

Zeti Akhtar Aziz: Islamic finance developments in Malaysia

Address by Dr Zeti Akhtar Aziz, Governor of the Central Bank of Malaysia, at the Launch of Public Islamic Bank Berhad, Kuala Lumpur, 3 March 2009.

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It is my pleasure to be here today on the official launch of "Public Islamic Bank Berhad". This marks the transformation of the Islamic window operations into an Islamic subsidiary, a dedicated institutional structure that will give greater focus to Islamic banking business operations. The continued progress of Islamic finance in our financial system has demonstrated that despite the on-going global financial crisis, it has not discouraged the further expansion and development of Islamic finance. Malaysia now has a total of 17 Islamic banks, of which nine (9) are the subsidiaries of the domestic banking groups.

The underlying philosophy for the incorporation of an Islamic subsidiary is primarily aimed at further strengthening the institutional structure for Islamic banking business operations. Financial institutions which have achieved a critical mass in their Islamic banking business, have migrated from their Islamic banking window operations to an Islamic subsidiary. The establishment of Islamic subsidiary has greater potential to complement the goals of the banking group by providing business flexibility and autonomy to the Islamic subsidiary.

Currently, the Islamic banking system in Malaysia has successfully positioned itself as a robust and competitive component of our financial system. Islamic banking assets now account for 17.4% of the total banking assets of the Malaysian financial system while in the bond market, the sukuk market constitutes 57% of the total market as at end-2008. The product range has now also expanded into broad array of innovative instruments. Several innovative Islamic financial products have been introduced which included residential mortgage backed securities, commodity based financing, as well as investment and equity linked products based on *musharakah*, *mudarabah* and *ijarah*.

Today, however, the international and domestic environment in which we are operating is going to become even more challenging. Delays in the resolution to the financial crisis in the advanced economies have resulted in a sharp and rapid deterioration in the recent months. The inability to stabilise conditions is highly likely to have a more protracted effect on the global economy. While there has been concerted monetary policy action and fiscal stimulus across the globe, confidence needs to be restored. This can however, only happen when the financial system in the crisis affected countries are repaired and credit continues to flow again, when markets continue to function efficiently and when prices reflects the value of the assets.

While Malaysian banks are sound and well capitalised and our economy is not over leveraged and our external position remains strong, Malaysia as an open economy is already adversely affected by these global developments. The domestic conditions are expected to remain challenging in the coming quarters and a range of policy responses are being implemented. Two elements are vital in this process. The first is to ensure that the domestic intermediation process remains strong so as to support domestic demand. And secondly, the fiscal stimulus is key to containing the effects of the external developments and to placing Malaysia in a position to resume growth once conditions in the global economy stabilises.

During this challenging period, financial institutions including Islamic financial institutions have an important role to ensure the continuous access to financing by the private sector. Key to this, is the forward looking business strategies being adopted by banking institutions, the organisational structure and the operational capability that is put in place.

I would like to take this opportunity to highlight two other important dimensions in the development of Islamic finance, going forward. For more than two decades, the Islamic financial system in Malaysia has gradually transformed into a comprehensive Islamic

financial landscape. This has been reinforced by a legal and regulatory framework, the essential financial infrastructure, and an environment conducive for product innovation.

Notwithstanding the success of Islamic finance, the global ramifications of the crisis also calls for more concerted efforts to bring the industry to a higher level of resilience. Of importance, in this process, is to embrace the values of Islamic finance of justice and fairness that benefits the society and the system. It is thus important for Islamic finance to transcend beyond just the pursuit of growth and monetary performance but also to emphasise ethical market conduct practices. Indeed, this is in line with the principles of *Maqasid al-Shariah* (*objectives of Shariah*).

Financial innovation, as has been shown in the recent crisis has led to adverse consequences for the economy. By learning from the lessons of the recent crisis, the process of innovation in the formulation of Islamic financial products and services must be done carefully and in accordance with Shariah in its entirety and to take into account the distinct risk characteristics of Islamic banking.

The second dimension is **on the need for continuous investment in human capital development**. It is important for the Islamic financial services industry to continually promote human capital development and expertise to create a larger pool of experts and high calibre professionals. This involves enlarging not only the existing talent pool, but also building a robust pipeline of skilled human resources for the future.

Bank Negara Malaysia is committed towards promoting human capital development. The establishment of the dedicated ancillary institutions such as the Islamic Banking and Finance Institute in Malaysia (IBFIM), the International Centre for Education in Islamic Finance (INCEIF) and the International Shariah Research Academy (ISRA) to focus on the area of training, education and research are aimed to meet this objective. We would like to see a higher degree of engagements by the financial institutions to meet the talent need of the industry. Islamic financial institutions are encouraged to collaborate and engage with these educational institutions, with exchange of staff, attachments, and internships.

In addition to these, is the strengthening of Malaysia's international linkages with other financial centres in the area of Islamic finance. Recently, Bank Negara Malaysia, under the MIFC agenda, signed an MOU with the UK Trade and Investment to promote the mutual development of Islamic finance and business linkages. In this respect Islamic financial institutions in Malaysia are encouraged to leverage on the MOU platform in building strategic partnerships with their counterparts to develop new value added activities and to expand the market.

While these steps are being taken to strengthen our international inter-linkages in the area of Islamic finance, Islamic financial institutions in Malaysia need to continue to strengthen their capacity and capabilities to meet the significant challenges of the current and future environment. On this note, I wish to congratulate Public Bank Berhad on the official launch of Public Islamic Bank Berhad and for the commitment to contribute to the success of Islamic finance. Wishing Public Islamic Bank every success in its endeavours.