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"New Opportunities, New Market and New Frontier in Islamic Banking & Finance"

Keynote Address by
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I. Introduction

Islamic banking and finance has emerged as a financial intermediation process that is competitive and resilient and that contributes to the overall wealth creation, growth and development of our nation. Amidst an increasingly challenging and competitive financial environment, the evolution of a comprehensive Islamic financial system seeks to meet the range of requirements of a rapidly changing economic environment, with its soundness and stability secured through the robustness of its regulatory framework supported by the strength of its financial infrastructure and the sophistication of its products and services. Indeed, the strength of the respective components of the system and the interconnections of its markets will open new frontiers in Islamic banking and finance and will maximize the potential and opportunities that it accords.

The Islamic financial system in Malaysia has evolved as a viable and competitive component of the overall financial system, complementing the conventional financial system as a driver of economic growth and development. The rapid progress of the domestic Islamic financial system, reinforced by significant developments in the Islamic financial infrastructure, including the legal and Shariah infrastructure and the regulatory and supervisory framework, has strengthened the position of the Islamic financial system as an increasingly important component in meeting the changing requirements of the new economy. The Financial Sector Masterplan launched three years ago provides the strategic direction envisioned for the development of the Islamic financial sector looking beyond the near term and taking a longer-term perspective into the needs and requirements of the future. The strategies outlined in the Plan have emphasized the development of the respective building blocks of the various parts of the financial sector that need to be put in place to form the solid foundation on which sustainable future progress can be achieved. The expansion of the Islamic financial system in Malaysia has therefore taken place with attention given for the development of a comprehensive system.

II. Towards A More Diversified Islamic Financial System

At the onset of our journey in the development of a comprehensive Islamic financial system that is progressive, efficient, dynamic and sustainable, due attention was thus given to the development of the key structural components of the Islamic financial system, comprising the Islamic banking industry, the takaful industry and the Islamic money and capital markets. The intra-dependency of these key components creates the enabling environment for the Islamic financial system to effectively perform its role as an efficient conduit for mobilizing resources and channeling the funds to finance productive economic activity. The absence of any particular component could reduce the effectiveness and efficiency and thus affect the viability and sustainability of the system. While the Islamic banking system has an important role in mobilizing deposits and providing financing, the Islamic capital market has an equally important role in providing a stable source of long-term funds for financing large investments and development projects as well as for capital and business expansion. The development of the Islamic capital market not only allows for a more balanced allocation of financial and economic resources within an economy but more importantly, ensures greater diversification of risks within the Islamic financial system. This enhances the resilience and robustness of the Islamic financial system to withstand financial shocks and contributes to the overall stability of the Islamic financial system.

In terms of the development of our Islamic financial system, as at June 2004, the assets mobilized by the Islamic banking sector have increased to RM89.1 billion, accounting for a market share of about 10% of the banking system. At the same time, deposits have also increased to RM64 billion, constituting a market share of 10.4% while financing mobilized amounted to RM54 billion to garner 11% of the market share. Product offerings have also increased in sophistication from the deposit products to hybrid products that are able to enhance returns to depositors. A further advancement was made with the introduction of the Islamic variable rate financing mechanism that provides an alternative to the fixed-rate financing. This will assist the Islamic banking institutions in mitigating part of the risks emanating from asset and liability mismatches.

The Islamic capital market, in particular, the Islamic debt market, has also experienced rapid growth since its emergence in the 1990s. The issuance of Islamic bonds has expanded steadily at an average growth rate of 33.7% since 1995. In 2003, the total funds raised via the issuance of Islamic bonds amounted to RM8.1 billion, constituting 19% of the total funds raised in the bond market. New innovative Islamic financial instruments such as Islamic asset-backed securities have also emerged and the financial structures underlying Islamic securities have become more diversified. The number of Shariah-based unit trust funds has also grown consistently over the years to reach 55 in 2003 with a net asset value of RM4.75 billion, constituting a market share of

6.8%. The rapid growth of Islamic unit trusts comprising a variety of bond funds, equity funds and balanced funds increases the efficiency and potential of the Islamic financial system as an intermediation channel by providing investors access to professional asset management that is based on their distinct risk tolerance levels.

The development of a vibrant, efficient and effective Islamic capital market requires the creation of a broad spectrum of innovative Islamic financial instruments and the infrastructure to promote active trading so as to enhance the breadth and depth of the market. In the development of Islamic financial instruments, the challenge is to develop innovative and more diverse Islamic financial structures that are not only able to accord flexibility to issuers in managing their distinct financing requirements but also able to meet investor's demand in accordance with their risk and return preferences.

At the international level, the successful issuance of the first sovereign global Islamic sukuk by the Government of Malaysia which attracted significant interest from a wide international investor base, acted as a catalyst for other countries and corporations to tap the international Islamic financial market and provided the impetus to the development of the International Islamic Financial Market (IIFM). The IIFM is entrusted with the task of creating an enabling environment that will encourage active participation by both Islamic and non-Islamic financial institutions in the secondary market for Islamic financial instruments. Strategic alliances such as those forged between IIFM, the Labuan International Financial Exchange and the Bahrain Stock Exchange will further pave the way for cross-border listing and trading of Islamic financial products. This will increase international investors' access to Islamic financial instruments, enhance liquidity and spur the development of an Islamic capital market with greater global reach.

