Muhammad bin Ibrahim: New and emerging Islamic finance jurisdictions – opportunities and challenges ahead

Remarks by Mr Muhammad bin Ibrahim, Deputy Governor of the Central Bank of Malaysia, at the 11th Islamic Financial Services Board (IFSB) Summit, Session 5: Panel Discussion on "New and Emerging Islamic Finance Jurisdictions: Opportunities and Challenges Ahead", Port Louis, Mauritius, 22 May 2014.

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I have taken great liberty in making my remarks today. I must admit these remarks are very much Malaysian-centric. I shall try to synthesise some of the lessons learnt by Malaysia that might be useful to new and emerging Islamic finance jurisdictions. These lessons are by no means exhaustive.

Let me start with some points to set the context of my remarks.

For new and emerging Islamic finance jurisdictions, they can learn from the experiences of other more established Islamic finance centres. These jurisdictions have the opportunity to jump start into 30 years of modern Islamic finance practices. They could move fast, avoid expensive pitfalls and adopt best practices.

I will raise nine points that I hope will provide some perspectives on the issues raised.

Islamic finance is for all (Gain acceptance). Islamic finance is for all. Its appeal extends to a larger global community, regardless of their faith and origins. Islamic finance is not only for the Muslims. Islamic finance cannot be successful if it is only supported by Muslims. Many now recognise that the inherent characteristics of Islamic finance are consistent with universal values. Islamic finance has proven beyond reasonable doubts its viability and the value proposition that it brings. Many of its tenets contribute to economic and financial stability; for example, restrictions on overleveraging; linkage of transactional activities to the real economy and a requirement for strong governance and transparency.

In Malaysia, Islamic finance has gained acceptance amongst all, irrespective of race or religion. Non-Muslims make up more than 50 percent of the customer base of Islamic banks. Similarly the sukuk market that totalled USD160 billion as at December 2013 are characterised by the involvement of diverse set of players and of all creed. The players include multinational corporations and institutions such as the World Bank, Toyota, Nomura Holding Japan, AEON Credit and Shell to name a few.

Islamic finance is competitive and able to fulfil the needs of the modern globalised economy. It competes on an equal basis with conventional finance. It is in the mainstream and no more a novelty. It can stand on its own. From my experience, the reason why non-Muslims use Islamic finance is that it makes business sense and it is as competitive and provides a welcome alternative to conventional banking.

The availability of established global best practices and standards. There are established global best practices and international standards in Islamic finance. New and emerging jurisdictions need not go to the trial and error period of the more established centres. New entrants can avoid costly mistakes. Global best practices, standards can be adopted and adapted to local circumstances. There is no necessity to reinvent the wheel. Reinventing the wheel takes time and very expensive, and you would never be sure whether it can be successful. Established Islamic finance jurisdictions are more than happy to share their experiences. The more jurisdictions adopt Islamic finance, the better the future of the industry.

There are already proven practices and documentation that bridge theology to practice. Many years of efforts have taken place. Accountants, lawyers, tax experts, regulators and bankers have put their minds to create standardised agreements and instruments, such as the Wakalah Agreement and Commodity Murabahah Master Agreement that are widely accepted across jurisdictions through bilateral and multilateral agreements. These agreements and instruments have stood the test of market and time. It is wise to adapt and customise them to the local environment.

Shariah a pillar of Islamic finance. It is a factor that will determine whether Islamic finance would move forwards. I have both good news and bad news on this. The good news is, a lot of concepts and contractual characteristics are already resolved and widely accepted. These are many and the differences are very few.

The bad news is, there is still a very small minority continuously asking the basic questions that I thought have been resolved collectively. While giving a dissenting view is not wrong nor discouraged, but if it is made by a well-known personality, it would create doubts and uncertainty. And this is not good for the confidence and general acceptance of the public.

However, if we go back to the glory days of Islamic civilization, diversity and differences of opinions were celebrated and one of the primary reasons for Islamic civilization to prosper. In this respect I very much believe that mutual recognition and diversity of opinions on Shariah matters would go a long way in resolving different interpretation and understanding. In fact diversity of opinions and interpretation would enable resolution of problems faced by the ummah who live in different systems, cultures and customs.

