

Effect of Global Standards on Islamic Finance

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Presentation Outline

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Global Financial Standards

What are they?

Why are they needed?

Imperative for Islamic Finance Standards

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International Collaboration www.ifsb.org



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GLOBAL FINANCIAL STANDARDS



FEATURES OF GLOBAL FINANCIAL STANDARDS



Global financial standards whether Islamic or conventional refer to core principles, guiding principles, guidance notes, technical notes, and best practices that are:

- **Developed and endorsed** by international organizations, regulatory bodies, and industry associations
- **Recognised and accepted** universally
- **Aimed to promote** consistency, soundness, stability, resilience, transparency, integrity, and stakeholders' protection, as well as regulatory and operational efficiency in financial markets and institutions worldwide..
- **Broad in coverage** of various aspects of financial activities e.g. capital adequacy, risk management, liquidity mgt, investor protection, disclosure requirements, market conduct, shariah and corporate governance, R&R, etc
- **Specific yet can vary** from country to country, as each nation's regulatory authorities implement these global standards within their domestic legal frameworks
- **Not legally binding** by themselves but exerts significant influence on national regulatory frameworks and industry practices.



EXAMPLES OF GLOBAL FINANCIAL STANDARDS

Accounting Standards (IFRS) by IASB, AAOIFI)

- Common framework for preparing financial statements
- Ensures accurate and consistent financial information

Banking Standards (BCBS, IFSB)

- Governs capital adequacy, liquidity, governance, risk management, and other prudential requirements

Capital Market (Securities) Standards (IOSCO, IFSB, IIFM)

- Pertains to issuance, trading, and reporting of securities to ensure transparency and investor protection

Insurance Standards (IAIS, IFSB)

- Addresses capital requirements and risk management practices for insurance companies
- Ensures stability and proper functioning of the insurance industry.

Deposit insurance standards (IADI, IFSB)

- guidelines and regulations put in place by governments and regulatory authorities to protect depositors' funds in financial institutions, maintain confidence in the banking system, and prevent bank runs,

Anti-Money Laundering (AML) and Combating the Financing of Terrorism (CFT) Standards (FATF)

- Aims to prevent illicit financial activities and enhance global security



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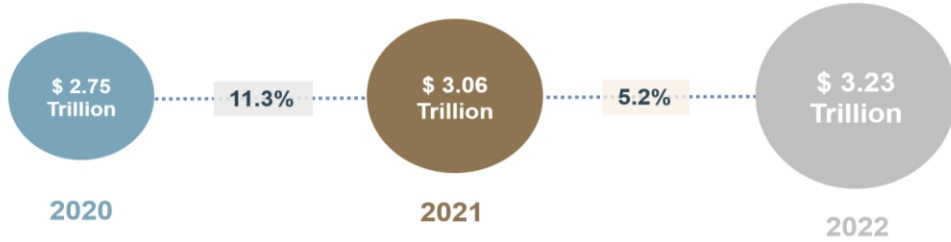
RATIONALE FOR ISLAMIC FINANCIAL STANDARDS



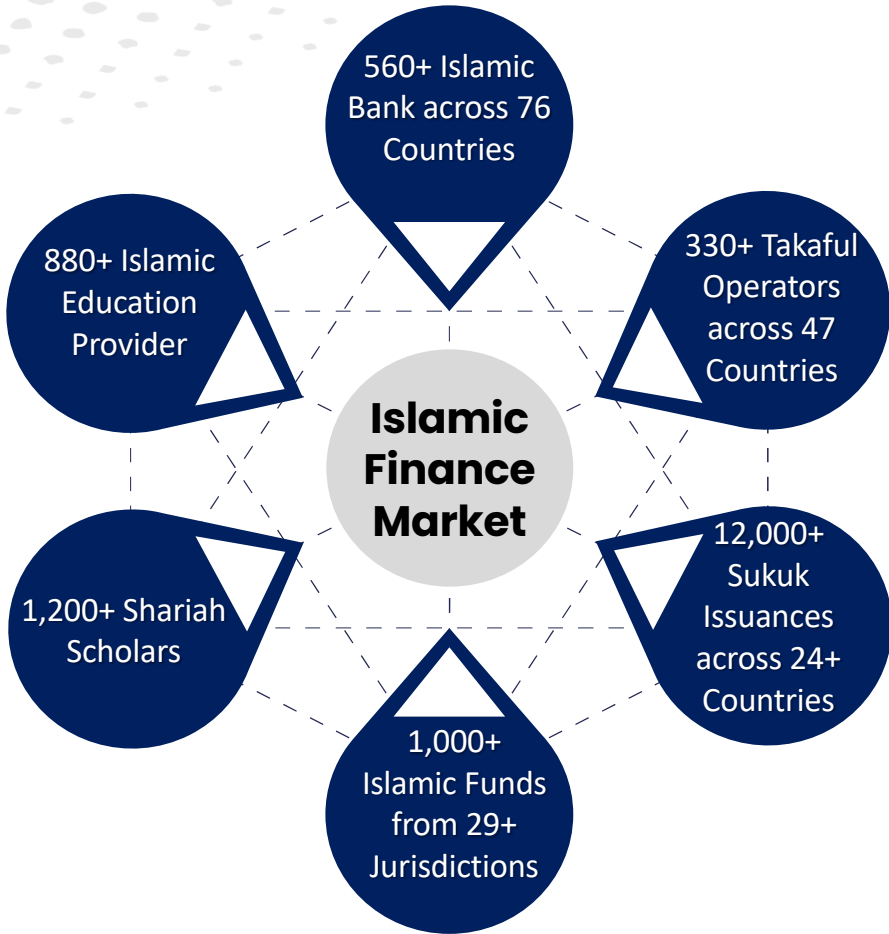
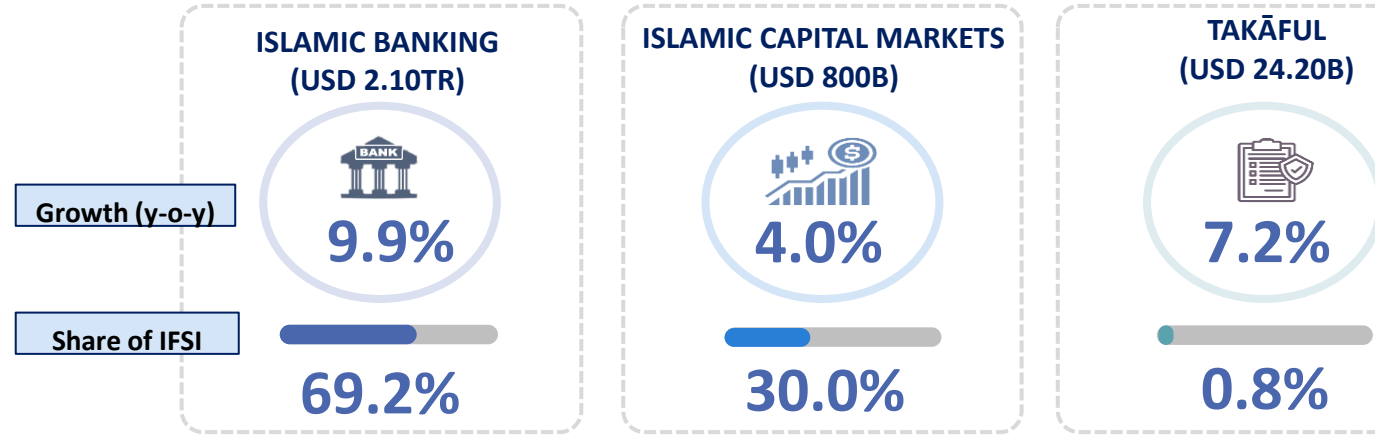
SIZE AND STRUCTURE OF ISLAMIC FINANCE INDUSTRY

ISLAMIC FINANCIAL SERVICES BOARD

GLOBAL IFSI GROWTH



IFSI's Sectoral Analysis (2021)



Islamic Finance Assets Across Sectors and Regions (2021)

| Region | Islamic Banking Assets | Shukūk Outstanding | Islamic Funds Assets | Takāful Contributions | Total | Share (%) |
|----------------|------------------------|--------------------|----------------------|-----------------------|---------------|-------------|
| GCC | 1342.9 | 356.6 | 24.1 | 16.7 | 1740.4 | 53.6% |
| SEA | 307.2 | 411.4 | 32.8 | 6.0 | 757.4 | 23.3% |
| MESA | 478.3 | 57.8 | 62.9 | 5.9 | 604.9 | 18.6% |
| Africa | 49.6 | 2.9 | 1.9 | 0.8 | 55.2 | 1.7% |
| Others | 71.2 | 1.0 | 14.9 | 0.6 | 87.7 | 2.7% |
| Total | 2249.2 | 829.7 | 136.6 | 30.0 | 3245.5 | 100% |
| Share % | 69.3% | 25.6% | 4.2% | 0.9% | 100% | |

SPECIFICITIES OF ISLAMIC FINANCE INDUSTRY

(Islamic Banking)

| | Assets | Liabilities | |
|-------------------------------------|---|---|--|
| Conventional banks do not have this | Inventories Real estates/Automobiles | Demand Deposits Wadiah/custodian | ← Currents and Savings accounts in Conventional banks |
| Loans in Conventional banks | Receivables from: Murabahah/Ijarah/Istisna'/Salam | General Investment Accounts Mudharabah | ← Conventional banks do not have this |
| Conventional banks do not have this | Profit Sharing Transactions Mudharabah/Musharakah | Specific Investment Accounts Mudharabah | ← Investment Linked Deposit (ILD) accounts in Conventional banks |
| | Fixed Assets | Equity | |

Islamic Banking

Credit risk

- the potential that a **counterparty fails to meet its obligations** in accordance with agreed terms

Financial exposure to potential loss in:

- Receivables and leases**
(e.g. *Murabahah*, *Diminishing Mushārahah* and *Ijarah*)
- Working capital financing transactions**
(e.g. *Salam*, *Istisna`* or *Muḍārahah*)
- Non-traded equity instruments**
(e.g. *Muḍārahah* and *Mushārahah* contracts, which are held for investment purposes and not for trading)
- Securitisation and investment activities (e.g. ***Sukūk***).

