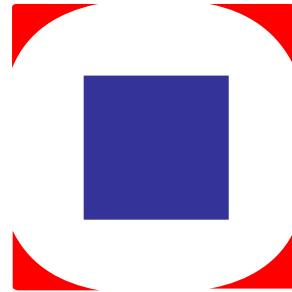


Global Islamic Finance Forum

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**“Regulation and supervision of Islamic Finance:
Industry expectations post crisis”**

**Stella Cox, Managing Director
DDCAP Group**

Regulation and supervision of Islamic finance: Industry expectations post crisis

Introduction

- 2010 - the global financial marketplace is just starting to recover from the worst financial crisis in decades
- Extraordinary measures have been called for to restore equilibrium in mature markets
- Government support has, and continues to be, central to sustained global recovery
- Growth prediction for evolved international markets for the coming 5 years suggests a significant slow down from recent, historical trends
- Conversely, projections for growth over the coming 5 years in emerging economies in Asia and also the Middle East and Africa, exceed the level of growth during the past ten years

Regulation and supervision of Islamic finance: Industry expectations post crisis

Introduction

- As a result of the crisis, various new economic and financial links are being created in an endeavour to support global prospects for growth
- Economic power will become more dispersed
- Desire to aid swift recovery has prompted focus on the delivery of strategies and solutions, at both operational and regulatory level, that will establish a stable foundation for the global financial system
- SE Asia has already benefitted from the strategic development of financial infrastructure and financial reform that took place during the past decade

Regulation and supervision of Islamic finance: Industry expectations post crisis

Does the recent financial crisis present an opportunity for the Islamic financial markets to expand its market share?

- Even pre-crisis there were strong signs outside of the core Muslim world that governments sought to provide for access to Islamic financial products
- Jurisdictions such as the UK have already made legal, regulatory and tax reforms to enable Islamic financial services to co-exist alongside conventional
- Formal integration is less evolved - even in some established Islamic financial markets - with the exception, of course, of Malaysia where the playing field is perhaps the most level of all
- Post crisis there is ongoing and significant requirement for funding, especially for infrastructure development, and traditional sources of finance may not be as readily available



Regulation and supervision of Islamic finance: Industry expectations post crisis

Prior to the crisis there was wide spread interest from jurisdictions keen to develop Islamic finance in their own market to integrate with existing players. Have recent events changed this perspective?

- We have touched on jurisdictions keen to provide for an Islamic financial infrastructure - increasing internationalisation of Islamic finance will support this
- Reports suggest that Islamic banks have weathered the global crisis better than conventional banks and that is also serving to increase global interest
- Selectively, this may be true, but many reports have been based upon over simplified assumptions about Islamic finance without analytical evaluation or statistical data
- On such basis, it is inappropriate and dangerous to make conclusions about the sector as a whole and without consideration of the varying regulations, controls and conditions across all jurisdictions in which Islamic banks operate
- In September the IMF published a working paper entitled "The Effects of the Global Crisis on Islamic and Conventional Banks: A Comparative Study" *



Regulation and supervision of Islamic finance: Industry expectations post crisis

What lessons can we derive from the crisis from the perspective of conventional banking to Islamic finance and from Islamic finance to conventional banking?

- The financial crisis was swift and unprecedented, emphasising the importance of the relationship between liquidity and solvency
- It exposed the structural flaws of the conventional financial system and we must learn from that
- Rapid decisions had to be made to introduce new levels of financial regulation, governance and supervision and some consider it is time now to distinguish between “more” and “better” regulation
- Conventional finance is largely based upon debt and risk transfer, Islamic finance is asset-based and focused on risk sharing
- The very essence of Islamic financial principles should help to mitigate certain risks, through avoidance of financing or investing in the sectors and instruments that adversely impacted the conventional space



Regulation and supervision of Islamic Finance: Industry expectations post crisis

What lessons can we derive from the crisis from the perspective of conventional banking to Islamic finance and from Islamic finance to conventional banking?

- It is equally important to be transparent about perceived weaknesses in the Islamic financial system
- Many believe that the pre crisis approach to regulation of Islamic financial activity in some jurisdictions did not consider its unique characteristics
- We must accept that our system is not yet complete and seek to create a market, regulatory and legal infrastructure relevant to our industry and to its global expansion
- Also subject to review:
 - Ongoing standardisation of contracts and Sharia'a harmonisation
 - Criteria for external rating and evaluation of financial institutions and products
 - Development of expertise and human resources



Regulation and supervision of Islamic Finance: Industry expectations post crisis

Summary:

- The Islamic financial system was not “immune” from the impact of the crisis
 - Lack of sufficiently diversified asset classes has caused excessive concentration (i.e. real estate)
 - Absence of a liquid market infrastructure and instruments for management of liquidity risk introduced stress
 - Incomplete or untested legal framework
- Within the Islamic financial sector we must remain focused on our core financial stability and effort and input in that area is being made
 - Task force on global financial stability – IDB
- In April 2010, the Financial Stability Task Force recommended establishment of an Islamic Financial Stability Forum (IFSF) to be based at IFSB. Objectives:
 - To interface with conventional system via the Financial Stability Board
 - Jointly promote global financial stability
- Liquidity risk is a key concern for the global financial system and robust solutions are being emphasised in the Islamic marketplace, too
 - Liquidity management – IFSB
 - Islamic Liquidity Management Corp – enhance industry access to short dated, liquid and highly rated Islamic securities



