



**Globalisation in Islamic Capital Market Instruments :**

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# **The Role of Islamic Financial Services Board**

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Islamic Financial Services Board





# Agenda

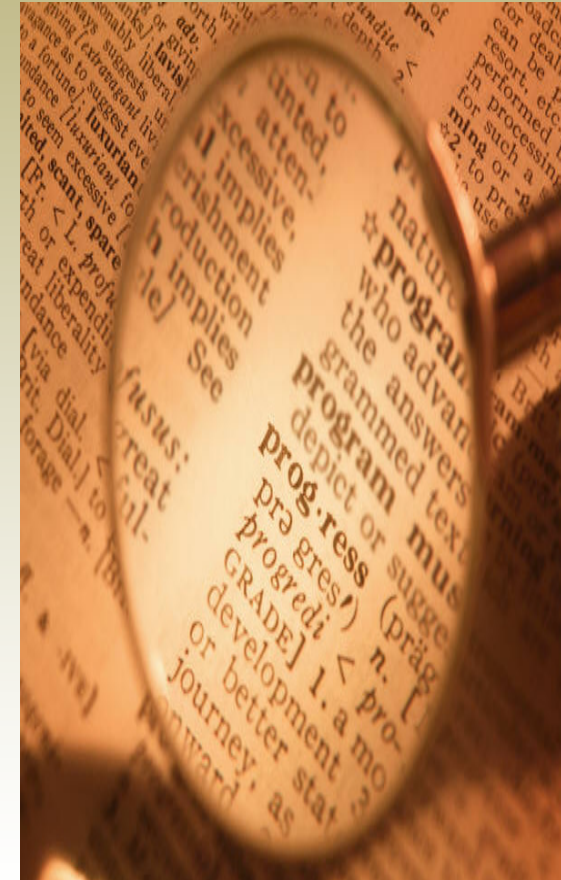
- ❏ The Islamic capital market, concepts, structures and statistics
- ❏ Challenges in globalizing the Islamic capital market instruments
- ❏ Role of the IFSB in the globalization of Islamic capital market instruments





# The Islamic Capital Market (ICM)

- ❑ The Islamic Capital Market refers to a market where the capital market transactions, operations and activities are carried out in ways that do not contravene *Shari`ah* principles and requirements
  
- ❑ Compliance with the *Shari`ah* requirement involves:
  - prohibition of payment/receipt of interest, or *riba*.
  - prohibition of activities with elements of uncertainty, or *gharar*
  - Prohibition of gambling activities, or *maisir*
  - Prohibition of the production and sale of goods and services that are prohibited in Islam
  
- ❑ Structured through underlying contracts of exchange
  - There must be an underlying asset
  - Profit are generated from the performance of the assets



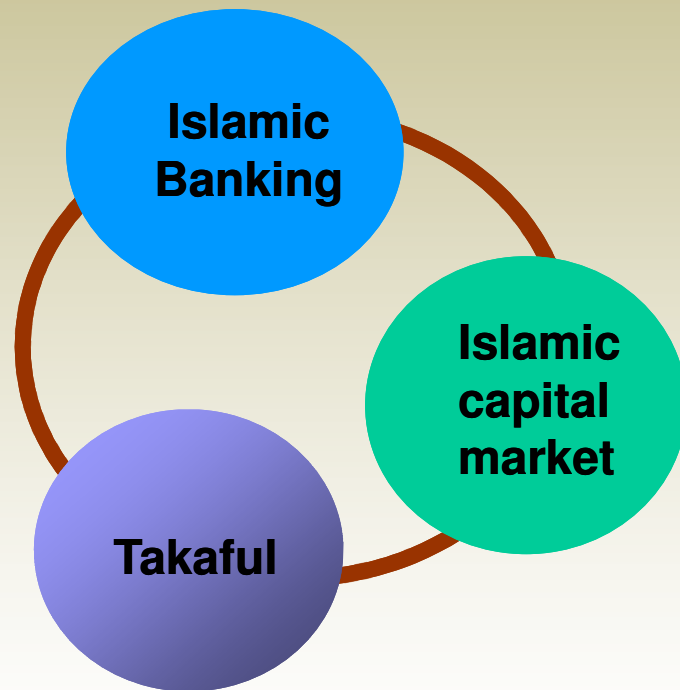


# The Concepts

- ❏ According to their application in Islamic finance, contracts can be divided into:
- ❏ Exchange contracts-for creating financing securities
  - *Murabahah* (based on cost plus concept)
  - *Bai Salam* (based on deferred delivery concept)
  - *Bai Istisna* (based on deferred payment concept)
  - *Ijarah* (based on leasing concept)
  - *Ijarah Thumma Bai* (based on leasing with option to purchase concept)
- ❏ Participating contracts for creating equity securities
  - *Musharakah* (based on profit and loss sharing concept)
  - *Mudharabah* (based on profit sharing and loss bearing concept)
- ❏ Other contracts
  - *Rahn* (based on collateralised financing concept)
  - *Kafalah* (based on guarantee/underwriting concept)
  - *Qard* (based on welfare concept)



# ICM as an integral part of the Islamic financial system



**Islamic capital market** to provide long term fund raising and investment and enhance depth & liquidity of Islamic financial system

