

# **Adnan Zaylani Mohamad Zahid: Leadership, values, ethics and Islamic finance - the next generation of Islamic financial institutions**

Keynote address by Mr Adnan Zaylani Mohamad Zahid, Assistant Governor of the Central Bank of Malaysia (Bank Negara Malaysia), at the IFN Asia Forum 2019, Kuala Lumpur, 23 April 2019.

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Allow me to first begin by thanking the organiser for inviting me to deliver the keynote address at this annual IFN Asia Forum. It is a pleasure to be here this morning in the company of such a diverse gathering of Islamic finance professionals and weigh in on an important subject of which the organiser had kindly assigned me; "Leadership, Values, Ethics and Islamic Finance: The Next Generation of Islamic Financial Institutions".

For many of us, the 2008 global financial crisis will be one of the major events that stays with us throughout our careers. In Asia, we had the Asian Financial Crisis in 1998 which was momentous but given the scale and its far reaching impact, the 2008 crisis has left far larger imprints. More than a decade has passed, yet we continue to live under its shadows. A world that has grown at a slower pace, in a low inflation, bordering on deflationary risk environment for the better part of a decade. Banking and financial regulations that undoubtedly have strengthened the resilience of the system, but could have had unintended consequences on growth. During this time, a multitude of financial misconducts have been uncovered that have deeply impacted the global financial sector and damaged its reputation. In many parts of the system, not only has the crisis sparked a rethinking of the economic architecture, the stability and resilience of the financial sector, it has also laid bare, the absence or lack of values and ethics in finance. This lack of moral compass and its role that contributed to the global financial crisis has resulted in a loss of trust in finance, prompting a need to restore integrity and trust in financial institutions and market players.

This should not greatly surprise us. After all, the influential works of economic thinkers that came to shape many economic and financial policies before the crisis, had as its fundamental basis, that people who are driven by self-interest, would be able to produce the best outcome for the economy and society. This reminds of an earlier quote attributed to John Maynard Keynes; 'Capitalism is the extraordinary belief that the nastiest of men, for the nastiest of motives, will somehow work together for the benefit of all'. Today, this lack of moral compass and base motivation for financial and economic decision making rings hollow. Society desires higher motives and a greater sense of purpose. Supporting this must be a stronger sense of ethics and values. In the mainstream or conventional financial system, many institutions and practitioners have latched onto sustainability, environmental and governance themes and standards as a manifestation of this. Finance must serve the good and is no longer about greed and self-interest.

## **Raising the impact of Islamic finance to the economy and society through stronger leadership, values and ethics**

Islamic finance has always been subjected to higher overarching objectives that place ethical and moral conduct at its centre. The Maqasid Shariah first articulated by al-Ghazali in the 12th century and developed further by later scholars, speaks towards preservation of religion, life, family, mind and property with the ultimate aim of prevention of harm and attainment of benefits. At the onset, such objectives entail the prohibition of any unethical or unlawful conduct in Islamic finance while putting in place features of an embedded governance that support the highest level of integrity and good conduct within Islamic finance. This is achieved through the branch of Shariah of Fiqh Muamalat which governs business and financial relationships in the Islamic economy. The main objective of Islamic economics itself is the human well-being, a concept that not only cuts across the necessities of Maqasid Shariah, but also extends towards a more

comprehensive social and economic aspiration for the betterment of the material and spiritual well-being of a society.

Islamic finance therefore naturally has the potential to take the lead striving towards an ethical, moral and also sustainable model for finance in the global financial system. In developing the Islamic financial system, these unique propositions are drawn out further from underlying Shariah principles. Islamic finance practitioners in principle, are at a minimum, duty-bound to observe the norms of high ethical conduct to uphold the values and the sanctity of Shariah. Principles alone however, do not insulate Islamic finance from experiencing conduct risks. Examples in the past from various cases of frauds, breach of trust and mismanagement have occurred, exposing Islamic finance to reputational risks. Operational safeguards remain critical in the day-to-day decision making and business operations. Islamic finance must also continuously reflect on whether the governance arrangements, practices and business models of their institutions are effective and impactful.

