

Japan Bids a Warm ‘Konnichiwa’ to Islamic Finance

By Paul Wouters

With a population of 60,000 Muslims as compared to nearly 127.5 million Shinto and Buddhist followers, Japan can hardly be described as a Muslim country. However, despite the lack of a domestic market, its leaders of industry have noticed the upside potential of Islamic finance. While this call for the moment is almost certainly founded on opportunistic inspiration and not on faith, it nevertheless will be clear that over time some of the ethical standards will be acquired.

As a matter of fact, provided one adheres to the ethical borders, Islamic finance is accessible by everyone. And the resources available are enormous.

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The Japanese industry has understood that and has devoted itself to the effort with the same seriousness as when it started building cars some 40 years earlier. Only two years ago regarded as a novice in the industry, the range of activities that has been developed since then is impressive.

In his opening speech at the Nikkei Islamic Finance Symposium held in Tokyo in February, the then Bank of Japan governor Toshihiko Fukui (whose term ended in March) said, “Development of the Islamic form of finance will contribute to diversifying the international financial market and transactions, and help fuel an expansion in the market and business opportunities.”

In his view, Islamic finance is now an essential factor in understanding the international financial mechanism.

G8 government Sukuk race

About a year ago, the state-owned Japan Bank for International Cooperation (JBIC) announced its interest in issuing a government Sukuk.

Spurred by the ongoing competition between neighboring Singapore, Kuala Lumpur and Hong Kong to be the Asian region’s Islamic finance hub, the Japanese had no alternative but to acknowledge the potential of the developing industry and the need to participate therein.

JBIC even hired a team of renowned financial Shariah scholars, originating from both the GCC (Gulf Cooperation Council) and Southeast Asia to assist in the effort. One year on, there seems to be little progress.

The issuance has been postponed repeatedly. First, JBIC became hostage to the fatwa of the Bahrain-based Accounting and Auditing Organization for Islamic Finance Institutions (AAOIFI). According to AAOIFI, a substantial number of Sukuk was too synthetic and the authority urged the Islamic finance market to adapt back to the roots. While most of the GCC-based financial world appear only too willing to

comply, this apparently created a conflict among the Southeast Asian scholars hired by JBIC, who were inclined to be more flexible.

Indeed, it became clear that JBIC had opted for — according to the AAOIFI ruling — a questionable commodity Murabahah Sukuk structure, originally to have been denominated in ringgit, and JBIC found itself caught between two views.

Most likely, the Japanese offering will be realigned with the generally accepted form of Sukuk Musharakah, denominated in US dollar.

Subsequently, JBIC was confronted with the current market turmoil caused by the fallout from the US subprime mortgage crisis. As such, it is likely that JBIC’s Sukuk probably will only be issued when the financial markets regain favor.



Japan is slowly but surely making a presence in the Islamic finance industry

The race for the first Group of Eight (or G8, an international forum that counts Japan and the UK as members) government Sukuk therefore is still on.

Indeed, London is eager to attract some of the Islamic money and is doing its best to become the regional Islamic finance hub for Europe. Talk about a first UK-government Sukuk has been in the air for some time now.

Japanese private sector does not wait

Already at the end of 2006, the Malaysian subsidiary of Japan’s Bank of Tokyo-Mitsubishi UFJ (Bank of Tokyo-Mitsubishi UFJ [Malaysia]) had entered into a strategic partnership with CIMB Malaysia that offered its Japanese clients access to Islamic finance resources.

In early 2007, this led AEON Credit to become the first Japanese corporate to issue a Sukuk when it raised a total of RM800 million (US\$229 million) in two tranches in Malaysia. Bank of Tokyo-Mitsubishi UFJ acted in effect as a middleman, introducing AEON to CIMB, which was the bookrunner.

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In May 2008, Toyota announced its intention to issue a Musharakah-structured Sukuk worth RM1 billion (US\$306 million) to raise funds for the expansion of its auto leasing and loans business in Malaysia.