Market risk

- the potential impact of **adverse price movements** such as benchmark rates, FX rates, equity prices and commodity prices **on the economic value of an asset**

- Fluctuations** in values in tradable and marketable instruments (including *Sukūk*), investments in lease assets and off balance sheet individual portfolios (for example, RIA).
- The risk arise from the **current and future volatility** of market values of specific assets, *Murābahah* assets and of foreign exchange rates.

Operational risk

- the risk of loss resulting from inadequate or **failed internal process, people and systems** or from **external events**.

Process, people, system, **Shari'ah non compliance** and **fiduciary duty**

Islamic Banking

Common Credit Risk Mitigation Techniques



Hamish Jiddiyah

Refundable deposit taken by IIFS **before** entering into a contract to cover any damage to IIFS due to **non fulfilling a binding promise**.



Urbun

An amount held **after** a contract is entered into to guarantee contract performance.



3rd party guarantee

With recourse to obligor/
non-recourse, fixed period,
fixed amount, blanket
(unknown amount or future
receivable)



Collateral (assets)

Shariah-compliant asset,
monetary value, lawfully
owned, saleable,
specifiable, deliverable,
free of encumbrance.



Leased assets

Quasi-collateral
(Might be repossessed
by the lessor in the
event of default by the
lessee).



On-balance sheet netting

Subject to sharia approval,
netting arrangements between
financing assets and
deposits/PSIA should be **legally
enforceable** in order to be used
as an eligible CRM technique.

SPECIFICITIES OF ISLAMIC FINANCE INDUSTRY

Islamic Banking

Various Liquidity Risk Mitigation Techniques

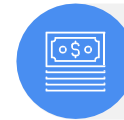
| Models for Deposits with Central Banks | Models for Obtaining Funds from a Central Bank | Islamic Interbank Instruments | Short Term Şukūk and Certificates | Sharī ah-Compliant FX Risk Management Models |
|--|---|--|-----------------------------------|--|
| Qarđ | Commodity Murābaħah CB Funding Model | Muđārabah Model for Interbank Investment | Salam Şukūk | Wa`d Forward Foreign Currency Exchange |
| Wakālah Central Bank Deposit Model | Collateralised Commodity Murābaħah Central Bank Funding Model | Wakālah Model for Interbank Investment | Murābaħah Şukūk | Commodity Murābaħah Forward Foreign Exchange Model |
| Wakālah Certificates of Deposit | Qarđ Central Bank Overnight and Intraday Funding Model | Commodity Murābaħah Interbank Deposit Model | Ijārah Şukūk | |
| Commodity Murābaħah Central Bank Deposit Model | Sell and Buy Back (Islamic REPO) Model | Muđārabah Interbank Investment Certificates | Mushārahah Şukūk | |
| | Wakālah Model for use of collateral for Central Bank funding | Sell and Buy-Back Islamic Interbank Model | Wakālah Şukūk | |
| | | Collateralised Commodity Murābaħah Islamic Interbank Model | Muđārabah Şukūk | |
| | | Islamic Interbank Qarđ Model | | |

SPECIFICITIES OF ISLAMIC FINANCE INDUSTRY

Islamic Capital Markets

- Need to abide by certain restrictions on **how funds are raised** and **how instruments are structured** - they must be in **accordance with the principles of Sharī'ah**.
- Islamic equity capital can only be raised for companies that are deemed Sharī'ah-compliant, in that they **observe certain quantitative thresholds** and are **not engaged in any business activities that are Sharī'ah non-compliant**.
- ICIS can only make investments in Shari'ah-compliant assets, determined using **Shari'ah screening criteria**.
- For **Ṣukūk** the underlying assets and use of proceeds need to be compliant with Shari'ah principles.

Relevant Principles of Islamic Finance



The charging or receiving of interest (riba) is prohibited



Prohibition of activities with elements of uncertainty (gharar)



Prohibition on gambling and speculative activities (maysir)



The assets or businesses underlying the instrument must be Shari'ah-compliant



Restrictions on tradability (debt can only be traded at par)

SPECIFICITIES OF ISLAMIC FINANCE INDUSTRY

Islamic Capital Markets



Islamic banks: Other sectors of the IFSI depend on the ICM to provide opportunities for **investment**. Islamic banks critically need Shari'ah-compliant financial instruments to meet their **regulatory capital adequacy and liquidity needs**.



Takaful: Takaful companies need short and long-term Shari'ah-compliant **investment** avenues to provide returns to their various risk funds **as well as manage liquidity**.



Faith-based consumers: Faith-based consumers refrain from Shari'ah non-compliant capital market products and need Shari'ah-compliant investment options.



Ethical finance: A growing focus and demand for ethically compliant financial products complements the ICM where Shari'ah principles uphold ethical dealings (e.g., fairness, transparency, etc.).



Full Islamic Finance Ecosystem

Some jurisdictions are aiming to develop a full, integrated, Islamic finance ecosystem in order to serve a substantial domestic Muslim population

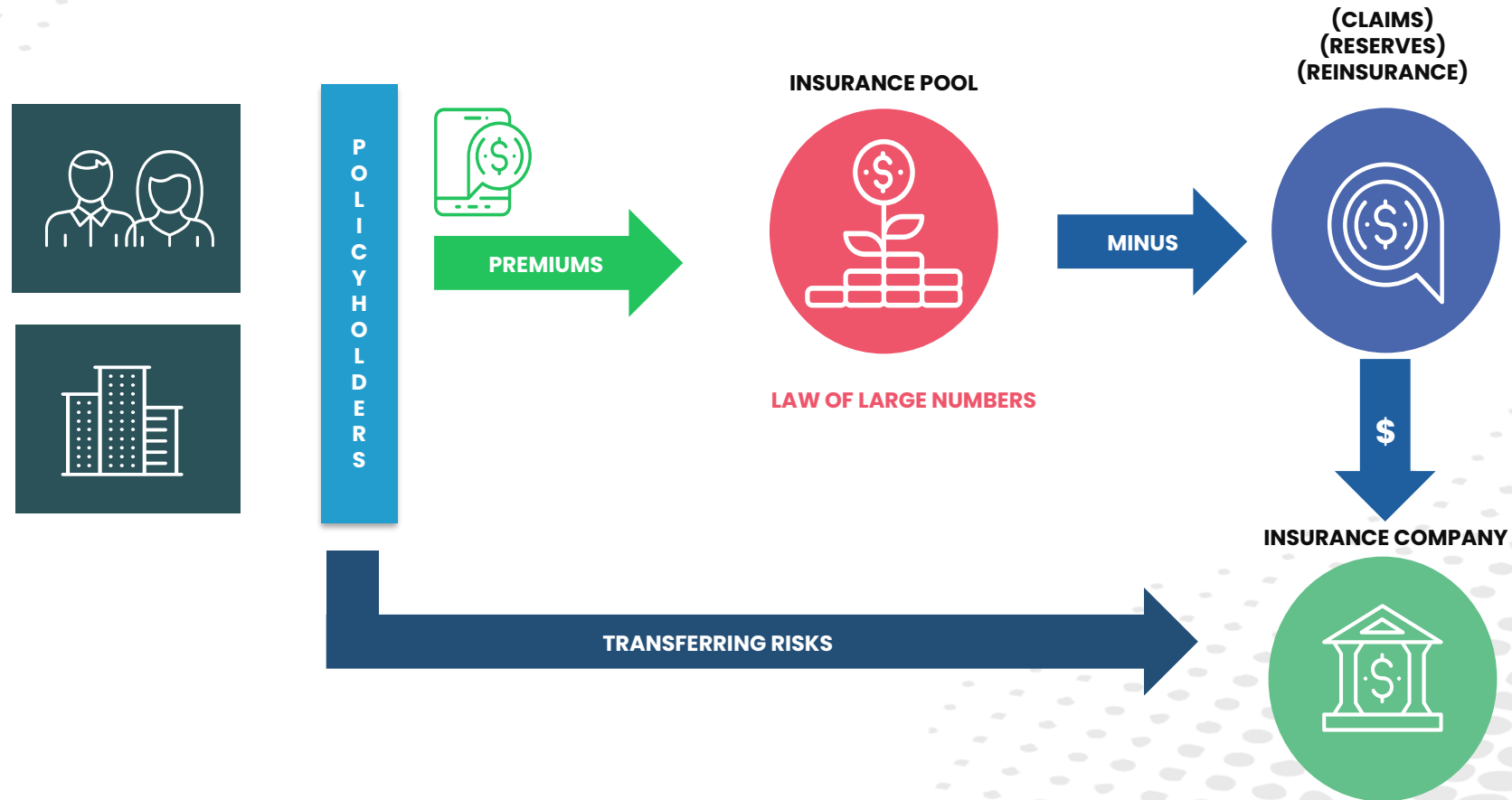
International Capital Market Hub

Other jurisdictions see themselves as international capital market hubs and want to play a similar role in the ICM, even though they may have only a minimal Muslim population and no wider Islamic finance aspirations, e.g. Ireland, Luxembourg, Hong Kong.

