

Rundheersing Bheenick: Islamic finance and its developments in Mauritius

Address by Mr Rundheersing Bheenick, Governor of the Bank of Mauritius, at the Opening Ceremony of the Seminar on Islamic Capital Markets, Port Louis, 19 May 2009.

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A very good morning to you all.

It is my great pleasure to welcome you all this morning and to offer a prelude to our important international seminar on Islamic Capital Markets.

The word “Seminar”, Seminarium, derives from the Greek work for seed – semen – and thus our task is the spreading of seeds. At our meeting, God willing, these seeds are for a fresh garden for the world freed from the perils past, and very present, in which the now-globalised economies of the world have been put at such grave risk by mistaken systems of management of global financial and capital assets. A past in which, some declare, western bankers, finance professionals, accountants, market players, and those regulating and supervising them have fatally wounded the golden goose of the market economy and even called into question some of the fundamental tenets of capitalism itself.

It is as well we hit on the word seminar for our task, rather than the other commonly-used Greek term for such encounters – Symposium. For “Symposium” derives from the ancient term for a drinking party, beloved of Plato, Aristotle and their friends and scholars, which might include not only the common supping of fermented grape juice, but also a goodly supply of lightly-clad dancing ladies.

I am not sure our friends and brothers, from the distinguished Islamic Financial Services Board, would have entirely supported such a venture. So an international seminar we have – that is, a meeting for discussion or training; and through that, the planting of seeds for the future.

We are honoured by the presence of Dr The Honorable Rama Krishna Sithanen, Vice Prime Minister and Minister of Finance, who has taken time off to be with us, only days before he presents his next budget at the end of the week.

We are proud to be co-hosting an event for the first time with the Islamic Financial Services Board; and we are delighted to have the full collaboration of our sister regulator, the Financial Services Commission, in this exercise. It is no coincidence that this seminar takes place at a time when we at the Bank have just launched our first Islamic finance operation, HSBC Amanah Mauritius. We have been working towards this for the last two years, and it is heartening to see our efforts have started to bear fruit. The Dodo is finally meeting the Camel!

But you might ask why this image of the Dodo and the Camel that appear on our posters for this event? For our overseas visitors who may not know it, the Dodo is that legendary but extinct species of bird that died out in Mauritius not long after man first set foot on our previously uninhabited island. The Dodo failed to adapt and paid the terrible price of this failure. Its memory lingers in the logo of our central bank. It serves as a symbolic warning and a reminder of the fate that awaits those who do not adapt to change. The Camel, of which I believe none exists in Mauritius, comes to us today, as a symbol of that species that is well adapted to that harshest of environments, the deserts of Arabia; it is that seasoned traveler who, when water is scarce, carries it on its back in its God-given hump.

This meeting of the Dodo and the Camel is not an image from Samuel Huntington’s “Clash of Civilizations”, in which those of sharply differing cultures are doomed to eternal conflict. No, indeed, our meeting here is just the opposite. It is a meeting of minds intent to seek fresh

thoughts on sustainable banking and this, not merely to avert the fate of more species like the Dodo, threatened by global warming and the carbon imprint of man, but to also avert the very recurrence of the financial and economic crisis that engulfs the world today, capital markets and banking in particular.

About the IFSB

For those who might not be in the know, the IFSB, a Kuala-Lumpur-based organisation, was set up in 2002 to promote soundness and stability in the Islamic financial services industry. Since its inception, the IFSB has been actively engaged in the development of international standards and guidelines for the Islamic financial services industry. The prudential standards adopted by the IFSB are globally accepted and are contributing to the smooth integration of Islamic finance with the conventional financial system. The IFSB also provides a platform which brings together all the stakeholders of the industry: regulatory agencies, private sector operators, rating agencies, professional associations, as well as regional and international financial institutions.

Islamic banking is a multi-billion dollar industry in global and national finance. It also happens to be growing at a very rapid pace. In the midst of financial and economic crisis, the IFSB brings to us the principles and practices of Islamic banking and the management of capital markets. This will contribute to our search for a new focus for resilience in investment and banking to withstand the shocks that have undermined the credibility of much current international banking practice and nearly forced the collapse of capital markets.

I wish to commend the IFSB for their remarkable work and for the catalytic role they have played in turning Islamic finance into a truly global phenomenon. From humble beginnings in 1975, when the first formal Islamic Financial Institution was established, Islamic Finance has spread well beyond the confines of the Middle East. It now spans the globe from New York to Hong Kong, via London and Singapore. To-date, there are over 300 Islamic Financial Institutions in more than 75 countries. Mauritius, an observer-member of the IFSB since 2007, is one of the newest additions to the Islamic Finance map. Now that we have proved our credentials in Islamic finance, we look forward to be admitted to full membership status in the near future.

This morning, I would not wish to engage in a lengthy discussion on Islamic finance. I leave this to the experts and I am glad that so many of them have joined us for this event. Instead, I will focus my intervention on those aspects of Islamic finance that are, according to me, relevant to the successful implementation of Islamic finance in Mauritius, namely its ethical dimension and the ability of Islamic finance to meet the transaction needs of the market.

