

Adnan Zaylani Mohamad Zahid: Keynote address - Islamic Financial Market Forum

Keynote address by Mr Adnan Zaylani Mohamad Zahid, Assistant Governor of the Central Bank of Malaysia (Bank Negara Malaysia), at the Standard Chartered's Islamic Financial Market Forum, Kuala Lumpur, 14 March 2023.

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CEOs, distinguished guests, ladies and gentlemen. Assalamualaikum w.b.t and a very good morning.

The Financial Sector Blueprint 2022–2026 sets out what BNM's development priorities are for the financial sector over the next five years. In its third iteration, Islamic finance remains a top priority. One of the thrusts, "Advancing value-based finance through Islamic finance leadership" is aimed at spurring growth that is progressive, sustainable and inclusive. This also intends to strengthen Malaysia's value proposition as an international gateway for Islamic finance which will be a reaffirmation of the "Malaysia as an Islamic Financial Centre (MIFC)" agenda.

Since its inception in 2006, the MIFC agenda of "Internationalisation of Islamic finance" has offered a platform for Malaysia to position itself as a centre for the offering of Islamic financial products and services in international currencies to the global and domestic financial community. Many of our early initiatives and efforts were to build the foundations and to create the necessary critical mass for participating financial players, which would increase the scale of activity and financial services offered. Malaysia aimed to attract global players as well as to enhance the capacity and capabilities of the domestic financial institutions. Today, despite the effort to develop foreign currency (FC) issuances and other businesses out of Malaysia, we have not yet reached a critical mass. To date, FC issuances constitute only 4% of the total outstanding sukuk in Malaysia (March 2023: RM1.3 trillion), with USD being the main currency¹. In terms of international players, these past few years have seen more consolidation rather than expansion or growth. Notwithstanding these, the FC or international business should represent a continuous opportunity for market players to develop further, in particular with the continued growth of our own international trade and investment and the foreign exchange liberalisations we have undertaken.

Moving forward, while the opportunities of FC business remain available, the MIFC agenda will also give due consideration to strengthening the domestic ringgit market. Inclusion of MGII into international indices such as Markit iBoxx ALBI, Bloomberg Global Aggregate and JPMorgan GBI-EM have already led to improved visibility of Islamic instruments and increased foreign participation. Increased foreign participation in the local market via government issuances and multinational corporations' (MNCs) investment in the Halal industry is also envisaged to increase ringgit market appeal among the investors. Growth of takaful and re-takaful also continues to be a development focus. In the financial sector, Malaysia's takaful industry has continued to grow at a faster rate than conventional insurance. It recorded a compound annual growth rate (CAGR) of 20.6% in the first nine months of 2022 and outperformed conventional insurance's CAGR of 10.8%². Not least, Islamic banking continues to grow

further with more institutions adopting an Islamic-first strategy. With the growth of the assets comes the demand for corresponding Shariah-compliant investing and treasury services. These factors point to another area where we believe to be important in further advancing Malaysia as an international Islamic financial centre.

The development of a vibrant Islamic financial market, in particular the ringgit

Islamic financial market. Currently, Islamic money market volume already accounts for 38% of the total turnover in the money market while total trading volume has increased steadily over the years to RM5.9 trillion in Islamic money market as at end of 2021 (2020: RM4.91 trillion). Commodity Murabahah has been the predominant instrument in the Islamic money market with a 92.7% composition, followed by Qard Acceptance (5.6%), Negotiable Instrument of Deposits (1.2%) and others³. The overall bond market (including sukuk market) continued to grow with outstanding bond and sukuk growing at 8% in 2021 to RM1.7 trillion⁴. Turnover of debt securities and sukuk remained robust at RM1.87 trillion as of end-2021, with average daily secondary bond trading volume of RM3.8 billion. To date, Malaysia remains the biggest global sukuk market with a share of 52% of total outstanding sukuk and 42% share of global sukuk issuances as of end-2021⁵. These are very good achievements - a strength that we can further build upon.