SPECIFICITIES OF ISLAMIC FINANCE INDUSTRY

Islamic Insurance / Takaful

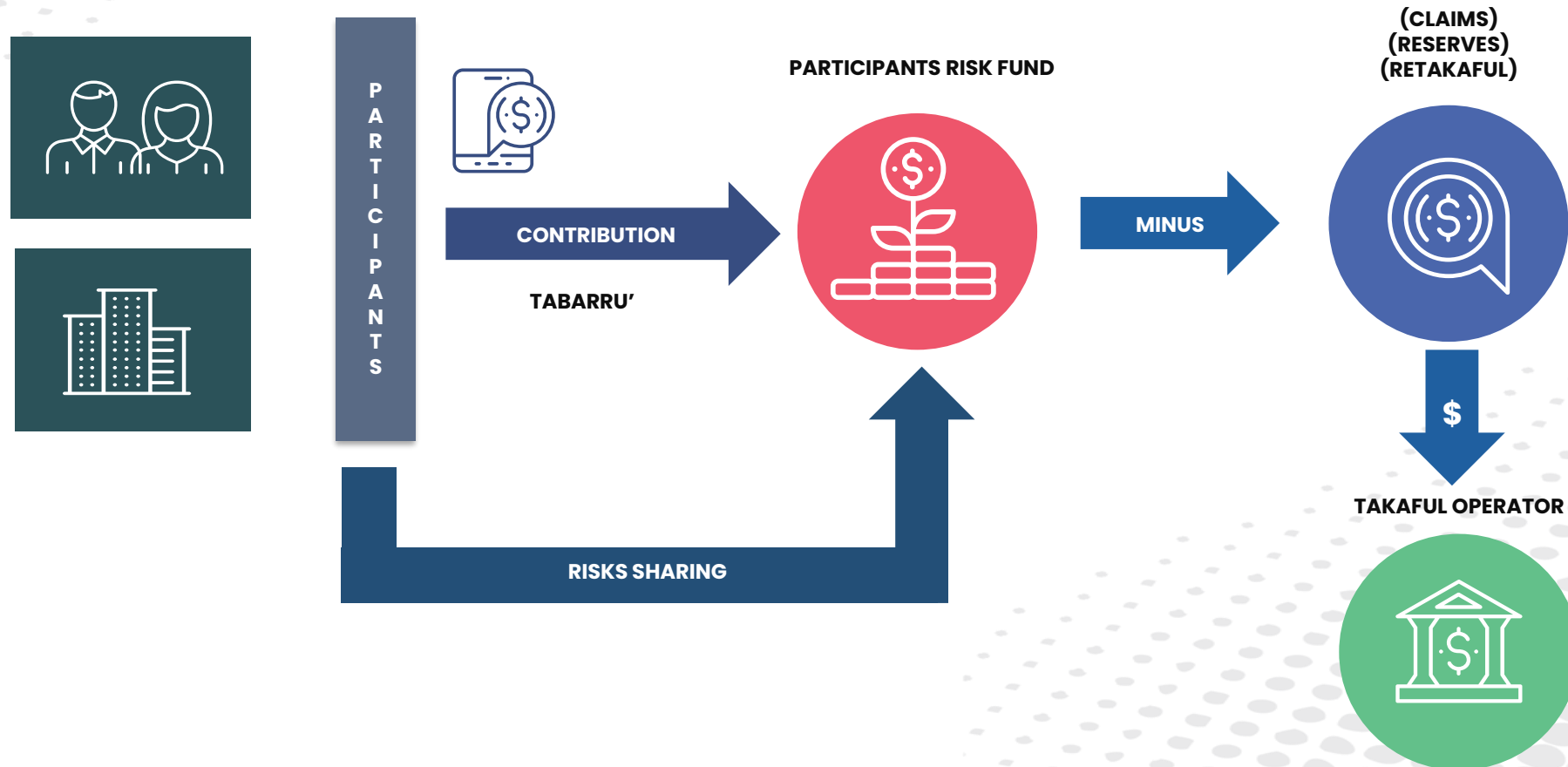
HOW DOES CONVENTIONAL INSURANCE WORK?



SPECIFICITIES OF ISLAMIC FINANCE INDUSTRY

Islamic Insurance / Takaful

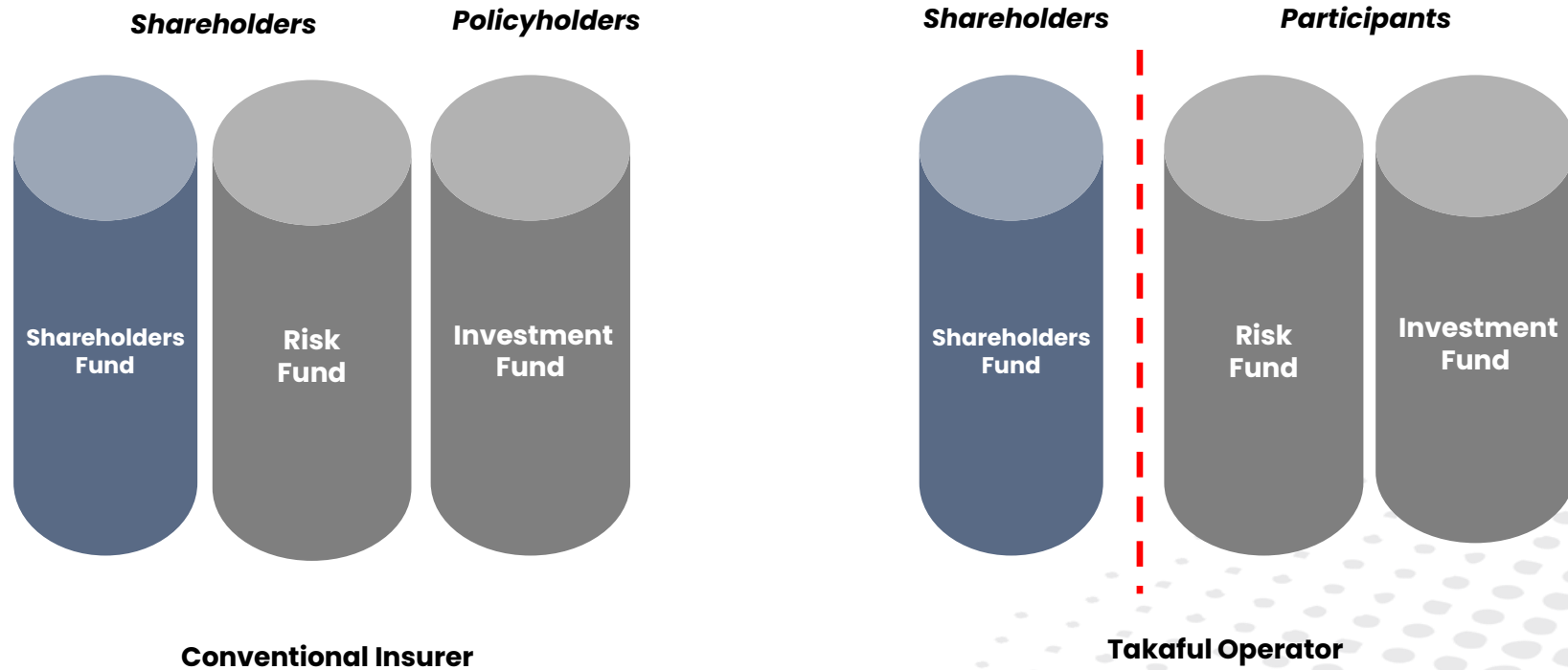
HOW DOES ISLAMIC INSURANCE (TAKAFUL) WORK?



