# Adnan Zaylani Mohamad Zahid: Launch of the World Bank's Islamic Trade Finance Report

Opening remarks by Mr Adnan Zaylani Mohamad Zahid, Assistant Governor of the Central Bank of Malaysia (Bank Negara Malaysia), at the Launch of the World Bank's Islamic Trade Finance Report, 23 August 2021.

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Thank you to the World Bank for inviting me today. I am pleased to be part of this event to launch the World Bank's Islamic Trade Finance Report. The publication of this special report will provide greater insights into the substantial role that Islamic trade finance can play to support trade, foster growth, and accelerate post-pandemic recovery. I therefore, wish to congratulate the World Bank for this timely contribution towards advancing Islamic finance.

It was recently reported by the World Trade Organization (WTO) that global trade in goods, which has been at record highs, could be near its peak. Some indicators point to a slowing with the outlook clouded by downside risks. The biggest threat being the pandemic which could undermine the recovery. Global trade, at least in goods, has been quite robust and resistant to the economic adversity that we see in general across many sectors and economies. Indeed, WTO still expects the volume of merchandise trade to hit 8% growth in 2021 after the 5.3% drop last year while the International Monetary Fund estimates expansion of 9.7 percent in 2021. As a trading country, Malaysia has certainly benefited from this despite the pandemic-related challenges to domestic activity. The country's exports to major markets experienced double-digit growth, surpassing RM1 trillion in value in the first half of 2021[1]. This has buffered us during the downtime for domestic activity, of which now with the re-opening of the economy we could expect a better recovery into the fourth quarter this year.

Enormous opportunities therefore, lie for Islamic trade finance to support global trade and the post-pandemic recovery. Globally, Islamic trade finance has reached USD186 billion in size and is growing both in scale and in demand as Islamic finance plays a more significant role in OIC countries. In mitigating the impact of the pandemic and sustaining trade supply chains, the Islamic Trade Finance Corporation has also provided support, approving USD4.7 billion of trade financing in 2020, to benefit member countries.

So what would the report tell us of how Islamic finance in Malaysia has fared in being a part of this. We would think that the strong trends we have seen should be accompanied by greater trade facilitation by the financial sector as we know that about 47 percent of global trade is estimated to be supported by bank-intermediated trade finance[2]. But we also know that in the past, Islamic trade finance share in Malaysia has been relatively low, and we measured this at 11.3% of trade financed in 2016. This has improved with the various initiatives that we have undertaken in creating awareness and working with the industry, government and agencies to expand the offerings and the use of Islamic trade finance facilitation with the share growing to 31.4% in 2020. However, we have to acknowledge that we may still have much to do and we look forward to the report which I have been informed also shares a host of ideas and recommendations for us to take forward.

Before that, please allow me to share some thoughts on some of the important thrusts that we see for us to take into consideration as we continue our work in this.

Firstly, we critically need trade-based solutions to ease liquidity constraints. The pandemic, which led to subdued domestic demand and stringent COVID-19 containment measures, has resulted in a liquidity squeeze among Malaysian businesses, particularly the SMEs. To stay afloat, some companies have had to resort to increased debt to meet their payment obligations.

While measures have been introduced to lessen the burden of SMEs in the form of wage assistance programmes, support grants and deferment of financing instalments, these are merely a temporary backstop akin to a band-aid. Prolonged assistance of this form may not be sustainable. The over dependence on debt-based instruments also reduces the financial flexibility of businesses in supporting their recovery.

Trade-based solutions can offer a viable option where funding is tailored to the lifecycle of production. Companies can obtain short-term liquidity via the sale of current assets such as receivables and inventories to financial institutions without increasing their indebtedness. The structuring of such solutions however, entails new sets of risks to financial institutions. In contrast to debt financing, the financier is exposed to risks beyond credit, such as inventory and market risk, which calls for additional safeguards for risk mitigation, different approaches to risk management, infrastructure and practices.

Given the nature of the exposures, this warrants Islamic financial institutions (IFIs) to take an exploratory approach to new trade-based offerings. This allows for a better understanding of the risks and their dynamics thus enabling IFIs to put in place the appropriate framework and policies. As an example, four Islamic banks have commenced a pilot programme with four government ministries in March 2021 to provide liquidity facilities for SMEs via the purchase of outstanding invoices from Government vendors. This is an example where non-traditional Islamic trade finance solutions can help satisfy the financial needs of businesses.

Another important thrust is for us and in particular Islamic finance to help businesses embrace sustainability and build resilience to climate change. The urgent need for an inclusive and greener recovery is undeniable. This is a point driven home by the recent publication of the Intergovernmental Panel on Climate Change report that spelt out code red for humanity. On the current trajectory, climate change is estimated to cost the world USD1.7 trillion a year by 2050, with potential escalation to approximately USD30 trillion by 2075[3]. Globally, efforts towards building climate resilience have intensified, with global supply chains joining the movement. The race towards Net Zero by 2050 has also seen multi-national corporations (MNCs) restructure their supply chains to be more sustainable, putting non-compliance suppliers at risk of being sidelined.