III. Strengthening the Foundations for the Development of a Sound, Progressive and Sustainable Islamic Financial System

The strengthening of the financial infrastructure is a key pre-requisite for the development of a dynamic and progressive Islamic financial system. An important feature of a comprehensive and well-developed financial infrastructure is the diversity of the players and institutions in the system that have been developed based on their distinctive capabilities and competitive advantage thus raising their performance level, valued added and contribution to overall growth and development. In addition, as part of the strategy to enhance our integration with the international financial system and to strengthen our inter-linkages with other economies, the liberalization of the Islamic banking industry has been brought forward to take place in 2004. The issuance of new Islamic banking licences to qualified foreign financial institutions will allow for the presence of foreign Islamic banking players to act as a bridge between Malaysia and other global Islamic financial markets and increase the potential to tap new markets and growth opportunities. It will also contribute to spur

financial innovation as well as facilitate international trade and investment flows between Malaysia and the rest of the world.

An important dimension of the financial infrastructure is a comprehensive and effective legal infrastructure for legal redress arising from Islamic financial transactions. The legal infrastructure needs to comprise both effective regulatory and substantive laws as well as appropriate adjudicative fora for parties to resolve disputes relating to Islamic financial transactions. This will instill confidence and promote the sound expansion of the Islamic financial industry. Towards meeting this objective, the High Court of Malaysia has assigned a dedicated High Court to preside over litigated cases on matters relating to Islamic banking and finance. To complement the court system, disputes may also be referred to the arbitration centre for resolution. In this regard, the Kuala Lumpur Regional Centre for Arbitration will be enhanced to serve as a platform to deal with dispute cases on Islamic banking and finance, and to extend these services beyond our borders. In addition to the dispute resolution mechanisms, the Central Bank has formed the Law Review Committee to review the common law-based domestic legislations to assimilate Shariah principles with the aim of removing any impediments to ensure the unhindered and efficient functioning of the Islamic banking and financial system. This review covers tax and stamp duty laws, company laws, land laws and procedural laws.

An important consideration in the development of an effective legal framework for Islamic banking and finance is the need to ensure enforceability of Islamic financial contracts in accordance with Shariah principles. In this regard, the Central Bank of Malaysia Act 1958 was amended to position the Shariah Advisory Council of Bank Negara Malaysia as the sole authority on Shariah matters pertaining to Islamic banking and finance that fall under the purview of the Central Bank. With this stature, the Shariah Advisory Council will therefore serve as the reference point for the court or arbitrator in dispute resolution that involves Shariah issues in Islamic banking and finance cases.

To further strengthen the Shariah infrastructure, guidelines will be issued to define the new structure, roles and functions of the Shariah Committees of the Islamic banks, the Islamic Banking Scheme banks and the takaful operators. The guidelines would specify among others, the requirements for the appointment of the Shariah Committee members and the duties and responsibilities of Islamic financial institutions to facilitate the effective functioning of the Shariah Committee. In the Islamic capital market, the establishment of a strong Shariah infrastructure is equally pertinent to ensure that the structuring of Islamic capital market instruments, the construction of Islamic investment funds and the execution of Islamic investment fund strategies are Shariah-compliant. This is important to preserve the integrity of the Islamic financial system and promote confidence that Islamic banking and financial operations do not deviate from the dictates of the Shariah.

The hallmark of a well-developed financial infrastructure is an effective

regulatory and supervisory framework which underpins the stability of the financial system. The regulatory and supervisory function is an indispensable and vital component of the financial infrastructure. In a dual financial environment, the prudential regulatory design needs to take into account the unique characteristics peculiar to Islamic banking and finance as well as provide a level playing field in relation to conventional banking and finance so as to ensure that Islamic financial institutions and transactions are not at a comparative disadvantage. It also needs to assess and mitigate any potential regulatory arbitrage practices between the conventional and Islamic financial system that could undermine the stability of the overall financial system. While conventional banking is primarily premised on an interest-based debtor-creditor relationship, Islamic banking transactions are relatively more complex arising from the diverse contractual relationships between the Islamic financial institutions and their customers, ranging from the low risk sales and lease-based modes of finance to the higher risk equity-based modes. Each of these modes of finance has a distinct intrinsic characteristic dictated by its underlying Shariah principles and thus, entails different risk profiles. Therefore, the risk management infrastructure in Islamic financial institutions must be in place to identify, unbundle, measure, monitor and manage all the specific risks in Islamic financial transactions and instruments to provide for their effective quantification and management. The establishment of the Islamic Financial Services Board (IFSB) in 2002 marks an important milestone in the development of internationally accepted prudential regulatory standards and best practices for the Islamic financial services industry. Since its establishment, the IFSB has attracted wide participation. To date, there are 13 full members, 4 associate members and 35 observer members in the IFSB. The technical committee of the IFSB is now in the final stages of the formulation of the prudential standards on capital adequacy and risk management. The IFSB has also commenced work on standards for corporate governance.

Whilst appropriate regulations and standards are vital to mitigate the risks involved, of equal importance is the oversight and monitoring of the Islamic financial institutions through effective supervision by the regulatory authority to ensure that the prudential requirements are observed. Lack of oversight, inadequate check and balances, and over exposure to risks are amongst the factors that may result in vulnerabilities to the system. The best of regulations and financial safety nets would not be able to avoid vulnerabilities if early warning systems are not in place. To effectively perform the supervisory function it is important to not only identify the risks involved in the various Islamic financial transactions but also to be able to detect any contravention of Shariah principles in financial transactions and operations.

