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“Islamic Finance – Steps for a Better Tomorrow”

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**Bismillahirrahmanirrahmin
Alhamdulillah Rabbal 'Alamin
Wassalatu Wassalamu 'Ala
Sayyidina Muhammadin Wa'ala Alihi
Wasahbihi Ajmain
Amma Ba'd**

The Honourable,
Pehin Orang Kaya Indera Pahlawan Dato Seri Setia Awang Haji Suyoi bin
Haji Osman, Minister of Education cum Deputy Chairman of Autoriti
Monetari Brunei Darussalam

His Excellency Mr David Campbell, British High Commissioner to Brunei
Darussalam

Yang Mulia Pg Dato Paduka Hj Bahrom bin Pg Hj Bahar, Deputy Minister
of Education

Associate Professor Dr Hajah Zohrah binti Haji Sulaiman, Vice Chancellor
of Universiti Teknologi Brunei

Professor Meryem Duygun, University of Nottingham, Founding
President of IFABS

Dr Mark Rhodes, University of Hull, IFABS Brunei Conference Co-Chair

Permanent Secretaries and Deputy Permanent Secretaries, Senior
Officials, conference participants, ladies and gentlemen,

Assalamualaikum Warahmatullahi Wabarakatuh

It is my pleasure to be here today to speak at the IFABS Asia 2016 Brunei Conference and I would like to extend my warmest appreciation to the International Finance and Banking Society and Universiti Teknologi Brunei for inviting me to deliver this keynote address.

Theme 1: Lessons learned from last GFC

The financial crisis that started in the middle of 2007 and exploded into a full blown crisis in the summer of 2008, did not end finance as we know it. In fact, in a few decades it will be seen as a small discontinuity in a broadly upward trend of global financial activity.

However, that Crisis and the series of European Sovereign Debt and Bank crises that started in 2011, all reminded us that finance, as any intermediation, is a risky business and failures in the financial sector all too often can spill over into the wider economy.

Risk cannot be separated from finance. This is the main lesson from all past crises. What may seem like a risk-free transaction or risk-free asset always carries risk. The risk could be small, or could appear to be small, but it is always there. Unlike in mathematics, physics, or chemistry, there are no absolutes in finance or economics. In every financial situation, every financial decision is unique, and must be evaluated in its own context.

Those who look at finance through a historical perspective -- like drivers over-focused on monitoring their car's rear view mirror -- risk frontal collision with risky reality.

Those who look at mortgage debt or gold prices through the historical, often short-term perspective of asset prices, be it property, gold, or commodity – oil -- prices, will not be able to properly assess and price risk.

Sadly, as research shows market memory among investors is short, often less than 10 years. As central bankers or regulators, we must have a much longer memory and perspective. We must remember what are the early signs of looming crisis. Continuous monitoring of risks is therefore imperative and we must stand ready to intervene effectively and early at the onset of possible crisis. If we act too late, we will be paying a higher price in mopping up after the crisis, which often far exceed the costs of early intervention.

Going forward, notwithstanding the most recent global financial crisis and market turmoils, financial intermediation has and will continue. We need it, we benefit from it, but we need to accept risks related to it. And that means we must understand, recognise and control those risks.

Domestically and internationally, we need to have in place a financial architecture that minimises moral hazard and information asymmetries, most importantly through the provision of detailed and timely information as well as pricing the risks in a manageable way. This could help to minimise the social, economic, and fiscal costs and socio-economic disruptions imposed by crises.

Ladies and gentlemen,

Theme 2: Resilience of Islamic finance during the GFC and why Islamic finance has been increasingly accepted by the international communities

I will now discuss on how Islamic finance fared during the Global Financial Crisis and the reasons why Islamic finance has been widely accepted by the international communities.

