

**ADDRESS BY
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Hijrah: Lessons for the Islamic Finance Industry

Bismillahi Rahmani Rahim

Assalamualaikum Warahmatullahi Wabarakatuh

A very good morning to all of you.

It gives me great pleasure to address this 2nd Global Islamic Finance Forum. This is a timely gathering given the stellar rise of Islamic finance in the last decade, and particularly in the past few years. The theme of this year's forum, "Islamic finance: Opportunities for Tomorrow", provides an excellent opportunity to take stock of what has been accomplished and where the industry should be heading.

A strategic opportunity for Islamic finance

2. Today, I would like to reflect a little on an important event in Islamic history and the lessons it holds for Islamic finance. Before I do so, however, allow me to summarise where I see the global financial system is today. Islamic finance does not exist in isolation but takes its place alongside a much larger conventional system of finance. This latter system was dealt a severe blow two years ago when it was brought to a near total shutdown. Despite its enormous size and sophistication, and despite all manner of prudential and risk management devices, the global finance industry was brought to the brink of collapse. It was only the quick thinking and actions of governments, individually and in concert, that prevented the onset of the financial equivalent of a nuclear holocaust. In the midst of the complete panic - one where even the world's best financial institutions would not lend to each other - governments in the advanced economies stepped in to take over the financial institutions that were considered "too big to fail" while pumping in liquidity. If they had not done so, we might be meeting under very different circumstances today.

3. What followed was an extremely tense period. The immediate threat of financial collapse had been averted but the spreading shockwaves through the real economy meant that the house of cards could still fall, and take financial institutions down with them. Again governments had to play a role by ensuring that there was sufficient aggregate demand and liquidity. Their efforts, by and large, succeeded and the world economy did not slip into a recessionary death spiral but managed to stage a strong and sharp recovery. But governments had also to try and restore faith in the conventional financial system by promising sweeping reforms. Last week, finance ministers of the G20 countries met in South Korea to continue this process in preparation for the summit of leaders in November. Among the issues discussed were financial safety nets and new capital and liquidity requirements for banks.

4. A little more than two years down the road from the collapse of Lehman Brothers, it would appear the worst is over although things are still very far from optimal. The corporate sector as a whole is running strongly rising surpluses and the financial institutions in the US, Japan, Germany and France are vastly improving. The exception would appear to be the United Kingdom. But levels of risks and uncertainty are very high and extreme caution remains the order of the day. Given high levels of deficits and debt, the threat of sovereign risk defaults are still real and credit spreads of a number of European countries are still rising. Households in the advanced economies also continue to be plagued by high levels of debt. Of course the high levels of unemployment do not help their

cause and the steps to cut back public expenditure seem destined to add further to the ranks of those out of work.

5. The corporate sector has been aided tremendously by fiscal and monetary stimulus. They are now in net cash accumulation mode and are only very slowly and carefully investing their surpluses given the uncertainty of what lies ahead. Corporates are opting to reduce their existing debt levels, and this is not helped by banks that seem more concerned with avoiding business risks and conserving capital. As a result, the world economy has ample liquidity and interest rates are expected to be low for some time to come. While not short of liquidity, the world can be said to be short of capital, especially productive capital. The liquidity that central banks are creating is finding its form in asset inflation, causing the prices of gold, land and bonds to rise. It is also causing the flood of opportunistic short-term portfolio flows that are inundating Asian economies, driving up their exchange rates. This has prompted some countries to intervene to keep their currencies from rising in value, raising concerns about the outbreak of currency wars.

6. In short, while there is no lack of liquidity, the challenge is in channelling this liquidity beyond the financial market, into the real economy. I believe this is the scenario the Islamic finance industry faces today. This is the environment in which we have to survive and thrive. If the leaders of our institutions continue to think and act strategically as they have been doing, I am convinced that Islamic finance can grow even more rapidly in this period and in the years to come. Islamic finance is, after all, very well suited to meeting the unmet demands for productive capital. The main goal of Islamic finance is to channel financial resources towards socio-economic development. With its emphasis on assets and partnership, Islamic finance is less exposed to risk. By avoiding speculation, Islamic finance reduces volatility and provides a sound basis for stability. Islamic finance has the opportunity to step into the breach created by conventional finance and prove that it can offer the surety and quality that investors are after.

7. What is certain is that there is a growing appetite for *Shariah*-compliant financial products in the global financial markets today. Increasingly, conventional investors are seeking sounder alternatives. *Sukuk* is emerging as an established asset class among international investors. Admittedly the global financial crisis has not left Islamic finance entirely unscathed. The system was affected by a few *sukuk* defaults. But it is recognised that the issue was one of credit risk and not because of any deficiency in the *Shariah* framework.

Lessons from the *Hijrah* for Islamic finance

Ladies and gentlemen,

8. How do we capitalise on the enormous potential that is before us? Allow me to take a different tack now. In doing so, I want to turn from the harsh and chaotic realities of the world today to the orderly way of life that Muslims have been commanded to live. I want to focus on a defining moment in Islamic history. I want to reflect on the *Hijrah* and see what lessons it holds for the world of Islamic finance. The *Hijrah*, as we know, refers to the migration of the Prophet Muhammad (pbuh) and his followers from Makkah to Madinah more than 14 centuries ago. Prior to the *Hijrah*, the small Muslim communities were spread out in the city of Makkah and Madinah. It was only after the Prophet Muhammad's (pbuh) migration to the city of Madinah that the Muslims were consolidated and strengthened under His leadership. By working together, they became stronger and prospered politically, economically and socially. But for Muslims the *Hijrah* was not just a physical journey. It was also a journey of mindsets.