SPECIFICITIES OF ISLAMIC FINANCE INDUSTRY

Islamic Insurance / Takaful

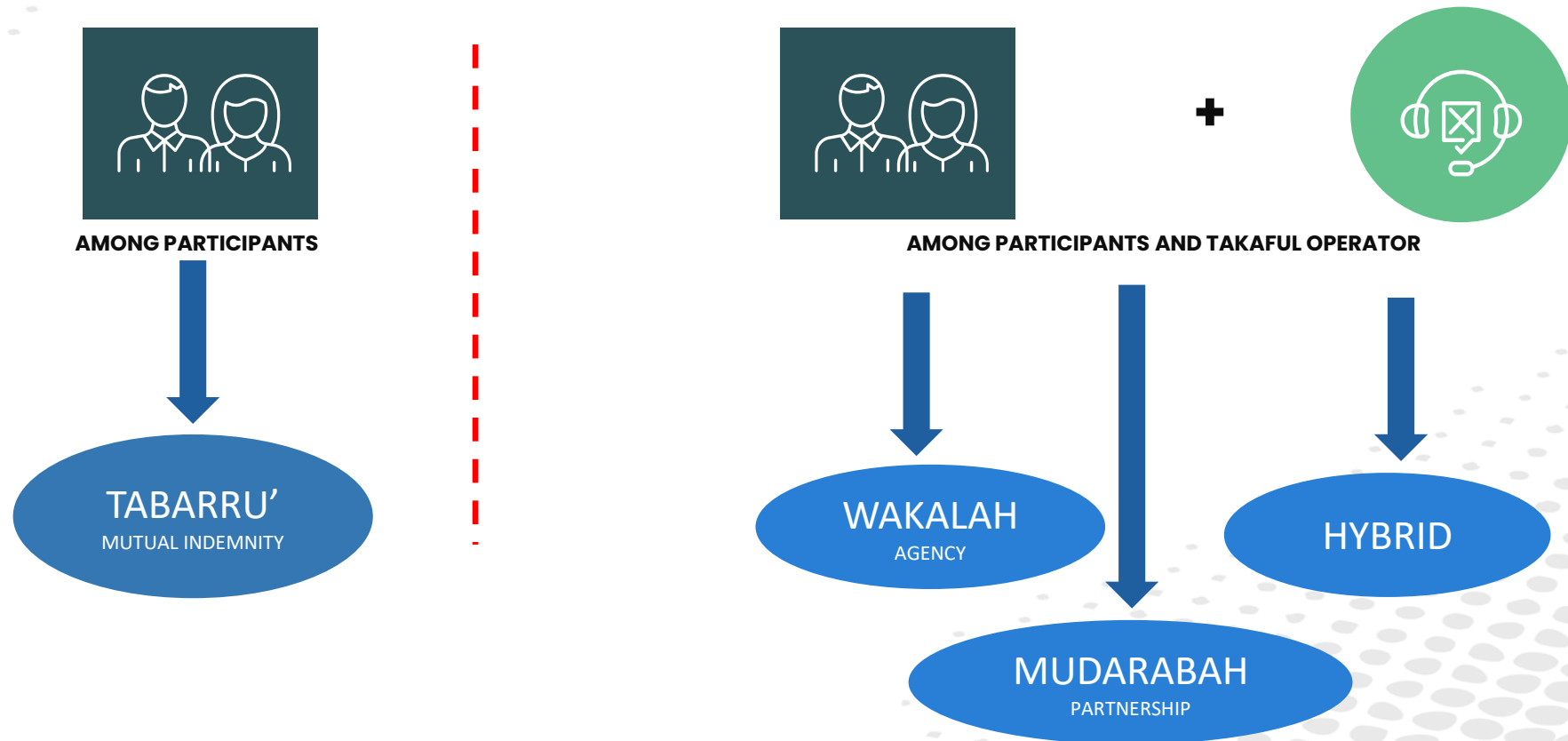
OWNERSHIP OF RISK FUND DIFFERS FROM CONVENTIONAL INSURER



SPECIFICITIES OF ISLAMIC FINANCE INDUSTRY

Islamic Insurance / Takaful

UNDERLYING CONTRACTS IN TAKAFUL





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EFFECT OF ISLAMIC FINANCE STANDARDS



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Specificities of Islamic financial services include the obligation to comply with Sharī'ah rules and principles.

The BCBS, IOSCO, IAIS and IADI core principles would be unsuitable for application if, and to the extent that, they conflicted with Sharī'ah rules and principles.

FINANCIAL SECTOR ASSESSMENT PROGRAMME

MILESTONE

01

In May 2018...IMF endorsement

The IMF approved the endorsement of the **IFSB-17 "Core Principles for Islamic Finance Regulation" (CPIFR)** for banking sector and their assessment methodology for the purposes of undertaking **financial sector assessments** and preparing Reports on the Observance of Standards and Codes (ROSCs)

MILESTONE

02

In December 2019...FSB Compendium of Standards

In December 2019, the Standing Committee on Standards Implementation (SCSI) of the Financial Stability Board (FSB), **approved the inclusion of the IFSB-17: Core Principles in Islamic Banking Regulation – Banking Segment into the Compendium of Standards.**

IFSB 17: CPIFR (Islamic Banking)
 IFSB 21: CPIFR (ICM)
 IFSB 27: CPIFR (Takaful)
 and IADIIFSB:CPEIIDS)



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EFFECTS OF GLOBAL ISLAMIC FINANCE STANDARDS

:



PROMOTE GROWTH

Provide international best practices in developing and promoting the growth of the IFS



DEEPEN LIQUIDITY

Provide guidance on deepening liquidity in the IFSI



HARMONISE PRACTICES

Promote the harmonisation of practices across the IFSI



STRENGTHEN STABILITY

Provide guidance on strengthening the regulatory frameworks and stability of the IFSI

EFFECTS OF GLOBAL ISLAMIC FINANCE STANDARDS

:



SYSTEMIC RISKS MITIGATION

Provide international best practices in risk management and prudential matters in IFSI



CROSS-BORDER TRANSACTIONS

International regulatory and financial integration



SUPPORT SDGs

Financial Inclusion and Islamic Social Finance instruments and institutions



RESPONSIVENESS TO EMERGING RISKS

- Digitalisation
- Climate change risks
- Cybersecurity

KEY IFSI HIGHLIGHTS

GLOBAL IFSI SUSTAINED POSITIVE GROWTH IN 2021



Y-O-Y GROWTH OF GLOBAL IFSI ASSETS

11.3%



TOTAL IFSI ASSETS AS AT END-2021

USD 3.06 Tr

The projected sense of optimism for further growth in 2022 is expected to be impacted by a number of headwinds and tailwinds.

HEADWINDS

- Uneven access to COVID-19 vaccines amid new mutations
- Russia–Ukraine conflict
- Spillover of effect of financial tightening in advanced economies
- Rising oil and commodity prices amid inflation concerns
- Exchange rate volatility
- Financial stability risk
- Political impasse, social unrest and civil conflict
- Climate change risk

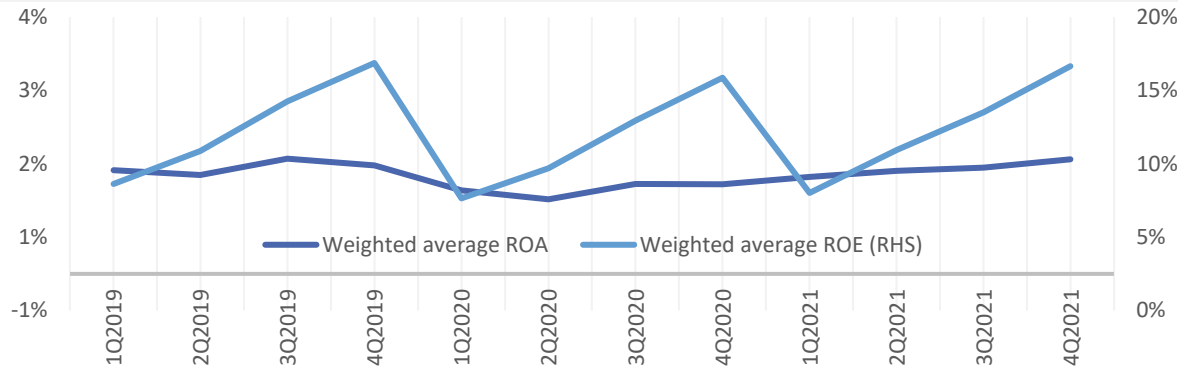
TAILWINDS

- Reopening and recovery of many economies
- Increased digitalisation
- Increased sustainability-linked investments
- Increased mergers and acquisitions
- Limited direct exposure to the Russia–Ukraine conflict



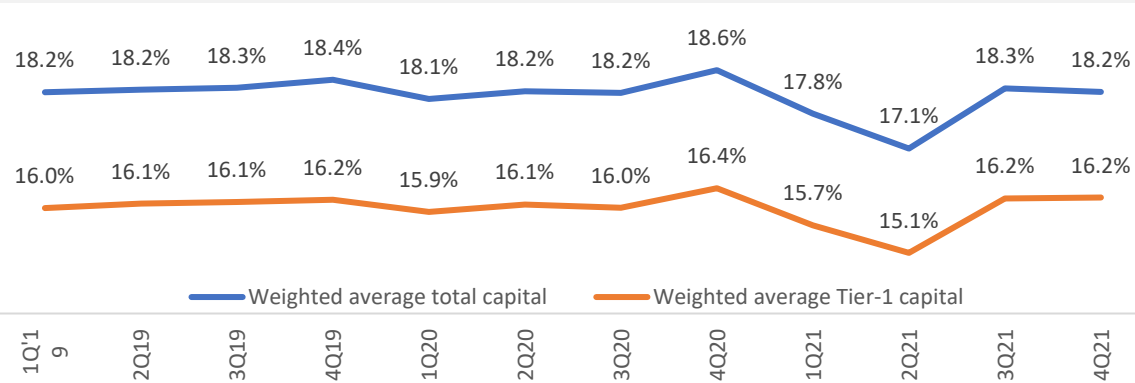
KEY HIGHLIGHTS OF ISLAMIC BANKING

Global Islamic Banking Weighted Average ROA and ROE



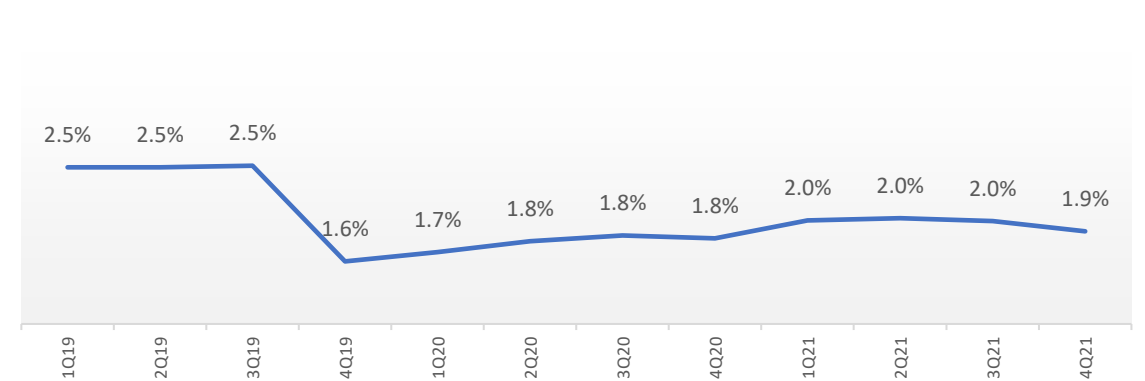
The profitability level of the global Islamic banking industry improved further in 4Q'21 surpassing its pre-pandemic level