A central feature of the regulatory framework for Islamic financial institutions is financial transparency and disclosure. This is particularly pertinent for Islamic financial transactions. For example, investment depositors in the Islamic banking institutions have the role of quasi shareholders that are not only entitled to share the profits of the

Islamic banking business but are also exposed to the risks of losing their capital in the event of losses. In this connection, the issuance of a standard framework for the derivation of the rate of return in Islamic banking business has an important role in addressing the information asymmetry between the Islamic banking institutions and the depositors so as to ensure depositors receive their appropriate share of returns on the investment. In addition, the issuance of the guidelines on the model financial statement for Islamic banks will provide for greater disclosure on the risk and return profiles of the different categories of deposits. This will enable depositors to obtain the true and fair assessment of the Islamic banks' financial performance and hence, promote confidence and strengthen the competitiveness of the Islamic financial industry.

Enhanced financial disclosure needs to be complemented by customer education and awareness programmes to elevate the level of financial literacy of consumers and businesses to be able to make informed financial decisions and instill market discipline amongst financial players. The launching of the Consumer Education Programme and the organization of the Islamic Banking and Takaful Week are aimed at achieving these objectives. These programmes have contributed to enhance the understanding and appreciation of the unique characteristics of Islamic banking and finance, Islamic financial products and services and their underlying Shariah principles and concepts. Enhanced awareness on the manner in which Islamic financial transactions are being conducted and Islamic financial contracts are being executed will not only strengthen the role of market discipline in driving Islamic financial institutions towards ensuring Shariah compliance in the operations, but also contribute towards improving operational efficiency, strengthening risk management infrastructures and instituting sound and dynamic risk management practices.

IV. Conclusion

To harness the full potential of the Islamic financial system, genuine endeavours to strengthen further the Islamic financial infrastructure, to develop the Islamic financial markets and to innovate Islamic financial instruments and activities that are able to meet the changing requirements of the new economy and the contemporary global marketplace need to be continuously pursued. With the acceleration of the global integration of Islamic finance, it will provide the synergies and opportunities for the Islamic financial industry to evolve into an important component of the international financial system that can contribute to enhance the prospects for a more balanced global growth and global financial stability.

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"Towards Creating an Islamic Financial System as an Integral Part of the International Financial System - Strategies and Challenges"

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I. Introduction

The integration of Islamic finance with international financial markets and institutions has demonstrated its viability, competitiveness, resilience and sustainability as a form of financial intermediation. This trend has contributed towards facilitating greater cross border flows in terms of increased trade and investment transactions thereby strengthening the global economic and financial linkages. As this international integration process intensifies, it not only raises the prospects for more balanced global growth but also allows for greater diversification of risks thus contributing towards greater global stability. At the core of this financial globalisation process is the robustness and resilience of the domestic Islamic financial system. The development of a sustainable Islamic financial system that is able to withstand the challenges of the uncertainties and instabilities inherent in the global financial system, thus not only requires an effective global financial architecture but a system that is also supported by an appropriate, comprehensive and sound domestic financial infrastructure. These mutually reinforcing structures would not only accentuate wealth creation and foster greater potential for trade but would also promote global financial stability and breakthroughs in new business relationships.

While the overall development of Islamic banking and finance for more than three decades has been evolutionary, the pace has intensified in recent years. Islamic financial concepts have been incorporated into many financial products to meet the changing needs of consumers, businesses and investors. New Islamic financial institutions are being established ranging from the traditional banking institutions to more specialised financial institutions. This Islamic financial landscape has been supported by a well-developed regulatory, prudential, legal, accounting, framework and reinforced by the necessary research and development. Initiatives to promote greater awareness and education amongst Muslims and non-Muslims have also been intensified.

In this recent decade, we have seen the financial globalisation of Islamic finance

with the participation of both the authorities and the private sector. In the case of the former, attention has been given to developing the financial infrastructure, including the financial markets, institutions and agencies as well as establishing the necessary prudential and accounting standards. While the latter has included the borrowers, investors and institutions that participate in the process. Sovereigns, corporations and multinational and multilateral entities have accessed the international markets while the institutions and investors have been a source of financing. Indeed, these funds are either raised directly from international banking institutions or through bonds and equity issues in international markets. It has not only expanded the investor base, but reduced the cost of capital and enhanced its liquidity. By operating beyond their domestic borders, financial institutions also provide their services from different geographical locations. There has also been greater use of international financial institutions by corporations, households and funds to increase their ability to diversify their risks. Investments in the domestic economies have also been financed by foreign capital. International firms have also participated in local markets through Islamic based financial structures. With increased liberalization, there is also increased foreign presence in terms of foreign entry into the domestic financial system. This is an area where Malaysia is taking a step forward during the course of this year. The globalisation process has also taken place in terms of participation by firms in international capital markets through cross listings. My remarks today will focus on the strategies on the approach to accelerate the transition of Islamic finance towards being an integral part of the international financial system in terms of both the international financial architecture of the Islamic financial system and the development of a comprehensive domestic financial infrastructure.

The establishment of the Islamic Financial Services Board (IFSB) has been an important initiative in the development of the international Islamic financial architecture. It has been established to promulgate the international regulatory and supervisory standards for Islamic financial institutions aimed at achieving best practices and to secure soundness and financial stability in Islamic finance. In this regard, the IFSB has already made progress in developing the prudential standards on the capital adequacy and risk management framework, and has commenced work on developing standards on corporate governance.