## ✚ An efficient conduit for mobilisation of funds

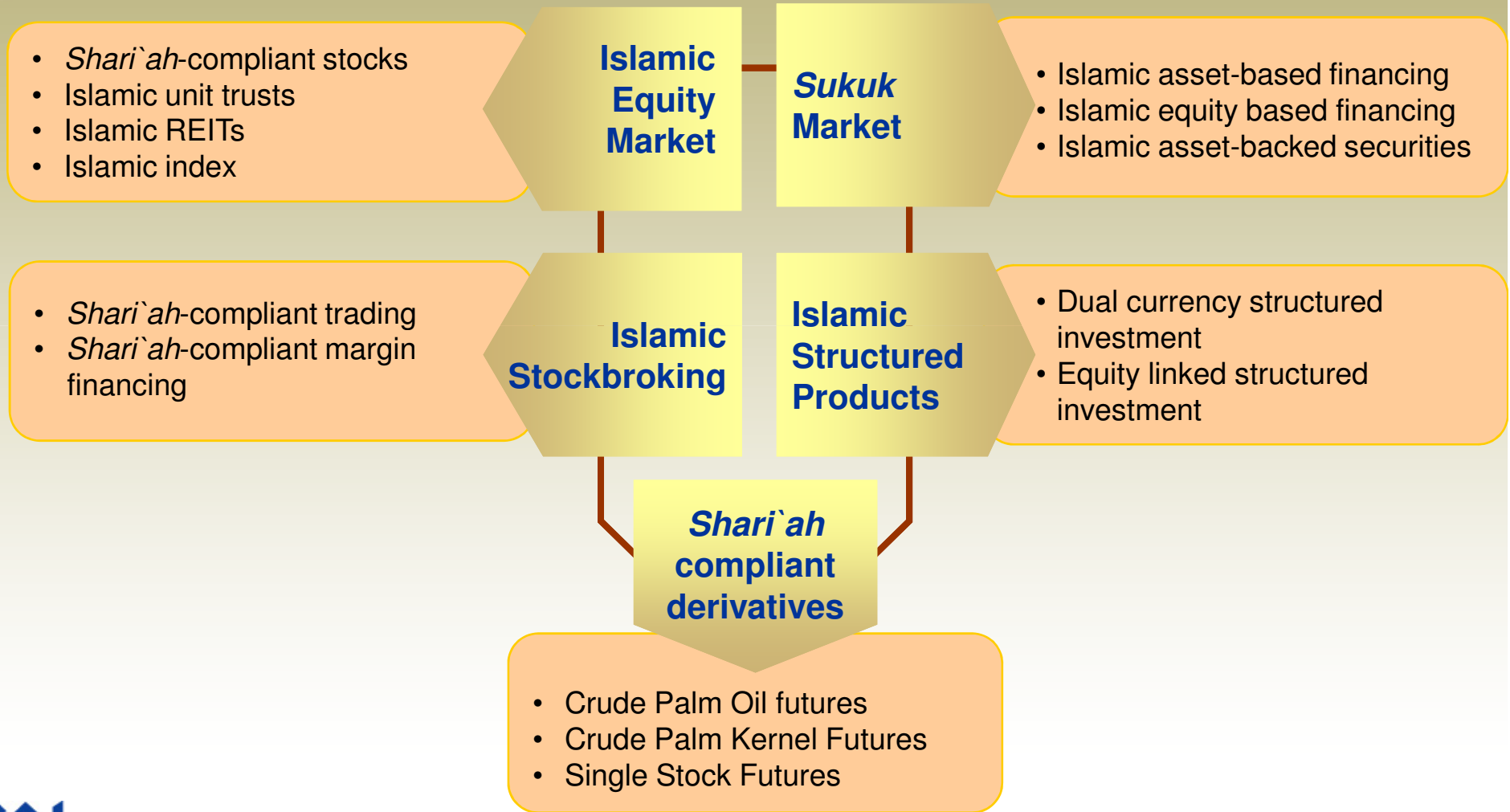
- long term fund raising and investment; enhances depth & resilience of Islamic financial system

## ✚ Gaining momentum as vibrant sector

- Increased preference for Shari'ah compliant products among Muslims
- Emergence of new demand from the Middle East, South-East Asia, South Asia and North Africa
- Conventional investors regard ICM as a new asset class