In the aftermath of the 2008 Global Financial Crisis, the global Islamic banking sector proved to be one of the most stable and resilient industries with a value of about USD 820 billion. According to the IMF, pre-crisis

Islamic banks were more profitable than their conventional peers in the run-up to the crisis. Smaller investment portfolios, lower leverage and adherence to Syariah principles amongst other factors contributed to limiting the adverse impact on profitability.

Effectively, Islamic banks were able to safeguard and provide economic stability during the crisis. Consequently, this led to higher solvency, allowing their credit and assets to grow double that of conventional banks. As a result, they were able to come out of the crisis less scathed. This highlights the importance of further efforts in research and development to spur the growth of Islamic Banking so as to be on par with the more matured and much developed conventional banking.

Ladies and Gentleman,

Islamic banks are governed by Syariah principles and ethical values, which protect them from taking undue and unnecessary risks. Here I share with you what are the special tenets of Syariah principles applied in the conduct of Islamic Finance.

Ayat on riba' Surah Al-Baqarah, excerpt of verse 275:

“...That is because they say trading is only like usury; and Allah has allowed trading and forbidden usury....”

As demonstrated by verse 275 of Surah Al-Baqarah in the Holy Quran, usury or riba is prohibited in Islam. This is because it can make one greedy and cause detrimental effects to society as a whole. Islam instead promotes economically productive activities and genuine trade and business transactions. Furthermore, the prohibition of Gharar (excessive uncertainty) and Maisir (gambling or speculation) in any Islamic transactions, means that the uncertainties within the financial sector are defined and linked to the actual performance of the real sector.

The excerpt of the **29th verse in Surah An-Nisa** of the Holy Quran reads:

‘O you who have believed, do not consume one another’s wealth unjustly but only (in lawful) business by mutual consent.’

This verse emphasizes that ethical values such as transparency, fairness, mutual consent and public interest as the fundamentals of trade, including finance to be practiced by Muslim.

Islamic financial transactions exist to support Islamic trading, and has long been in place with documented evidence dating as far back as the mid 7th century. In an article on Capitalist Traditions in Early Arab-Islamic Civilisation by Shaikh M Ghazanfar, financial innovation during that time took in the form of bills of exchange or letters of credits (suftajeh) which were devised to safeguard the integrity of money transactions and was commonly used in state and private commerce. In its earliest form, sukuk or sakk was used as an international cross border cheque and the first Sukuk was issued in 1775 by the Ottoman Empire.

Despite these early advancements, Islamic finance had only started to thrive again in the mid 20th Century . Prior to this, conventional banks operating in the Muslim world were questioned by the Syariah scholars as their operations involved interest and this was amounted to riba. From its early beginnings in retail banking, the Islamic financial system has evolved to include takaful (Islamic insurance), Islamic capital markets and more recently in fintech.

According to the Islamic Financial Services Industry Stability Report 2016, published by the Islamic Financial Services Board (IFSB), the global Islamic Finance services industry has reached an overall of total value of USD 1.88 trillion as of 2015. It has also been estimated that annual growth is between 15 to 20 percent. While the majority of Islamic finance activities is centred around the Middle East and Asia, it has increasingly gaining

traction in non-Muslim countries where we see the likes of Hong Kong, the United Kingdom, Luxembourg and South Africa have issued their own sovereign Sukuk. To accommodate the requirement of Syariah compliance of the Islamic financial products, these countries have made necessary amendment to their legal, regulatory and taxation frameworks.

More recent examples of the burgeoning interest in Islamic finance are that of Germany with the opening of the Islamic bank, KT Bank AG in July 2015. Also, in January 2016, Woori Bank became Korea's first bank to make a financial transaction with an Islamic bank and they are planning to expand this type of deal in other Islamic jurisdictions. Russia also established its first Islamic bank this year at the Republic of Tatarstan which has a significant Muslim Tatar population.

Ladies and Gentleman,

You might be wondering the reasons for the growing interest from Muslim and non-Muslim countries to use Syariah-compliant products and services. One obvious answer for a Muslim country is as fulfilment of their religious duties. But far and beyond that, I believe the values of Islam which prohibit excessive speculation and promoting investments in ethical ways are giving investors' confidence in the stability of Islamic financial system since it is not prone to frequent volatility due to changes in interest rates.

