SPECIAL ADDRESS

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BY

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"ISLAMIC FINANCE: A SYNTHESIS BETWEEN SHARI`AH PRINCIPLES, LEGAL COMPLIANCE, MARKET NORMS AND MAQASIDIC ATTAINMENT"

بسم الله الرحمن الرحيم

الحمد لله رب العالمين، والصلاة والسلام على رسول الله وعلى آله وصحبه أجمعين

Assalamu Alaikum Warahmatullahi Wabarakatuh and Good Morning

Distinguished Guests, Ladies and Gentlemen:

1. Alhamdulillah, it is indeed an honour for me to be able to address this august audience at the 11th annual Kuala Lumpur Islamic Finance Forum (KLIFF) 2014. KLIFF has indeed made its mark as one of the much-awaited annual events in this region that has attracted speakers and delegates from all-over the world. The discussions in its forums have in the past been lively and intensely participated in by practitioners, regulators, scholars and members of the academia. I pray that

this year's KLIFF will be eventful and insightful in bringing out the many issues and up-dates on local, regional as well as global Islamic finance to the fore, to the benefit of all participants and delegates.

Ladies and Gentlemen, brothers and sisters,

2. Islamic finance has grown in leaps and bounds since its introduction some 3 to 4 decades ago. Now, Islamic finance asset is said to be worth 1.7 trillion US dollars in 2013, with an annual growth rate of 17.6% per annum (Ernst and Young, World Islamic Banking Competitiveness Report 2013-14). Islamic finance market and services have broadened and deepened, at all fronts, be it the Islamic banking sector, takaful or Islamic capital market; both in terms of volume and market participants.

3. Yet, with honest reflection and self-introspection, to some extent, the success of Islamic finance may be said to be bittersweet. On the one hand, its growth and development are awesome and perhaps hypnotizing; yet on the other, we hear or read strong criticisms and skepticism against Islamic finance, where some people are just not convinced or worse still become sort of disillusioned by Islamic finance and what it entails.

The critiques

4. It may be tempting and perhaps natural for us to be defensive towards the criticisms and skepticisms. Many of us tried to defend Islamic finance, sometimes aggressively. We make excuses: we are still a young industry; we are not operating in a vacuum, thus, need to comply with the legal dictates and socio-economic norms and idiosyncrasies; the people are not ready, be they the market players or their consumers, or even the regulators; more education is needed; the ecosystem necessary for a full blown Islamic finance is not yet there, we are still struggling

within a conventional and capitalistic ecosystem – these are some of the excuses that we offer to defend ourselves against those critics and skeptics.

5. Yes, to some extent these excuses are admittedly valid and true. There are indeed real problems and obstacles faced by the Islamic finance industry. But, is it enough for us to just offer excuses, be complacent and then let the market take its normal course? Or should we face the criticisms and skepticisms head-on, do an honest soul-searching, and try to amend some of the ways we do Islamic finance, remove some of the obstacles and do what we ought to do though perhaps that will mean going against the market norms? Shouldn't we try harder and think outside the box and improve towards achieving the ideal, rather than merely letting ourselves being swayed and dictated by the circumstances?

Ladies and Gentlemen, brothers and sisters,

6. Let us look at the main criticisms that are commonly leveled against Islamic finance. In brief, they are:
    - Islamic finance is just a change in name!
    - Islamic finance is a mere replicate of conventional finance
    - Is Islamic finance genuine? In short, the issue of form over substance
    - Islamic finance may be Shari`ah compliant, but it is not necessarily Shari`ah based
    - Islamic finance fails to attain the maqasid al-Shari`ah

7. Admittedly, most of the criticisms and skepticisms stem from the general impression that there is no real and observable difference between Islamic financial services and conventional practices and services. This lead to the allegation that we are just replicating conventional finance.

