

## **Adnan Zaylani Mohamad Zahid: Resilience and stability of the Islamic financial services industry in an evolving risk environment**

Welcoming remarks by Mr Adnan Zaylani Mohamad Zahid, Assistant Governor of the Central Bank of Malaysia (Bank Negara Malaysia), at the 22nd Islamic Financial Stability Forum, Kuala Lumpur, 27 May 2024.

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It is my pleasure to welcome everyone to the 22nd Islamic Financial Stability Forum, held in conjunction with the Global Forum on Islamic Economics and Finance (GFIEF). I hope the discourses happening at GFIEF this week can serve as an action-oriented platform to build stronger cooperation towards shaping a better future. One in which, Islamic economics and finance play a greater role in promoting inclusive growth, resilience and shared prosperity.

The theme of today's forum, "Resilience and Stability of the Islamic Financial Services Industry in an Evolving Risk Environment," is indeed poignant in guiding our journey forward amidst shifts in the operating landscape.

### **Current global risk landscape poses challenges and opportunities in Islamic finance**

The complexities of the financial world are ever-increasing. It becomes more evident that traditional risk paradigms are being challenged by a multitude of factors. Ranging from geopolitical tensions to elevated inflation, moderating global trade, as well as technological disruptions and climate change. Against this backdrop, we witness a growing expectation for the financial sector not only to maintain its resilience but to also assume a greater role in supporting sustainable economic transformation. This expectation arises from the pressing need to drive necessary changes at the scale and the speed needed to achieve the Sustainable Development Goals (SDGs). The UN Conference on Trade and Development and the IMF estimate that a significant funding gap of approximately USD 4.3 trillion in global annual investments is needed to make strides in the SDGs. While this may appear as a staggering figure, this is equivalent to only around 1% of the USD379 trillion of the total financial assets held by banks, institutional investors and asset managers.

The modern financial sector stands at a crossroads of unprecedented challenges and opportunities. Against this backdrop, financial institutions must not only anticipate emerging risks but also adapt swiftly to mitigate these risks. At the same time, there is the expectation to progressively enhance the vibrancy of the finance industry in order to keep meeting the needs of the society and economy.

### **Capitalising on emerging trends for more innovative and impactful solutions**

In Islamic finance, financial transactions are grounded in the core principles of Shariah, which strive towards *ihsan*, or 'the pursuit of excellence', by upholding the highest standard across all aspects of business. This entails conducting operations with

fairness and transparency, maintaining robust Shariah governance, and embracing equitable practices such as risk-sharing. Embedding the value of 'inclusive and efficient distribution of wealth' as a central business objective can profoundly motivate Islamic financial institutions to actively recalibrate their efforts, fostering more equitable allocation of financial resources for productive and sustainable endeavours.

The space for innovation in Islamic finance is vast, and I believe many in this room would agree that Islamic finance has not yet been fully leveraged as a transformative tool to address global financial needs. The challenges presented can serve as a catalyst for Islamic financial institutions to provide alternative solutions to debt-based instruments. With a diversity of Shariah contracts and instruments at our disposal, tailored solutions can be crafted to cater to varying needs of different societal segments and nature related projects. Islamic finance offers the unique capability to "blend finance", amalgamating different capital forms like philanthropic and risk capital, thereby broadening its intermediation function beyond mere credit provisioning and risk transfer. In addition, waqf structure can also be harnessed to fund large-scale social projects, showcasing the potential for impactful financing within Islamic finance.

Technological advancements will be another dimension that can unlock the distinctiveness of Islamic finance, thereby creating unique value propositions to financial consumers. Leveraging on blockchain technology that can enhance transparency and security in financial transaction, the use of smart contracts can automate Shariah-compliant agreements and ensure compliance with Islamic principles while reducing transaction costs and settlement times. These developments necessitate regulators, with the support of IFSB, to adopt an agile and forward-thinking approach to ensure that the existing regulatory framework strikes the right balance between managing potential risks and facilitating developmental initiatives.

## **Importance of robust ecosystem to withstand challenges and advance innovation**

Ladies and gentlemen,  
Drawing from Malaysia's experience, we recognise the importance of establishing a robust ecosystem to support Islamic financial business and operations. This entails developing a comprehensive legal and regulatory framework alongside relevant market instruments and infrastructures to ensure the well-functioning of Islamic financial sector amidst dynamic market conditions. Adopting globally recognised prudential standards, such as standards issued by the Islamic Financial Services Board (IFSB), enhances investor confidence and futureproofs the Islamic financial system by fostering effective risk management practices within Islamic financial institutions. Malaysia has fully adopted IFSB standards and remains committed to advancing their implementation by actively engaging with the IFSB and sharing our expertise in Islamic finance to enhance regulatory capabilities of other jurisdictions. Continuously strengthening our prudential regulations, we recently finalised the policy on capital requirements concerning operational risk and exposure to central counterparties, and we are currently finalising the capital requirements for credit risk. These capital and liquidity measures – which are part of the Basel III reform package – aim to fortify the financial system against unforeseen shocks by establishing buffers during periods of stability. We are also engaging industry players for feedback on the new risk-based capital framework for takaful (RBCT) to ensure its effectiveness in addressing both existing and emerging

risks in the financial landscape. However, Islamic finance should look beyond the prevailing standards. It is crucial to ensure that prudential standards and regulatory frameworks are pragmatic enough to support the intermediation function beyond credit provisioning. This enables Islamic financial institutions to leverage the diverse Shariah contracts effectively within a conducive regulatory environment. In line with this, we are also currently reviewing our Shariah Contracts Standards to streamline the regulatory framework and foster industry innovation.

Our efforts are concentrated not only on regulatory clarity but also on equipping the Islamic financial system and markets with diverse market instruments and a comprehensive infrastructure. In pursuit of this objective, recently we issued an Exposure Draft (ED) on Islamic Collateralised Funding, aiming to enhance transparency for market participants and further refine Islamic repo activities. Additionally, our Shariah Advisory Council (SAC) has issued a ruling on the permissibility of anticipatory hedging, empowering Islamic banks to engage dynamically in Islamic Profit Rate Swaps (IPRS) and Islamic Cross Currency Swaps (ICCS) without prior underlying exposure, albeit subject to specified conditions. Also, we witnessed the inaugural issuance of Islamic repo via Bank Negara Malaysia's FAST, or Fully Automated System for Issuing /Tendering in November last year.

Ladies and gentlemen,

Islamic finance has proven its resilience and sustained its performance despite the challenges it has encountered. As of 2022, global Islamic finance assets are estimated at USD4.5 trillion, reflecting the industry's significant growth, with approximately 60 countries now having Islamic finance regulations in place. As leaders in the Islamic finance sector, it is incumbent upon us to collectively showcase the industry's impact and uphold the intrinsic values of Shariah, which advocate for equitable distribution of wealth and the practice of ihsan or doing good in the best possible manner. This is in line with aspiration of Quranic verse 77 of Surah Al-Qasas, Allah s.w.t mentioned "Strive for the Hereafter using the blessings Allah has granted you but remember to also enjoy the blessings of this world. Do good deeds just as Allah has bestowed goodness upon you. Avoid committing misdeeds on the earth, as Allah dislikes those who do so". It is crucial for all of us-whether as regulators, industry players, or consumers of financial solutions-to embody these principles and lead by example.

On this note, I wish you all a productive discourse ahead. To our international delegates, I hope you enjoy your stay in Kuala Lumpur.

Thank you.