

**ADDRESS
BY
HIS ROYAL HIGHNESS SULTAN NAZRIN SHAH
AT THE
OPENING CEREMONY
14TH KUALA LUMPUR ISLAMIC FINANCE FORUM (KLIFF) 2017**

**DATE: 3rd OCTOBER 2017 TIME:10.00AM
VENUE: HOTEL ISTANA, KUALA LUMPUR**

Bismillahirrahmanirrahim,

In the name of Allah, the Most Gracious, the Most Merciful.

Distinguished guests, ladies and gentlemen,

Assalamualaikum warahmatullahi wabarakatuh.

1. I am grateful to Allah the Almighty for this great opportunity to address you at this 14th Kuala Lumpur Islamic Finance Forum or KLIFF. I would like to thank and congratulate the organisers for putting together this event, a prestigious one in the calendar of global Islamic finance conferences. I am very happy with this achievement and I pray to Allah the Almighty that KLIFF will continue to inspire all Islamic finance stakeholders in the years to come.

2. It is an exciting time, if a challenging one, to be in Islamic finance. When the industry started more than 40 years ago, few could have expected that Islamic finance would have come this far and achieved so much. Few would also have imagined that conventional banks and the world's multilateral development banks would embrace this new way of doing finance, including the recent arrival of Islamic fintech and crowd funding. It would seem opportune at this juncture to share some of my thoughts on the current state of affairs and the next tactical moves to ensure that the Islamic financial system continues to be relevant, impactful and self-sustaining into the future.

3. There have been very solid reasons for Islamic finance's upward trajectory. It was not a matter of coincidence or luck. Certainly, the support of brave-heart shareholders at the initial stage of this industry's development and the relentless efforts of regulators have been critical. But important as these have been, I believe that the demand for Islamic finance has been driven by the intrinsic appeal of the *Shariah* features of Islamic financial instruments and products.

4. Collectively, this has enabled the industry to withstand the multitude of challenges it has faced, including slower global economic growth rates and trade flows, the high financial volatility and systemic risks of conventional financing. Islamic finance has fared better than its secular counterpart in terms of growth, albeit from a smaller base. It is imperative

that efforts persist in developing and innovating the Islamic financial system so that it becomes an even more competitive alternative to the mainstream financial system than it already is. Insyallah, one day it may even be the preferred alternative.

5. Of course, with huge ambitions come huge challenges. There is, and can be, no room for complacency. With regard to Islamic banking, such challenges at present include lower oil prices – particularly for countries dependent on oil-revenues – and changes in the global regulatory and supervisory framework. Basel III / IFSB liquidity standards, for example, have constrained Islamic banks the world over. Thus far, capital adequacy ratios of Islamic banks are still above the minimum regulatory requirements and they must remain that way.

6. Global Islamic banking assets today have grown to around USD1.5 trillion. The number of countries in which Islamic banking is present has increased to 18. In 12 of these 18 countries, the Islamic banking system is considered to be of systemic importance. This is very encouraging but still a relatively small number. The opportunity for the industry to further extend its reach to other non-OIC members must be considered to be very good.

7. Further expansion, however, will require investor interest and this, in turn, requires competitive returns on investment. Competitive returns

are something that the Islamic banking industry needs to look into as data indicate that average net profit margins on the whole have declined, although returns on assets and returns on equity have been maintained in the past two years. It would appear that bank management would need to pay more attention to lowering operating cost and improving profitability, while remaining prudent.

8. Islamic banks must be exemplary in their governance and market conduct if they are to be pillars of strength in the financial systems of the respective jurisdictions in which they operate. As Islamic banks strive to grow their assets, finance and deposits, they need to manage the risks associated with non-performing loans. Equally important is the mobilisation of Islamic deposits. It has been observed that in some jurisdictions, much of the Islamic deposits have ended up being invested in government bills and treasury products instead of higher-yielding assets.