8. Let us first address the issue of replication. Personally, I feel that replication is perhaps a natural and practical response to kick-start Islamic finance. Most of the financial services needs are common. People need a place to deposit or invest their money; they may need financing to acquire assets and services; corporations need to raise finance to do business or undertake projects; sovereigns need avenues to raise finance to develop their country or build infrastructure. Replication is normally preferred because it can ride on market familiarity to satisfy the demands of the common needs of people.

9. Moreover, at the initial stage of Islamic finance development, the main driving concern is the need to abide to the Shari`ah principles and to have legal compliance because without these two, Islamic finance cannot validly exist. Since these two forms of compliances (Shari`ah and legal) can be achieved without dismantling the whole structural framework of banking and finance, we tend to work within that framework as far as possible. This results in a very micro, contract-driven approach to the issue. Under this approach, a number of contracts that comply with the Shari`ah principles – such as sale, lease, mudarabah, musharakah, wakalah, etc. – are used in many different ways and structures, within what is allowable in the law and regulation, to arrive at economic or commercial behaviours that are similar with conventional products. Though the end product may not be exactly the same like conventional financial products – in term of contract, contractual relationship, and some detail characteristics – the commercial and economic effects are very similar. This results in the lack of overall product differentiation and gives the impression that Islamic banks are "replicating" the conventional products.

10. Moving forward, it is actually better to move away from replication and do more product differentiation. The ability to do product differentiation actually creates competitive edge and niche advantage. In a saturated and competitive market, innovative solutions are good to attract more diversified market followers and consumers. Islamic finance can afford to be more adventurous to innovate and

invent, beyond the conventional box and way of thinking. Perhaps, innovation and invention can be better promoted if we think beyond banking and banks, in the bigger context of the Islamic economic system. By going beyond banks, we can avoid banking stereotypes and can avoid some of the legal and regulatory constraints within that stringently regulated sector, in particular, the capital, governance and risk management framework that are currently based on conventional set-up as per Basel requirements. Even within the banking sector people have started to talk about other different ways of doing banking, such as participatory banking, positive banking, charity-driven finance and others. It is perhaps just a matter of time before these different approaches will be put to practice by the market, at least on a pilot or trial basis.

Ladies and Gentlemen, brothers and sisters,

11. The issue of genuineness of Islamic finance has a direct relation with the issue of replication. When we want to develop an Islamic financial product, we normally start with the end in mind. This "end" is more often than not, reflective of characteristics of a conventional product that we want to replicate. This may include simple products like credit card, personal financing or a mere deposit product such as CASA (current account saving account). Or, it can also be more sophisticated instruments like repo, share lending and borrowing in a regulated short-selling, profit rate swaps, sukuk etc. When we approach product development in this manner, we inadvertently put our selves in a box. We then will think within that box. We use and structure the Islamic contracts in such a way that will meet most, if not all the requirements of the "end product". This practice more often than not, results in superficial and complex transactions that have a synthetic feel.

12. This kind of maneuver always put the Shari`ah boards in a dilemma. In term of contracts and contractual requirements, there may be full compliance. In term of

legal and regulatory requirements, there may also be full compliance. Yet, in term of economic effects and commercial behaviours, it replicates the very conventional product that uses contracts or contains elements that are non-Shari`ah compliant. In this situation, do we judge based on the compliant form, or do we go beyond that?

13. Most of the time, the Shar`iah board will go beyond mere compliance and will seek explanation from the bank on the possible impact of the products, in particular, whether there is potential harm (darar) or unfairness, or whether it will result in *maslahah `ammah* (public good) and attainment of *maqasid al-Shari`ah*. Normally, if the bankers and practitioners can convince the Shari`ah board that there is a public good to be attained, or a valid need to be satisfied, or a hardship to be avoided, a regulatory requirement to be complied with, the need to move the market, or other similar line of arguments, the board will approve the products. Shari`ah boards do not want to prohibit what is permissible in as much as they do not want to permit what is prohibited. At the end of the day, all of us, Shari`ah boards, bankers and practitioners alike, will be accountable before Allah s.w.t. and also, the other stakeholders as well.