Appropriate accounting standards have also been put in place to reflect the true and fair value of banking operations that would lead to greater accountability and responsibility on the part of financial institutions. While the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) has made a significant contribution in formulating and issuing accounting and auditing standards for Islamic financial institutions, efforts need to be intensified to promote of the adoption of these standards.

The International Islamic Financial Market (IIFM) further provides the environment that will encourage active participation by both

Islamic and non-Islamic financial institutions in the secondary market for Islamic financial instruments. Several global sovereign sukuks have been issued in the international market that has attracted wide interest, both by Muslim and non-Muslim investors. The next phase in this development is the raising of funds from this market by multinational corporations and multilateral institutions. As the volume increases, it would strengthen the inter-linkages and integration amongst the Islamic financial centres. In addition to structuring a variety of attractive off-the-shelf instruments, efforts need to be intensified to create a benchmark curve for future issues. With a well-developed system, the trading of instruments would encourage the free flow of capital movements and would in turn facilitate greater Islamic fund management activities.

As a platform to promote greater cooperation among Muslim countries and further promote IIFM, a proposal that can be explored is the creation of an Islamic universal bond, structured similar to the universally-accepted asset-backed Ijarah sukuk. Under this proposal, interested countries and selected organisations could be invited, where each country sells its assets to an SPV, which in turn would lease back the assets to the country. Proceeds could then be transferred to the participating country for the general purpose of socio-economic development. This could be an avenue for countries that have not secured stronger ratings to get more competitive funding. Indeed regional and multilateral entities would be well positioned to explore the viability of this proposal.

The role of Shariah is one of the key elements that can spur the innovation process and enhance the global integration of the Islamic financial system. To effectively enhance Shariah governance, the understanding of the mechanics of finance by the Shariah experts is imperative to assist in the deliberation process in deriving a sound Shariah decision. The Shariah decision should then be made transparent. With such disclosure, the ability for others to appreciate the juristic reasoning based on contemporary analysis and logical inference of process could lead to wider acceptance of a Shariah decision, especially if it has implications on cross-border transactions.

With better understanding, the likelihood of a Shariah convergence is higher and this will enable the creation and trading of Islamic financial instruments at the international arena to be more universally accepted, as interpretations will be uniform and consistent. Harmonisation of the differing views among the scholars from different schools of thought is necessary to enhance the global development of Islamic banking and finance. I believe, at this juncture, the right approach is to advocate mutual respect in any Shariah discourse where there are differences in opinions, interpretations and practices.

To complement the efforts to create a sustainable and comprehensive Islamic financial system, consumer education and awareness on Islamic banking and finance should be extensively undertaken. Concerted efforts between the governments and Islamic financial fraternities should be engaged to develop such a consumer education

programme. Such programmes would increase transparency on the virtues and availability of Islamic financial instruments offered by the Islamic financial institutions. How consumers can expect to benefit will depend on how well informed they are about the financial services being provided. Barriers across geographical boundaries can be removed by leveraging upon the advances on Information Communication Technology to create an integrated internet platform as means for the knowledge sharing on research findings, conference discussions, Shariah rulings and other vital information on Islamic banking and finance. Improvements can be made to the existing internet portals to be more comprehensive with linkages to other useful information providers. Equally important is the consumer protection infrastructure. An international financial information dissemination body should be set up to disseminate the development of Islamic banking and finance worldwide. In addition, with greater disclosure and transparency on the manner in which Islamic financial transactions are being conducted and the risk and return profiles of the products, the role of market discipline in driving Islamic financial institutions towards ensuring Shariah compliance will be strengthened. This will ensure operational efficiency, strengthen risk management infrastructures and institute sound and dynamic risk management practices.

As part of the process of enhancing inter-linkages with the rest of the world in the area of Islamic finance, Malaysia is also encouraging the domestic Islamic financial institutions to be more global by expanding beyond the domestic shores. With the experience that has been acquired in Islamic banking and finance that has been accumulated over more than three decades now, it is timely and desirable to extend this experience beyond our own borders. The domestic Islamic financial institutions would need to undertake feasibility studies and in-depth groundwork to identify new markets to expand their business operations, in particular with economies in which there is potential for greater economic linkages and integration.

As the pace of globalisation and liberalisation accelerates, securing financial stability and confidence has increased demands for more robust and resilient financial systems. While affected by some market instability and uncertainties, it has not, however, undermined the development of the global Islamic financial system that has now become an increasingly integral component of the international financial system.

The approach to building a sustainable and progressive domestic Islamic financial system involves the creation of the key components comprising the **Islamic banking industry, Islamic financial markets, the Islamic insurance or takaful market**, and fund management industry given the strong linkages, inter-dependence and synergies among these components in the system. In addition, to the financial intermediaries and fund managers, other institutional players such as brokers, specialists and corporate treasurers also have important roles to play.

Another area of focus is the growth of non-bank Islamic Financial institutions. In

Malaysia, the first included Tabung Haji, the Pilgrim Fund Board. Other components include institutions such as waqaf, corporate zakat, investment trusts, mutual funds and inheritance management. This is part of wealth management that will become more significant as the domestic economy enters into its next level of development and as savings across borders becomes more institutionalized. This will become an important source of funding for productive investment, in particular for large-scale investments. New forms of financial structures may be developed for this purpose.