# ICM Products & Services





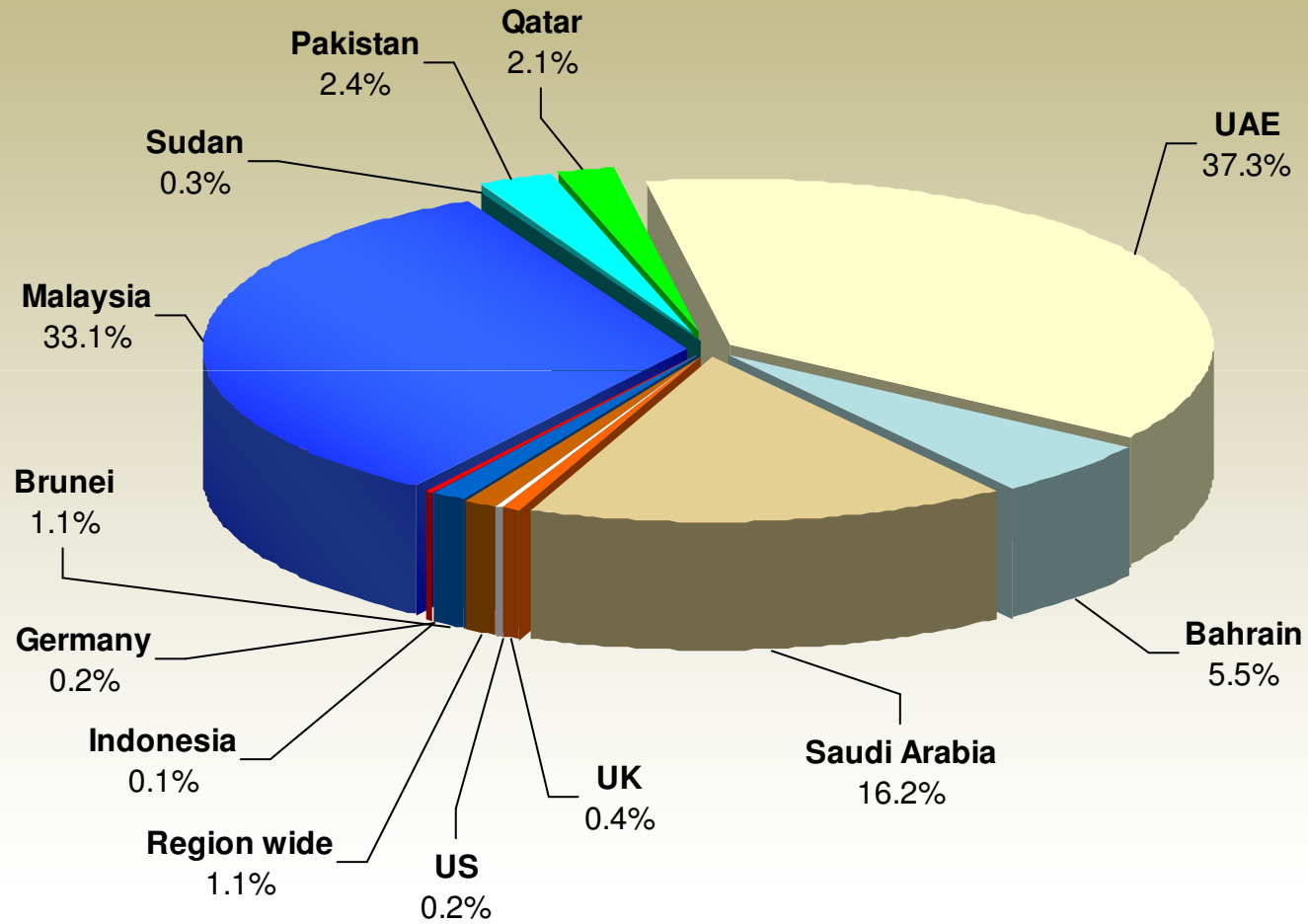
## ICM Statistics

- ❏ More than 300 Islamic financial institutions and 80 *takaful* operators with assets over US\$1 trillion worldwide
- ❏ Increasing in liquidity, particularly from GCC countries due to oil price surge
- ❏ Over 350 *Shari`ah*-compliant funds valued at over US\$300 billion globally
- ❏ Market capitalisation of Dow Jones Islamic Index more than US\$20 trillion
- ❏ Global *sukuk* market valued at more than US\$75 billion

GDF ↓ .15 HJK 1.25 ↑ RTY 1.23 IOP .05 ↑ BNM 12.0 ↑ XCV .20 ↑ QEW ↓ .65



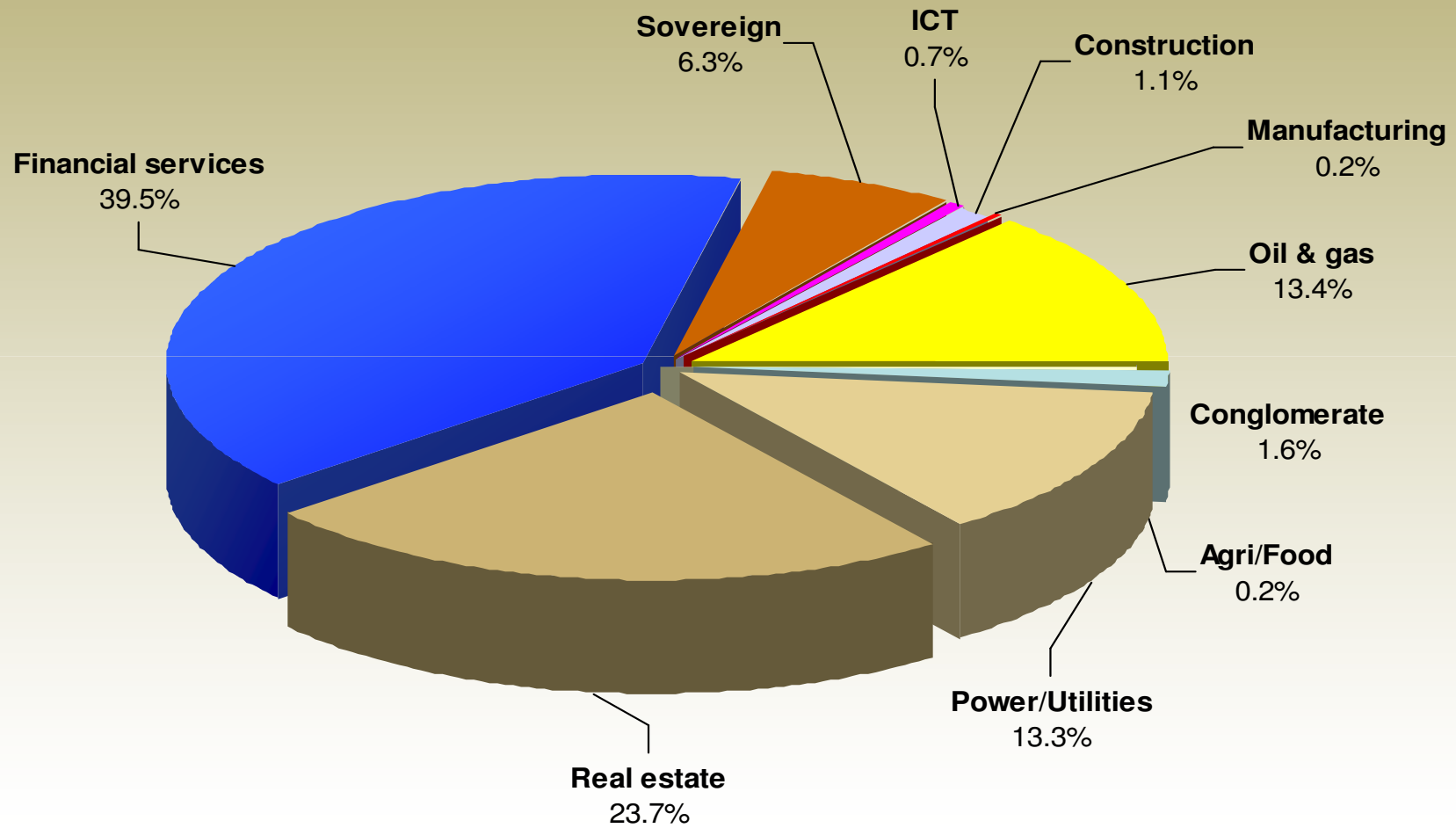
## Sukuk Issuance by Country (2001-2007)