Furthermore, the growing high and middle-income Muslim population also increases the liquidity in Islamic finance space. Thus Islamic finance is seen as a high potential market to be tapped and it provides an avenue for investment diversification for both Muslim and non-Muslim investors.

Ladies and gentlemen,

THEME 3: Challenges and emerging issues of Islamic finance

While the Islamic financial industry has passed the robustness test by demonstrating greater resilience during the global financial crisis, the crisis has also brought into attention some challenges the industry is currently facing. There have been active discussions in many forums to address a wide spectrum of issues surrounding the industry. Therefore, I would like to take this opportunity to briefly touch upon the challenges and emerging issues facing Islamic finance today and the ways that have been proposed or are being done to alleviate the problems.

A low penetration rate and lack of critical mass remain the key impediments to the growth of Islamic finance. This is likely due to the lack of public awareness and perception toward Islamic financial products and services. Most people are not familiar with the Syariah principles and concepts behind Islamic finance and some mistakenly believe that it is only meant for Muslims. In addition, there might also be an aversion to switch from well-established conventional financing to Islamic finance. In this respect, the stakeholders in Islamic finance should undertake mass awareness programmes through seminars and conferences to create critical mass for the industry, as well as promote a standardised education or certification system so that we are able to fully persuade the public to consider the discipline of Islamic finance seriously.

With the fast pace of Islamic finance growth, there is a need for more skilled human capital with expertise and experience in the field of Syariah and Islamic finance. One of the biggest concerns for Islamic finance is the global shortage of Syariah scholars possessing the necessary financial sector expertise. There is a lack of clear succession plan for the emerging generation of Syariah scholars to be involved with Islamic finance and succeed as senior Islamic Finance Syariah scholars.

The gap between knowledge and experience facing most Syariah scholars must be addressed. This requires that Syariah scholars be multi-disciplined and possess in-depth understanding of the financial systems and the global changing environment. These scholars must be given

exposure to the world of finance and how the demand of finance comes about so that they could understand what specific financial products are aimed for. In addition, these young scholars must be nurtured and mentored by the senior scholars so that there is clear and continuous knowledge transfer from the experienced scholars to the new ones.

Lack of sound research and product innovation are also seen as the stumbling blocks for the advancement of Islamic finance, in particular, in relation to Takaful, asset management and microfinance. We must be willing to invest in supporting infrastructure for product research and development for example, by setting up a dedicated research institutes and universities that promote innovation and creativity in Islamic financial products and services.

Developing new and creative Islamic financial products is certainly not an easy task. It involves utilising the classical Islamic nominated contracts in new ways which are Syariah compliant and are able to achieve the economic benefits of the financial products. Hence, a qualified and skilled workforce well versed in both Syariah and modern corporate finance is essential to take on this difficult but rewarding task.

In developing these new Islamic financial products, we should consider and appreciate well-articulated discussions on the concept of Syariah compliant and Syariah based products. The former is derived using conventional products as a reference and the contract may behave similarly to the original conventional product that was its reference. On the other hand, Syariah based products are new products developed by Islamic bankers or Syariah scholars to fulfill the needs in Islamic banking and finance services. Increasingly, there is a call for the creation of Syariah based products to distinguish themselves from the conventional practices. Thus, a new viable technique in product development must be used to facilitate the growth of Syariah based instruments.

Another challenge to the development of Islamic finance is the different interpretations among Syariah scholars on what is Syariah compliant.

Differences in opinion among Syariah scholars or lack of Syariah convergence regarding the Syariah compliance of specific financial arrangements could expose the Islamic financial industry to the risk of non-compliance with Syariah principles and thus could affect trust in the industry. Harmonizing these interpretations into a consistent and efficient regulatory framework is one of the biggest challenges currently faced by the regulators of Islamic financial industry. In this regard, the Islamic Financial Services Board of which Brunei Darussalam is a member aims to address such discrepancies so that there would be more clarity, consistency and greater integration between Syariah rulings, national laws and global standards.

