Hamad Al-Sayari: Islamic banking prudential standards

Speech by His Excellency Hamad Al-Sayari, Governor of the Saudi Arabian Monetary Agency, to the "Symposium on Islamic Banking Prudential Standards", Institute of Banking, Riyadh, 15 January 2007.

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Ladies and Gentlemen,

It gives me a great pleasure to address this honorable and distinguished attendance at this important symposium on "Islamic Banking Prudential Standards" organized by the Institute of Banking (IOB) in cooperation with the Islamic Financial Services Board (IFSB).

The issue of Shari'a (Islamic Law) compliant banking is increasingly drawing attention of those concerned with financial stability, including international financial institutions such as the IMF, World Bank (WB), development banks, Basel Committee on Banking Supervision as well as supervisory authorities in the countries where Islamic banks operate. This is the result of rapid growth in the volume and scope of Islamic services offered in many countries. Those entities have shown a great interest in the growth and expansion of finance business compliant with the principle of avoiding interest and its impact and implications with respect to world markets and the global economic system.

Currently, Shari'a compliant banking transactions have spread in most countries of the world through banks that totally comply with Shari'a or through Shari'a compliant windows offering all services, investment and commercial activities, leasing, investment funds and joint liability products.

The Kingdom has been a forerunner country in supporting and encouraging Saudi banks to offer such products required by the Saudi market. All Saudi banks now provide a range of products that are compliant with Shari'a requirements and with financial engineering specifications of the highest levels under the supervision of well-reputed Shari'a committees and top class financial professionals.

In the context of supporting such efforts, SAMA's IOB has offered many programs, courses and symposia in the area of developing, marketing and supervising Shari'a compliant products. The number of bankers benefiting from those programs stood at 6,300 who participated in 374 programs during the last seven years. These endeavors have considerably helped in developing Islamic banking in Saudi Arabia without undermining compliance with Islamic Shari'a or the technical flexibility needed by an emerging and dynamic market.

Dear Audience,

It is very important to mention that the industry of Islamic financial services should be completely integrated into the global financial markets while maintaining at the same time its distinguished nature and unique services. The industry should also be subject to the same level of supervisory control as other financial institutions. Any breach of standards, practices or application by Islamic banks will not only be an obstacle to their services and products, but it will also serve as a hindrance to accepting their services and products by international financial markets. Consolidating a bank's financial data with those of all its subsidiaries and branches is another principle that must be applicable to all banks, and such principle is necessary for ensuring consolidated and comprehensive supervision by the supervisory authorities in the bank's home country.

Central banks' governors in Islamic countries, members of the Islamic Development Bank realized the importance of such consolidation 25 years ago when a technical committee was formed, including a number of governors and specialists, of which I was honored to be the chairman, to consider the needs of Shari'a compliant banking services. The most important recommendation was that Islamic banks must be subject to the same supervisory rules and requirements as those that govern conventional banks, with the necessary flexibility, taking into account their specific work methods and products so as not to isolate these banks from global financial markets.

Encouraging Islamic banking institutions to integrate into global markets will push them forward to compete with all other financial institutions, stimulating them to innovate to meet the needs of corporate and individual customers, expand their scope and base of work, and not to be tied to a specified category of customers or specific markets. This will help them adapt with the requirements of the global financial system, provide them with necessary instruments, helping them develop and reinforce their structures, and facilitate their spread.

Dear Brothers

Banking business, in all its types and forms, is not free from risks that pose a challenge to banks and supervisory authorities. In this context, Islamic banks, like their conventional counterparts, are financial institutions providing services to depositors and investors, on the one hand, and offer financing to companies, public sector and individuals, on the other. Therefore, they are subject to many risks that are similar to those confronted by conventional banks. In addition, Shari'a compliant banking has its own risks. In principle, there is a range of various activities through which Islamic banks can work in different ways that enable them to provide funds. These activities are adapted to meet the principles governing Islamic banking business, the most important of which is the principle of risk sharing. Therefore, there is an urgent need to identify, measure, manage, monitor and control such potential risks and mitigate them within the capacity and capital adequacy of the relevant bank.

The most important challenges confronting Islamic banks are risks arising from financing formulas and Shari'a compliant banking, especially investment risks, method of applying "Basel II" proposals, capital market and financial derivatives risks. In addition, Islamic banks may bear a wide range of risks that differ, in nature, from those borne by commercial banks.