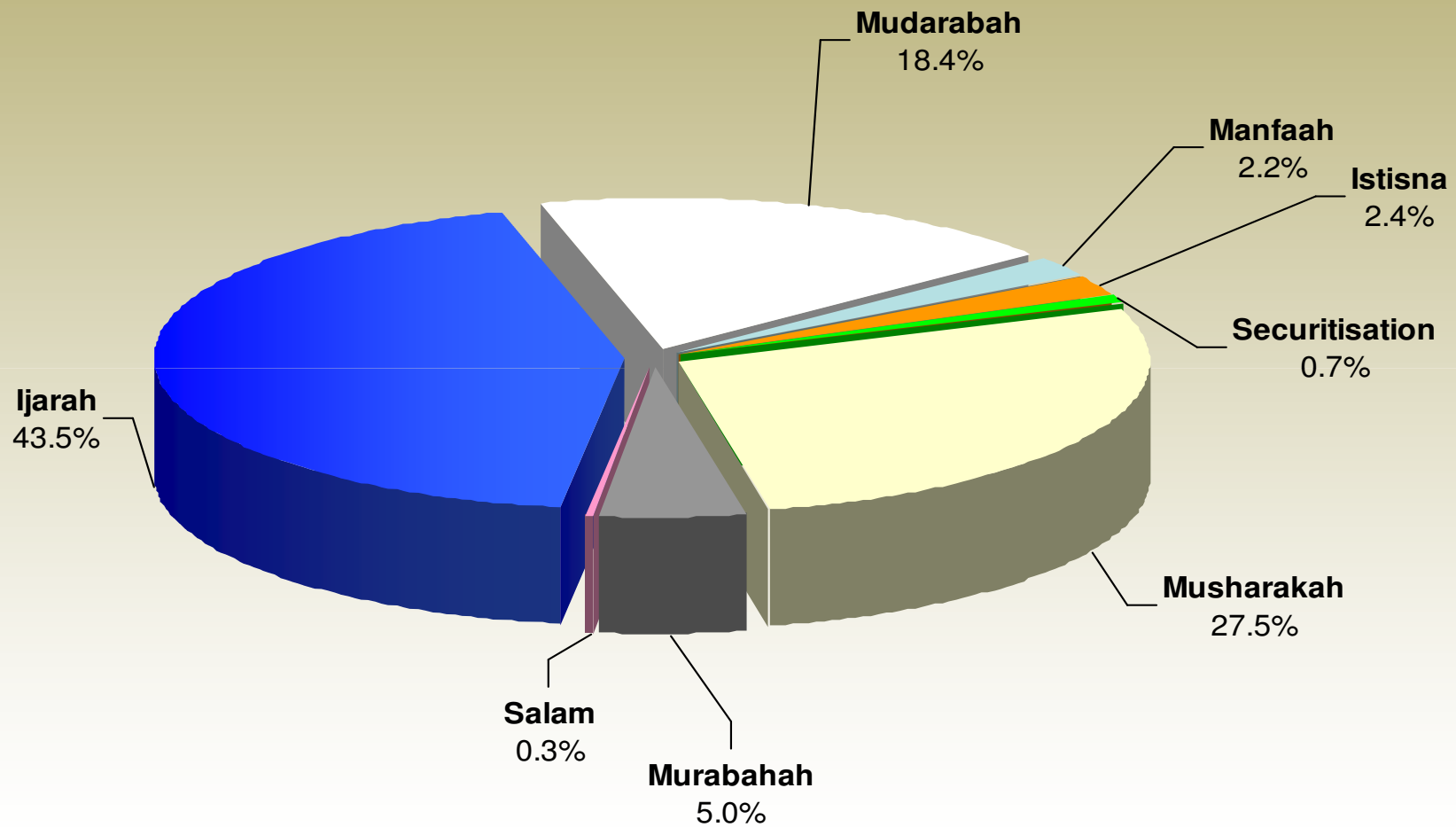


## Sukuk Issuance by Sector (1H08)



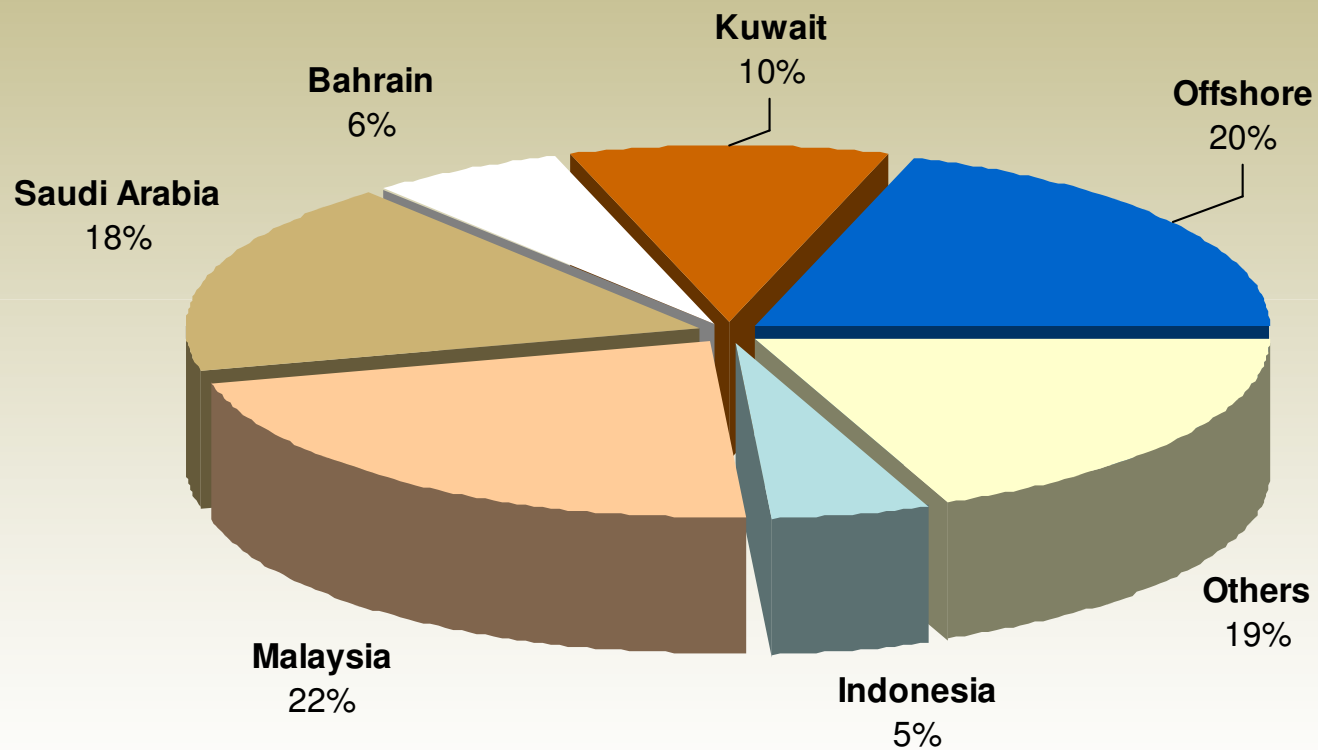


## Types of International *Sukuk* Issued (2001-2007)



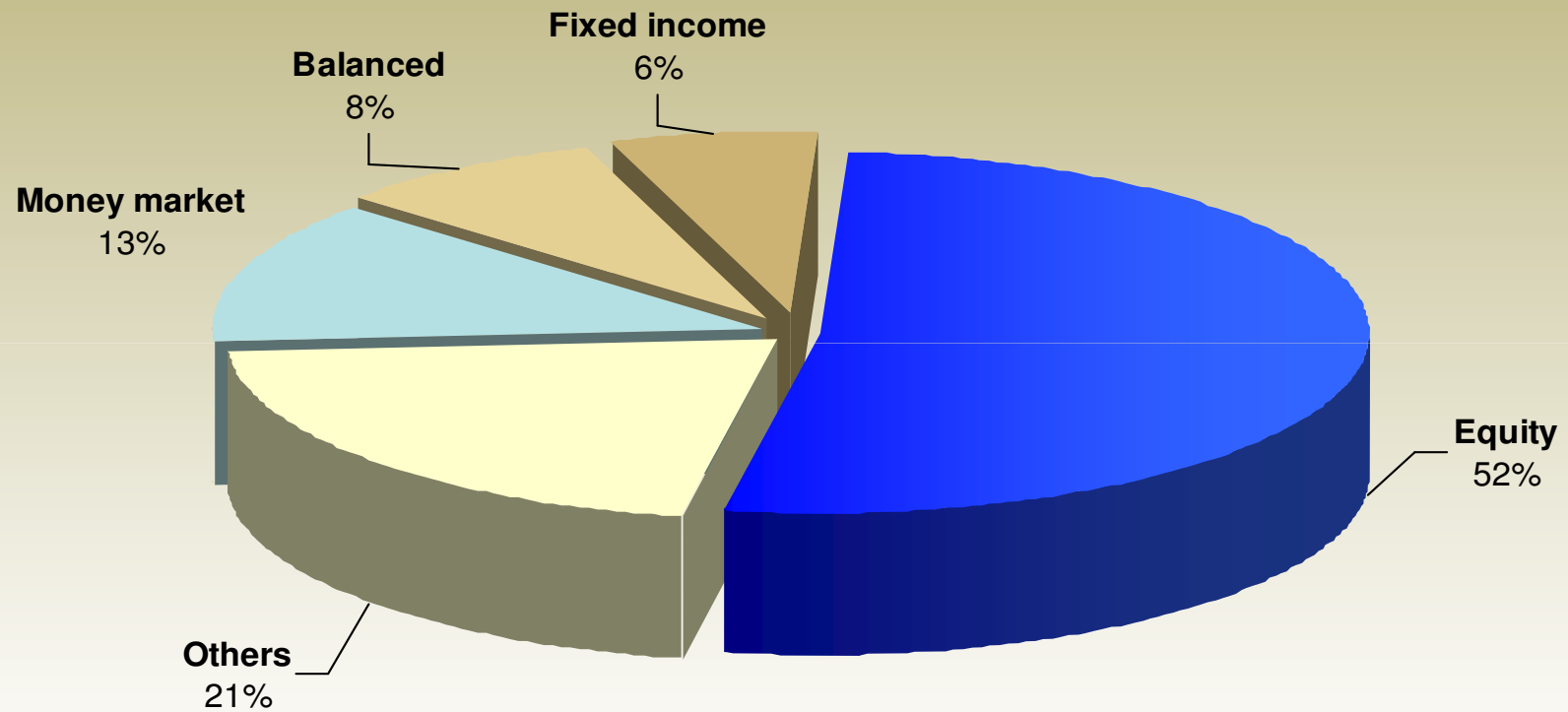


# Islamic Funds by Geographical Distribution (Domicile)





## Islamic Funds by Asset Class Breakdown (2007)





# Present state of Islamic finance

## ☒ Recognised as an integral component of the global financial system

- Operate in a competitive environment – performing relatively better than conventional during the period of turmoil
- Evolve to become an industry beyond domestic borders – encouraging growth in size and scope

## ☒ Diverse Systems and Environment

- To a large extent, institutions are governed by the same regulatory framework applicable to conventional financial system
- Transformation of entire economies
- Selective and non-mandatory compliance with some *Shari`ah* standards

