Islamic Financial Stability Forum Speech

Thank you all for joining me here in the Islamic Financial Stability Forum (IFSF). This forum was established with the aim of achieving financial stability among the regulators of the Islamic financial system who are addressing the new challenges that have emerged.

To repeat a history lesson, the depth and severity of the financial crisis of 2008 and 2009 was amplified by weaknesses in the financial sector which led to excessive risk-taking and inadequate capital. Therefore, financial reform has been a core dimension of global policy response after the financial crisis.

What has been this reform? The G-20 as a platform for international economic cooperation is a remarkable development following the financial crisis. Inclusion of many emerging economies in the global financial authorities that play a vital role in financial regulation has been a significant display of international cooperation.

For example, in March 2009, the Basel Committee for Banking Supervision expanded from 13 to 27 countries including several emerging economies and the committee on the Global Financial System in Basel expanded from 13 to 22 countries including Brazil, China, Hong Kong, India, Mexico, Singapore and South Korea.

The global financial crisis provided significant scope to restructure the standards and regulations for the global financial system in view of minimizing risk issues related to global capital and liquidity rules. In December 2010, the BCBS released Basel III proposals enhancing the regulatory framework adopted by Basel II and Basel 2.5 in the capital and liquidity requirement for the banking institutions.

Basel III is aimed at improving the quality and quantity of capital with ultimate objective to improve loss-absorption capacity as well as to provide countercyclical mechanisms. Along with this, Basel introduced two internationally harmonised global liquidity standards – Liquidity Coverage Ratio and Net Stable Funding Ratio. Starting from the requirement of 60 percent LCR in 2015 and increasing incrementally 10 percent each year for maintaining 100 percent LCR are to be implemented at the start of 2019. The challenge, and the progress towards this will require plenty of hard work, but is necessary.

Lessons for Islamic Financial Services Industry

Resilience of the Islamic financial services industry after the financial crisis indicates its intrinsic strength because of its close link of financial transaction with underlying productive activities. However, it was not immune to second round shocks of the crisis, which impacted into the real sector economy.

Despite uncertainty and challenges posed by the recent financial crisis, Islamic finance experienced vibrant growth with assets estimated to have reached USD 1.6 trillion at the end of 2012. Though not completely insulated from the crisis due to global interlinkages of economic transactions, there may be a lesson that Islamic finance can offer an effective and sustained system for the economy.

Another issue is that innovation of Islamic finance must be compliant with Islamic *Sharī`ah*, where the main concern is to protect people from any speculation of products, and hence, maintain its basis as ethical form of finance.

Another equally important issue is that Islamic finance has a unique risk management mechanism that is embedded in partnership contracts bringing the capital requirement of Islamic financial institutions closer to true economic risks.

After the global financial crisis, the international standard-setting bodies, supervisory and regulatory institutions made great efforts to strengthen their standards, regulations and guidelines in different areas. In line with these developments, the IFSB has been introducing prudential standards in the areas of capital adequacy, risk management, stress testing and governance. Let me share with you some of the work that has been accomplished by the IFSB.

Until 2008-09, the IFSB issued more than 10 standards and guidance notes on Islamic finance. The change in regulatory landscape at the global level after the financial crisis led the IFSB to re-align its strategic priorities. After a thorough review of the global developments, the new work plan of the IFSB was prepared in 2012. It envisaged the launch of a second generation of standards.

In March 2012, the IFSB issued IFSB-12: Guiding Principles on liquidity Risk Management to provide a set of principles for robust management of liquidity risks.

To complement the standards of the Basel Committee on sound stress testing issued in May 2009 and August 2010 respectively, the IFSB issued Guiding Principles on Stress Testing in March 2012. The stress testing framework guides Institutions in assessing and capturing vulnerabilities under various stress testing scenarios to analyse the IIFS's ability to meet its capital requirements at all times throughout a reasonably severe economic recession.

Given the specificities of Islamic finance and in response to Basel III, the IFSB issued Exposure Draft-15: Revised Capital Adequacy Standard in November 2012 to provide a more comprehensive guidance to Regulatory Supervisory Authorities and Islamic Institutions offering Financial Services on capital adequacy regulations and macro-prudential tools. The project on Revised Capital Adequacy Standard (IFSB-15) was initiated to adopt amendments made to Basel II after the financial crisis. I am pleased to note that this standard was approved today the IFSB Council earlier today.

For more current work, the IFSB is currently working on Revision of its Supervisory Review Process Standard (ED-16). The exposure draft of this standard was recently issued for public consultation and a public hearing was here in Doha yesterday.

Implementing reforms: The way forward

In line with Basel III proposal, implementation of IFSB Standards and Guiding Principles is an opportunity for institutions to improve their risk management and ultimately economic capital management. However, there are many challenges along the way, as numerous procedures are involved in obtaining the approval of Parliament as well as implementing the standards.

IFSB and its member jurisdictions are continuing to work towards the adoption of global standards for IIFS updating the regulatory framework that fully take into consideration the nature and specificities of Islamic finance.

This forum carries the mandate to promote implementation of these IFSB standards with international dialogue, engagement and cooperation. As such, I hope this forum will carry that mandate strongly.

We are pleased to welcome today Karl Cordewener, the Deputy Secretary General of the Basel Committee who will speak to us on the progress made in the implementation of the new Basel framework. We will also discuss the implications of this framework on Islamic Finance.