Corporate governance has gained more importance in the wake of recent corporate scandals and global crisis. The rules of corporate governance must be applied across all types of financial institutions, be it conventional or an Islamic one. However, in Islamic finance, there is another layer of governance which is the Syariah governance. It has been given due attention by the regulators, industry players, Syariah scholars and researchers with the resurgence of Islamic finance. In fact, a report jointly published by IRTI and IFSB in 2014 titled 'Islamic Financial Service Industry Development: Ten Year Framework and Strategies – a Mid Term Review,' recommended to enhance Syariah compliance, effectiveness of corporate governance and transparency.

We have to understand that there is no 'one size fits all' approach in applying the best practice in Syariah governance. This is due to the varying levels of development of Islamic finance from one jurisdiction to another. But still, a proper framework for Syariah governance should be put in place. The adoption of international standards and guidelines specific for Islamic finance is essential as a basis for implementing national regulatory requirements. In this aspect, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) Syariah and governance standards and IFSB Syariah Governance Guidelines are important to promote the standardisation of the best practice in Syariah governance. Essentially, Syariah governance is an important element that would

determine the growth of Islamic finance in the years to come, since a well-established and sound Syariah governance will boost public and market players' confidence in the Islamic financial system.

While the money laundering and terrorism financing risks associated with conventional finance are generally well-identified and understood, there has been little research done by international standard setting bodies on the specific risks that may be associated with Islamic finance. The IMF recognises that there may be specific risks related to: (i) the complexity of some Islamic finance products; (ii) the nature of the relationship between the institutions and their clients; and (iii) the limited experience in the supervision of Islamic finance. In this respect, the Financial Action Task Force, the Islamic finance standard-setters and national regulators have been urged to cooperate and explore this area.

Ladies and gentlemen, just to recap, we have examined the lessons that can be learnt from the Global Financial Crisis. Secondly, we have covered the growing acceptance of Islamic finance by international communities and we have also reviewed the challenges facing Islamic Finance. Finally, I would like to share with you Brunei Darussalam's experience in Islamic finance and our future plan to develop the industry forward.

Theme 4: Brunei Darussalam's Experience in Islamic Finance and Future Plan to Grow Islamic Finance

Brunei Darussalam can provide an excellent platform for the growth of the Islamic finance industry with its strong Islamic values. It is ranked 10th out of 92 countries by ICD Thomson Reuters Islamic Finance Development Indicator 2014. Islamic finance has been available in Brunei Darussalam for the last 30 years and has a substantial market share in both banking and takaful.

On the capital market side, the Government Sukuk Al-Ijarah Programme has been consistently issued since 2006 as a benchmark, to encourage the use of sukuk for corporates as a means of funding. While there have been

similar corporate sukuk issuances, we would like to see an increased activity in corporate issuances so as to diversify the risks in the financial industry.

Ladies and gentlemen,

In preserving the purity of Islamic financial products and the operations of the Islamic financial institutions, Brunei Darussalam implements a rigorous two-tier Syariah governance framework, comprising of a Syariah Financial Supervisory Board (SFSB) at the national level, and Syariah Advisory Board (SAB) at the industry level. The board members are renowned and prominent Islamic scholars with diverse experience and background including Syariah, legal, economics and finance.

To ensure continuity and efficiency of the Syariah bodies, AMBD is highly supportive of cultivating the local talent for the purpose of expanding the pool of Islamic scholars so that there is an orderly succession planning. To this end, the Centre for Islamic Banking, Finance and Management (CIBFM) has produced junior Islamic scholars under the Fiqh Muamalat Professional Programme (FMPP), which has attracted participation both from Muslims and non-Muslims alike. Furthermore, our higher education institutions such as the Universiti Brunei Darussalam (UBD) and Universiti Islam Sultan Sharif Ali (UNISSA) offer courses up to PhD level in Islamic finance.