Global Islamic Banking Average Capital Adequacy Ratios



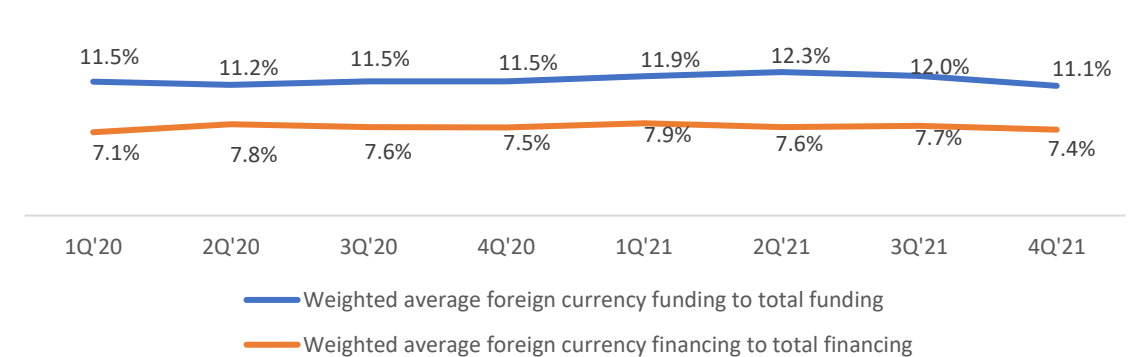
The capital structure of the Islamic banking industry remained stable and strong

Global Islamic Banking Average Gross Non-Performing Financing to Total Financing



Due to forbearance measures, the average non-performing financing (NPF) ratio remained somewhat flat for most of the period

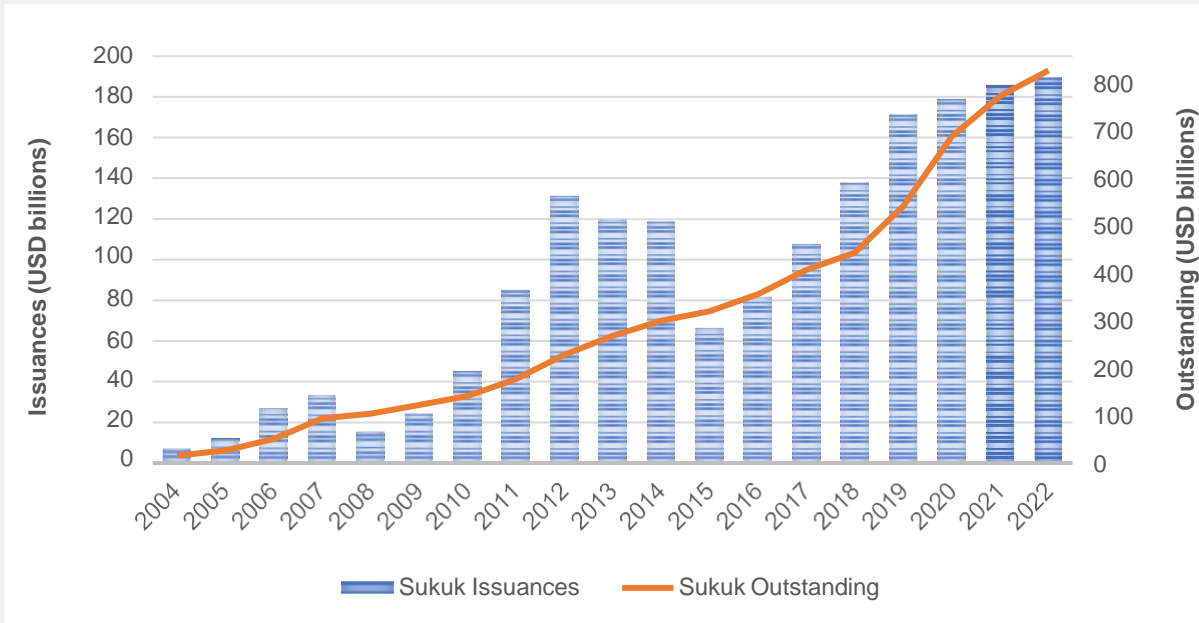
Global Islamic Banking Average Foreign Currency Funding and Financing to Total Funding and Financing



The proportion of both foreign currency funding and foreign currency financing vis-à-vis the total funding and total financing of the global Islamic banks, respectively, remained relatively unchanged

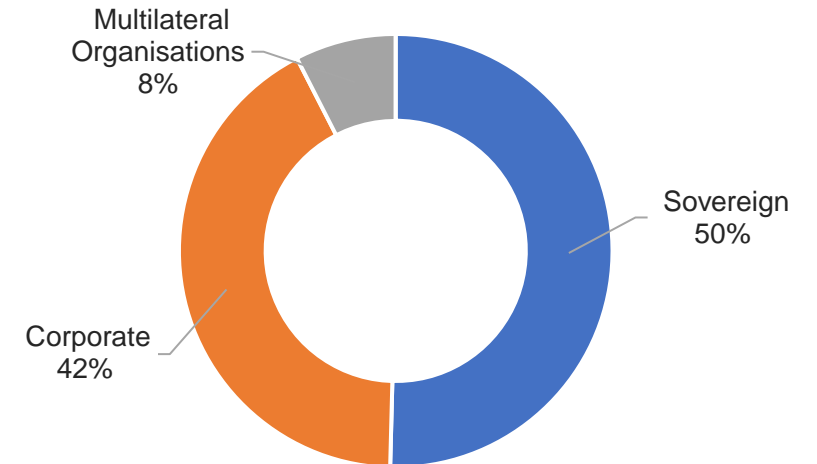
ŞUKŪK MARKET TRENDS

Global Şukūk Issuances and Şukūk Outstanding Trends (2004–22)



- The overall **şukūk** outstanding rose to USD 829.7 billion in 2022, demonstrating a y-o-y growth of 7%
- The **şukūk** market slowed down in 2022, seeing a y-o-y growth of 2.3%, although still maintaining the consecutive upward growth trajectory observed since 2015. Issuances in 2022 saw a y-o-y growth of just 2.3%.

Global Şukūk Issuances by Issuer Type (2022)

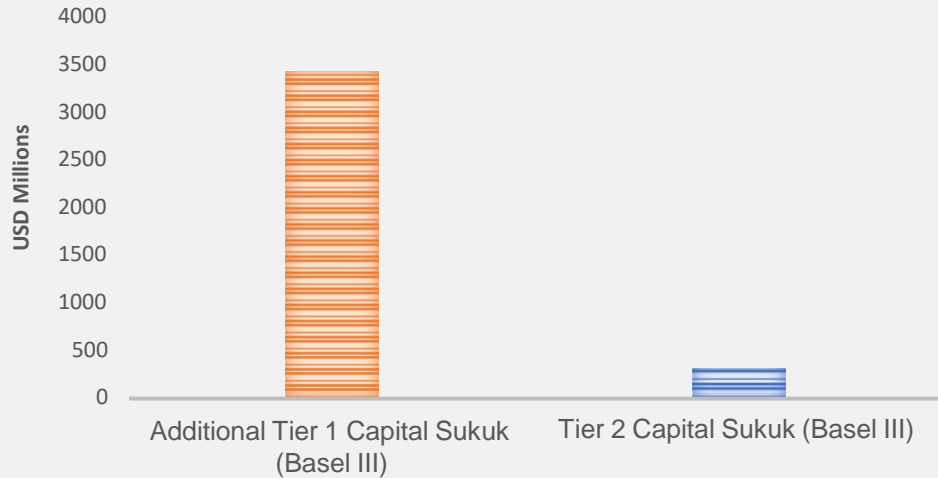


- **Sovereign issuances have dominated** the şukūk market, with the corporate market generally less active in most countries with the exception of Malaysia.
- The **trend has been changing** in recent years with the corporate market seeing strong growth momentum.

ŞUKŪK MARKET TRENDS

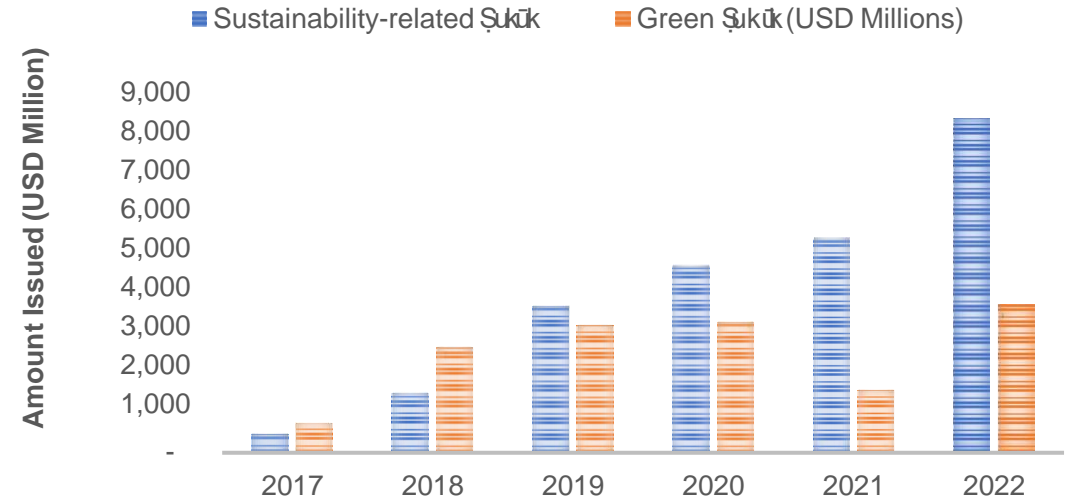
Out of the financial sector issuers, **Basel III regulatory capital şukūk issuances by banks made up about 7% of financial sector issuances** (14% in 2021)

