Rasheed Mohammed Al Maraj: Prospects for the Islamic financial industry against the background of the current global financial turmoil

Keynote address by His Excellency Rasheed Mohammed Al Maraj, Governor of the Central Bank of Bahrain, at the AAOIFI-World Bank Annual Conference on Islamic Banking and Finance, Manama, 10 November 2008.

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Distinguished Guests, Ladies and Gentlemen:

It is a pleasure to participate in the Opening Ceremony of this Conference and in the Graduation Ceremony for the “Certified Shari’a Adviser and Auditor”, and “Certified Islamic Professional Accountant’ programmes. In addition to congratulating the graduating students, I should like to thank the many distinguished speakers who will be appearing during the Conference, as well as the event organisers. Particular thanks are due to the World Bank for their support for this event.

Against the background of the current global financial turmoil, it appears good time to take stock of the prospects for the Islamic financial industry.

In recent months, as the global financial crisis has deepened, there have been many commentators who have pointed to the relative success of the Islamic financial sector. So far, Islamic financial institutions have escaped relatively unscathed from the severe downturn which is affecting most conventional financial institutions. This certainly presents the industry with an opportunity to continue its successful growth of recent decades.

Because interest-based transactions are prohibited, Islamic finance encourages business and trade activities that generate fair and legitimate profit. The prohibition on speculative activity also helps to ensure that there is a close link between financial flows and productive activities. These intrinsic properties of Islamic finance contribute towards insulating it from the potential risks resulting from excess leverage and speculative financial activities.

But while Islamic financial institutions have been largely sheltered from the present crisis, there is no room for complacency. It is inevitable that they will be affected to some degree, as they are part of the wider global economic system. The effects of the global financial crisis on the real economy has the potential to transmit shocks to Shari’a compliant institutions as well. This means that there must be a very high priority placed on sound management and risk management practices at Islamic financial institutions.

As I have pointed out in the past, the sensational growth of the industry in recent years, combined with high levels of liquidity, has meant that Islamic banks have not needed to fight for funding or ideas. New entrants to the industry have merely tended to copy the strategies they see being successfully pursued by their more established rivals. As a result, a very high percentage of Islamic banks have a strategy that is heavily weighted towards real estate and asset finance.

The downturn in global economic conditions will provide these business models with a stern test. Project-driven business strategies will be affected by the reduction in global liquidity and the slowing of global economic growth. Islamic financial institutions will need to plan and prepare for these more challenging operating conditions.

The industry needs to respond to this challenge by developing a greater diversity of business models, more diverse and stable income sources, and more rigorous risk management and stress testing techniques to assess its preparedness to deal with any downturn in economic activity.

The essential consideration in Islamic finance, as in all forms of finance, is to find the right balance between business development and risk management. There are certain measures that the Central Bank of Bahrain can take to assist Islamic financial institutions in this process. We have recently launched an Islamic Sukuk liquidity instrument, which is a repurchase agreement that enables financial institutions, both conventional and Islamic, to access short-term liquidity against the Government of Bahrain Ijara Sukuk. At the same time, however, the primary responsibility for sound risk management and control resides with the firms themselves. The principles and standards developed by AAOIFI provide Islamic financial institutions with a sound basis on which to manage their activities. Those of you today, who are graduating with the qualification of “Certified Shari’a Adviser and Auditor”, and “Certified Islamic Professional Accountant”, will be at the forefront of Islamic financial institutions’ ability to manage, monitor and control their risks in the future.

There is a continuing need for high quality human resources in the industry. Islamic banking has been growing so fast that it has been difficult for institutions to find enough skilled or qualified staff. This is why the CBB has participated with Islamic institutions in Bahrain in setting up the Waqf Fund to provide financial and technical support in upgrading training programmes and introducing new ones. We are now beginning to see a larger number of financiers qualified in Shari’a related subjects and this can only be to the benefit of the Islamic finance industry.

The two courses which are graduating today, are both challenging study programmes, and congratulations belong first and foremost to those students who have successfully completed them. Doing so has required hard work and commitment. It is an achievement to be proud of, and one that I am sure will serve you in good stead, as you further develop your professional careers.

Let me conclude by wishing the graduating students all the best in their future careers, and to wish you all a very successful Conference.