As part of the Financial Market Committee's (FMC) effort to further develop the onshore financial markets, the **Islamic Financial Market Subcommittee** has been tasked to formulate specific market development initiatives to take us forward. The committee has already started work in 2022 with an assessment on the current state of the Islamic financial market in Malaysia and identifying gaps on potential growth areas. Key areas with gaps that need to be addressed are the general market liquidity, the extent of foreign participation in the domestic market and the vibrancy of the interbank market for derivatives. The Islamic repurchase market registered RM39.4 billion in volume in 2021 or around 1% of the total Islamic money market volume for the year while the derivatives market witnessed a mere fraction of 0.1% of Islamic instruments with the rest being conventional instruments. If we consider that Islamic financing comprises more than 40% of the total, we have a lot of opportunity here. Meanwhile, foreign participation in the sukuk market was less than a third of the conventional bond market and hence, further efforts can be undertaken to boost this. The assessment also observed that the outlook for the Malaysian Islamic financial market in the next 5-10 years is generally positive, pointing towards continued growth and development as well as Malaysia remaining as a major global Islamic financial centre⁶.

The committee identified the following immediate development areas:

- the need for continued collaboration between regulators and the financial market community in promoting and improving the transparency to broaden the investor base of the Malaysian sukuk market;
- the concept of "anticipatory hedging" was identified to be vital in advancing the Islamic derivatives market in Malaysia and in creating a healthy, liquid market for practitioners' hedging activities;
- enhancement of ESG data so that capital and funding can be directed towards more sustainable and higher-impact assets; and

- Islamic Social Finance (ISF) has a role to play in the Malaysian retail market, potentially through a Cash Waqf Linked Sukuk model. This model can serve as a guide for similar social financing models for IFIs to emulate in the Malaysian market.

Looking beyond the financial market, there will be a higher platform that will steer the MIFC agenda. With the growing maturity of the Islamic financial sector in Malaysia, Bank Negara Malaysia also believes that the industry is now well positioned to drive the broader MIFC agenda. The MIFC Leadership Council, a joint initiative of Bank Negara Malaysia and the Securities Commission Malaysia will provide thought leadership, and drive strategy formulation and implementation to enhance Malaysia's position as an international gateway for Islamic finance. It is envisioned that the Council will also evolve into a fully industry-led structure that will be better able to respond to - and capitalise on - global opportunities in Islamic finance. We are confident that with stronger industry stewardship, we will be able to foster greater market dynamism and growth.

My last point today is to touch on the MADANI vision introduced by the Government and share my thoughts on how Islamic finance can further leverage on the concept for the further development of Islamic finance. The word itself has its roots in Arabic and means "being developed in terms of thinking, spirituality and mentality". The Malaysia MADANI concept – or civil society – envisions a country that looks beyond economic wellbeing and materialism to one which emphasises humanity and good values like fair, just and effective governance. MADANI is an acronym for a policy that embraces six core values – keMampanan (Sustainability), Kesejahteraan (Prosperity), Daya Cipta (Innovation), hormat (Respect), keyakinan (Trust) and Ihsan (Compassion).

Indeed, many of these core values have been embraced by Islamic finance through its Shariah foundation and Value-Based Intermediation. Over the past few years, we have expanded Islamic finance to encompass and strive for higher ideals beyond the generation of profits, among others. For example, embracing sustainability, protecting the environment and strengthening our governance practices. With the MADANI aspirations or values in mind, Islamic financial institutions could look into a broader agenda of empowering the people and alleviating their economic conditions and status. One ideal, for example, is in achieving zero recipient of Zakat, which had been among the key achievements of Khalifah Umar bin Abdul Aziz r.a during his 2-year reign from 717-720 M.

The Islamic finance sector indeed still has some way to reach its full potential based on these values to fulfil contemporary economic and social needs. Today's Islamic finance ecosystem has yet to match the idealism of Islamic finance vanguards as expressed by Professor Dr. Muhammad Nejatullah Siddiqi who emphasised the concept of justice and morality, in accordance to maqasid al-syariah. I quote from him, "More than anything else, Islamic banking and finance, a sub-culture of Islamic economics, has been a quest for justice and morality into the ordinary business of life." Therefore, new initiatives are needed to empower and advance the Islamic finance system by emphasising on the principle of driving growth, wider participation, and equitable wealth distribution, and not only focused on company and conglomerate profits⁷.

Ladies and Gentlemen,

With that, I wish you a productive forum ahead. Thank you.

¹ Bank Negara Malaysia

² The Malaysian Reserve

³ League Table 2021

⁴ ICM, Securities Commission

⁵ MIFC

⁶ Survey conducted among 50 financial institutions which comprise of diverse organisation type including, but not limited to, asset management firms, commercial banks, Islamic banks, and development financial institutions.

⁷ 2023 Budget speech, <https://budget.mof.gov.my/pdf/belanjawan2023/ucapan/ub23-BI.pdf>