14. Yet, in the above situations, even when we decide to approve the so-called "synthetic" products, relying beyond mere Shari`ah and legal compliance, on the maslahah based arguments put forward by the banks, I personally still feel a tinge of doubt. Are we making the right decision? What will be the impact of the decision in the long-term, even when the short-term impact is said to be positive?

Ladies and Gentlemen, brothers and sisters,

15. I do not have an immediate answer to this dilema. Of course as humans, we do not have the ability to see beyond what is apparent and observable. It requires perhaps quantitative and qualitative assessment to measure the long-term impact

of the Islamic financial services, particularly in meeting the maqasid al-Shari`ah. I know some researchers have embarked on the development of maqasid index and the like, but, thus far, no real and impactful outcome can be seen at least at the industry and regulator's level that can influence market behavior and decision making processes.

16. On a positive note, I, for one, am convinced that Islamic finance can positively contribute to the attainment of maqasid, provided that it is practiced and implemented correctly. The correct implementation goes beyond mere Shariah compliance, but involve a conscious decision to align our short and long term objectives with maqasid al-Shari`ah. This in turn, necessitates the understanding and observance of prioritization in the use and distribution of resources, based on the level of needs (daruriyyat, hajiyyat and tahsiniyyat) and in promoting the protection of religion, life, intellect, posterity and wealth of people. The development of measurable maqasid al-Shariah framework applicable to the various segments of Islamic finance is vital to facilitate this exercise. In my view, Islamic finance can achieve its full potential, only if they are implemented and practiced based on this maqasidic alignmet

17. It should be noted that the alignment to maqasid al-Shariah will not be possible without a supportive ecosystem in the bigger socio-economic landscape. This supportive ecosystem need to be developed and shall consist of:
    - Strong legal support: Law, legal services and dispute resolution
    - Friendly political, accounting, tax & risk management regime
    - Strong and effective Shariah framework and governance, including friendly and measurable maqasid al-Shariah framework
    - Strong and competent Human Capital
    - Strong and timely Research & Development function
    - Efficient and cheap Information System & Databases
    - Continuing Education & Training

- Good Promotion & Marketing

Ladies and Gentlemen, brothers and sisters,

18. In conclusion, I would like to share my vision of what can be attained if Islamic finance is successfully implemented with necessary supportive ecosystem and alignment to maqasid al-Shariah. First, Islamic finance will be integrated into the real economy where the growth of Islamic finance will be in tandem with the growth in the real economy. This will spur the development of a full blown Islamic economic system that comprise of:
    - a vibrant private sector (Islamic financial services, Islamic capital market private deals, non-bank institutions,)
    - a responsible and clean public treasury
    - a well developed and effective organization of charity and philantrophy

19. When a full blown Islamic economic system is in place, then we can anticipate the attainment of maqasid al-Shariah as a natural consequence. When the maqsad of wealth protection (hifz al-amwal) is attained, the economy will be more inclusive, resources will not circulate among the wealthy few, there will be optimal distribution, followed by effective redistribution of wealth, there will be fair and just economic atmosphere with healthy competition and minimal monopoly, poverty will be alleviated and people practice responsible use of wealth and resources such that the world will be a better and sustainable place to live and enjoy.

20. This may sound like utopia. But together, we can make it a reality, provided that we are clear of the objective and strategise a work-plan. However long it may take, we will be there, with the grace and help from Allah s.w.t. inshaAllah. As the theme of KLIFF 2014 suggests "Positioning and Repositioning for Sustainable Globalised Market". Islamic finance need to position and reposition itself, in line with the

Shariah principles, legal compliance and maqasid al-Shariah. With this repositioning, Islamic finance can positively contribute towards a just economic system and long-term sustainability in a globalized market.

Wallahu A'lam bi ssawab, wassalamu alaykum warahmatullahi wabarakatuh.