As a trading nation, Malaysia stands to lose USD65.3 billion[4] worth of annual export revenue if we do not embrace the transition towards a low carbon and climate resilient economy by 2025. Trade partners have started to impose expectations on sustainability as preconditions to transact. For example, Malaysia's major trade partners (e.g. China, EU, South Korea and Japan) commitments to Net Zero by mid-century and the recently EU's proposed Carbon Border Adjustment Mechanism will increase the cost of business to export into these markets. It is clear that sustainability is no longer a nice to have but an imperative business consideration critical for long-term survival.

It is encouraging to see that the financial sector is stepping up on this front including via the offering of sustainable finance solutions and assistance to companies in their transition journey. Islamic financial institutions have and continue to lead through Value-based intermediation (VBI) practices. VBI stems from the underpinning values of Maqasid Shariah that propagates attainment of benefits and prevention of harm that is consistent with the principles of sustainability. The Islamic banking industry, through the VBI Community of Practitioners, has also issued the Value-based Intermediation Financing and Investment Impact Assessment Framework (VBIAF) sectoral guides, a set of detailed impact-based risk assessment toolkit for application in financing and investment decisions. Thus far, sectoral guides on palm oil, renewable energy and green energy efficiency have been issued with a few more in the pipeline. Likewise, the takaful industry has issued the VBI for Takaful Framework that integrates the principles of VBI into products and business practices that promote financial resilience and climate risk management for households and businesses. These complement the Climate

Change and Principle-based Taxonomy document issued in April this year that supports businesses transition paths by recognising climate risk mitigation and adaptation efforts over time.

My third and final thrust that I would like to touch on relates to key prospects and opportunities to Islamic finance. Malaysia has thus far been at the forefront in the global halal economy. The nation's success is attributed to a strong supportive ecosystem of which Islamic finance is a key pillar. The Malaysian Islamic finance industry players have been supporting Malaysia's halal industry through the offering of customised halal financing packages. These entail supportive ancillary services that complement the industry's existing financial solutions such as business matching and advisory services. Such packages are currently made available by five Islamic banks on the Halal Development Corporation (HDC)'s Halal Integrated Platform, a one-stop online advisory portal for halal companies. More institutions are expected to participate later this year. In this space, there are continuing ample and growing opportunities for Islamic finance to tap on as we ramp up in high value-added sub-sectors such as halal pharmaceutical and cosmetics, as highlighted in HDC's sectoral development roadmap. Islamic finance also is primed to support initiatives under the National Investment Aspiration (NIA). As the new national investment policy strategy, the NIAs aim to increase Malaysia's capacity to produce more complex and high-value products and create more high-skilled jobs[5]. This, in turn, will result in Malaysia producing new lines of goods and services beyond the traditional and upstream products, which will require support including in trade financing in developing businesses across these new product supply chains and penetrating new markets. The different nature of these needs, however calls for more well designed solutions that extend beyond readily available products.

## Conclusion

Before I end my remarks, I would like to touch on the importance of calibrating trade finance processes with digitalisation. The World Bank's Islamic Trade Finance Report recognises this as a priority area and calls for enhancements to online Islamic trade finance supply chain financing, and the use of blockchain technology. Such technological advancements that leverage distributed ledger technology and API-enabled trade finance platform can address long-standing issues in trade finance operations that mainly arise from the voluminous and manual nature of trade finance processes. This could also potentially reduce the cost of trade finance of which according to WTO, has surged by 30% on average over the past year as well as eliminate fraud and increase transparency.

The Bank, in recognising the potential of digitalisation in advancing the delivery of meaningful access to consumers, provides an enabling environment for financial institutions to foster innovation through the fintech regulatory sandbox and facilitation of pilot projects. Such avenues enable us to identify potential adjustments or responses to the existing regulatory framework, commensurate with the risk and scale of activities. One such initiative is the development of proof-of-concept for double invoicing detection carried out by selected financial institutions, which is now being enhanced by PayNet for commercial use.

In closing, I would like to share an excerpt from the book of (Musnad) of Ibn Hanbal – The Prophet (peace and blessings be upon him) was once asked about the best kind of earnings, of which he replied, "That for which a man works with his hand. And honest trading."[6] Trade is held in such high regard in Islam, and hence we should always strive towards betterment in its execution. Thank you.

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1 Source: MATRADE article, 29 July 2021, "Double-digit growth in exports in major markets"

2 Source: World Bank Islamic Trade Finance Report 2021.

[3] Source: World Economic Forum article, April 2021, "Economists support 'immediate and drastic action' against climate change"

[4] Source: Standard Chartered (June 2021). "Carbon Dated: Multinational companies planning to cut suppliers by 2025 for failing to curb carbon emissions".

[5] Source: MITI (April 2021). "Investment Policy Reforms to be rooted in the National Investment Aspirations (NIA)", Media Release and MIDA (May, 2021). "Malaysia is shifting gears: National Investment Aspirations (NIA). e-Newsletter.

[6] Source: Musnad Ahmad, ar-Risalah issuance, page number: 502/ 28, hadith number 17265.