

## **Mohd Razif bin Abd Kadir: Islamic finance and the collaboration between Malaysia and Bahrain**

Special remarks by Mr Mohd Razif bin Abd Kadir, Deputy Governor of the Central Bank of Malaysia, at the Signing Ceremony of Memorandum of Understanding between Bursa Malaysia – Bahrain Financial Exchange, Manama, 24 January 2010.

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It is my great pleasure to be here today on this occasion of the signing ceremony of the Memorandum of Understanding between Bursa Malaysia Berhad and the Bahrain Financial Exchange. The signing we are about to witness today will lay the foundation for the collaboration by the two exchanges on Bursa Suq Al-Sila'. I wish to thank the two exchanges for inviting me to give some remarks at this auspicious occasion. I also wish to applaud this commendable effort by the two exchanges which marks another important milestone in the development of the global Islamic financial services industry and in bridging further our two countries.

### **Maintaining the stability of Islamic financial system**

This effort takes place at a time when the global economy is entering into a period of improved international economic and financial conditions. The global financial crisis has highlighted several structural weaknesses and drawbacks in the international financial system. While Islamic finance is not insulated from the effects of the current environment, the Shariah principles and values that are inherent in Islamic finance provide an important underlying foundation. The Islamic financial system has continued, during this period, to become increasingly integrated with the international financial system. However, as this inter-connectivity intensifies, the exposure to risks arising from financial and economic developments from other markets will increase. Indeed disruptions in the functioning of financial markets have brought the focus of attention on financial stability issues.

In addition, this recent financial market turmoil has demonstrated the consequences of liquidity constraints. This has accentuated the importance of a strong and well developed liquidity management infrastructure. Essentially, international Islamic financial transactions will require the development of the supporting financial infrastructure, in particular, the systems and structures for the management of liquidity. Several key measures are required to improve the ability of the Islamic financial system in managing such disruptions and ensure its stability. A well functioning markets and liquidity management framework are vital for Islamic financial institutions to effectively manage funding of Islamic financial transactions. These would also facilitate cross border capital flows and help expand the Islamic financial markets as well as manage liquidity risks in a Shariah compliant manner.

This current global financial crisis has prompted a search for an enduring solution to ensure the stability of financial systems. As part of the global collaborative efforts to enhance the efficiency of Islamic financial institutions in managing liquidity at both national and across borders, a Liquidity Management Task Force was established by the Islamic Financial Services Board (IFSB) and the Islamic Development Bank (IDB) early last year to develop a liquidity management framework.

### **Timely collaboration between Malaysia and Bahrain to strengthen interlinkages**

The collaborative effort we are witnessing today is expected to strengthen the liquidity management framework between Malaysia and Bahrain, thereby enhancing the financial interlinkages between the two countries. Bursa Suq Al Sila' is a purposefully designed

exchanged-traded platform to facilitate commodity murabahah transactions. It is the first internet based platform in the world with crude palm oil (CPO) as its underlying base commodity. The establishment of Bursa Suq Al Sila' in August 2009 is a collaborative initiative of the Central Bank of Malaysia, the Securities Commission, Bursa Malaysia and the market players that was conceptualised some three years ago. Bursa Suq Al-Sila' will provide a viable alternative to the well functioning of liquidity management in Islamic financial system.

The platform will provide another dimension to the liquidity management infrastructure of the Islamic banking industry; thus providing market players with greater tools to manage their assets and liabilities. It is expected to unlock a vast potential of opportunities for the Islamic financial industry by providing a wider range of new instruments. Not only can it be used for liquidity management and risk management purposes but players can derive additional linkages by utilising the platform to facilitate the creation of financing and deposit products. It creates a more transparent and streamlined commodity transaction practices based on the concept of murabahah or tawarruq. Leveraging on the experience of Bursa Malaysia in the area of exchange traded products, this platform is able to eliminate uncertainty in the transactions and could mitigate risks such as legal risk, market risk and counter-party risk.

As Bursa Suq Al-Sila' is designed to be a multi-currency platform, it can enhance liquidity and risk management capacity of the international Islamic banking community. Furthermore, it could be harnessed into a cost effective global platform to develop universally acceptable Islamic financial products for the financial and capital market. Overtime, in making it into a truly multi-commodity global exchange, the scope of the exchange-traded product offerings could be expanded to include other commodities and the level of participation should be expanded to include players from outside the financial services industry as well.