To support the development of Islamic finance in Brunei Darussalam, AMBD is encouraging academics and professionals to conduct more research on the areas of product structure, harmonisation of Islamic concepts, regulation and governance. As a result, we hope to see more product innovation to cater to the demands of consumers in the global changing environment and at the same time, to reach a level playing field with the conventional financial industry.

Further initiatives are in the pipeline for ease of conducting Islamic Financial banking within Brunei Darussalam. This includes encouraging the use of Fintech via the use of online applications to facilitate Takaful transactions. Besides this, public–private sector dialogue has been increased to raise awareness of the benefits of takaful products through various conduits, including digital platforms, and this has also contributed to raising the public’s financial literacy.

In this post global financial crisis era, we have seen that the regulatory landscape has evolved to better promote and safeguard the public interest, as well as to instil more responsibilities on the financial institutions to practice greater transparency. This can be seen from the development of new and enhanced requirements issued by international standard setting bodies such as the Bank for International Settlements (BIS), the International Association of International Insurance Supervisors (IAIS), the International Organisation of Securities Commissions (IOSCO) and the Islamic Financial Services Board (IFSB).

Autoriti Monetari Brunei Darussalam (AMBD) as the central bank and regulator of the financial services sector in Brunei Darussalam is committed to promoting monetary and financial stability. By and large, the banking system in Brunei Darussalam weathered the Global Financial Crisis well by being conservative in its business practices and risk-taking activities, and also by being adequately capitalised. Nonetheless, we cannot be complacent and think that business is as usual.

To date, AMBD continues to enhance the regulatory framework, by updating our legislation and supervisory processes to be on par with international best practices. Furthermore, with recent events overseas showing lapses and weaknesses in Anti Money Laundering (AML) controls and heightened awareness on the financing of terrorist activities, Brunei Darussalam is in the process of completing its first National Risk Assessment (NRA) exercise. Through the completion of the NRA report, Brunei Darussalam will be able bring itself closer to the Financial Action

Task Force (FATF) standards and thus, demonstrate the integrity and stability of Brunei Darussalam's financial sector to the world at large.

To further heighten the platform of the financial services sector, we have completed a number of financial infrastructure initiatives such as the establishment of the Credit Bureau and the upcoming Collateral Registry system; as well as the modernization of Brunei Darussalam's national payment systems. Moreover, since 2014, AMBD has required financial institutions under its supervision to publish their financial statements in accordance with International Financial Reporting Standards (IFRS).

Ladies and gentlemen,

By 2035, Brunei Darussalam wishes to be seen for the accomplishments of its dynamic and sustainable economy. In realising this national vision known as Wawasan Brunei 2035, AMBD plays a vital role in particular in terms of promoting and maintaining financial and monetary stability. One component of Brunei Darussalam's financial ecosystem that has scope for enhancement and investment is the development of Brunei Darussalam as an international hub for Islamic Finance. Therefore, special attention is given to the strategies that will elevate the reputation and quality of Islamic finance in Brunei Darussalam. To accelerate growth and dynamism of Islamic finance in this country, we welcome participation both locally and from abroad to work together to shape the future path of Islamic finance.

We are also continuously pursuing capacity building initiatives, both for ourselves and the market, in fulfilling Brunei Darussalam's aspirations to be a highly productive and successful nation.

Ladies and gentlemen,

To conclude, I believe that Islamic finance can be a solution to support economic growth and promote long-lasting financial stability. Insyah-Allah, with concerted efforts among standard setting bodies, central bankers,

regulators, Islamic scholars, and financial industry, we can face the hurdles in developing Islamic finance so that many more people could benefit from the magnificent values of Islam.

Wabillahitaufiq walhidayah. Wassalamualaikum Warah Matullahi Wabarakatuh.

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