

## **Zeti Akhtar Aziz: Building a sound global Islamic financial system**

Opening remarks by Dr Zeti Akhtar Aziz, Governor of the Central Bank of Malaysia (Bank Negara Malaysia), at the Islamic Financial Services Board (IFSB) – Meet the Members & Industry Engagement Session, Kuala Lumpur, 28 January 2016.

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It is my pleasure to welcome you to this Industry Engagement Session organised by the IFSB. Since its introduction in 2012, these sessions have drawn encouraging response from the members and the industry. Such an interface between the regulators, industry and the IFSB has become even more important in the current environment in which greater global attention is being accorded to the reform of prudential regulations. The strengthening of such an interface provides an important platform for building greater understanding on the expectations, issues and areas of concern amongst the regulators, the industry and the IFSB.

With more than a decade since the inauguration of the IFSB in November 2002, the IFSB has built a solid global reputation as a prudential standard-setting body for Islamic finance. Its achievements also include initiatives to increase international regulatory cooperation, to encourage uniformity of regulatory frameworks and the efforts to enhance the monitoring of financial risks in the Islamic financial system. The enhanced stability and resilience of the current global Islamic financial system is reinforced by its vibrant growth and its increasing internationalisation and integration into the international financial system. This is a realisation of the aspirations and vision of the IFSB Founding Members.

The IFSB has also made significant advancements in taking forward the recommendations made in the Islamic Finance and Global Financial Stability Report 2010 towards achieving financial stability in the national and the international Islamic financial system. The prudential standards including that for liquidity management issued by the IFSB takes into account the unique characteristics of Islamic finance and are also designed to not impose any regulatory burden while upholding the financial stability agenda.

The effective implementation of the standards issued by the IFSB is key towards promoting the soundness and stability of Islamic financial institution. To enhance this prospect, the IFSB has strengthened its role in facilitating greater jurisdictional preparedness in the adoption of these standards through the provision of technical assistance to its members. Malaysia is one of the jurisdictions that has adopted and operationalised the prudential standards and the guiding principles that have been issued for the industry. The implementation of these standards and guiding principles support the regulatory framework that we now have in place in our Islamic financial system. As the industry is aware, it places emphasis on the enforcement of standards for capital adequacy, effective risk management practices, liquidity management, greater financial disclosure and governance, reinforced by a strong Shariah and legal framework.

Among the important initiatives of the IFSB is also the establishment of the International Islamic Liquidity Management Corporation (IILM) in 2010 which has changed the landscape for liquidity management in the international Islamic financial system, particularly in strengthening the cross-border liquidity arrangements among the Islamic financial institutions. A further initiative during the same year was the introduction of the Islamic Financial Stability Forum (IFSF), set up in 2010 to further solidify the global efforts in areas that will contribute towards safeguarding financial stability. Deliberations on wide ranging issues that pertain to risks to financial stability in the Islamic financial system have taken place at this forum. Greater awareness on issues relating to regulation and supervision of Islamic finance have also been raised at international meetings, conferences, seminars, workshops and other dialogues that have been organised by the IFSB in many countries across several continents.

The initiatives and milestones achieved by the IFSB have indeed paved the way for jurisdictions across the globe to build a solid foundation for the progressive growth of Islamic finance that is underpinned with stability.

Additionally, the early recognition by the IFSB of the increasing interconnectivity in a financial system, the IFSB, unlike other prudential standard setting bodies, has advanced its mission through the development of prudential standards for a broader coverage that includes the banking, capital market and insurance or takaful sectors. The prudential standards issued by the IFSB takes into account the specificities of Islamic finance and the dynamics of the various Shariah contracts used in the wide ranging products offered by Islamic financial institutions. It is within this context that Islamic financial institutions are able to perform its role more effectively as financial intermediaries that are differentiated from its conventional counterparts.

With greater readiness, Islamic financial institutions can strategically position themselves to further realise the true value proposition of Islamic finance, particularly as a financial regime that places emphasis on risk-sharing and that further strengthens the link of finance to the real economy. Of importance, industry players will be better positioned to ride the evolutionary waves of financial innovation that is prevalent in Islamic finance in order to enable greater offerings of risk-sharing products to customers and businesses.

In Malaysia, Islamic banks now have the potential to be better able to pursue their role as investment intermediaries through the offering of investment accounts in addition to the entrenched deposit products, in which various modes of risk-sharing contracts can be applied. This is supported by the legal recognition of investment accounts in the Islamic Financial Services Act 2013 (IFSA). It provides a differentiation between the deposit account and the investment account which offers a new investment avenue that caters for a wider range of investor risk-return preferences.

In contrast to the deposit account, these funds are being channelled directly to finance entrepreneurship in productive activities. In promoting entrepreneurship and value-creating activities, it also contributes towards generating growth and enhances the prospects for job creation. Additionally, the Investment Account Platform (IAP) that is currently being developed will provide a centralised multi-bank platform as a new financing option for entrepreneurs with viable projects as well as an opportunity for the investing public to finance these projects.

It is encouraging that to date, eight Islamic banks are offering investment accounts to their customers. More are expected to follow when the value proposition of such investment accounts, with its unique features and the different target market become better understood. The industry-led communication by the Association of Islamic Banking Institutions Malaysia will contribute towards increasing the awareness of customers on the concept and on the key features of investment account. The latest establishment of a consortium developed by four Islamic banks to develop and operate the IAP which is to be launched next month is also another initiative to advance this new offering.

In the development of the investment account, it will be essential for Islamic banks, investors and entrepreneurs to embrace the different approaches in the management of the risk and return relationships that are embedded in the variations of the Shariah contracts used in such investment accounts. These relationships need to be well understood by the parties involved and which are aligned with clear contractual and operational requirements. The IFSB has an important role in not only providing guidance but also in initiating the convergence of the different practices between IFSB members with regard to the treatment of the investment account – also referred to as profit sharing investment account (PSIA) – in the IFSB standards. More in-depth work can also be explored by the IFSB on the prudential requirements for the investment account to further ensure a conducive environment for such risk-sharing offerings.

The global Islamic financial system is now operating at a time when the international economic and financial environment has become immensely more challenging. New risks that are more complex, with more profound systemic implications are emanating with the increasing forces of financial liberalisation, globalisation, technological advancement, intensified competition,

financial innovation and the internationalisation of Islamic finance. Cumulatively, these developments necessitate greater prudential regulation and supervisory oversight to ensure a resilient and sustainable financial system.

The role of the IFSB remains instrumental and paramount as we face a time of increasing uncertainties. Continuous and stronger support for the IFSB, particularly from its members including in actively providing feedback on its Consultative Papers and in the participation in IFSB related events, supported by the existing collaboration and cooperation among the regulators would collectively strengthen the potential for the IFSB to manage its journey ahead. Greater concerted efforts by members to consistently adopt and implement the prudential standards issued by the IFSB will not only contribute towards preserving financial stability but it will also enhance regulatory harmonisation across jurisdictions.

These efforts will indeed place us on a path to realising our quest and shared aspirations for a more resilient and sound global Islamic financial system. It is also timely for the IFSB to elevate its level of engagement and connectivity with other international standard setting bodies. This would enable the framework for financial stability in the context of Islamic finance to interface with the arrangements that exists for the conventional financial system, therefore avoiding any fragmentation in the global regulatory framework. Malaysia, as the host of the IFSB will continue to be committed to support its development and its potential as a prudential standard-setting body in the international financial system.

On that note, I wish you a productive session today and look forward to the constructive outcomes of this engagement.