In promoting Islamic finance in the Labuan offshore financial center, emphasis is being given to several of these areas, in particular, to promote the fund management industry including via the Labuan International Financial Exchange (LFX). Labuan will also be promoted as a center for waqaf administration. It will also promote the development and market acceptance of IIFM. In the LFX, dual listing and trading of capital market instruments are being undertaken, for both Islamic and conventional papers. This includes equities, debt instruments, bonds (sukuks), asset back securities and mutual funds. In addition, the Islamic capital market will be expanded through IIFM and strategic alliances with other stock exchanges. These offshore activities will thus complement the onshore activities. Not only has attention to be given to the financial infrastructure, the financial markets and to institutional development, but also to the regulatory, Shariah and legal dimension. The hallmark of a well-developed financial infrastructure is an effective legal, regulatory and supervisory framework which underpins the stability of the financial system. For the Islamic financial system, this framework also needs to be consistent with the requirements of the Shariah.

It is also recognised that good corporate governance reinforces sound regulation and supervision. This contributes towards maintaining market confidence, and strengthening transparency and accountability that is implicit in Islamic finance. Its emphasis is value-oriented and to promote fairness and justice with respect to all stakeholders of the financial institution. Transparency and disclosure is essential to this process. While the comprehensive and timely availability of financial information will increase market discipline, it also needs to be complemented with the ability of the market players to analyse, and appropriately interpret the information. Closely related to this issue is the need to strengthen the framework for consumer protection to provide an avenue for redress in the event of disputes.

Emphasis on improved corporate governance goes hand in hand with the need for improvements in risk management standards. Sound risk management practices will minimise adverse consequences faced by financial institutions during periods of uncertainty. Robust internal controls to provide qualitative standards are also necessary to complement the quantitative analysis of risk to provide the necessary checks and balances. In the area of Islamic banking, the requirement to manage the risks becomes more important because of the unique peculiarities in the contracts. Basel II has, to a certain extent,

incorporated some aspects in the identification of risks, in particular the credit, market and operational risks that can be assimilated by the Islamic banks in terms of its product offering.

Another important pre-condition to sustain the continued growth of Islamic banking and finance is a comprehensive legal infrastructure for legal redress arising from disputes in Islamic financial transactions. The legal infrastructure needs to comprise both effective regulatory and substantive laws as well as appropriate adjudicative fora to resolve disputes relating to Islamic financial transactions. To address this, efforts are needed to develop a sufficient number of competent lawyers and judges that are equipped with sound knowledge and expertise in both Shariah and civil laws to deal with such matters. This would need to be supported by an efficient court system that can effectively deal with all Islamic banking and finance cases, whose decisions are enforceable over the range of financial issues. Above all, these pre-conditions have to be in conformity with the Shariah framework.

Whilst it is necessary to have in place the market infrastructure, institutional players and the regulatory, Shariah and legal framework, it is still not sufficient in sustaining the robustness and dynamism of an Islamic financial system. To achieve this, the strong linkages and synergies especially among the components in the financial markets, namely, the money market, foreign exchange market and the capital market, have to be extensively capitalised. The Islamic money and foreign exchange markets are integral to the functioning of the Islamic banking system, firstly, in providing the Islamic financial institutions with the facility for funding and adjusting portfolios over the short-term and thus the necessary liquidity mechanism to promote stability, and secondly, serving as a channel for the transmission of monetary policy.

The inter-linkages in the functioning of the Islamic financial markets have brought about a natural environment for innovation of Islamic financial instruments. A broad spectrum of instruments, such as Government papers including bonds and treasury bills, Central Bank notes and Islamic accepted bills, can be structured on a Shariah-compliant basis to meet the needs of these markets. In addition, instruments for a risk mitigating mechanism for hedging or value protection need to be developed. While risk mitigation is desirable in Islamic finance, innovations need to be made for this purpose.

To aid the process of developing the financial markets, Bank Negara Malaysia has recently developed a website on the Islamic money market as a source of information on domestic Islamic financial instruments and to facilitate investment decisions and secure public confidence in their investment. The website aims to effectively meet the needs of bankers, financiers, statisticians, economists and prospective investors as well as increase awareness of the users - domestic and foreign. Moving forward, the website will be linked with other markets to serve as a

platform for exchanging information and knowledge beyond our borders.

The existence of a well-developed capital market is also important to provide users of capital with an alternative and cost efficient source of medium and long-term financing. It would also provide investors and savers with a wider range of financial instruments to suit their individual return and risk profiles as well as allow for better diversification of risks in the financial system. One of the linkages in this market is asset securitisation. Mortgage financing is an example of where the asset liability mismatch can be addressed. This would substantially improve the liquidity and quality of assets of the banking institutions, while at the same time contribute towards promoting the development of the capital market and secondary trading of instruments through the issuance mortgage-backed private debt securities. Over the years, the scope of securitisation activities can evolve and expand with the introduction of securitisation of Islamic hire and purchase or leased assets ending with ownership, and other types of leased financing.

At the core of a financial system of any country must lie an efficient and effective payment system as a means for clearing and settling payments. In modern economies, this function is already highly mechanised to support a sound and stable financial sector. It is vital that a real time settlement system for inter-bank funds transfer be implemented to reduce the credit and settlement risk in the financial system. It must be able to handle scripless debt securities trading, processing and settlement on a model that reduces counterparty risk.