## ☒ Lack of Reliable and Comparable Financial Information

## ☒ Need for Continuous Education



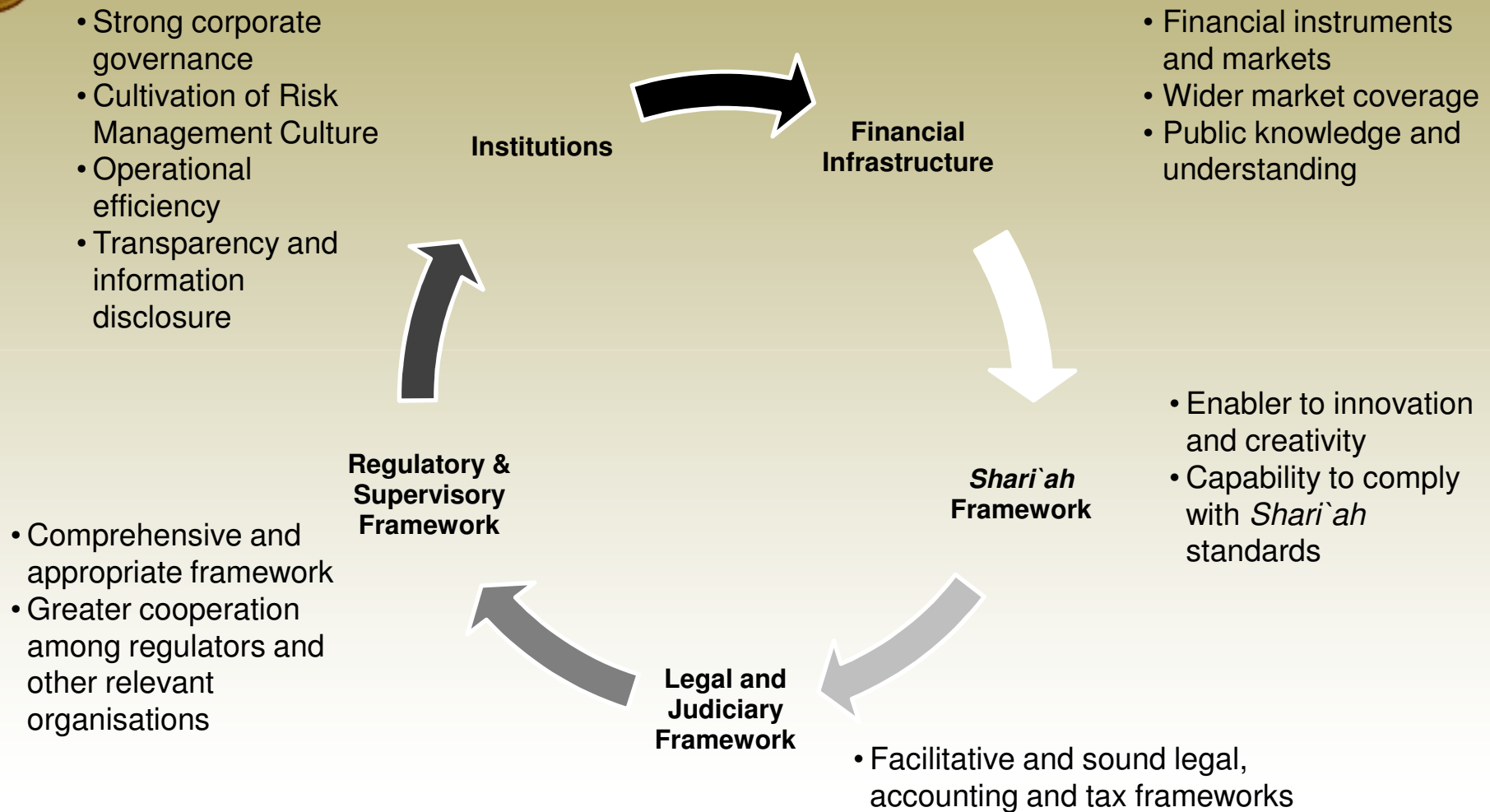
## Significant initiatives

**The same issues in the conventional financial markets that may affect Islamic financial services industry are, among other things, informational asymmetry, moral hazard and regulatory arbitrage.**

- ❏ Development of Supervisory Standard Practices
  - Formation of various institutional supports
  
- ❏ Establishment of Regulatory Framework and Market Infrastructures in Certain Countries
  - Prudential information and regulatory framework for institutions offering Islamic financial services



# Inter-related foundation





## Strengthening the foundation



Establishment of financial instruments	Improve efficiency	Commitment to common goals
Formulation of early warning system	Maintain sustainability and transparency in reporting	Coordinated activities across sector
Formulation of the rules governing conduct of business	Enhance corporate governance	Commitment to implementation
Development of concept on regulation	Ensure <i>Shari`ah</i> compliance and systemic stability	Political acceptance and harmonisation of market practices





## Challenges in globalizing ICM instruments

- ❏ Enhancing Regulatory Framework Reinforced By *Shari`ah* Framework
  - High degree of convergence and harmonisation to create level playing field
  - Mitigate any opportunity for regulatory arbitrage
  - Mitigate risks inherent in Islamic Financial system
  
- ❏ Enhancing *Shari`ah* Framework
  - Unity in diversity
  - In line with initiatives to enhance legal and judicial frameworks
  
- ❏ Enhancing Supervisory Framework for Effective Supervision
  
- ❏ Enhancing Public Confidence Through Transparency and Disclosures



## Maintaining the momentum of globalizing ICM instruments

- ✚ Demystify Islamic financial terms
  - Make them more understandable
  - Further build on the reputation of ethical and socially responsible principles underpinning Islamic products
  
- ✚ Provide more data on Islamic finance
  - Centralise data gathering and dissemination among countries
  - Increased availability of reliable and comparable financial information for effective assessment
  
- ✚ Create innovative products adaptable to rapid changes to market demands in the wake of globalisation, liberalisation and technological advancements
  
- ✚ Initiate greater collaboration in terms of resources and commitment for effective regulatory and supervisory framework



## Maintaining the momentum of globalizing ICM instruments

- Ensure regulatory agenda remains dominated by the following priorities
  - Enhance the awareness and understanding of Islamic products
  - Strengthen internal management and control infrastructure
  - Align with internationally established standards and foster significant improvement over disclosure
  - Employ appropriate assessment of capital adequacy and risk management
  
- Human intellectual capacity building must be accorded with high priority in the development efforts



## Islamic Financial Services Board (IFSB)

- Based in Malaysia, officially inaugurated on 3 November 2002, and started operations on 10 March 2003
- Serves as an international standard-setting body of regulatory and supervisory agencies that have vested interest in ensuring the soundness and stability of the Islamic financial services industry, broadly defined to include banking, capital markets and takaful
- The work of the IFSB complements that of the BCBS, IOSCO and IAIS

