



Maintaining Financial Soundness of Institutions offering Islamic financial services: Role of the IFSB

**High-Level Conference on Financial Stability
Kuala Lumpur | 24 November 2009**

Professor Rifaat Ahmed Abdel Karim
Secretary-General

ISLAMIC FINANCIAL SERVICES BOARD



OUTLINES

This presentation aims to provide an overview of:

- What is the current legal and regulatory environment for institutions offering Islamic financial services (IFS);
- How do these factors affect the resilience and stability of the Islamic financial system; and
- The role of the Islamic Financial Services Board (IFSB) in promoting the soundness and stability of the Islamic financial services industry (IFSI).



CURRENT LEGAL AND REGULATORY ENVIRONMENT FOR IIFS

About **30** countries, e.g. Iran, Kuwait, Malaysia, Sudan, Turkey, UAE, Yemen have enacted **specific laws and regulations** for the establishment of IIFS.



In most other countries, IIFS are established by the **same laws of conventional banks.**

- Regardless of whether or not a country introduces a specific framework for Islamic finance or not, what matters is whether that framework accommodates the *specificities* of Islamic finance. Otherwise, this could result in a **lack of level playing field** that penalises IIFS and the IFSI. For example, in most jurisdictions, the same insolvency, trust and securities laws, or restrictions on property ownership that govern conventional banks are equally imposed on IIFS, despite the latter having a business model that requires different treatments on these issues.
- It is uncertain how the courts will address compliance with Shari'ah rules that govern the contracts of IIFS.



CURRENT LEGAL AND REGULATORY ENVIRONMENT FOR IIFS

- Furthermore, since the distinctive characteristics of *Sharī'ah*-compliant financial transactions raise a number of issues related to the risks borne by the IIFS, failure to adequately recognise and manage these risks, could impose systemic risk to the entire financial system and jeopardise the **stability and soundness** of the industry.
- Hence, the need to develop **uniform prudential and best practices standards** that are tailored to the specific characteristics of these institutions is vital.





RESILIENCE AND STABILITY OF THE IFSI

- Several independent reports indicate the relative resilience of the IFSI compared with their conventional counterpart at least throughout 2008. Several *Shari'ah* compliant stock indices have also recorded lesser losses compared to the main indices during the stock market crashes.
- However, the **IFSI is not totally insulated from the crisis**. It could face challenging and uncertain prospect in the near future, due to a number of reasons:
 - (i) Islamic finance in many jurisdictions is concentrated in certain economic sectors, e.g. real sector. Adverse developments in these sectors would adversely affect the business activities and performance of IIFS.
 - (ii) Some IIFS, perhaps due to enthusiasm to pursue aggressive expansions, particularly during economic “booms”, may have **neglected fundamental and sound risk management standards**.
 - (iii) IIFS may, out of immense competitive and economic pressures, **violate their fiduciary responsibilities** towards investment account holders in their business operations and conduct, resulting in financial losses and triggering confidence crisis and systemic risks in the Islamic financial system.





RESILIENCE AND STABILITY OF THE IFSI

SIX KEY BUILDING BLOCKS:

- Effective implementation and enforcement of a set of robust and consistently applied **prudential standards for risk management and supervision** which take into account all the specificities of the IIFS.
- Robust **systemic liquidity infrastructure** which encompasses the monetary policy and exchange operations, payment and settlement systems and the microstructure of money, exchange and securities markets.
- Strengthening of the **financial safety net mechanisms**, namely liquidity risk management of IIFS, emergency financing arrangements, deposit protection and insurance, as well as lender of last resort (LOLR) facility.
- Development of a **reliable crisis management and resolution framework**, which includes (in addition to financial safety nets), bank insolvency laws and the arrangements for dealing with non-performing assets, asset recovery and bank restructuring.
- **Closer cooperation** among policymakers and financial supervisors.
- **Macro-prudential** surveillance and financial stability analysis.





ROLE OF THE IFSB: ITS MANDATES

1. To promote the development of a prudent and transparent IFSI through introducing new, or adapting existing, international standards consistent with *Shari'ah* principles, and recommending these for adoption.
2. To provide guidance on the effective supervision and regulation of IIFS and to develop for the IFS industry the criteria for identifying, measuring, managing and disclosing risks, taking into account international standards for valuation, income and expense calculation, and disclosure.
3. To liaise and cooperate with relevant organisations currently setting standards for the stability and the soundness of the international monetary and financial systems and those of the member countries.
4. To enhance and coordinate initiatives to develop instruments and procedures for efficient operations and risk management.
5. To encourage cooperation amongst member countries in developing the IFSI.
6. To facilitate training and personnel development in skills in areas relevant to the effective regulation of the IFS industry and related markets.
7. To undertake research into, and publish studies and surveys on, the IFS industry.
8. To establish a database of Islamic banks, financial institutions and industry experts.





THE IFSB'S MAIN CONTRIBUTIONS

- Provides a platform for stakeholders of the IFSI - supervisors and regulators, market players and other international bodies - to embark on **collective and systematic efforts** to develop a supervisory and prudential infrastructure for this industry.
- Support the **transfiguration of the industry** from one that is regulated on a narrow/niche approach to a broad/comprehensive approach, thereby facilitating its integration into the mainstream of global financial system.
- **Complement** and **address the gaps** in the existing international prudential framework established by other international standard-setting bodies such as the Basel Committee, the IOSCO and the IAIS by issuing standards that address the specificities of the IIFS.
- Disseminate **better awareness and understanding** of the risks relating to Islamic finance amongst authorities who allow or intend to introduce Islamic financial services in their jurisdictions.





BRIEF INFO ABOUT THE IFSB

- Established on 3 November 2002 by 9 founding members.
- Is an umbrella body in the IFSI with the broadest stakeholders representations (193 members, including 49 regulatory and supervisory authorities as well as the International Monetary Fund, World Bank, Bank for International Settlements, Islamic Development Bank, Asian Development Bank and the Islamic Corporation for the Development of Private Sector, Saudi Arabia, and 145 market players and professional firms operating in 39 jurisdictions).
- Malaysia, the host country of the IFSB, has enacted a law known as the Islamic Financial Services Board Act 2002, which gives the IFSB the immunities and privileges that are usually granted to international organisations and diplomatic missions.

Standards and Guidelines issued by the IFSB:

- IFSB-1: Risk Management
- IFSB-2: Capital Adequacy
- IFSB-3: Corporate Governance
- IFSB-4: Transparency and Market Discipline
- IFSB-5: Supervisory Review Process
- IFSB-6: Governance for Islamic Collective Investment Schemes
- IFSB-7: Special Issues in Capital Adequacy
- IFSB-8: Governance for *Takāful* Operations
- IFSB-9: Conduct of Business
- IFSB-10: *Sharī'ah* Governance
- GN-1: Recognition of Ratings on *Sharī'ah*-Compliant Financial Instruments
- TN-1: Development of Islamic Money Markets

Other documents :

- 10-Year Framework & Strategies for the IFSI
- Compilation Guides on Prudential and Structural IF Indicators
- Issues Paper on Regulations of *Takāful*



**THANK YOU FOR
YOUR ATTENTION**

URL: www.ifs.org