

Zeti Akhtar Aziz: Islamic finance – the new regulatory challenge

Introductory remarks by Dr Zeti Akhtar Aziz, Governor of the Central Bank of Malaysia, at the book launch of “Islamic finance – the new regulatory challenge, 2nd edition”, Kuala Lumpur, 22 July 2013.

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It is my pleasure to be here this afternoon to witness the launch of the second edition of “Islamic Finance: The New Regulatory Challenge”. As the Islamic financial industry transitions into a new era of growth and development in this post-crisis world, the evolving regulatory reforms that are taking place to strengthen the resilience of the financial industry has presented wide ranging challenges in the implementation of the reforms and in also ensuring a more inclusive and sustainable growth. The various dimensions of these regulatory challenges and its impact on Islamic finance are captured in the publication that is being launching today.

It is indeed a more challenging time for financial regulators and policymakers worldwide. Priorities for strengthening financial stability and growth are now focused on achieving global financial systems that serve the needs of the real economy. Driven by concerns to ensure that banking institutions are more robust against multi-faceted and more complex dimensions of risks going into the future, regulatory efforts are being directed at significantly strengthening the capital and liquidity structures of banks, and ensuring that there is better alignment between risk-taking behaviours and long-term viability as well as ethical conduct. At the centre of the reforms have been the Basel III reform package, principles for risk-aligned compensation structures and improving the consistency of regulatory regimes across the different parts of the financial system, including the shadow banking institutions. Significant work is also progressing to strengthen resolution regimes and financial safety nets, particularly in a cross-border context. Given the specificities of Islamic financial institutions, the implementation of these reforms require a careful examination of the different implications that they present for individual institutions and the system as a whole.

We are now witnessing wave of the internationalisation of Islamic finance as the role of Islamic finance has expanded to become significantly more globalised. This has resulted in domestic Islamic financial systems to become more inter connected and with the consequence that integrated, risks are more rapidly transmitted across the financial system. Building on the foundations that have been put in place with the adoption of prudential standards introduced by the Islamic Financial Services Board (IFSB) in the key areas of capital adequacy, risk management, corporate governance and Shariah governance, the regulatory, supervisory and legal frameworks will need to reflect the growing cross-border dimensions of Islamic finance and its increased connectivity. Of priority will be efforts to strengthen the cross-border regulatory and supervisory cooperation arrangements in the relevant jurisdictions and to strengthen further the international financial infrastructure for Islamic finance. As we advance forward, this will be of great importance to promote stability and confidence in the more challenging international environment.

A key area for cooperation that is being advanced relates to the provision of a robust liquidity management infrastructure for Islamic finance. This is an important imperative to ensure the resilience and stability of the Islamic financial system, as well as to reduce the cost of intermediation. A significant regulatory challenge remains in terms of having efficient cross-border liquidity risk management in the Islamic financial system, due to the lack of short-term Shariah compliant instruments in international currencies. A chapter in the book describes the regulatory response to the issue of liquidity risk facing Islamic financial institutions, including the important role of the International Islamic Liquidity Management Corporation (IILM) in facilitating cross-border liquidity management.

With these changes set to re-define the financial landscape going forward with far reaching implications, the publication of this book is both timely and relevant. Six years from its first edition in 2007 which made an important contribution to the literature on the regulation of Islamic finance, this second edition captures the diverse range of current information and updates arising from the regulatory issues in a post-crisis global economy. Reviews on the various characteristics of risks faced by Islamic financial institutions will improve the understanding and examination of the implications of current and new reform initiatives for the regulation and supervision of Islamic finance. In view of the requirement for growth of Islamic financial transactions to be linked to real economic sectors, salient issues on stronger corporate governance and more efficient human resource management are discussed in a pre-concluding chapter of the book.

Renowned industry practitioners and academicians have contributed to the book, providing deep insights, perspectives and views that are supported by practical experiences which will be invaluable to those who wish to understand the critical regulatory issues in Islamic finance. Contributions by the two respected co-editors who have extensive knowledge on the subject and are internationally recognised for their academic publications on Islamic finance, completes the book as an indispensable reference for all.

It is hoped that in addressing the implications of the recent global financial crisis on the regulation of Islamic financial services, this book will provide further clarity and understanding on the multi-dimensional goals of policymakers and regulators in ensuring that the resilience of the Islamic financial system and its core tenets are aligned with the evolving global regulatory developments. Let me take this opportunity to congratulate the two co-editors for their invaluable contribution in enriching the body of authoritative information on the regulation of Islamic finance.

Thank you.