Basel III Şukūk Issuances (2022)



Regional diversity was observed in 2022 among issuers of regulatory capital şukūk, including issuances from, Indonesia, Malaysia, Saudi Arabia and Nigeria (In 2021, 91% were issued from the GCC region)

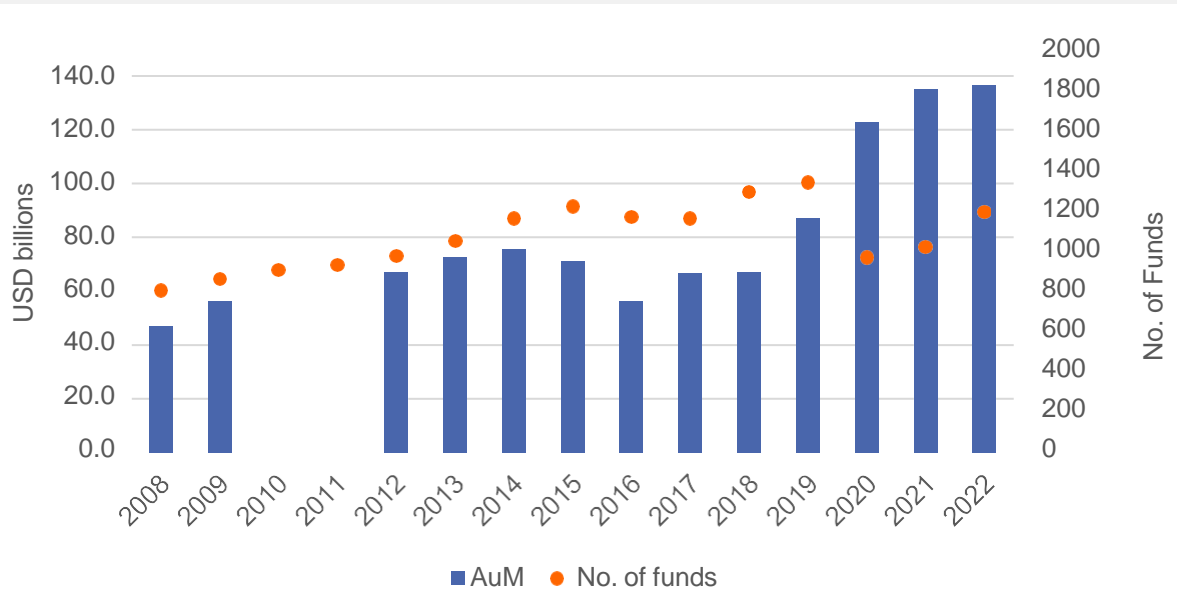
Sustainability-related Şukūk Issuances (2017–22)



- Sustainability-related şukūk issuances have continued to grow in both existing and new markets.
- Sustainability-related şukūk issuances increased in 2022, amounting to a total of **USD 8.4 billion** (2021: 5.3 billion)
- **USD 3.7 billion** (68% of total sustainability-related issuances) were green şukūk

ISLAMIC ASSETS UNDER MANAGEMENT AND EQUITIES

Growth in Assets under Management and Number of Islamic Funds (2008–22)



- The total assets under management of Islamic funds grew by **1%**, but generally continued its upward growth despite the slow down

Ten-Year Historical Performance (2013-Feb 2023)

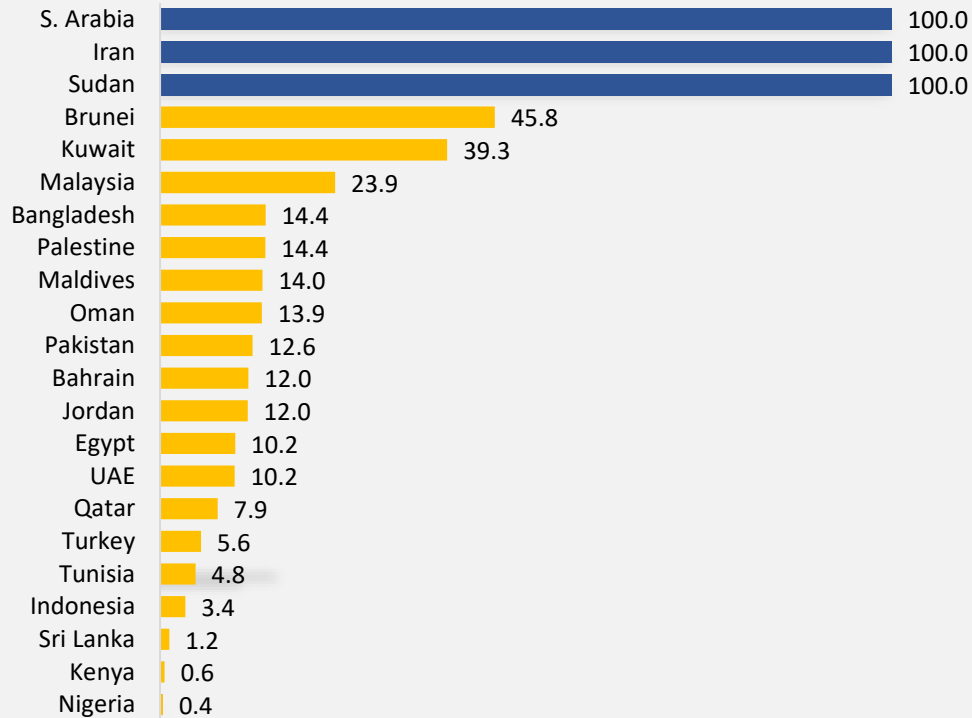


Rebased at 100

- Islamic indices, in relative terms performed better than the comparative conventional indices over a 10-year period

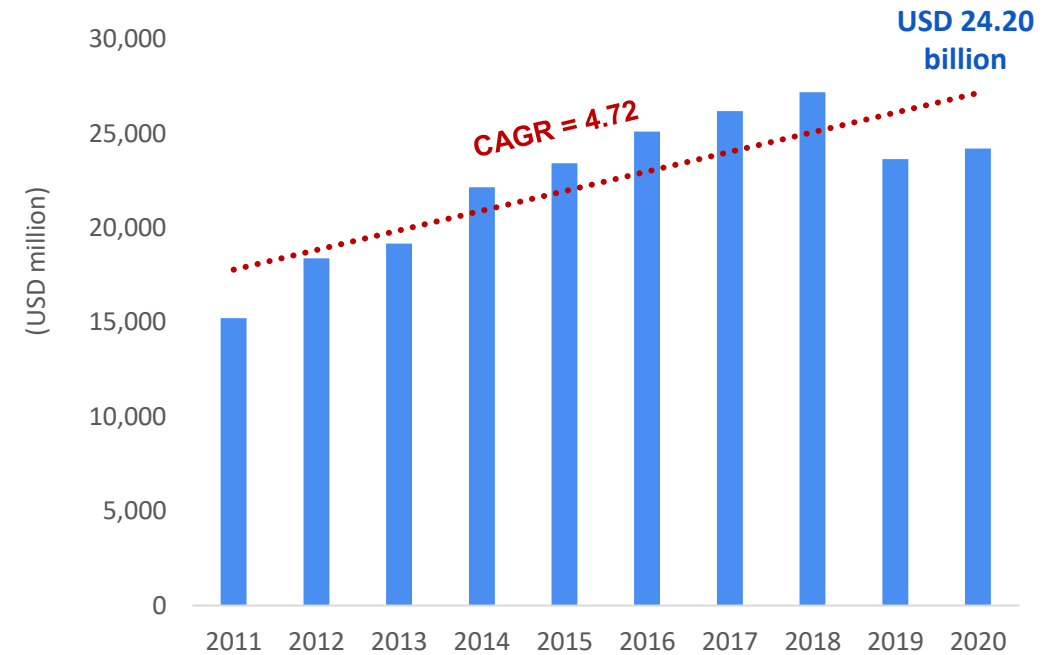
KEY HIGHLIGHTS – TAKĀFUL SEGMENT

Share of Takāful Sector’s Business Relative to Insurance Sector in (%) (2020)



While COVID-19 posed considerable threats to the *takāful* sector’s efficiency and stability in 2020, it has shown flexibility and resilience in facing the pandemic.

Trend of Global *Takāful* Contributions (USD million) (2011 – 20)



The overall *takāful* sector’s direct contributions increased by 4.8% y-o-y to USD 24.2 billion, after a significant decline.