Ethics in Islamic finance: sowing the seeds for success

In Islamic finance, the moral dimension is its *raison d'être*. Islamic finance is firmly anchored in the *Sharia*, which derives from the *Qur'an* and the sayings and deeds of the Prophet Mohammed in the *Sahih hadith*. At the very core of Islamic finance is the concept of *Riba* which is where a buyer demands more of one item in exchange for just one item of equal value; this does not mean zero profit but zero interest.

As many countries now have the lowest levels of interest on capital in living memory – and in Mauritius we have for some time now had negative real interest rates – it is time to ponder anew on the role of central banks in capital markets and the utility of interest rates as a guiding system. Our friend Aristotle, the eager symposiast who I referred to earlier, was deeply opposed to positive interest rates. If negative rates are bad for saving, positive rates are not an unqualified blessing either. Too positive, and they become “usury” which the Oxford Dictionary defines as lending at an exorbitant rate of interest above the level allowed

in law. In Islamic banking, the legal level is zero and any rate above that is usury and therefore prohibited.

But we would risk gross reductionism if we were to introduce Islamic finance, to the uninitiated, merely as faith-based finance. Islamic finance does propose a morally-inspired economic behaviour. It envisages a partnership between capital, business acumen, and entrepreneurial ability. Any activity that promotes the common good finds its place within the spectrum of Islamic financial instruments. Islamic banking tries to maximize both investment in the real economy and consumption so that development is promoted fast. Any incremental value, which generates from this productive enterprise, is shared; and if there is a loss, the entrepreneur goes without reward. The distributive justice, which follows from risk-sharing, and the promotion of public good are ideals that most of us share. This integration of ethics and values into finance is viewed positively by many.

Such ethical safeguards are however not exclusive to Islam. To take another example from a different faith, St Thomas Aquinas opposed usury; but then you might say that was history, before modern banking; indeed it was well before the excesses of modern banking and financial engineering, and the mismanagement of capital markets got us into the state we are in today.

Let us not forget that we also live in the age of ethical consumerism. There is a growing number of people who are constantly on the lookout for products that are “organic” or “green” – in short, for anything that espouses the principle succinctly summarized in the following four words: **“First, Do No Harm”!**

What sets Islamic finance apart, though, is the degree to which its prohibition on *Riba* requires that its adherents rethink the way they make their money. The sacred principle is that money should not produce money, and bankers from Islamic financial institutions make no compromise here. This commitment is translated in the fact that to every credit extended there should be an underlying asset. Money should be used only to finance the real economy. Adherence to this principle affects the relationship that each nurtures with money, whether we are an individual or an enterprise. An entity cannot borrow more than the total value of its listed shares while a person cannot *de facto* suffer from over-indebtedness. Most certainly, such principles cannot be harmful to borrowers!

Another principle in Islamic finance that sets it apart from conventional finance – and which assumes a particular relevance in the global financial crisis – is that uncertainty in contractual terms and conditions is not permissible. All the terms and conditions of a financial transaction need to be clearly understood. This principle has insulated Islamic financial institutions from exposure to toxic assets. Fools rush in where angels fear to tread, they say. Then the herd instinct takes over ... and before you know where you are, you find yourself in the kind of crisis that has engulfed conventional finance, in particular, the world of shadow banking. Islamic finance operators do not have this option. They can only enter ground that has been declared compliant by *Sharia* scholars.

Global financial crisis

The current global financial crisis has brought into sharper focus some worrisome aspects of contemporary financial markets. At the heart of our current global crisis has been the fateful distance of much of modern finance from the real economy. *Per contra*, at the heart of Islamic banking and Islamic capital markets is the salutary insistence on bringing these two elements closer together. We cannot turn the clock of globalisation and of global finance back. But we do need to look for a better way of managing our affairs insofar as money and finance is concerned. To quote Raghuram Rajan, former Chief Economist of the IMF, the time has come for “regulatory soul-searching”.

The economic model which follows from Islamic finance is very different from the “originate and distribute” model which has failed conventional finance so spectacularly. The founding

principles of Islamic finance, the prohibition of interest and the close linkage between the real economy and finance, offer a viable alternative to the conventional financial system.

At a time when global conventional finance markets are in such a state of turmoil, Islamic finance does represent an appealing alternative. The short-term fixation on private benefits by hook or by crook, which has turned yesterday's financial wizards into today's leading exponents of white collar and financial crime, must give way to a clearer focus on the longer term and the public good aspects of our financial interaction with our fellow-man.

Now, in today's world, Keynes and his precepts are experiencing a revival. It has taken open clamouring for government interventionism and the introduction of fiscal stimulus measures on a mind-boggling scale to remind us that "we are all Keynesians now." As Greenspan reminds us in his autobiography, Time Magazine declared this way back in 1965, that is well before those words became indelibly associated with US President Richard Nixon.