In this connection, it is necessary to emphasize that the role entrusted to the supervisory authorities is to pursue a comprehensive control method based on risk assessment process and not to make any discrimination in a way that may suggest that Shari'a compliant banks are being rated differently or confronting larger risks.

Corporate governance, risk management, transparency, disclosure, and internal control requirements in Islamic financial services industry should always be developed, and adjusted to meet the needs specified for Islamic banks, especially that an important part of the work of these banks is based on impression and reputation of the nature of their work. Therefore, these banks should be aware of the role entrusted to them, especially the ethical one.

The nature of risks faced by Islamic banks may raise specific issues in terms of assets and inventory assessment, investment costs, regular income and recognition of losses, adequacy of guarantees and others. We must emphasize here the importance of continued development of mechanisms to cover such risks. This underlines the importance of integration into global financial markets, encouragement of competition, and provision of a proper climate for on-going innovation so that Islamic banks can consolidate their positions in all markets and boost their ability to provide products for all segments of customers.

On the other hand, a controversy is sometimes raised and comparisons are made between Islamic and conventional banks in terms of risk degree, exposure to insolvency, and the argument ensuing concerning capital adequacy. However, the important point is the awareness and understanding the nature of risks, development of mechanisms to cover such risks, and the ability to compete in markets and meet the needs of customers. Perhaps it is imperative here to emphasize that it is important for Islamic banks to provide all information about their activities and financial statements with full transparency, especially that they bear moral responsibility. This would enhance their credibility, contribute to their good reputation to be accepted on a broader range, and remove any false beliefs concerning their activities.

Dear Brothers,

A number of central banks and supervisory authorities have recognized the nature of risks confronted by Islamic banks and pursued a supervisory approach based on measurement of risks. Thus, they have developed appropriate mechanisms for banking supervision depending on the type of risks. They have also realized the need for international cooperation to develop standards that could form the basis of a strong structure for Islamic banking.

The increasing global interest in Islamic banking, in recent years, is attributable to the rapid growth of this type of activity in terms of size, scope and significance both in Islamic countries and other parts of the world. Islamic banking has spread widely in more than twenty-five countries in Asia and Africa. It has also emerged in many financial centers in Europe and North America to the extent that major international banks and specialized financial institutions have started to offer Shari’a-compliant products to meet the needs of a wide spectrum of customers in their markets and those of Islamic countries.

Dear Brothers,

You all know the efforts made by Basel Committee to issue various standards governing conventional banking in the area of capital adequacy, corporate governance, and the principles of compliance, and others. These and other standards have helped create an appropriate environment for banking business which supports competition.

On the other hand, a number of central banks in a number of Islamic countries, including SAMA, have established the Islamic Financial Services Board (IFSB) to promote establishment and development of Shari'a compliant financial services industry, characterized by prudence and transparency, through the adoption of existing or new international standards compatible with Islamic banking principles and methods.

Since its establishment in November 2002, the Board has made great efforts in issuing international standards governing Islamic banking business through a number of committees and work teams in the membership of which SAMA participates effectively. Such standards will help setting up a strong structure to create robust banking entities able to compete in the international markets. The Board also makes great efforts in organizing conferences and workshops to promote awareness of the nature of Islamic banking. I can not, on this occasion, but thank the Board's members.

Dear Audience

Saudi Arabian Monetary Agency exerts persevering efforts to promote awareness and emphasize the importance of applying international standards that help manage risks, enhance competition and create strong entities. Therefore, this symposium is the first of its kind on Islamic Financial Services Board's standards which complement the guidelines of Basel II. The symposium aims specifically at providing a clear understanding of Islamic Financial Services Board's standards with regard to capital adequacy, risks management , supervisory review process , corporate governance systems , transparency and market discipline , which constitute fundamental bases to ensure soundness and stability of Islamic banking services. Therefore, it is expected that this symposium will facilitate the application of these standards by all relevant parties.

Finally, I would like to thank the Islamic Financial Services Board, especially its General Secretariat, Dr. Refa'at Ahmad Abdulkareem and his colleagues for their great efforts. I also would like to thank the colleagues in the Institute of Banking for organizing this symposium as a continuation of the Institute's efforts and role. I wish the symposium all success.

Thank you for your listening.