9. Islamic banking assets today account for about 80 per cent of the global Islamic financial system, while Islamic capital products make up the balance of 20 per cent. There is a tremendous need to grow the share of capital market products so as to ensure lesser dependence on the banking system and greater financial stability. Wisdom dictates that prudent action be taken before something unfavourable happens rather than after it happens. This means that other asset classes, such as *sukuk*,

mutual and venture capital funds, private equity, insurance and microfinance and crowd funding need to be developed at much faster rates. The mainstays of the Islamic capital market are, of course, the *sukuk* and equity markets, both of which have been experiencing positive growth. Global *sukuk* outstanding today amount to about US\$320 billion. On average, in the past 3 years, about one-fifth of issuances was corporate in nature, while four-fifths have been sovereign or sovereign-related. While the overall *sukuk* market is growing, however, it is the sovereign, government-related and multilateral *sukuk* segment of the market that is expanding. The recent issuance of the Saudi sovereign *sukuk* of USD9 billion – which is the single largest *sukuk* amount thus far – is a shining example in the space of sovereign *sukuk*.

10. The corporate *sukuk* market, in contrast, has been on the downtrend for the past four years. This is something that needs to be addressed and reversed. *Sukuk* issuances are often perceived as costly, time consuming and complex. Some argue that this deters many corporate players from issuing *sukuk*, although it may well be just unfamiliarity with the products. There needs to be more concerted efforts to promote and educate corporates so that they are more willing to integrate *sukuk* into their corporate finance plans. Those involved in Islamic capital products also need to closely collaborate if the corporate *sukuk* market is to register an uptrend.

11. While the overall *sukuk* market has posted growth, Islamic equities and funds are not doing as well. We have all heard the success stories of how Islamic equity indices have outperformed conventional indices. What is less known is that the number of Islamic funds and the size of Islamic funds' assets have been decreasing. Of the 1,100 plus Islamic funds in existence, slightly less than three-quarters have an average of just US\$25 million Assets Under Management. This is a far cry from the average US\$395 million mobilised by conventional funds in the global arena. To make matters worse, around one-third of the 1,000 plus Islamic funds have been classified as inactive.

12. The *takaful* industry is the only one to sustain double-digit growth, although this is also due to its small base of *takaful* contributions. With 305 *takaful* and *retakaful* operators and windows, the total *takaful* assets stand at US\$25 billion or slightly more than 1 per cent of the global Islamic financial system. This is miniscule compared to other segments. Insurance penetration in most OIC countries, however, is still quite low and the huge untapped market means that *takaful* companies should ramp-up their efficiency and effectiveness in providing innovative products and services to their potential customers.

13. In summary, there are at least six challenges that the Islamic finance industry faces. First, the Islamic banking industry needs to improve profitability and attract more investment as it ventures into new markets.

Second, the industry needs to maintain high standards of loan quality and corporate governance. Third, Islamic capital markets need to grow at a faster pace so that there is not an undue reliance on Islamic banking alone. Fourth, the negative trends of corporate issuances of sukuk need to be reversed. Fifth, the Islamic equity market also needs to be more comprehensively developed and sixth, takaful insurance needs to be grown to exploit the huge opportunities that are available.

14. We need to work assiduously to strengthen the weaknesses while continuing to expand, innovate and progress in every sense of the word. Islamic finance needs to be able to connect with the fast changing nature of global finance, while remaining absolutely uncompromising in terms of faithfulness to Shariah principles and ethics. It is imperative that we be driven by a vital and energising vision of Islamic finance and our roles in it. Ours is, after all, more than a profession; it is a calling.

15. Each of us believes that Islamic finance is not only a matter of our faith but also offers an alternative solution to the world at large. As you are all practitioners in the field, I do not have to belabour the many ways that Islamic finance differs from conventional finance. What I want to emphasise, however, is that we need to constantly remind ourselves that because Islamic finance must deal with commodities – both soft and hard - or services or investment activity, it delivers ‘real value for the real economy and is of benefit to real people’. Others may have deviated from

the objective of doing good but we in the Islamic finance community must not be similarly swayed.

