Zeti Akhtar Aziz: Unlocking finance, expanding impact

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It is my distinct honour and pleasure to welcome you to Malaysia and to this Responsible Finance Summit for 2016, with the theme "Unlocking Finance, Expanding Impact". The theme gives strong recognition to the essential role of finance in driving sustainable development and growth in the world today.

It is now almost a decade since the eruption of the global financial crisis. Despite the challenges, much progress has been made to forge a vision for a stronger post-crisis world. Whilst having to strike a balance between pursuing financial stability and the potential increased costs to financial intermediation, efforts have been made through the global financial reforms towards more sustainable financial systems. This includes the recalibration of financial regulations to curb tendencies for excessive leveraging, strengthened regulatory and supervisory systems that are forward looking and responsive to risk, as well as provisioning standards that reduce procyclicality and that restrain the build-up of risks. In addition, advancing consumer protection, furthering financial education and literacy as well as improving access to financial services have remained important long-term items on the agenda.

In tandem with these efforts to strengthen financial stability, the role of finance is also being re-examined to enhance its positive impact. This entails focusing our sights on the path ahead, towards re-building a global financial architecture that will facilitate and secure our economic prospects. With the considerable benefit of hindsight, we now know that finance, if not anchored to the aim of creating sustainable value in the real economy, will become inherently unstable and destabilising to the ultimate goals of greater shared prosperity. There is thus a compelling need for finance to have a greater role in shaping responsible behaviour that underpins a stable and well-functioning economy, and advances the goals of a progressive society and sustainable environment. This is the underlying objective of responsible finance. Of significance, aligning business practices towards responsible finance entails a paradigm shift away from the conventional thinking of finance - the most important distinction being the need to recognise and appreciate that responsible finance delivers value by focusing on its ultimate outcomes, rather than its immediate returns.

Responsible finance at its core strives to serve wider objectives that is consistent with, but goes beyond, the predominant objective of enhancing shareholder value. In delivering long term sustainable value, allocative efficiency is achieved in a manner that promotes stability and prosperity in the broader economy and sustainability of the environment. Above all, responsible finance aims to optimise its positive impact on society, economic wellbeing and development.

Over the recent decade, the heightened advocacy for ethical and socially responsible investments has also seen the proliferation of financial instruments that cater for both financial and societal objectives. More importantly, this has moved beyond negative screening, to more impactful approaches involving the adoption of environmental, social and corporate governance (ESG) considerations in investment and business practices. These have served to align risk and reward in a more sustainable manner. Indeed, some global banks and insurers have begun to incorporate sustainability considerations, including environmental concerns in their lending and investment decision-making processes via the adoption of international risk management frameworks such as the Equator Principles and the UNEPFI Principles for Sustainable Insurance. These positive forms of finance are increasingly becoming powerful market forces, driving focus into the kind of productive activities needed for long-term growth.

Islamic finance, a well-established component of responsible finance, is similarly gaining significant growth and prominence in the global financial system due to its inherent orientation towards promoting societal welfare. This includes the propagation of strong ethical values that engenders accountability and trust in its intermediation function, as well as the promotion of risk sharing that fosters entrepreneurship and equitable distribution of wealth. By virtue of its requirement for financial transactions to be supported by genuine productive activities, Islamic finance is also deeply rooted to the real economy. All these are hallmarks of Islamic finance that underpin greater market discipline and stronger focus towards building sustainable and long term value in capital allocation. Collectively, these characteristics enable Islamic finance to also serve as an effective model for responsible finance.

On the path to achieve stronger, more balanced and sustainable growth, the potential of responsible finance has therefore become greater than ever. Most important is for finance to be aligned towards its ultimate goal of serving humanity and of uplifting social wellbeing. Thus, more than merely performing its role as a passive intermediary of funds, finance today has the distinct potential of catalysing and shaping social outcomes. As mobilisers of funds towards socially empowering activities in the economy, the financial sector can act as a "social multiplier", significantly expanding the impact of positive finance.

This is what responsible finance can achieve. Infrastructure financing, with its focus on long-term and socially impactful considerations, is an area of finance that can be instrumental in filling the vast development needs of many emerging economies, with an estimated global funding demand of about USD57 trillion by 2030, or about USD1 trillion a year. Recognising this, greater attention has been focussed on infrastructure finance, both at the national and international levels. The evolution of the sukuk market, in particular, has been an effective avenue in bridging this financing gap. Since 2003, an estimated USD115 billion of infrastructure sukuk has been issued by more than 10 different countries, which has been vital in contributing towards the long-term development of these economies. In Malaysia, the sukuk market has similarly been pivotal in supporting infrastructure financing, with Malaysia-domiciled infrastructure sukuk accounting for 79 percent of global infrastructure sukuk issuances in 2015. The positive response by investors of these issuances with maturities of up to 30 years is reflected by its oversubscription of up to 10 times.