II. Conclusion

As Islamic finance advances forward to become an important integral component of the international financial system, efforts need to continue to strengthen further both the international architecture and to enhance international cooperation and collaboration as well as to develop the domestic financial system to meet the changing requirements of a highly dynamic and rapidly evolving environment. Malaysia will continue to play an active role in this process. In our quest to build a viable and sustainable Islamic financial system, the aim is to contribute to the channeling of capital flows to productive investments, create wealth and promote trading activities, with the activities undertaken not just among Muslims but with the rest of humanity.

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"The Importance of Financial Literacy Among Women in Asia"

Special Address by
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I. Introduction

Asia represents the fastest growing region in the global economy. Of significance, is that more than half the population in Asia are women. The participation of women in the economy would therefore not only enhance their own economic well being but would also contribute towards raising further the economic potential of Asia. Women are already engaged in both the informal and formal sectors and are increasingly emerging as a more important force in the economy. The effective participation, however, needs to be an informed participation. Financial literacy among women becomes an important part of this process, regardless of the income constituency to which they belong. There needs to be a better understanding of their financial rights and responsibilities, and their opportunities for income generation and the associated risks and costs involved. This is particularly important for Asia, where rapid economic and financial transformation is occurring. Financial literacy among women is thus a vital part of this process, not only to promote greater engagement of women in the current economic environment, but also to prepare them for the future.

My remarks today will first discuss some of the major structural and cultural transformations in Asia that are changing and impacting the economic environment faced by women in Asia, and their rapidly changing role in the economy. I will also touch on aspects of the challenges faced by women in Asia in their endeavour for greater economic engagement. This will be followed by a discussion on the important enablers for enhanced financial literacy and to share with you Malaysia's experience in driving a more financially literate society in particular, that enhances the inclusion of women in the economic mainstream.

Asia is being transformed. For more than two decades now we have seen unprecedented structural and cultural changes in Asia that have resulted in the transformation of the environment faced by women. Asia has emerged as the fastest growing region in the world with GDP in Asia now accounting for 23% of the world economy, compared to 17% in 1980. Per capita income during this period has more than quadrupled. If these trends continue, by the year 2020 Asia will account for about 27% of the world economy while the income per capita would have further tripled.

These dynamic changes have made financial literacy among women even more vital.

Indeed, against these favourable trends, there has been a growing participation of women in the growth and development process in Asia. In particular, there has been a strong migration from the informal to the formal sector, following the modernisation and industrialisation process. The increase in the relative significance of the financial sector in most Asian economies can be seen in terms of the momentum in the financialisation of savings and the increase in the volume of financial transactions being conducted through the formal financial sector. These trends are being reinforced by the shift of activities that is taking place from the traditional sectors to the industrial and services sectors. On average, the industrial and services sector now accounts for 74% of the economy in Asia, compared to 60% in 1980. In contrast, agriculture now accounts for 12%, compared to 26% in 1980. Involved in this transformation, women have demonstrated a high degree of mobility, participating in all segments of economic activity. Most discernable is the increasing participation of women in the services sector. Here in Hong Kong, the percentage of women in the services sector relative to the total population increased from 43% in 1980 to 87% in 1999. Similarly in Indonesia, the rise was from 32% to 42%, and in Malaysia, it was from 33% to 57% and in Thailand, from 18% to 34%.

In Asia, the demographic structure also reinforces the economic potential of Asia. The population in Asia continues to grow at a relatively high and stable rate to account for more than half the world's population. Of significance is the relatively young demographic structure in Asia. More than 50% of women fall in the age group 15 to 49 years, similar to that for men. This demographic structure thus not only contributes to enhance the potential of the economy but combined with rising incomes and improved standards of living, has resulted in increases in consumption spending. This resultant increase in purchasing power has strengthened domestic demand, making it an important driver of growth in the Asian economies. Indeed, these trends have strengthened the sustainability of consumption-based growth. As part of this process, women have become an important consumer target group with enhanced purchasing power. In fact, in several of the Asian economies, women are emerging as a key target market. This greater capacity for earning, spending, saving and investing requires ability for financial management, and hence the urgency for greater financial literacy.

While financial literacy is important, regardless of economic status, it becomes even more important for those that are less privileged. For those that have less to manage, it becomes more vital to manage the finances even more effectively. It is also those that have been under-served by the financial system that need to be more aware of the financial services that they should be able to access, and the benefits that can be drawn from the various options available. They too have the same need for maximising the benefits from their limited resources, and to achieving financial and economic security. Strengthening their financial position becomes even more

important for this target group. There needs to be awareness of the alternative assets that can be accumulated not only to generate an income stream but also towards building wealth. Of equal importance is to draw those operating in the informal sector into the formal sector, where their financial requirements, whether households or businesses can be better served.

A further phenomenon taking place in Asia is the increased regional economic and financial integration that is taking place. This has manifested itself in increased intra-regional trade, investment flows and the increased intra-regional presence of corporations and financial institutions. A more recent phenomenon is the increased mobility of labour in the region. Of significance is the number of women who have ventured beyond their own borders in search of new employment opportunities. While data on this is not available, the statistics on remittances of income show this is a growing trend. Overseas employment is particularly evident in the manufacturing and services sectors. Financial literacy under these circumstances becomes even more vital. In venturing to new areas where different systems, languages and cultures prevail, it becomes important to have knowledge of the basic financial matters so as to maximise the benefits the new employment is expected to yield.