16. Obviously, while Shariah principles are immutable, we cannot afford to be locked-in to fixed and traditional solutions. I cannot emphasise enough on the importance of being flexible and tactical, as well as smarter in this world, which is full of distractions and competition. There is a need to recognise the increasing complexity and sophistication of economic transactions and to creatively respond to these developments with solutions that are as, if not more, effective and equitable, while offering certainty and predictability.

17. The world today is entering the Fourth Industrial Revolution, one where not only are individual technologies developing at rapid rates but also reinforcing one another and converging. The requirements to participate in the 4 IR world are immense and so too are the financing requirements. Islamic finance cannot be left out of new forms of technology financing and, indeed, may be said to be ideally suited given our established participatory profit-and-loss sharing financing schemes. Crowd funding, for example, is a prime example.

18. Islamic fintech must rise to the occasion. The one-shoe-fits-all approach to financing must be eventually discarded in favour of more tailored or structured financial solutions. With the vast amounts of big data

being generated, this is now possible, provided that Islamic finance institutions can manage, analyse and customise products for corporations and individuals alike. Regulatory authorities need to catch the vision and facilitate developments.

19. This is what I see to be the central challenge and opportunity going forward. If we are able to do so and can educate the world at large, I believe that we will not only impress but be facilitating sound, value-driven economic growth. Our mission and vision must be marked with ever higher standards and benchmarks of performance and professionalism.

20. On this note, I would like to encourage the best minds in Islamic finance, many of whom are gathered here, to envision the role of Islamic finance going forward, taking into account the challenges facing the industry and to crystallise ideas on how to deliver real value for the real economy and benefit real people into actionable blueprints covering all aspects of finance. This would be an outstanding contribution to the Islamic financial system.

Distinguished guests, ladies and gentlemen:

21. I am happy to know that this 14th KLIFF series will embark on discussing a number of themes and issues which are of significant importance to the current state-of-affairs of Islamic finance. I am sure there are many pearls of wisdom to be gleaned from the experiences of participants. Smart, open and, most of all, honest discussion on Islamic finance, as well as a dedicated discussion on the digitalisation of Islamic finance and regulatory enhancement and market stability will reinforce the features of real Islamic finance.

22. If Islamic banking and finance can rediscover its own identity, I would like to believe that this would reinforce the newly launched White Paper by the Central Bank of Malaysia on the theme of Valued-Based Intermediation. Value based-intermediation will definitely open many doors of innovation and differentiation for Islamic finance practitioners, but only for those who are inspired and motivated to change for the better. One must be willing to be shown the way, but more importantly, one must be steadfast in traversing the path.

23. I am also pleased to note that the selected issues for discussion, which are dedicated for the 12th instalment of the *Shariah* Scholars Dialogue or KLIFF Muzakarah include topics, such as ‘the game changer’ in *Shariah* strategies of high impact, the new jurisprudence of conversion and the Islamic response to merger and acquisition. The discussions and dialogues of such far-reaching issues amongst *Shariah* scholars will

benefit not only the industry but also, more importantly, the *Shariah* minds of the *Shariah* advisors who are functioning in this new and fresh set of variables and realities.

24. It is my pleasure to congratulate the organisers for organising a special closed roundtable discussion and workshop on Islamic trade finance, involving relevant experts and intellectuals to make trade financing as close as possible to the practices of Islamic finance. Trade finance is real finance and it should be *prima facie* *Shariah*-compliant, without having many changes to be made. The data, however, shows that the market share of Islamic trade finance across both individual nations and the global space is quite negligible. The question is: how do we address this anomaly? I hope the roundtable workshop could solve this long outstanding mystery and dilemma once and for all. I place high hopes on the success of this workshop and I am personally interested to receive a summary of the discussion later.

25. I hope KLIFF 2017 will benefit everyone. Given the wide array of issues and topics that have been carefully selected, I strongly feel that KLIFF 2017 is a promising event for both intellectual accomplishment and business development. I would like to wish everyone a meaningful and insightful event ahead of you.

26. In the name of Allah Subhanahu Wa Ta'ala, Bismillahirrahmanirrahim, I declare the Kuala Lumpur Islamic Finance Forum 2017 officially open.