A relatively recent form of finance that has been gaining attention recently is green financing. The market for green bonds tripled in size in from 2013 to 2014, with over USD100 billion of issuances expected this year . Of significance, the signing of the "Paris Agreement", a global action plan on climate change, by 195 countries in December of 2015 will serve to further accelerate the momentum of green financing. As the principles of Islamic finance share substantial synergies with the concept of environment-friendly and sustainable development, there is also tremendous opportunity for Islamic finance to develop instruments that can support the global demand for green projects. These forms of finance can be embraced and brought together to leverage in a mutually reinforcing manner to enhance their collective impact.

Socially responsible investments in the West began as far back as the 18th century, while Islamic finance evolved in the Middle East and Asia since the 7th century, in which lending based on Sharia or Islamic principles included moral directives in the conduct of business. Reinforced by globalisation, society today is no longer defined only by national boundaries. Finance, and indeed responsible finance has also evolved to be global. The need for responsible and sustainable form of finance is recognised - and even deeply desired - throughout the world. Nonetheless, while responsible finance has flourished in many local communities, its next phase of development requires responsible finance to be brought into the global mainstream, to become a core building block in our efforts towards forging a more sustainable financial architecture going forward. Similarly, decisions and solutions to finance need to also be considered on a global scale and not confined to any community or nation.

Of equal importance, the benefits of finance should be extended across all segments of society. Despite the size and scale of our financial sectors in the global financial system, many households and businesses still remain excluded from formal financial services. Globally, as many as 2 billion adults do not have access to a bank account . Perhaps even more revealing are the findings that financial exclusion is not limited solely to developing or low-income economies. Even in advanced countries such as Japan, 3.4% of adults remained financially excluded, while in the United States, over 8% of households are unbanked and 20% remain underbanked . There is thus a still much important impact that finance can bring about.

Indeed, in various parts of the world, such greater access is already making a significant impact, particularly for small and medium enterprises, with its market size estimated to double to almost USD14 billion by 2019 from USD7 billion in 2015 . There is, however, still scope for such access to be expanded to bring about more balanced and sustainable growth in the global economy.

Finally, an important aspect of responsible finance requires strong and effective governance. John Locke, one of the most prominent 17th century theorists, refers to the concept of a "social contract" in describing the origin of society and its inherent need for governance. The erosion of this social contract and of governance would drastically weaken the foundations of society, setting the stage for its eventual decline in the future.

This was evident during the global financial crisis. The experience serves as a strong indication that the own version of the "social contract" in finance should not be overlooked. This extends not only to governance but also to trust, which has traditionally been the social bond between finance and humanity. Central to this is the realisation that financial markets cannot operate in the absence of trust, which in turn necessitates minimum standards for governance, ethics and integrity. This involves not only heightened expectations on the fiduciary duty of boards, but the alignment of compensation packages from short-term personal gains towards long-term value creation. In addition, corporate culture also have an important role in entrenching financial goals with ethical values, through the promotion of sound risk taking cultures and ethical codes of conduct.

Conclusion

Allow me to conclude my remarks. Often at its most defining moments in history, the rise of society has been intricately marked by the strength of its leadership and its people. Indeed, the global financial crisis witnessed unprecedented levels of global cooperation as the world came together to pursue a common interest of restoring stability and building more sustainable financial systems. In the same manner today, the future of finance demands strong leadership and cooperation in fostering collective will towards achieving the necessary positive transformation.

The Responsible Finance Institute, as a think tank connecting various responsible finance practices and expertise around the world, is in a unique position to contribute towards realising this aspiration. But for responsible finance to gain real traction, this cannot be an undertaking of a single institution.

Finance, with its potential to serve society, is capable of so much more. As responsible global financial participants, the opportunity to come together again to rebuild trust and provide the foundations of a more stable and sustainable long-term economic growth can be achieved through our commitments to responsible finance. The call is for greater global cooperation and leadership to unlock the future of finance and expand its positive impact in the global economy. With that, I wish you an engaging and impactful summit.