Until then, those had been financed using cash from Malaysian Islamic banks. To boost its Asian operations, Toyota Malaysia began offering Shariah compliant loans in 2005 and Islamic leasing in 2007.

In June 2008, it was reported that Mizuho Corporate Bank lead-managed a US\$3.85 billion syndicated Ijarah (lease) facility for a Saudi Arabian mining and refining phosphate ore project.

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That same month, Okachi Malaysia, the Malaysian subsidiary of a Japanese futures commission merchant with active membership in all Japanese commodity exchanges, was appointed as the commodity trader for Alliance Islamic Bank’s new fixed deposit product, Alliance Fixed Investment AFI (Tawarruq structure-based, considered highly questionable in the GCC region).

Further Japanese expansion — foreign traded ETFs

The Japanese financial world has learnt that investors can be reluctant to invest in foreign stock exchanges, or in foreign currency. Then again, they might be keen to invest in foreign compliant companies, but may not be adequately equipped to conduct sufficient research into who is compliant.

The first step to overcome this hurdle of course is to have your company included in Shariah compliant indices. In December 2007, the Tokyo Stock Exchange launched the S&P/TOPIX 150 Shariah Index.

The more recent FTSE-SGX ASIA Shariah 100 Index includes relevant companies from Japan, Singapore, Taiwan, Hong Kong and South Korea. The Islamic indices help the compliant investor choose from among the eligible target companies and keep track of them.

The second step is to list on the various stock exchange baskets of such eligible Japanese companies that are grouped under exchange-traded funds (ETF).

The investor can invest in his own stock market and in his own currency in Japanese Shariah compliant companies — that’s Islamic investment made easy, Japanese style.

In June 2008, Daiwa Asset Management launched the Singapore Exchange’s first Shariah compliant ETF, the Daiwa FTSE Shariah Japan 100. The ETF includes Japan’s top 100 Shariah compliant companies by market capitalization.

And from Deutsche Bank, there is the ETF on the London Stock Exchange modeled after the S&P Japan 500 Shariah Index. The Frankfurt Stock Exchange is set to follow soon.

Despite the absence of local regulations, Kuwait’s Boubyan Bank completed in November 2007 what is believed to be Japan’s first compliant real estate deal using Islamic financing.

Boubyan Bank bought, after more than two years of exploring and preparation, three office buildings in Tokyo for JPY4.38 billion (US\$41.4 million). This is its first real estate investment in Japan.

Yet, even though they do not offer Islamic finance products, the Bank of Japan, Nomura Asset Management and other Japanese financial institutions became observer members of the Islamic Financial Services Board (IFSB), based in Malaysia.

The IFSB aims to be an important prudential standard setting organization for regulatory and supervisory agencies in Islamic finance that complements the work of the Basel Committee on Banking Supervision, International Organization of Securities Commissions and the International Association of Insurance Supervisors.

Government initiatives

The Japanese government has had to contend with personnel, money and know-how moving from its local financial sphere into other financial hubs, such as Hong Kong, Singapore and Kuala Lumpur.

Out of all these developments, it has realized the need to embark on a thorough overhaul of its existing financial and tax regulations.

For instance, one of the legal amendments filed by the Japanese Financial Services Agency in June 2008 advocated that Japanese banks be allowed to engage in Islamic finance activities through subsidiaries.

The Japanese private sector has decided to commit fully to the present growth of the Islamic finance industry and is waiting for the government to pave the way.

In fact, the government seems to be playing catch-up. Pioneering companies are leading the track for an expansive policy that at the same time can capture money where it can be found through various ways.

Only two years ago, Japan seemed to be lagging behind in the race for petrodollars. Now, it seems to be developing at light speed.

Most of the activity, however, still seems to be locked inside Asia. GCC banks should not sit back but instead compete for part of the business. ⁽²⁾

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