The proposed collaboration between the Bahrain Financial Exchange and Bursa Malaysia is expected to strengthen cross border financial traffic between both our markets, as this platform has a vast potential to facilitate liquidity flows from one financial centre to another. It will also pave the way for optimisation of financial resources across borders as well as diversification of risks between our markets. Furthermore, this venture will also allow both our markets to explore various opportunities for further collaboration in the future, leveraging on each other's strengths and achieve synergies for effective and efficient Islamic financial services industry. I urge the banks in Bahrain and Malaysia to work together and use Bursa Suq Al-Sila' to enable the flows of funds that would enhance the liquidity management framework.

Bahrain and Malaysia has one of the strongest relationships among the countries in the Middle East. It was further cemented with the signing of a Memorandum of Understanding between the Central Bank of Bahrain and the Central Bank of Malaysia in 2001 to jointly develop Islamic finance internationally. In fact, an 80-strong Malaysian delegation led by HRH Raja Dr. Nazrin Shah, Crown Prince of the State of Perak and Malaysia's financial ambassador, visited Bahrain in October 2009 to forge greater financial ties with the Bahraini Islamic financial community. It is heartening to note that common grounds have been reached on the standard contracts that the Association of Islamic Banking Institutions Malaysia or AIBIM, and the International Islamic Financial Market, or IIFM, have produced. This is invariably a reflection of the growing cross border harmonisation of interpretations of concepts and agreements.

Furthermore, AIBIM's interbank Murabahah master agreement (IMMA) and the corporate Murabahah master agreement (CMMA), recently launched in Malaysia, would further unlock the potential of the Malaysian Islamic money market, which saw around US\$2 billion worth of transactions daily last year. In the global scene, it is estimated that the global commodity murabahah market is valued at more than US\$1 trillion, giving rise to a huge business potential. I would encourage you to focus more resources here as it is one of the key areas that we can jointly promote in our regions.

## **Other challenges ahead for the global Islamic financial system**

The Islamic banking and finance industry is still relatively young and to a certain extent, is functioning at the experimental stage of development. At this stage, it requires an enabling and conducive environment to innovate new products and try out the various Shariah concepts in Islamic finance. However, going forward, there are some challenges that may impede our efforts in developing the Islamic financial system. A rigorous and well developed Shariah framework is needed to govern market practices of the Islamic financial institutions. To achieve consistency in the development of Islamic finance, all stakeholders involved in Islamic finance must work in a concerted manner on interpretation issues. Nonetheless, there has to be a check and balance between the need to have innovative and advanced products and the need to uphold the Shariah requirements.

Efforts, time and resources must be pooled among the Islamic finance community to expand the industry and compete healthily with the larger conventional finance markets. As such, mutual recognition and understanding of different practices are essential in allowing Islamic finance to grow. For instance, Bursa Suq Al-Sila' could also be used as a unifying application of *Tawarruq* practices by adopting acceptable best market practices for the Islamic financial institutions and at the same time observe the Shariah principles. In Malaysia, we adopt a stance of mutually recognising the various Shariah interpretations. This is because the interpretations have been derived from the Quran and Sunnah and accomplished through rigorous juristic reasoning or *ijtihad* by the learned Shariah scholars based on religious knowledge and norms.

Let me conclude my remarks. Awareness and appreciation of the inherent strengths of Islamic finance and its vast potential for progress have generated interests amongst the global financial community. Needless to say, the Islamic finance community should take advantage by increasing the role of Islamic finance in linking with the different parts of the world. Today, the signing of the memorandum of understanding between Bursa Malaysia Berhad and the Bahrain Financial Exchange, marks an exciting future in Islamic finance.

I would encourage you to fully exploit the opportunity presented through this memorandum of understanding. Islamic finance has a potential role in contributing not only to global financial stability but also towards a more balanced global growth of our countries and the Islamic world at large. Indeed, both Malaysia and Bahrain can pave the way towards bridging Islamic financial markets between our regions, while we prepare ourselves for the next phase of development of the global economic and financial system, insyaAllah.

On that note, let me congratulate both the Bahrain Financial Exchange and Bursa Malaysia Berhad on the signing of the Memorandum of Understanding on Bursa Suq Al-Sila' and on exhibiting the commitment in making this collaboration a successful one. I am indeed grateful to the All Mighty be here today to witness this event.