As the formal economies of Asia prosper and grow, there is a greater need to integrate the informal sectors of the economy with the formal sector. There are millions of women in Asia involved in a wide range of economic activities from the home, making handicraft, assembling parts for international brand names and working in the fields. They work for a small income, and generally in difficult circumstances. Deliberate actions to integrate the informal economy into the formal economy will give this segment of society increased opportunities. In many countries, the success of various national and international socio-economic reform programs have resulted in women becoming an increasing part of the formal economy. Through the concerted efforts of women's rights movements, economic policy intervention and gradual shifts in cultural norms, women today have more opportunities for education, careers and political representation. However, in many instances the increase in participation in the formal economy has not come with a commensurate level of sophistication in financial literacy. As a result, women continue to face special challenges in their endeavour to be active participants in the economic system.

II. Challenges women in Asia face in financial literacy

Let me now turn to discuss some of the challenges faced by women in Asia in their endeavour to become more financially literate and financially independent. Firstly, with the socio-economic environment in Asia changing rapidly, there is greater uncertainty and volatility which represents a challenge even for financial experts. The financial system has also become more complex, with new risks emerging. This increased sophistication thus makes it increasingly difficult for those who are less financially literate to make sound decisions.

Secondly, the advances in technology has led to a proliferation of financial products and services. There needs to be a greater understanding of the basic concepts and practices of banking, insurance and equity so as to know how to make choices from the wide range of financial products available, and to assess the respective risks, costs and returns. Also important is the basic principles of debt management, wealth management and personal budgeting to be able to understand the importance of long-term savings in funding future requirements.

Financial literacy involves being able to identify and understand the opportunities for income generation, access to funding, and learning how to make the most of the range of financial products available. It also involves learning how to manage financial risks in an environment where the financial infrastructure may be under developed. This may relate to the laws and procedures in the country. Also important is the need to be able to recognize illegal schemes and other exploitative practices such as predatory lending.

Thirdly, while women in Asia are being less stereotyped and given greater opportunities for entering into the economic mainstream, nonetheless the working conditions for women in many countries have tended to be less favourable. The exploitation of labour in the informal sector in some instances are particularly bad, not only for women, but also for children and minority groups. Women who are disadvantaged in this manner have found it difficult to escape from the trap of indebtedness.

Frequently, the disadvantaged and those who are not able to access the formal financial system have resorted to the informal financial systems. Recourse to these financial sources have also been due to the lack of awareness. These may be in the form of deposit schemes that entail high risk, access to financing from sources that are highly costly, and almost inevitably against high collateral. Very often, the practices are unfair and deceptive. Examples in predatory lending are found to be unscrupulous and highly disadvantageous to the borrower.

Fourthly, in some Asian societies, traditions continue to create cultural pressures that restrict a woman's choices and liberties. Though there is increased freedom for women to pursue education and careers, in some societies, cultural pressures still make it more difficult for a woman to get the exposure on financial matters. In addition, the increased incidence of divorces and single parenthood mean that more women are left to fend for themselves and their children. In certain Asian societies, single women may face unusual difficulties in arranging their finances. In some cases, a woman may even have difficulty claiming her legal rights in a contract, even though the law does not dispute such a right. Deeply entrenched human behaviour is not able to change as rapidly as the financial system is evolving.

Fifthly, statistics on life expectancy confirm that women tend to live longer. In segments of society where women earn less than men, combined with the fact that they may live longer, it is crucial to have financial acumen in order to increase the financial

independence of women. This trend also magnifies the need to plan for retirement especially in an era of rising medical costs.

III. Enabling Environment for Financial Literacy

The promotion of greater awareness and understanding in financial issues in a dynamic and constantly changing environment has to be a continuous process. The effort needs to focus not only on providing education programmes but also on putting in place the supporting infrastructure to enhance the access to financial services, to ensure an environment of financial transparency and disclosure as well as adequate consumer protection. Enhanced financial literacy is about bringing people into the financial mainstream so that they are able to make well informed decisions regarding their earnings, spending, savings and investments. The effort thus has to encompass a comprehensive set of strategies including the education process reinforced by the supporting infrastructure.

The goal of any financial education programme is to increase awareness of the value of effective financial management, to show how it can contribute to financial security and improvement in the economic well-being. The most effective of programmes have been those that are targeted to specific groups. Fundamental education for greater financial literacy that will have most sustainable impact are those through the school system. Such educational programmes would provide the education to women from an early age. Essentially, it would not result in the marginalisation of anyone target group, in particular women. Such programmes would therefore best serve its purpose as part of the core curriculum. Indeed, the national education system can play a pivotal role in financial literacy within a country.

The responsibility of promoting economic and financial literacy needs to be a collaborative effort amongst the authorities, the financial service providers and the community to connect to the different target groups including all social groups. These would include the lower income groups, workers and businesses. Important are programmes directed to families where women have an important role and to engage those we have not been able to participate fully to benefit from the favourable economic environment prevailing in the region.

Among the successful financial education programmes are those with specific objectives that are tailored to meet particular needs. This includes programmes to promote savings for specific objectives; for education; or for retirement. The education programmes can also be linked to other objectives such as good health, house ownership and so on. Financial products can be tailored for such purposes to not only to promote interest but to also meet these objectives.

All distribution channels need to be relied on to maximise the effectiveness of financial education programmes. Formal training programmes can be reinforced by web based content via the Internet. The World Wide Web offers dramatic economies of scale in terms of distribution of content at low cost. Connectivity to the Internet can serve to bring

information from all over the world to the local education system. Iterative programmes can be useful to encourage participation. Web based programmes while requiring computer literacy, has a wider outreach and allows for flexibility of time that is of particular importance to women.

