioning Sukuk markets and cashless credit but could improve its infrastructure to facilitate global capital flows.
- **Talent:** Kuala Lumpur has a good talent base but could seek to improve talent access by reducing frictions associated with talent mobility, such as with visas. Malaysia also benefits from having one of the world's strongest passports, giving its local talent improved mobility.

The Fourth T: Taxes

In addition to the core 3 T's identified, a favorable Tax regime was proposed by an audience member as a potential fourth T. Investors do not consider taxation in an IFC attractive, explaining why many other IFCs have eliminated taxes. Even when countries like India implemented policies such as retrospective taxes and hidden taxes, investors can still recognize and identify these forms of taxation.

IFCs may eliminate corporate taxes for companies only if certain criteria are fulfilled. For example, companies in Dublin are required to have “front office” staff, as opposed to “middle office” or “back office” booking staff, and the head of insurance, preferably Irish, at the very least based out of Dublin, to avoid a 10% corporate tax – even if the company does most of its business elsewhere.

The challenge with tax incentives, however, lies in ensuring that zero tax rates are not exploited to the extent that Malaysia is perceived as an offshore tax haven.

Determining the Location of an IFC

The location of an IFC should be dictated by access to the global market, especially as access allows for liquidity to increase and reinforce itself. While regional IFCs have their own advantages, these are limited as compared to having a more accessible IFC. Apart from a financial perspective, access also matters for attracting talent to an IFC to spur growth.

While other locations in Malaysia have been identified as promising financial zones and therefore potential candidates for IFCs, regional priorities end up distracting from a core, national IFC strategy. Furthermore, zones such as Labuan are not as well-recognized on an international stage, as compared to the Cayman Islands, even by academics. Thus, an IFC located in Kuala Lumpur makes the most sense for Malaysia, due to both its access and international name recognition.

Islamic Finance, Green Bonds, and Ethical Finance

Green bonds and Islamic finance were compared to each other as unique forms of finance that deserve special treatment. The taxonomy around green bonds is currently vague; however, Islamic finance is clearly defined and generally well-recognized as ESG-friendly. While disagreement may exist on which assets are or are not Shariah-compliant, the underlying concept is well understood – the Islamic finance system thus requires centralized Shariah governance to enforce decisions. Even looking at ESG finance more broadly, stakeholders still struggle to define what counts as an ESG mutual fund, with the U.S. no longer labeling funds as ESG. As such, the stricter taxonomy surrounding Islamic finance may be more appealing.

Islamic finance also provides the appeal of ethical finance, especially with substantial interest globally in similar concepts such as ESG finance and green finance – while all these concepts may vary, they all share common ethical principles, beyond merely maximizing returns. Thus, centralized Shariah governance helps to establish Islamic finance as a more objective form of ethical finance.

Islamic Finance in Malaysia

Malaysia controls about 36% of the global Sukuk market, having previously commanded a larger share.

One of Malaysia's advantages in Islamic finance is its centralized Shariah framework, backed up by its strong institutions. Bank Negara's sovereign bond tick-by-tick transactions data was touted as being very high-quality at the global level, even somewhat better than data from the U.S. Treasury. This is due in part to Bank Negara offering Malaysian sovereign bond data on a transactions basis, which many countries do not make available. Malaysia also benefits from strong connectivity in Asia.

Other Islamic IFCs and Geopolitics

While other IFCs, such as Dubai and Riyadh, may be able to claim advantages in Islamic finance and connectivity, these cities have been shown to be geopolitically vulnerable considering the recent instability in the Middle East. Furthermore, Dubai may not be able to rebuild its recent loss of confidence and desirability, since global confidence in its safety and security has diminished. As a result, Kuala Lumpur now appears to be a more desirable destination to live and work in compared to Dubai, which was not the case several weeks ago.

While Kuala Lumpur pursues its IFC ambitions, it is not alone. Elsewhere in Southeast Asia, Brunei, Ho Chi Minh City, and Da Nang, among others, seek to establish themselves as IFCs. However, not every country will be able to do so – and may not even realize this. Vietnam was suggested as a country whose odds of establishing a successful IFC are slim. In a diverse IFC landscape, a country must therefore establish why the world needs one more IFC by identifying its competitive advantage – something that no other country can claim to have.

Malaysia's competitive advantage could be its strong **Sukuk rule of law**. As established, Sukuk requires a central body to classify financial instruments; however, as an example, according to bankers in London, Bahrain has a weak reputation for governance, from which Malaysia can benefit comparatively.