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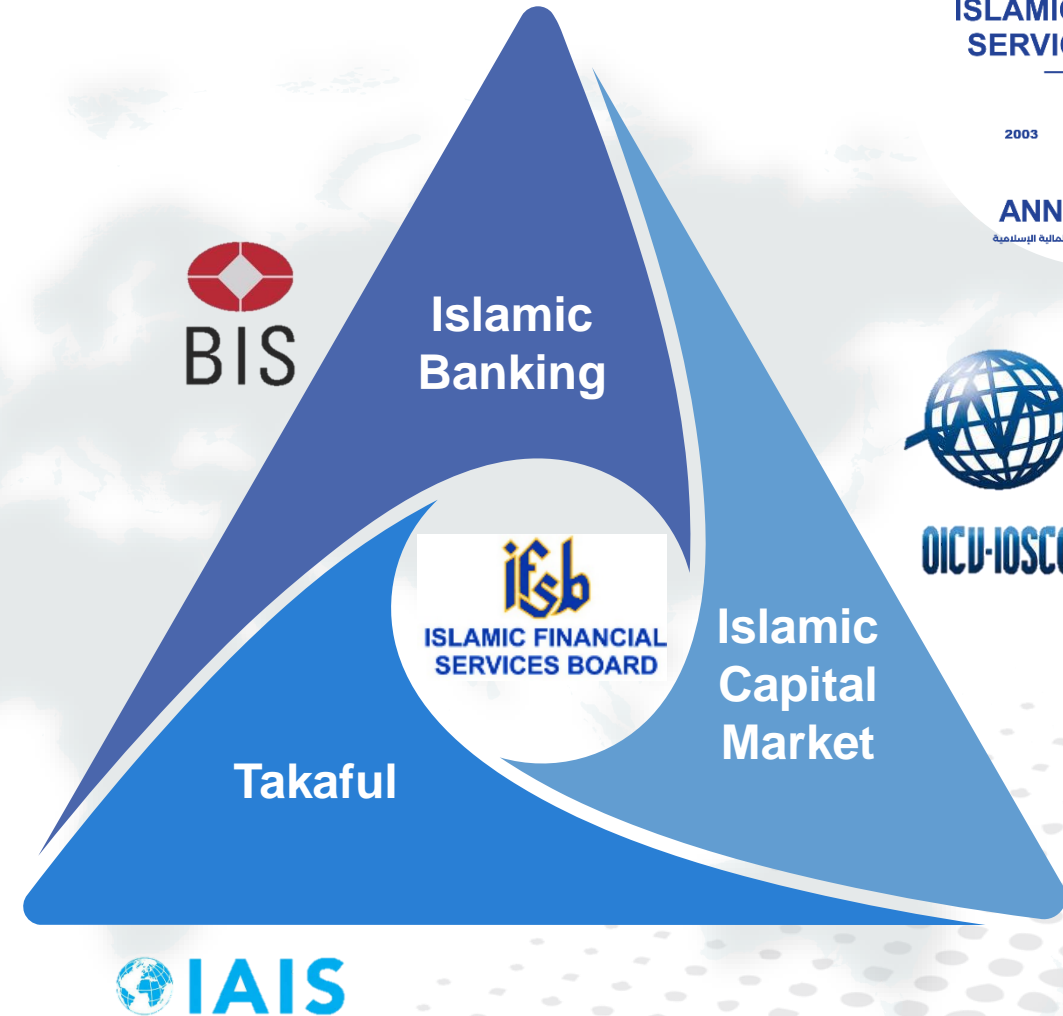
THE ROLE OF THE IFSB



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THE ISLAMIC FINANCIAL SERVICES BOARD

- The IFSB looks at the global regulatory framework and **fills crucial gaps in the Islamic Financial Services Industry ..**
-to ensure that regulatory frameworks adequately address the **specificities and unique features related to Islamic finance ..**
-which are complementary to and fit within **the existing international regulatory frameworks** for the financial services industry.




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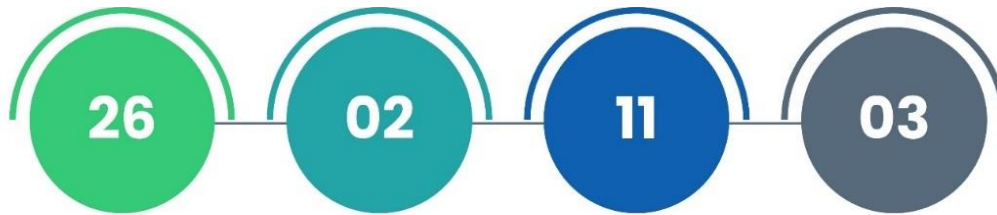
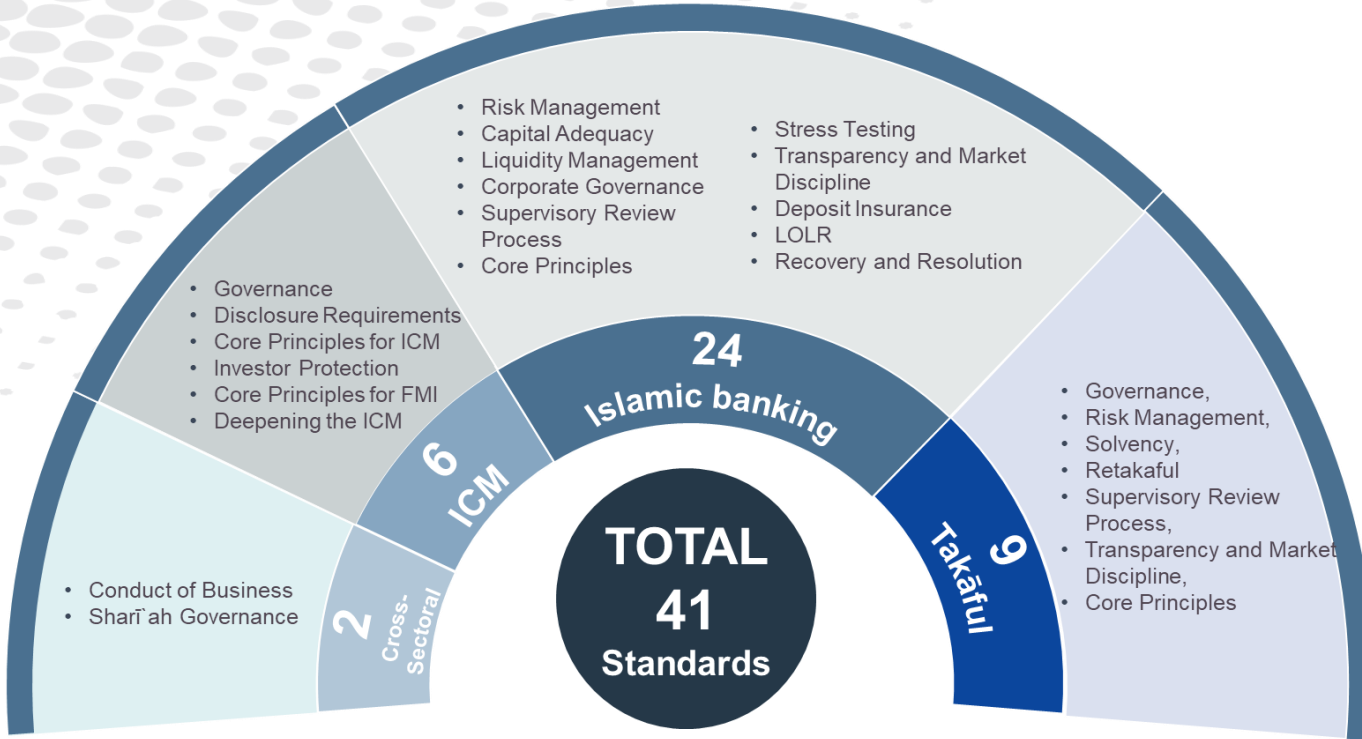
20TH
ANNIVERSARY
2003 2023
الذكرى العاشر لاجلس الخدمات المالية الإسلامية



