

Zeti Akhtar Aziz: Legal & Shariah issues in the Islamic financial services industry

Opening remarks by Dr Zeti Akhtar Aziz, Governor of the Central Bank of Malaysia, at the Third IFSB Seminar on Legal Issues: Surveys on Legal & Shariah Issues in the Islamic Financial Services Industry, Kuala Lumpur, 28 March 2007.

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Professor William Blair QC, Chairman of the International Monetary Law Committee of the International Law Association (MOCOMILA),
Professor Rifaat Ahmed Abdel Karim, Secretary General, Islamic Financial Services Board,
Distinguished Guests,
Ladies and Gentlemen,

I would like to join Professor Rifaat in welcoming you to this 3rd IFSB Seminar on Legal Issues. I would also like to take this opportunity to extend a special welcome to the many of you who have travelled long distances to join us for this important event.

Ladies and Gentlemen,

A strong legal and Shariah framework as a pillar to Islamic finance

The need to continually strengthen the legal framework for the financial services industry is imperative given the powerful forces of change continually transforming the functioning of the global economy and the international financial system. A legal framework which is aligned with market developments lends certainty and predictability to financial transactions and innovative products and instils public confidence in the financial system.

The legal and Shariah framework is a vital pillar in the sustainable development of Islamic finance. It provides the legislative framework that unambiguously defines the conduct of Islamic financial institutions. It also gives due protection to the consumers of Islamic finance, ensures the enforceability of Islamic financial contracts and provides an effective mechanism for legal redress.

The legal framework for Islamic finance also needs to address any specific elements that could result in a comparative disadvantage to the industry. More specifically, in a world in which finance has long been defined by conventional practices and laws, the features that are unique to the requirements of Islamic finance need to be taken into account to ensure neutrality of treatment.

In Malaysia, the rapid evolution of Islamic finance has been supported by the development of a comprehensive legal infrastructure. A series of legislation since 1983 has provided the foundation for a regulatory regime for Islamic banks, takaful operators, the Shariah Council for Islamic finance, Islamic finance windows in conventional banks and the various forms of bond and money market instruments. In addition, the corporate, securities and insolvency laws and guidelines are compatible with the Shariah. These legislation have been reinforced by the establishment of a dedicated High Court bench to provide a comprehensive adjudicative system to deal with disputes involving Islamic finance. In addition, the new Islamic Finance Arbitration Rules of the Kuala Lumpur Regional Centre for Arbitration provides a customised mechanism for the resolution of disputes in the Islamic financial services sector.

The development of an efficient and vibrant Islamic financial market

Equally important to the development of Islamic finance is not only the financial intermediaries but also the Islamic financial markets. The demand for Islamic financial products and instruments is expanding at increasingly significant rates in predominantly Muslim countries in the Middle East and Asia as well as in the non-Muslim economies in the West. The rapid growth of the Islamic financial markets has seen the development of a wide range of products including money, debt and capital market instruments. Such markets are important for the effective management of investment portfolios and for the diversification of risks.

Today, the global demand for Islamic capital market products is served by the existence of the Dow Jones Islamic Index whose market capitalisation now exceeds USD 10 trillion. About 350 Shariah-compliant funds have already been established across the globe.

In Malaysia, the sukuk market has been a leading segment of growth in the domestic bond market accounting for half of our domestic bond market and two thirds of the total global outstanding sukuk. A wide range of new Islamic financial instruments has been developed including the Bank Negara Malaysia Sukuk Ijarah, Bank Negara Malaysia Monetary Notes, the Islamic residential mortgage-backed securities and most recently the Commodity Murabahah Programme for managing short-term liquidity in the inter-bank money market.

While Islamic finance practitioners and scholars continue to draw from the source of fiqh muamalat to create new and innovative instruments, the legal framework however, needs to be further strengthened to ensure continued acceptance and utility of the financial instruments. In Malaysia, the progress in this area has been facilitated by the common law which forms the foundation of the legal system. More specifically, the concept of "trust" under the common law has facilitated the issuance of Islamic securities such as sukuk and Islamic Real Estate Investment Trust (REIT). Since "trust" as an inherent notion embedded in the common law system is not generally found in the jurisprudence of civil law, some civil law countries have enacted specific legislation to provide for the introduction of trust so as to align their legal systems with the requirements of Islamic finance.

The challenges brought by the integration of Islamic finance with the international financial system

While legal issues within a domestic financial system can be resolved by the home regulators and Shariah authorities, the integration of Islamic finance with the international financial system brings with it many challenges. There is a need for mutual recognition of financial standards and products across jurisdictions. The progressive harmonisation of Shariah, in this respect, needs to be viewed as a driver towards greater international financial integration.

Such a convergence and harmonisation can only happen with greater engagement among the regulators, practitioners and scholars in Islamic finance in the international community. The Annual International Shariah Scholars' Dialogue that has been taking place since 2005 is aimed at achieving this objective. This Dialogue has served to promote interactions between Shariah scholars from around the world contributing towards greater understanding and international convergence.

In Malaysia, the efforts to enhance the international dimension of our Islamic financial system have been intensified in the more recent period to facilitate greater international trade and cross-border investment flows. The new initiatives that have been announced allow the establishment of new International Islamic financial institutions that will be permitted to offer the full range of Islamic financial services to residents and non-residents in international currencies. These initiatives also aim to serve as a catalyst for the development of the domestic financial markets as well as the development of talent and knowledge in Islamic finance. Collaboration with other emerging regional centres in Islamic finance will be an important part of this process that will contribute towards greater international financial integration.

The establishment of the Islamic Financial Services Board in 2002 represents a major structural enhancement in building the international financial architecture for Islamic finance. The achievements thus far by the Islamic Financial Services Board in developing the prudential standards that can be universally applied have been very encouraging. The efforts represent a testimony of the collective capacity for greater international collaboration which has contributed towards strengthening the fabric of Islamic finance.

While the legal framework and rules are constantly being reviewed to ensure that they remain relevant for the new areas of financial activity, it should not only be undertaken for the domestic Islamic financial system but also in the context of the international financial system.

Conclusion

In closing, I would like to take this opportunity to congratulate the Islamic Financial Services Board for commissioning the "Surveys on Legal and Shariah Issues in the Islamic Financial Services Industry". The survey findings represent an important contribution towards augmenting the literature on the

existing legal and Shariah framework across different jurisdictions. It serves as a useful source of reference for countries that are interested in establishing a legal and Shariah framework for their Islamic financial system. Deliberation on the survey results and the exchange of views and experiences among lawyers, Shariah scholars and Islamic finance practitioners will be important in contributing to increasing the efficiency in Islamic finance and facilitating its robustness as an integral component in the global financial system.

Thank you.