Start small but with confidence and achieve success with a series of well-targeted group. Action speaks louder than words. The starting point does not require focus on high-end Islamic financial products such as sukuk and fund management. Instead, start where it matters most. Embark on initiatives that could assist the low and middle income groups. Devise a scheme that could provide alternative for source of funds for the small and medium enterprises (SMEs). Start with basic banking facilities; saving accounts, current accounts and term deposits. Provide financing facilities that are simple and easy to understand such as microfinancing and microtakaful.

In Africa, the retail banking market segment has an enormous potential for growth. Currently, less than five percent of individuals aged 15 and above are likely to borrow from a formal financial institution in Sub-Saharan Africa and the MENA region.

Many adults in Africa use informal methods to save and borrow. Similarly, a majority of SMEs in Africa are unbanked and access to finance is a major obstacle. Only 20 percent of African SMEs have a line of credit from a financial institution. This gap provides abundant opportunities for those who are willing to tap into very promising African financial market by providing Shariah-compliant financing facilities to the retail and SME clientele. Islamic microfinance facilities can also enhance financial inclusion in Africa.

The role of Government and the central bank. The government has an important role to play. Any new industry requires harnessing and nurturing. Government's commitment is key but commitment must commensurate with substantive action. For new entrants to the Islamic financial industry, sovereign sukuk issuance by government would be a bold and strategic move. Naturally, the private sector will follow suit as there is already readily available pricing benchmark.

In the first quarter of this year, 81 percent of the USD31 billion new issuances in the global primary sukuk market were by sovereign and quasi-sovereign issuers. Several more debut sovereign issuances are in the pipeline including issuances from United Kingdom, Luxembourg, Hong Kong and countries in Africa, namely South Africa, Tunisia, Mauritania, Senegal and Oman.

Our own experience in 2003 showed that the private sector would start issuing their own sukuk once the government had shown the lead. The act of government issuing its own sovereign sukuk is the single most important initiative to prove its commitment to Islamic finance. Start with local currencies and follow up with non-domestic currencies when the timing becomes suitable. In Malaysia, both the Federal Government and the central bank issued long and short term papers that formed the basis for the creation of a vibrant Islamic money market and a deep and sophisticated sukuk market.

Another lesson that can be learnt is that central bank can play a catalytic role in promoting a new market. Central banks have the capacity to issue Shariah compliant money market instruments to enable investment in short term papers. It could assist in the liquidity management of Islamic banks. It also gives an opportunity for the public at large to invest in short term Shariah-compliant papers. At the same time, conventional investors have an opportunity to invest in a new asset class.

Usage of Waqf. Another interesting area for Islamic finance and this applies, not only to new entrants but also established finance jurisdictions, is the innovative use of waqf in areas underserved by the present financial system. The endowment received from waqf, together with the revenue generated from the waqf properties can assist in the socio-economic uplift of the community. Utilisation of waqf by Islamic microfinance institutions can potentially create more options in offering interest-free financing in the economy. Islamic financial institutions and corporate organisations can also consider including waqf as part of their corporate social responsibility programmes for more suitable solutions that have profound impact over the long term, particularly in education.

In Africa, we have seen successful waqf projects such as the construction of a commercial complex for Islamic studies in Sudan. Waqf, properly structured and with the right governance could create wealth and economic opportunities.

Helping to kick start a Market. Another idea to explore is for the AfDB, sovereigns including central bank, and pension funds to set up sukuk funds to give out funding mandate to support and kick-start domestic and regional sukuk investment in Africa. In Malaysia, our Employees Provident Fund and Central Bank of Malaysia have created its mandate to external portfolio managers to include international Shariah compliant equities and sukuk. This strategy has further stimulated growth of Islamic fund management industry. Perhaps these ideas can be adapted to suit the operational environment in Africa.

These ideas that I outlined above have been tested and implemented. I believe the same can be considered by new and emerging Islamic finance jurisdictions.

Conclusion

Let me conclude that the journey in Islamic finance is a rewarding experience. For this journey, we have to bear in mind that -

It takes serious efforts. We need to be patient and organized. With determination and perseverance, the result will surely follow. We need to work in unison. Respect diversity. Amplify on the collective agreements. Seek solutions for differences. In time we should come to an understanding. We have to ensure, always, that Islamic Finance must remains competitive. It must make sense. The maths must be right.

Exciting opportunities exist for new and emerging jurisdictions in Islamic finance. For Africa, Islamic finance has tremendous opportunities to support the nation’s development and economic needs.

I end my remarks with these words:

“Actions Speak Louder Than Words”

Thank you.