Along with stimulus measures and public spending, we are re-discovering the Keynesian concern with zeroing down interest rates. "What enormous social changes would result from the gradual disappearance of a rate of return on accumulated wealth..." he declared in his General Theory. His principal preoccupation at that time was relief of unemployment and poverty in Europe.

Keynes saw unemployment and its social and economic consequences as the essential target for action. He said it would be better to employ people to bury money in bottles and then employ others to dig it up, rather than put up with rampant unemployment. We find much common ground between Keynesian theory and the Islamic concept of Capital markets. This is particularly evident in their shared focus on closing the gap between the function of money as a repository of value and the function of the economy to promote trade and employment.

Islamic finance is just finance

I mentioned earlier that Islamic finance has transcended borders and regions. What appeals in Islamic finance is its ability to transform products and services from mainstream finance into *Sharia*-compliant equivalents. In many ways, the development of Islamic finance has rivaled the innovations in mainstream finance in recent years. The growth of Sukuks (Islamic bonds) has been dramatic; the London Stock Exchange has already listed over 20 Sukuks. Some governments have been considering the idea of sovereign Sukuk issue. This is indeed a remarkable achievement for an institutional arrangement which was formalised less than a generation ago.

Here, in Mauritius, Ijarah (leasing) and Takaful (insurance) services are already available. The range of Islamic financial products is set to expand further with HSBC Amanah starting operations here early this month and the expected launch of two other full-fledged Islamic banks soon.

The development of Islamic finance in Mauritius forms part of our strategy to become a world-class financial centre, offering a whole range of financial services at a competitive price to an international clientele. Experts on Islamic finance concur that it is now emerging as a competitor to conventional finance on efficiency grounds. The development of Islamic finance in Mauritius can encourage new levels of dynamism in the sector and attract more foreign direct investment and portfolio flows especially at a time when our economy is showing signs of slowdown. It can smooth out the disparities between levels of financial development and capability, as well as foster deeper regional ties in Africa.

This first event in Islamic finance, which we are starting this morning, has generated a lot of interest among all stakeholders. The response has been simply overwhelming and bears testimony to the eagerness of each and everyone here to learn more about Islamic finance. We are acutely aware of the need to build up rapidly a local pool of experts in Islamic

finance. Seminars such as these provide the appropriate platform for sharing and developing expertise. A bridge has been created between the IFSB and Mauritius and we hope to be able to organize other seminars and workshops in future. We are confident that this will create the necessary synergies to enable Islamic finance to gather momentum in our part of the world.

Regulatory challenges for Islamic finance

The ethical dimension of Islamic finance is an essential ingredient for its success. What matters even more to us in Mauritius is its smooth integration with the rest of the financial system. This hinges on a sound regulatory framework embedding best international practices. There is no denying that there are regulatory challenges facing the Islamic finance industry in Mauritius. As is the case in any burgeoning enterprise, some of the real challenges are still in the domain of the unknown. The experience of other jurisdictions provides us with precious insights and helps us to avoid certain pitfalls. Indeed, this is not the case only with Islamic Finance, but applies to the entire financial sector. In this sense, the global financial crisis can have a salutary effect. It serves as a wake-up call for modern finance to review the regulatory apparatus, in terms of our operating framework, processes and procedures.

Standardisation with regard to Islamic finance laws and regulatory practices and the interpretation of the *Sharia*, is an essential ingredient in increasing the marketability and acceptance of Islamic products. There is a need to foster greater transparency and credibility. The work of international institutions such as the IFSB and the Accounting and Auditing Organisation for Islamic Financial Institutions on the harmonisation of standards is absolutely crucial.

There is one key aspect in which there is absolutely no difference in our regulatory approach to Islamic finance as against our approach to conventional finance. And this is our uncompromising and steadfast adherence to global prudential standards and the adoption of international best practice for risk management and corporate governance. Additionally, we want to achieve a smooth integration with the conventional financial system.

While doing all this, we must bear in mind that Islamic finance is just finance – it provides an alternative mode of financing that may appeal to all depositors and investors, irrespective of their religious beliefs.

Conclusion

Today, as we find ourselves at the centre of a turning and troubled world, we at the Central Bank are privileged to bring together the flower of our entrepreneurs, bankers, financiers, and economic thinkers under the threat of the fate of the Dodo to meet with our distinguished and experienced brothers from afar to, if I may use the phrase, distill what we can from the meeting of minds on this great issue of our times, the better management of capital markets. Can the Camel supplant the Dodo in our quest for a better future?

I thank all stakeholders who have contributed to this event – the IFSB for sharing their experience and wisdom in the preparation of this event, the FSC for joining hands with us, the speakers, discussants, participants and the organising committee. Events such as these provide excellent networking opportunities and I fervently hope that participants will take advantage of the interaction to emerge wiser and richer.

Thus I have the honour and great pleasure to welcome you warmly and to declare the Seminar open for those who wish to sow the seeds and reap the harvest generating fresh species that can survive the rigours of our troubled times.

Thank you for your attention.