### **Islamic finance can lead in financial inclusion and governance**

Today, Islamic finance has already established itself and garnered significance in many parts of the world. Though much of this appeared as a natural outgrowth of growing prosperity in many Muslim countries, it did require governmental support and regulatory pushes. In Malaysia, where the modern form of Islamic finance has developed for over 40 years, the national strategy to develop Islamic banking and finance was driven from two perspectives, as an initial strategy for financial inclusion and to later on position the country as a leader in Islamic finance.

In financial inclusion, Islamic finance played an important role in bringing those who exclude themselves from the conventional system on religious grounds. Demographically, Muslim households make up the majority in our country, including that of the B40 income category. There is a natural affinity to subscribe to Islamic finance. Nevertheless, outreach beyond the urban areas always requires additional effort. Now, with the help of technology, Islamic finance is playing a greater role in expanding outreach of financial services and increasing financial inclusion. Digitally-enabled financial services are resulting in greater access, quality and usage of financial services. Islamic banking and takaful customers are able to equally benefit from online and mobile banking services, and enjoy seamless business transactions through digital platforms for supply chain finance. Digitisation of Islamic products and instruments has even contributed in specific initiatives of enhancing financial inclusion, such as the online application of takaful products that offer affordable and easy to understand protection plans with a convenient claims process. The Islamic banking industry's recent launch of the myWakaf portal is another such initiative to enable easier and more effective wakaf contributions by individuals to selected projects such as education, healthcare, investment and economic empowerment.

In our leadership aspiration in Islamic finance, key areas that were and are emphasised are in governance and ethics. Strong corporate governance and leadership are crucial to uphold Shariah values and raise the impact of Islamic finance to the economy and society. A robust Shariah governance framework within Islamic financial institutions is a must to ensure that Shariah values are internalised and upheld in business practices. The Islamic Financial Services Act 2013 accords due recognition to the importance of governance structure within Islamic financial institutions. In practice, Shariah compliance is supported in Malaysia under a two-tier governance structure that operates at the industry and institutional levels. This comprises the Shariah Advisory Council of Bank Negara Malaysia as the highest authority in the ascertainment of Islamic law for Islamic financial business; and a Shariah committee setup in each Islamic financial institution to advise the management and the board on all matters relating to Shariah issues that are specific to the institution. Currently, we are in the midst of revising the Shariah Governance Framework to further strengthen it by providing, among others, greater clarity on the roles, responsibilities and accountabilities of the board, Shariah committee and key organs involved in instituting a robust Shariah compliance risk culture. Through the governance,

application of Shariah will be more closely integrated with the business and risk strategies of Islamic financial institutions.

These efforts, and many more, have culminated in an unparalleled growth in the Islamic banking market share which grew six fold over the last 20 years. Islamic banking system now comprises over 30% of the overall. Takaful has also grown in acceptance, registering double digit growth rates outpacing the conventional counterpart for the past few years. Ar-Rahnu, Islamic investment accounts are becoming more familiar products among Malaysians. We have also become and have maintained a position among the world's largest sukuk issuers. Islamic finance is thriving and competitive.

### **Islamic financial institutions should consider the wider impact of their activities**

Beyond this, Islamic finance is also spearheading initiatives in sustainable finance with Islamic banking institutions championing the implementation of Value-based Intermediation (VBI). Through VBI, Islamic financial institutions adopt a highly structured framework to assess how they create value and impact, for example, from economic, social and environmental perspectives. VBI accords equal emphasis to economic value creation and upholding of ethical values, and strengthens Islamic finance as a “uniting force for good”. The VBI initiative is currently bringing together the banking groups through a pioneering Community of Practitioners (CoP) to advance the sustainability agenda in a collaborative, concerted and synergistic approach. This includes forming close engagement with organisations that share similar sustainability aspirations.