A further means by which financial advise is provided is through financial advisors. Financial advisors are able to address the issues for the more sophisticated investors. Similarly, infrastructure for advisory services for small businesses is key. This can in particular be provided by financial institutions. Systems need to be in place where consumers and businesses are explained their rights and responsibilities. Micro credit institutions have also been highly successful in many countries in providing access to financial services to microenterprises. This will contribute towards greater reliance on the formal financial infrastructure and less on the informal structures.

Higher level of consumer education and financial literacy must be complemented with effective disclosure regime, fair and transparent market practices, simplification of financial products and enhanced communications in the marketplace to minimise information asymmetry.

While efforts may be taken to enhance transparency and disclosure by service providers, and while programmes for enhanced literacy can produce positive results, consumer protection is still needed. Given the asymmetry of information, consumers often do not have enough information to be completely protected. Building the confidence of consumers also requires that there be adequate avenues for consumers to seek redress to enable consumers to resolve conflicts through an equitable process. Also important are the requirements for complaints to be handled promptly by financial institutions.

IV. The Malaysian Experience

For several decades, Malaysia has made significant economic progress. The economy grew by an average of 7% per year, while the per capita income has increased from USD300 in 1970 to USD4,236 in 2004. From a commodity-based economy, Malaysia now has a highly diversified economy, with significant contribution from the manufacturing and services sectors. Women account for about half of Malaysian population, and have played an important role in this economic transformation process. Women account for about 45% of the labour force, with increasing representation at the professional, managerial and technical levels. Such progress is achieved following increased educational opportunities that have been made available to women. Female primary and secondary students account for half of total enrolment, while at public universities, female students account for 55% of total enrolment. While women continue to play a major role in household financial planning, a new generation of women who are financially independent and sophisticated is emerging.

The financial sector in Malaysia has also experienced significant progress, with greater diversity of players, products as well as delivery channels with extensive distribution nationwide. The widespread distribution of financial institutions has been a conscious and deliberate policy to ensure the widest reach of financial services to both the urban and rural areas. With the improved access of consumers and businesses to financial products and services, consumer education on financial matters is an important priority for the Central Bank.

Consistent with the belief of the importance of instilling financial awareness at an early age, Bank Negara Malaysia introduced a pocket money book to inculcate smart financial management habits among students in 1996. The programme also included Household Account Books to assist families in the management of household income, savings and investments. This was distributed to cover a wider group, including women, teachers and workers.

Following this, in 1997 together with the Education Ministry, the Central Bank embarked on a School Adoption Programme. Through this programme, more than 7000 schools have been adopted by banking institutions to play a leading role in educating school children on basic financial knowledge. In October this year, an online interactive version of the Pocket Money Book to be used in the School Adoption Programme was launched.

The Central Bank of Malaysia has also laid out a blueprint known as the Financial Sector Master Plan that charts the development of the Malaysian financial system over a ten year period commencing in 2001. A key component of that plan is the 10-year Consumer Education Programme for the banking and insurance sectors. This programme is known as BankingInfo and InsuranceInfo, and was launched in 2003. To reach a wide spectrum of the population, various channels are being employed to disseminate information, including through media, road shows, information brochures and a dedicated web site. There is also a dedicated outreach programme aimed at specific target groups, which includes women in rural areas, low income earners and disadvantaged women such as single mothers. To date, the BankingInfo website has received an overwhelming response - about 14 million hits and more than 2.5 million booklets were taken up by the public. In the insurance sector, over 1.4 million hits have been received on the InsuranceInfo website, and more than 1.3 million insurance info-booklets have been disseminated by the insurers to the public.

Similar to many other Asian economies, microenterprises in Malaysia are a substantial contributor to employment. Women are extensively involved in microenterprises, often operated as family run businesses. To support the growth of microenterprises, dedicated agencies and funding mechanisms have been established. In order to equip the microenterprises with proper knowledge, education materials were developed on the fundamentals of starting a business, specifically addressing issues of getting access to appropriate financing

within the constraints faced by microenterprises. Dedicated agencies, including specialist development financial institutions, were identified to provide training and advisory services to complement these initiatives.

In addition to the consumer education programmes, the Central Bank has put in place a consumer protection framework. In collaboration with the financial industry the Central Bank has established a Financial Mediation Bureau. The Financial Mediation Bureau aims to serve as a one-stop center for the resolution of retail consumer complaints against financial institutions regulated by the Central Bank. The Central Bank is also establishing a one-stop service centre in the Bank that will function as a Public Information Centre for the promotion of financial literacy among the Malaysian public. The service centre will provide advisory services on financial matters to small and medium enterprises.

V. Conclusion

Financial literacy among women is all about having sufficient awareness of financial matters to enable women to protect and prosper for themselves and their families in a world that is becoming increasingly more complex and uncertain. To be an effective participant in this modern economy, we cannot take financial literacy for granted. It is a knowledge and skill that must be deliberately pursued. From a national and institutional perspective, promoting financial literacy must be an integral part of the overall agenda for financial and economic reform and development.

Let me conclude with the words of Jawaharlal Nehru, "We talk of revolutions, political and economic. And yet the greatest revolution in a country is the one that affects the status and living conditions of its women. It is in so far as our revolution has affected our women that it is basic."