The spectrum for Islamic finance-based products and services is broad, covering foreign exchange trading, bond trading, and derivatives, with Sukuk-based asset and wealth management having high demand. While Dubai could provide these services, benefiting as well from its attractive quality of life, it suffers from having a high **cost of living**. Conversely, Kuala Lumpur stands out as a more affordable – and as attractive quality of life – IFC.

Another advantage Malaysia has is its relatively low **cost of funds**, especially when compared to other IFCs. However, companies must combine this with faster turnaround and processing times for Malaysia to succeed. HR and Technology, Data Analytics and AI were proposed as two levers to improve turnaround times, with the conversation mainly revolving around the latter.

India Stack, India's national data system, was used as an example of effective technology use. The stack layers development on top of a central infrastructure system through the use of APIs. This system allows for complete transparency in medium to large transactions, as well as payments through the United Payments of India banking system within seconds.

Digital Finance Centers

The issue of creating a digital financial center was raised, as aspects of digital finance could be used to meet the requirements of the 3 T's: stablecoins and the blockchain would allow for trust, transactions could be digitized, and the security token industry is considering establishing a talent base in Forest City, Johor, due to a combination of the existing infrastructure, the appeal of living in Malaysia, and the proximity to Singapore.

Digital finance can serve as a complementary pathway alongside Islamic finance. For example, the first-ever Islamic security token was issued in Malaysia, backed by Malaysian sovereign Sukuk. Malaysia could build on this innovation by beginning to issue sovereign-denominated digital currencies.

As Malaysia benefits from a strong Shariah framework, the country has the potential to lead in the field of Shariah-compliant digital assets. As the Shariah market is currently underserved, technologies such as blockchain, security tokens, and fractionalization may help to increase accessibility. However, other IFCs such as Dubai and London are also examining Shariah-compliant digital assets, such as Shariah-compliant stablecoins and Shariah-compliant commodity Murabaha. Given the overall market landscape, Malaysia must move quickly to truly capitalize on its advantages in this field.

Islamic Stablecoins

Islamic stablecoins were highlighted as a potential asset class for Malaysia's Shariah-compliant digital asset offerings. In practice, an issuer would use funds from Islamic accounts to issue the stablecoin, which could then be used to invest in sovereign Sukuk.

As Malaysia has a low share of the international Sukuk market at under 1%, such a stablecoin would need to be denominated in USD to attract international investors and

be competitive, as opposed to MYR, which is how the majority of Sukuk issued in Malaysia are denominated. While this Islamic stablecoin would not necessarily have universal appeal, the niche market for such a product has potential and needs to be examined further.

Prior Research into Sovereign Sukuk

Professor Subrahmanyam and Professor Cherian previously collaborated on research comparing sovereign conventional bonds and sovereign Sukuk in Malaysia. This research was initially inspired by two bonds issued roughly concurrently by Emirates Airlines, one conventional and one Sukuk, with the Sukuk being issued with a lower yield compared to the conventional bond. This finding can be explained by investors having non-monetary preferences that result in them accepting lower Sukuk yields (implying a higher price).

When examining Malaysian sovereign debt issuances, however, Professors Subrahmanyam and Cherian found that yields for conventional sovereign bonds had lower yields (implying higher prices) than those for sovereign Sukuk. The flipped yield spreads can be explained by the fact that Malaysian conventional sovereign bonds having special repo rates, meaning that an investor accepts the lower yields from the conventional bonds as the investor benefits from the liquidity premium offered in the repo and reverse repo markets for those bonds. This is popularly called the “convenience yield” of bonds.¹

In addition, their research also found that the price of the same sovereign Sukuk rose above (implying lower yields) than the price of conventional bonds during the Global Financial Crisis, proving that the ubiquitous **flight-to-quality** effect during times of financial and geopolitical crises had no impact on Malaysian Sukuk bonds, while it did for the conventionals.²

Previous International Sukuk Issuances

Malaysia had previously sought to promote the issuance of foreign currency-denominated Sukuk, starting with the inaugural issuance in USD by Shell Corporation. Furthermore, the Malaysian government was the first to issue a USD-denominated global

¹ "A Model of the Convenience Yields in On-the-run Treasuries," (J. Cherian, R.A. Jarrow and E. Jacquier), **Review of Derivatives Research**, 2004, v.7, pp 79-97.