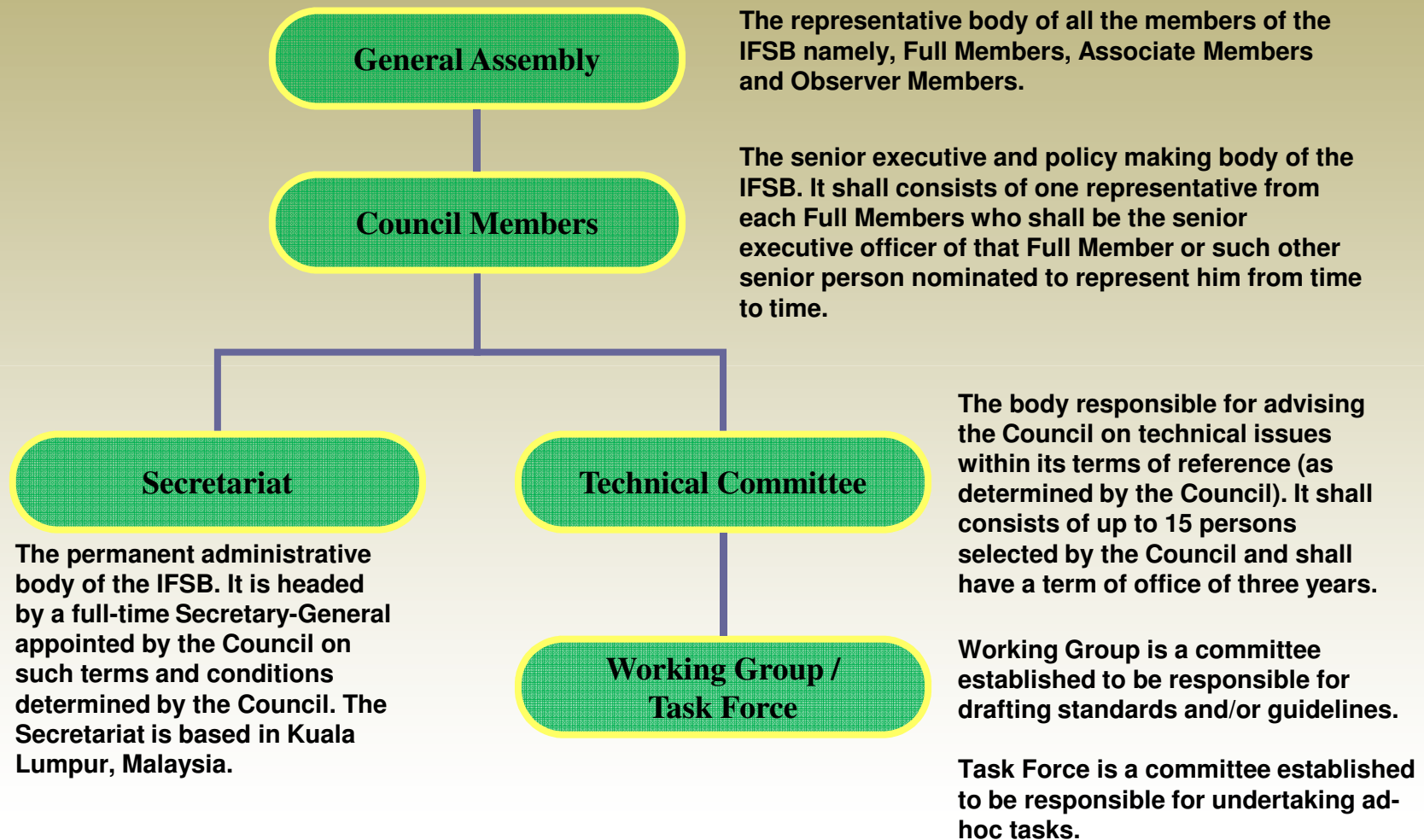


## Objectives

- ❏ Develop standards and recommend its implementation
- ❏ Provide guidance on effective supervision and regulation & develop risk management & disclosure criteria
- ❏ Establish cooperation with other international standard-setting bodies & member countries
- ❏ Enhance and coordinate initiatives to develop instruments and procedures for efficient operation and risk management
- ❏ Encourage cooperation among member countries
- ❏ Facilitate capacity building and development of human capital
- ❏ Undertake research
- ❏ Establish database
- ❏ Miscellaneous objectives agreed by the General Assembly



# Organisational Structure





# Membership

The GENERAL ASSEMBLY is the representative body of all the members of the IFSB namely, Full Members, Associate Members and Observer Members.

175 members from 34 countries

*By membership type*

<b>Full Member</b>	<b>21</b>
<b>Associate Member</b>	<b>21</b>
<b>Observer Member</b>	<b>133</b>

*By organisational demarcation*

<b>Regulatory / supervisory authorities</b>	<b>42</b>
<b>Inter-governmental organisations</b>	<b>6</b>
<b>Financial institutions and professional firms</b>	<b>127</b>

*Membership as at September 2008*



# IFSB activities – Overall overview

## IN NUMBERS

**7**

**PUBLISHED  
STANDARDS**

**2**

**EXPOSURE DRAFTS**

**3**

**INITIAL  
DISCUSSIONS AND  
DRAFTING**

**IFSB-FIS WORKSHOPS**

**SEMINAR, CONFERENCE**

## Standards Development

Since its inception, the IFSB has issued seven standards, guiding principles and technical note for the Islamic financial services industry focusing on Risk Management, Capital Adequacy, Corporate Governance, Supervisory Review Process, Transparency and Market Discipline, Recognition of Ratings on *Shari`ah*-Compliant Financial Instruments as well as the Development of Islamic Money Markets.

The IFSB is also working on new standards and guidelines on

- 1) Special Issues in Capital Adequacy;
- 2) Governance of Investment Funds;
- 3) Corporate Governance in Takaful Operations;
- 4) *Shari`ah* Governance; and
- 5) Conduct of Business.

The standards prepared by the IFSB follow a lengthy due process as outlined in its Guidelines and Procedures for the Preparation of Standards/Guidelines which involve, among others, the issuance of exposure draft and, where necessary, the holding of a public hearing.

## Facilitating the Implementation of IFSB Standards

## Awareness programmes





# Standards Development – Working Group/ Task Force

Working Group is a committee established to be responsible for drafting standards and/or guidelines.

Task Force is a committee established to be responsible for undertaking ad-hoc tasks.

<b>Risk Management</b>	<b>Supervisory Review Process</b>	<b>Conduct of Business</b>
<b>Capital Adequacy</b>	<b>Special Issues in Capital Adequacy</b>	<b>Shari`ah Governance</b>
<b>Corporate Governance</b>	<b>Governance of Investment Funds</b>	<b>Solvency Requirements for Takaful Operations</b>
<b>Transparency &amp; Market Discipline</b>	<b>Governance of Takaful Operations</b>	<b>11 WORKING GROUPS</b>

<b>Money Market</b>
<b>Prudential Statistics</b>
<b>Human Resource</b>
<b>3 TASK FORCES</b>



## Standards Development - Published Document

Documents	Commencement of preparation	Issuance
IFSB-1: Risk management	2003	2005
IFSB-2: Capital Adequacy	2003	2005
IFSB-3: Corporate Governance	2004	2006
IFSB-4: Transparency and Market Discipline	2005	2007
IFSB-5: Supervisory Review Process	2005	2007
Recognition of Ratings by External Credit Assessment Institutions	2006	2008
Development of Islamic Money Markets	2006	2008

