

Zeti Akhtar Aziz: Malaysia's part in the growing global Islamic finance industry

Welcoming remarks by Dr Zeti Akhtar Aziz, Governor of the Central Bank of Malaysia, at the INCEIF Inaugural Intellectual Discourse "Islamic Finance: Issues and Challenges of Co-existence in an Entrenched Conventional System", Central Bank of Malaysia, Kuala Lumpur, 23 February 2007.

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It is my great pleasure to welcome you to INCEIF Inaugural Intellectual Discourse Series. INCEIF has made remarkable progress within a period of less than a year. In 2006, INCEIF has gained the university status, it has currently enrolled 756 students from 39 countries, and it has entered into strategic alliances with a number of industry training and education providers from the Middle East, South East Asia and the West. Indeed, INCEIF has received an overwhelming response. As an institution of higher learning dedicated to the development of human capital for the growing global Islamic finance industry, INCEIF will have an important role in meeting the increased demand for talent and expertise for the industry.

The topic for today's deliberation, "Issues and Challenges of the Co-existence of Islamic Finance in an Entrenched Conventional System", is most relevant in the currently highly competitive financial services industry where new challenges and opportunities are continuously emerging in this era of globalisation and of rapid change that is also driven by advances in technology.

Today's initiative brings together Islamic finance experts and scholars to deliberate the issues confronting Islamic finance in an environment where the conventional finance is dominant and highly entrenched. The primary objective of today's Inaugural Intellectual Discourse is to explore the prospects for Islamic finance which has now reached a stage of development in which it is now no longer regarded as a niche product serving a specialised market. Today, it is a robust industry that operates in more than 60 countries, and it is a viable form of financial intermediation that is competitive and resilient. Islamic finance, nevertheless faces many challenges with respect to its product offering, its distinctive ethical and moral dimension, and its relevance to all customers.

The Islamic financial system in Malaysia has evolved as a competitive component of the overall financial system, complementing the conventional financial system as a driver of economic growth and development. Malaysia will continue to foster the expansion of the dual banking system where both, the Islamic and conventional systems operate in parallel to deliver innovative and competitive financial products and services. The global experience has however shown that institutional and development financial infrastructure, the broadening and deepening of the financial markets, and a rigorous legal and regulatory framework is vital for the soundness, stability and resilience of the financial system. Developments in both domestic and international economic and financial conditions have from time to time tested the resilience of financial systems. Thus, Islamic financial institutions will not only be assessed by their Shariah aspects, but also by other factors including their effectiveness and efficiency, their resilience and their ability to evolve and reinvent to meet the challenges of the continuously changing demands as we advance forward.

After more than two decades of experience in the development of Islamic finance, we are now seeing the international dimension of our Islamic financial system gain significance. This has followed the increased foreign presence and participation in our domestic Islamic financial system. Malaysia has also ventured to participate in international financial markets and in term of presence beyond our domestic borders. More specifically, three new foreign Islamic banks are now participating in our domestic financial system. Following further liberalisation measures, there is also increased foreign participation in our domestic Islamic financial institutions. Our takaful industry has also become one of the success stories in Islamic finance. In the four new licences issued recently, it has comprised of joint ventures with foreign participation. The Malaysian bond market has also been liberalised to enable foreign entities to raise funds in our domestic market. Our experience in launching the first Sukuk has drawn significant interest by corporates and sovereigns for raising long-term financing based on Islamic structure instruments.

Following these developments we are now entering a new phase in the development of Islamic financial system in Malaysia with the new initiatives to promote Malaysia as an International Islamic Financial Centre. This aims at strengthening our economic and financial inter-linkages and thus promoting greater trade and investment across borders. This is therefore the beginning of a new

phase of development for Islamic finance in Malaysia as it becomes more integrated with the international financial system.

We have set high standards in market coverage and broadening of Islamic financial products being offered to the market. The challenge is for the financial institutions to have a more extensive outreach. Islamic finance must promote greater financial inclusion involving all levels of the community. Opportunities also need to be created for Islamic financial products to have an outreach to the small and medium-sized enterprises. Moreover, financial instruments structured under the Salam, Istisna' and Musyarakah contracts need to be designed to stimulate activities in those sectors such as agriculture and manufacturing where there is limited participation by conventional finance. We need to reach those segments of society and economic activities that have not fully benefited from the success of Islamic finance.

As part of the global development of Islamic finance, of equal importance is the supporting international architecture that is evolving. Both AAOIFI and IFSB have contributed significantly to the development and the harmonisation of accounting and prudential standards. This will allow for the potential of strengthening the inter-linkages across borders to take place.

The conventional banking as a more matured market has also continued to grow and prosper in Malaysia. Since the beginning, it has attracted dominant global players. There are fourteen 100% owned banks in our financial system that accounts for almost one third of the market share. In the insurance sector the foreign participation is even greater. In conventional finance, Malaysia is therefore already highly integrated with the international financial system. This has been reinforced by the progressive liberalisation of our capital account which now allows for the free inflow and outflow of funds. Our financial system has therefore facilitated Malaysia 's strong international economic and financial linkages which have for several decades contributed to our economic growth and development.

In this competitive global environment, new challenges and risks can be expected to continuously emerge. The growing world wide participation in Islamic finance as a form of financial intermediation in this highly challenging environment has demonstrated its viability and competitiveness. This dynamic environment in which we operate will thus require continued developments to be pursued on all fronts.

The discourse among the expertise in the field will not only provide us with further insights into the issues and challenges of coexistence not only in our domestic systems but also in the international financial system. This will contribute to the awareness and understanding of the journey for the sustainable development of Islamic finance.

Ladies and Gentlemen,

On this note, I wish you a successful and productive discourse. Thank you.