OBJECTIVES OF THE IFSB

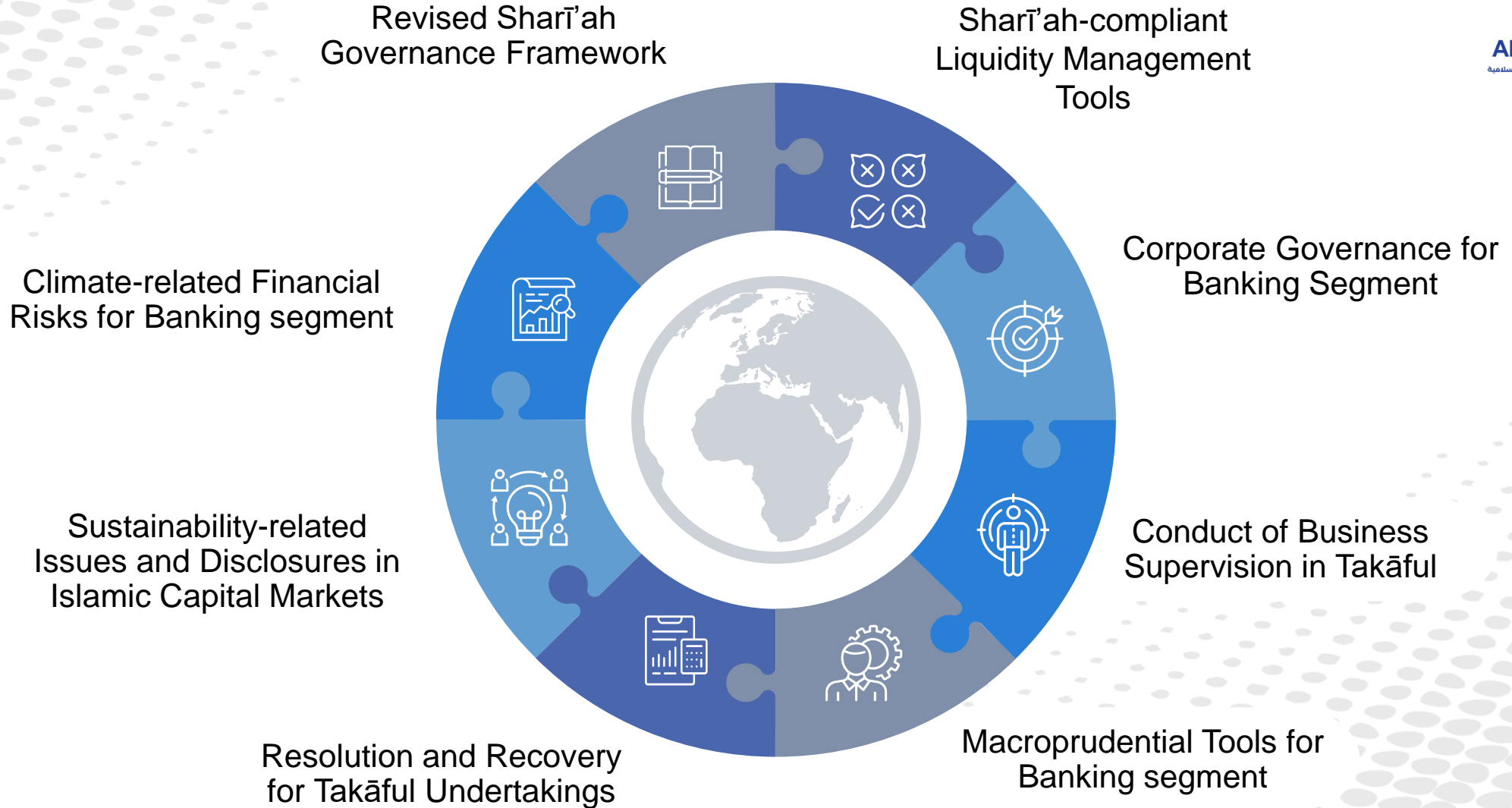


IFSB STANDARDS AND RESEARCH ACTIVITIES

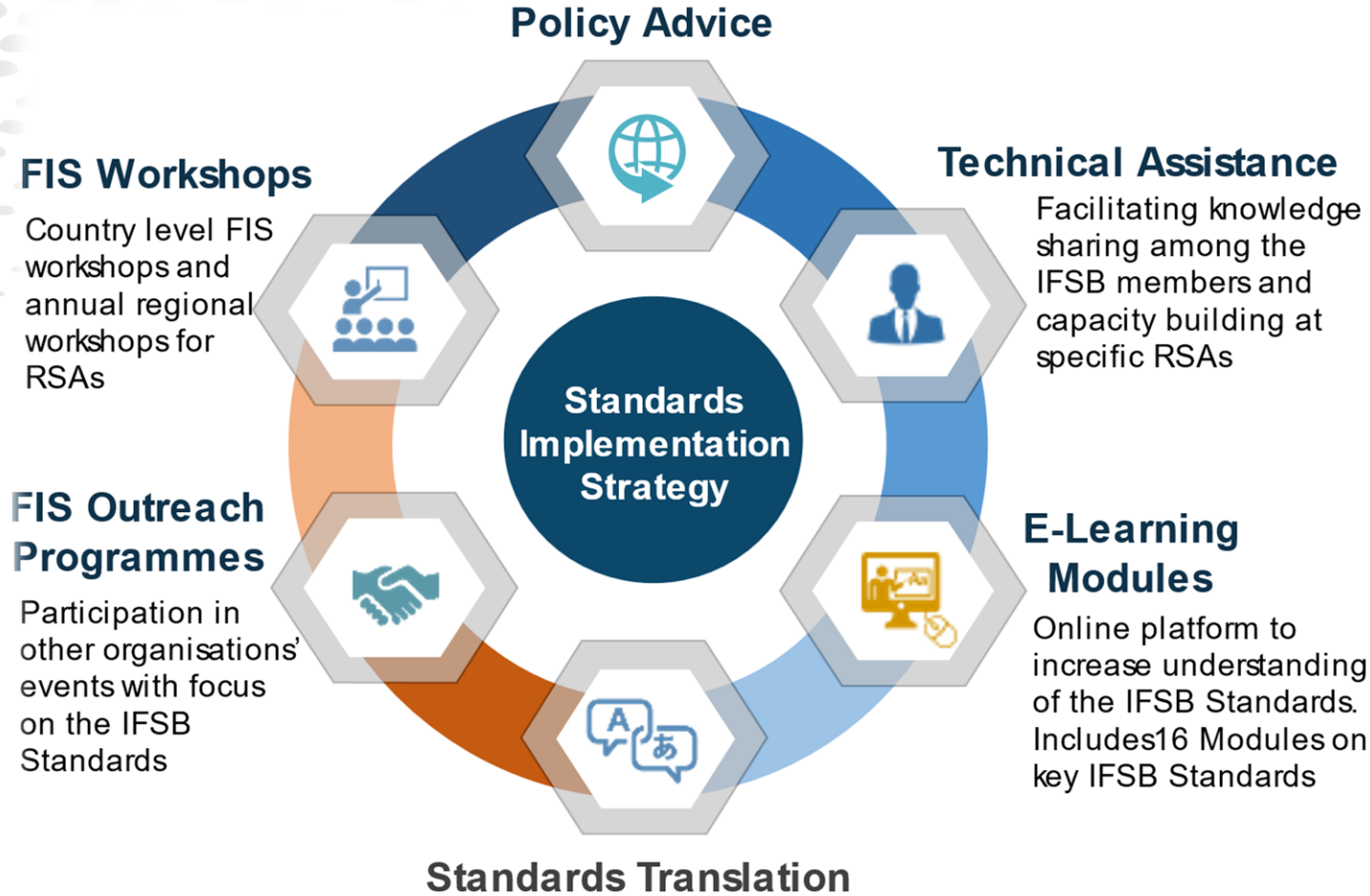


26 Working Paper Series **02** Issues Paper Series **11** Islamic Financial Services Industry Stability Report **03** Islamic Financial Services Industry Development Report


IFSB's ONGOING STANDARD DEVELOPMENT WORK



IFSB IMPLEMENTATION ACTIVITIES



Other Implementation Activities

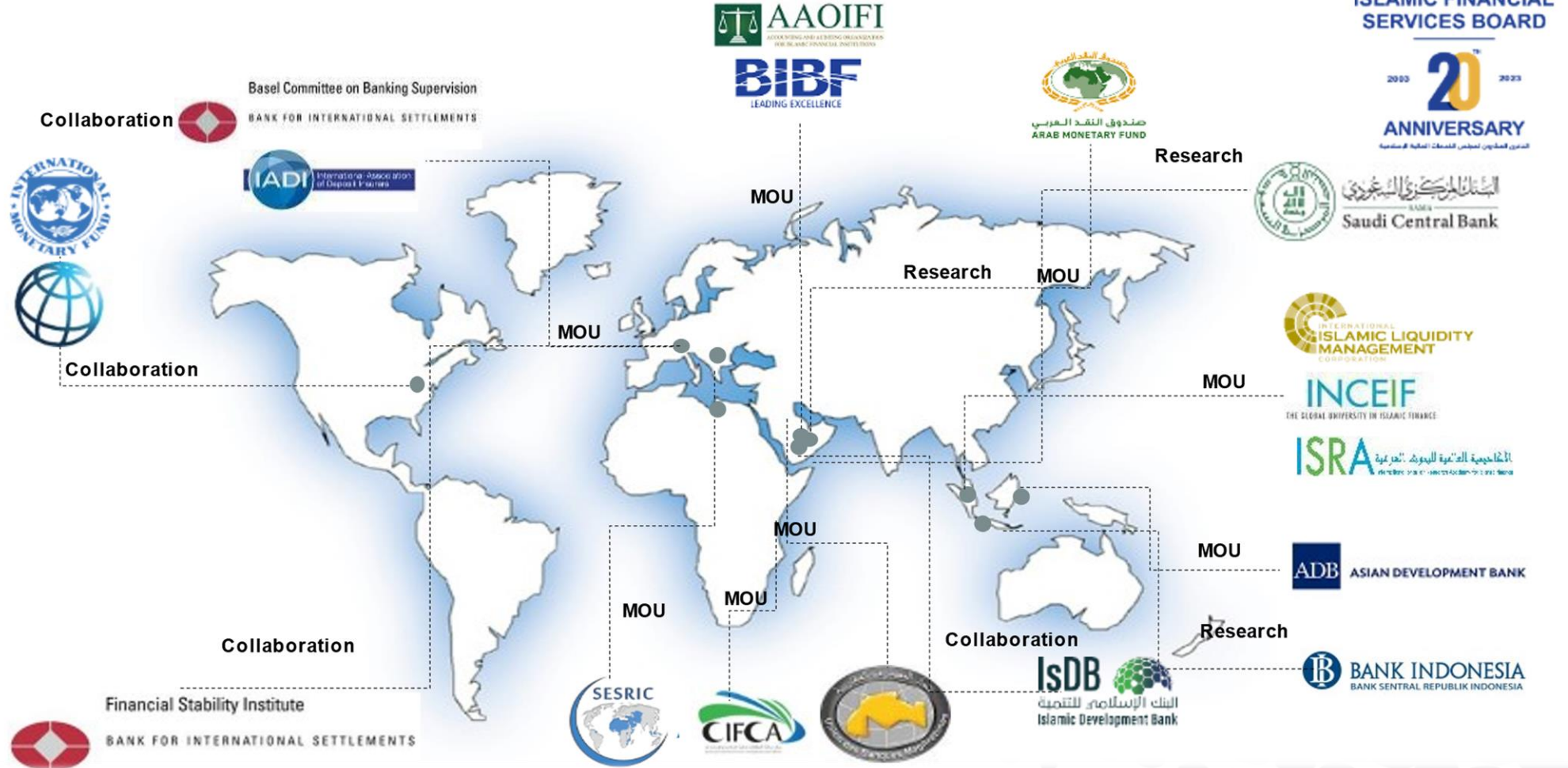
 **Annual Implementation Survey**

 **45**
Countries

179
Workshops 

 **7,117**
Participants

IFSB STRATEGIC COLLABORATION



THANK YOU