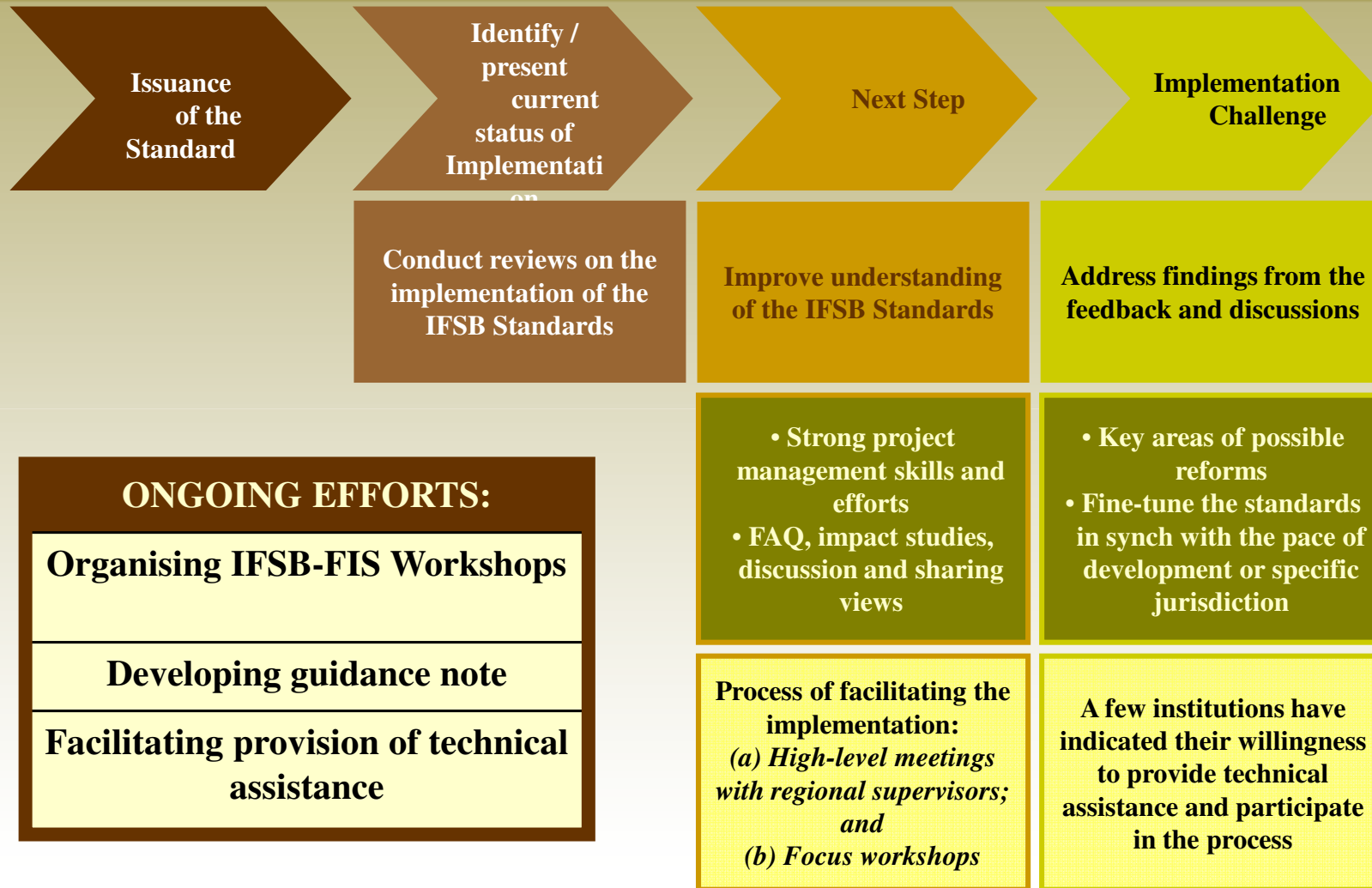


## Standards Development - Work in Progress

Documents	Commencement of preparation	Issuance
Special Issues in Capital Adequacy	2006	2007 (ED)
Governance of Investment Funds	2006	2007 (ED)
Governance of Takaful Operations	2006	2009 (ED)
<i>Sharī`ah</i> Governance	May 2007	2009 (ED)
Conduct of Business	May 2007	2009 (ED)



# Facilitating the implementation of the IFSB standards





# Awareness programmes

The IFSB is actively involved in the promotion of awareness of issues that are relevant or have an impact on the regulation and supervision of the Islamic financial services industry. This mainly takes the form of international conferences, seminars, public lectures, dialogue sessions, forums and meetings staged in many countries.

<b>Summit</b>
<b>Conference</b>
<b>Seminar</b>
<b>Forum</b>
<b>Interactive Session</b>
<b>Public Lecture</b>

<b>Website</b>
<b>www.ifsb.org is the main communication tool for the IFSB to disseminate information to members and stakeholders.</b>

The screenshot shows the IFSB website homepage with the following content:

- Navigation: Home | Contact IFSB | Sitemap | Quiclinks
- Menu: About IFSB, Standards Development, IFSB Membership, Events & Activities, Press Room, FAQs, Terminologies, Contact IFSB
- IFSB Members Zone: Access to members zone & IFSB Papers
- Reaching new heights (Image)
- Enhancing the Resilience and Stability of the Islamic Financial System (Image)
- Latest Press Releases: 27 September 2008, State Bank of Pakistan hosts Islamic Financial Services Awareness Programmes in conjunction with Heftem of the Council of the IFSB; 20 September 2008, International regulators and financial industry players continue to join the membership of the IFSB
- Defining New Standards in Islamic Finance: The Islamic Financial Services Board (IFSB) is an international standard-setting organisation that promotes and enhances the soundness and stability of the Islamic financial services industry by issuing global prudential standards and guiding principles for the industry, broadly defined to include banking, capital markets and insurance sectors. The IFSB also conducts research and coordinates initiatives on industry related issues, as well as organises roundtables, seminars and conferences for regulators and industry stakeholders.
- Standards & Publications: IFSB Published Standards, Exposure Drafts
- Calendar of Events: 20 Oct 2008 | Riyadh, SAUDI ARABIA, IFSB-IFS Workshop Series (Saudi Arabia); Risk Management | Corporate Governance; 27 Oct 2008 | Karachi, PAKISTAN, 3rd International Conference on Islamic Banking and Finance: Risk Management, Regulation and





Thank you for your attention