Through VBI, Islamic banks are taking the lead in advancing finance for the good. While these banks are still at early stages in their journeys, there are already concrete examples of VBI being put into action today as we see progress in embedding its elements in their financial products, practices and operations. Though VBI has a far wider scope, these early applications capitalise on contemporary sustainability themes. These include preferential financing rates for hybrid vehicles and green buildings, specialised financing scheme for women entrepreneurs and issuance of the world's first Sustainable Development Goals (SDG) sukuk. Where VBI goes beyond are in provision of non-financial services bundled in financial solutions such as advisory, business network and relevant infrastructures to groom small clients with business potentials such as SMEs and micro finance. Alongside this move towards responsible financing, the CoP members are actively reviewing their business portfolios, identifying and prioritising VBI issues within their institutions and building the required capacity. The banks' progress and effectiveness of VBI-related initiatives would be captured through the VBI Scorecard. The underpinning thrusts of VBI are also gaining relevance in the takaful industry as takaful operators are taking initial steps in exploring value-based protection for their customers. Given the universal nature of VBI, I believe that its adoption by financial groups which comprise the conventional financial institutions, as well as issuers and investors would be a natural evolution in the financial ecosystem.

### **Expectations on the next generation of Islamic financial institutions**

The next generation of Islamic financial institutions would thus be driven by values and not just profit. With a moral outlook for the ultimate good, strengthened by self-discipline, greater accountability and integrity, Islamic financial institutions will have stronger consideration of the impact of decisions made. There should be greater drive to continuously improve their offerings and treatments towards customers and employees, which include fair and transparent disclosure in order to increase the positive impact of their activities. Development of banking practices based on VBI concepts are also anticipated to encourage the creation of new business opportunities and provide the foundation for better returns for Islamic banks over the long term. An example is assessment of financing application by Islamic banks based on value-creation instead of mere credit scoring which would benefit business propositions from new sectors such as SMEs. Another example is refocusing, strengthening and repositioning of personal financing

by Islamic banks to best meet the needs and circumstances of customers. In time, there may emerge greater differentiation between VBI and non-VBI institutions which will be better understood by shareholders, fund providers and financial markets more generally. Furthermore, the more comprehensive and holistic approach of VBI in advancing the good for society could prove to be a key competitive advantage that will influence and shape the future of the financial industry.

The drive for positive changes in the Islamic financial services industry however requires a major paradigm shift in many institutions. It takes a long view to recognise returns beyond financial profits where social and environmental gains are also highly valued. It will also take increasing professionalism and high quality talent that will contribute to this transformation of mind and culture. In Malaysia, we can readily leverage on the available Islamic finance talent development ecosystem, which has a comprehensive and diversified range of offerings, spanning tertiary and professional education, research, training and consultancy services which are globally-recognised. The implementation of VBI has already galvanised many stakeholders including institutions of higher learning such as the International Centre for Education in Islamic Finance (INCEIF) and International Shariah Research Academy (ISRA) to undertake impactful applied research that advances the implementation progress of VBI by the financial industry. Indeed, Islamic finance has greatly benefited through these institutions that have contributed towards enlarging the pool of Islamic finance professionals and deepening expertise through various programmes and initiatives. At the same time, these institutions have also grown in recognition. INCEIF for example, has been awarded the prestigious accreditation by the Association to Advance Collegiate Schools of Business (AACBS) International in recognition of its excellence in various areas, including its diverse programmes that have benefitted students from more than 80 countries.

Besides talent, strong and visionary leadership in particular at the Board and Senior Management will be crucial for success in this paradigm shift. This leadership and strong professionalism must continuously be complimented with the right ethics to transform the culture, systems and people. Nurturing talent also needs to be extended to the board level. In Malaysia, directors can gain greater appreciation on the dynamics of Shariah principles through programmes such as the Islamic Finance for Board of Directors Programme. This specialised Islamic finance training programme builds on the core foundations on corporate governance as set out in the Financial Institutions Directors' Education programme. Directors would also be exposed to diverse perspectives from within and beyond the Islamic banking community on contemporary issues in the industry.

Let me conclude. The Islamic financial sector has made great strides over the recent decades. The next growth frontier in Islamic finance however lies in realising its potential to create greater socio-economic impact. Values and ethics, strongly instilled would strengthen trust between people and the system. For the Islamic finance industry, the move towards embracing VBI manifests the larger aspiration of Islamic finance. In shaping positive behaviour amongst industry players, Islamic finance can become a leading agent of change and bring about sustainable positive impacts to the economy and society. Translating this vision into reality then requires our collective efforts, steered by strong and capable leadership.

On that note, I wish you a productive forum ahead.