9. The same may be said for Islamic finance today. The Islamic financial services industry is still small relative to conventional finance. Whilst each jurisdiction independently pursues its objectives and aspirations, this pursuit should not be confined to geographical boundaries and jurisdictions. It is only by expanding one's horizons that the full benefits of Islamic finance can be spread and felt. It is only by combining the strengths of individual players that the cause of Islamic finance is cumulatively advanced. The development of Islamic finance must not be seen as a zero sum game. It is an industry that has more than enough capacity to sustain and prosper all participants, provided the separate Islamic finance jurisdictions work together to bring about prosperity and growth.

10. Closely related to the lesson of greater collaboration is that of creating linkages. In the days when Madinah was the first Islamic state, the Prophet Muhammad (pbuh) sent envoys or ambassadors to other territories to foster relationships between governments. In developing these linkages, parties had to accept their differences with an open and tolerant mind.

11. For Islamic finance, such linkages promote strong partnerships and networks of partnerships through which ideas, knowledge and expertise can be shared among jurists, industry participants and investors. These, in turn, benefit not just the parties involved but also the general population, Muslim and non-Muslim. Strong relationships between financial centres enhance the capacity and ability to deliver services, products and value beyond the reach of each. This is as true of Islamic finance as it is of conventional finance. One direct benefit is liquidity management. Islamic financial institutions will be able to tap and place surplus funds from outside their jurisdiction.

12. Acceptance of diverse and distinctive views was one characteristic that made post-*Hijrah* Madinah a fertile ground for the development of new ideas and practices. The building of Al-Masjid al-Nabawi was a prime example of the pooling of ideas of the Madinah community during the design and construction stage. The *masjid* became more than just a place of worship. It served as a community centre, a court of law and a religious school. But most importantly, it became an administrative centre where ideas and opinions were openly discussed and debated towards achieving the common good.

13. The lesson to be drawn from this is to welcome more global participants who are able to contribute more ideas. It is critical that Islamic financial products are on par with their conventional counterparts in terms of competitiveness, comprehensiveness and returns. For this to happen, markets must be deep and liquid. Expecting such products to be driven purely by religious loyalties cannot and should not be the primary approach. Islamic finance products have to be commercially driven and based on yield optimization. They must therefore have broader appeal than just to one section of Muslims. This has been the general trend in Malaysia. The Islamic fund management sector has grown from 4 funds in 1993 to 152 funds in 2010. Since 2006, the number of Islamic funds in Malaysia has grown at an average rate of 12.3 percent every year. Malaysia's *sukuk* issuance has been able to attract investors from varied jurisdictions, including the United States and Europe, and from a wide range of institutions including banks, asset managers, sovereign wealth funds, insurers and pension funds.

14. It is also critical that Islamic financial products are able to cater to the end-to-end financing requirements of consumers and businesses. Encouraging friendly competition will ensure that innovative *Shariah*-compliant instruments are developed. Initiatives such as Bursa Suq Al-Sila' in Malaysia could be utilised to achieve this goal. Bursa Suq Al-Sila' is a commodity trading platform that facilitates liquidity management of Islamic financial institutions. By integrating the capital market with the commodity market, financial institutions are able to conduct transactions in multiple currencies around the world.

15. Recently, Al Rajhi Bank of Saudi Arabia and Cagamas Berhad of Malaysia collaborated to issue an innovative *sukuk* called al-Amanah Li al-Istithmar or Sukuk Alim. One distinctive characteristic of this *sukuk* is that it aims to meet the *Shariah* demands of investors in the Middle-East as well as in Asia by combining the concepts of *Ijarah* and commodity *Murabahah*. This demonstrates that diversity in Islamic schools of thought is not a hindrance in the Islamic finance industry. It is my hope that the birth of Sukuk Alim could be the catalyst for more harmonised products that can meet the demand of Islamic finance participants worldwide.

16. Human capital is essential to support the development of a nation, be it for economic, social or religious purposes. The *Hijrah* transformed Madinah into a centre of excellence where scholars were trained. These scholars then travelled the globe to spread the teachings of Islam. For Islamic finance to reach its full potential, it is necessary for the industry to be well supported by a pool of capable professionals who are well versed in conventional and Islamic finance, and in the *Shariah*. The responsibility for this has so far been largely with governments, driven primarily by the Islamic Development Bank and national agencies such as Bank Negara Malaysia and the Securities Commission in Malaysia. These efforts are still needed and should continue, but it is timely for industry participants to take greater responsibility for human capital development.

17. Soon after the *Hijrah*, in an effort to support the work of the Prophet (pbuh) and His followers, the people of Madinah allocated capital, land and raw materials for the Prophet (pbuh) and His followers to have a head start. This eventually generated a stream of wealth that benefited not only the followers of the Prophet (pbuh) but also the people of Madinah.

18. One of the driving forces for Islamic finance to prosper is for large investment organisations such as sovereign wealth funds of Muslim countries to take a developmental view when determining their asset allocations. It is completely understandable that yields and returns are the main focus of attention. But it is important for these institutions to also pave the way for Islamic finance to reach the next level. For example, a certain fraction of the funds could be allocated to those financial institutions with the expertise to invest in *Shariah*-compliant investment funds and instruments. This would enable a greater number of participants to be sustained and the industry to be broadened.

Concluding remarks

19. I believe there are key lessons we can learn from Islamic history. These are lessons about unity, not absolute uniformity, about tolerance and collaboration and about thinking for the future even as one exists in the present. We have a significant opportunity to make a difference in the world. It is my hope and prayer that we will make full use of this opportunity.

20. I wish to commend Bank Negara Malaysia for organising this prestigious event. I hope that this dialogue will reinforce the on-going intellectual discourse on Islamic finance and thus contribute towards re-shaping global finance for the benefit of the whole *Ummah*.

Thank you.