² "Foreign Clientele Effects in Malaysian Sovereign Bond Markets: Evidence from Islamic Sukuk Bonds in Malaysia," (M. Chen, J. Cherian, Z. Li, Y. Shao and M. Subrahmanyam), 2022, **Critical Finance Review**. Vol. 11: No. 3-4, pp 677-745. <http://dx.doi.org/10.1561/104.00000124>

Sukuk securities issuance. Bank Negara incentivized such activities by awarding gold plaques to parties that issued foreign currency-denominated issuances. Successful companies included Petronas, Khazanah, and Cagamas, the latter being noteworthy because their issuance was in SGD. Many of these issuances followed Malaysia's issuance structure, with institutions such as Nomura and HSBC participating by co-arranging the deal.

It is unclear why the momentum around foreign currency-denominated issuances for both conventional and Sukuk eventually slowed down. Nevertheless, Malaysia still holds a comparative advantage in this field, supported by its legal infrastructure and talent pool, and must act on it before it becomes too late.

Incentivizing Corporate Sukuk Issuance

It was flagged that the bulk of new Sukuk issuance in Malaysia is performed by the government (60 – 70%), rather than by corporations (30 – 40%). Furthermore, as government funds and bodies typically buy such products, the Sukuk market in Malaysia has ended up as an insular system. Thus, a successful Islamic finance strategy for Malaysia would need to expand the pool of issuers, particularly the major international players.

Professors Subrahmanyam suggested that incentives will be needed for corporate bodies, either Malaysian or international, to issue Sukuk in USD, rather than simply relying on government issuance. Ideally, Malaysia should convince a global, non-Malaysian, trustworthy corporate to issue Sukuk in USD, in exchange for a lower rate, say by 10 – 15 bps, that is comparable to those offered by the U.S. Treasury. While major efforts will be required to execute this strategy of issuing corporate Sukuk in USD, successfully capturing business from one noteworthy foreign issuer should enable Malaysia to attract additional global Sukuk issuers.

Additionally, while these issuances should involve Malaysian financial institutions as co-managers, the participation of one or two large banking institutions, such as JP Morgan and Goldman Sachs in the issuance process will be essential to attracting other notable issuers and investors. Issuances will need to be pre-sold via the book building process to Islamic entities, such as the Abu Dhabi Investment Authority, who can in turn pre-sell issuances to their partners and contacts by offering a rare opportunity to purchase high-grade, U.S. dollar-based Sukuk.

Since the investor pool, and in turn the potential pool of banks, is likely to be small, the Malaysian government has an important role to play in offering further incentives to

attract investors, such as by offering investors preferred status for other financial activities in Malaysia. Furthermore, this strategy would need to be effectively executed by multiple stakeholders, including international banking institutions, political leaders, and regulatory authorities, alongside the active participation and buy-in of Khazanah and EPF as Malaysia's key government funds. However, government should serve as a facilitator, rather than an active participant.

A potential milestone for success would be to have a global Fortune 50 company launching a corporate Sukuk in USD, co-managed out of Kuala Lumpur, within the next two years. If Malaysia can achieve this goal, it can set itself on an effective trajectory for further success as an IFC. Parties looking for large sources of capital, such as for data center projects, should be identified so that Malaysia can capture a portion of this value.

Malaysia has various, but separate, structures in place to drive a milestone international corporate Sukuk initiative, including a unique government-linked company structure and a network of conglomerates that can issue such bond deals, but many parties have few incentives to accept the increased risk associated with growth, necessitating the involvement of other reliable global financial institutions, rather than simply relying on the government.

Shifting from Fragmentation to Collaboration

Multiple participants highlighted inefficiencies in Malaysia's cross-institutional collaboration, driven in part by the siloed nature of different government ministries and agencies. Fragmentation was noted to be more pronounced in Malaysia than in other regions, based on the experiences of roundtable participants. Without adequate coordination and alignment, even well-designed policies may lack the consistency required for long-term success, as reflected in part by the decline in Malaysia's international Sukuk issuance. Furthermore, academic and private-sector institutions must work closely with the government to effectively advance Malaysia's international financial center (IFC) strategy.

Reputation and Talent

While Malaysia offers multiple competitive advantages, the country may not be promoting itself enough, oftentimes only highlighting one or a few of its many advantages – perhaps due to a desire to be perceived as being humble.

Malaysia's talent pool is recognized globally due to its specialization, rather than its generalization. Many Malaysian finance professionals specialize in compliance, in line with the nation's main competitive advantage; however, these skills are often

headhunted by other countries. As a result, Malaysia continues to lose talent to jurisdictions such as the UAE, Hong Kong, and Singapore. In particular, Singapore's Government Investment Corporation (GIC) was highlighted as a key financial institution whose leadership includes several individuals, originally from Malaysia, who have since taken up Singaporean citizenship.

Other Malaysian successes in finance were discussed, including Bank Negara's leading approach to financial controls and monetary policy. For example, with other countries copying Malaysia's approach to lowering interest rates during the Asian Financial Crisis. Furthermore, Malaysia is home to the third largest accessible bond market in Asia (normalized by GDP), whereas Singapore's bond market is significantly weaker. Such financial successes, then, motivate the question of how Malaysia can effectively capitalize on its financial status. Considering that the Sukuk market has helped to increase market participation, while offering safe financial products with underlying collateral that meet investor requirements, Malaysia must now determine how to transform these advantages into success as an IFC.

It was proposed that Malaysia should promote itself more strongly. One route for this is to collaborate with other IFCs such as the Dubai International Financial Center (DIFC), thus demonstrating the need for strong relationships in finance and government. Such collaboration would require increased consistency and efforts: Malaysian communications are frequently conducted electronically, whereas the UAE values the commitment associated with physical, in-person meetings. As such, Malaysia needs to demonstrate to other collaborators that they are willing to commit and follow up, while being able to make decisions faster.

Geopolitical and Economic Trends Affecting Sukuk

While global banks advise clients to grow their investor base in order to absorb shocks, the investor base for Sukuk is smaller. Furthermore, investors are less willing to enter smaller markets in the face of uncertainty. Given the global shift from globalization to nationalization, investors will wish to deploy capital to companies with high demand, though these companies, such as Microsoft, may not always want more capital. This implies that Malaysia should broaden its investor base while growing its Sukuk market.

Global capital markets, however, have been remarkably dynamic and resilient in the face of geopolitical shock, as capital will move freely across systems where possible. Furthermore, markets that have been traditionally closed off, such as China and India, are beginning to open up and spread out.

Closing Reflections

Malaysia's IFC strategy should take to account the overall 4 T's: trust, transactional liquidity, talent, and taxes.

Investors typically avoid products that they do not understand, which may initially position Sukuk as a less appealing asset class. However, by issuing dollar-denominated, credit-enhanced Sukuk and explaining how such products align with ESG goals, Malaysia may be able to diversify its investor base and increase demand in turn. Bankers can inform this strategy by explaining their needs through their policy statements and aspirations. They can also help to increase demand by educating potential investors of the benefits of Malaysia's Islamic finance products, especially towards global pension plans in the U.S., Europe and Asia, whose requirements align well with these offerings.

Furthermore, Malaysia's financial sector strategy should encompass both conventional and Islamic finance. For example, Kuala Lumpur serves as a major operational hub for U.S. Treasury-related transactions, with Citibank centralizing its treasury and trade services, markets and securities services, as well as transaction and clearing operations in the city, employing approximately 4,000 staff.

Kuala Lumpur should not serve as a mere booking center, but rather as a thought leader, using its pools of liquidity that can self-sustain an IFC's operations. Such efforts must be supported by effective talent mobility strategies, in line with how other IFCs function and benefit as a result.

Ending Notes

1. An IFC serves as a platform for cross-border capital, a place to house multiple financial services, and a facilitator for price discovery. A successful IFC should be strong trust, transaction liquidity, and talent, while implementing a favorable tax regime.
2. Islamic finance is better defined than green bonds are through central Shariah governance, while sharing the appeal of ethical finance. Malaysia's strength comes in its robust centralized Shariah framework.
3. Malaysia may be able to leverage its Shariah framework to offer more Shariah-compliant digital assets, such as USD-denominated Islamic stablecoins.
4. Professor Subrahmanyam and Professor Cherian found evidence of the ubiquitous **flight-to-quality** effect for Malaysian sovereign Sukuk bonds during the Global Financial Crisis, demonstrating the resilience of Malaysian Sukuk bonds compared to conventional bonds.
5. Malaysia previously incentivized the issuance of foreign currency-denominated Sukuk, though this momentum has stalled in recent years. The country should target the launch of a corporate USD-denominated Sukuk by a global Fortune 50 company, co-managed out of Kuala Lumpur, within the next two years to revitalize these efforts.
6. The success of Malaysia's international Sukuk strategy will be contingent on cross-sectoral collaboration and the participation of international financial institutions.