

## Keynote Speech of His Excellency the Governor, CBK

### Introduction

Representative of the patron of the conference, His Highness the Amir Sheikh Sabah Al-Ahmad Al-Jaber Al-Sabah,  
His Excellency Dr. Nayef Falah Al-Hajraf, Minister of Finance,  
His Excellency Dr. Abdul Latif bin Rashid Al Zayani, Secretary-General of Gulf Cooperation Council,  
Excellencies,  
Governors of central banks and monetary authorities,  
Dr. Bello Lawal Danabatta, Secretary-General of the Islamic Financial Services Board,

Distinguished Guests,  
Ladies and Gentlemen,

Assalam-o-Alaikum and a very good morning.

I would like to start by expressing my deepest gratitude to His Highness the Amir Sheikh Sabah Al-Ahmad Al-Jaber Al-Sabah for kindly patronizing this global conference on Islamic finance. I would also like to express my profound thanks to the representative of His Highness the Amir, His Excellency Dr. Nayef Falah Al-Hajraf, for being with us today.

It is the guidance and wise leadership of His Highness that has enabled us not only to grow our economy in the last decade, but also to build one of the safest and most robust financial systems in the region, with a dual banking system that has facilitated the growth of both Islamic and conventional finance.

**Your Excellencies, Distinguished Guests, Ladies and Gentlemen,**

It gives me great pleasure to welcome you today to this prestigious global forum on Islamic finance. I am deeply indebted to all the honorable ministers, governors of central banks, heads of regulatory and supervisory authorities, heads of financial institutions and other distinguished guests for joining us today.

In particular, I would like to thank the Islamic Financial Services Board (IFSB), and its Secretary General Dr. Bello Lawal Danbatta, for their support in organizing this joint conference, in conjunction with the IFSB annual meeting.

I would also like to sincerely thank the staff of the IFSB and my dedicated colleagues at the Central Bank of Kuwait for their efforts in making this conference a success.

The IFSB, established in 2002, is recognized today as the leading international standard-setting body for Islamic finance, promoting the development of a prudent and transparent Islamic finance industry.

The Central Bank of Kuwait, one of the founding members of the IFSB, has long recognized the importance of its work in issuing and/or adapting international standards for the specificities of the Islamic finance industry, and the complementary role that the institution plays alongside other international standard-setting bodies such as the Basel Committee on Banking Supervision.

As the current Chairman of the IFSB, I am extremely pleased by the growth and development of this international institution, which has expanded in the last 15 years from its nine founding members to 185 members today, which include 75 regulatory and supervisory authorities in 57 jurisdictions.

## Your Excellencies, Distinguished Guests, Ladies and Gentlemen,

To begin with, let us remind ourselves that we must always be mindful of the fact that the ultimate objective of all our efforts is to ensure prosperity, provide high living standards and promote the broader welfare of the whole society on a sustainable footing. Similar to this, we all, in our different capacities and roles, must strive for this objective and ensure that our actions and initiatives are aligned to this goal.

With that said, I feel that this august gathering comes at a suitable time for the Islamic finance industry. The world today faces numerous economic and social challenges that require a collective approach. Market volatility, limited economic diversification, lack of social engagement, poverty and unemployment are just some of the issues that communities are facing around the world. Islamic finance can help in addressing many of these challenges, subject to adherence to its core values.

That is why we are hosting this event under the theme '*Islamic Finance: A Universal Value Proposition*', because we feel that Islamic finance offers a global value proposition, to governments, corporates and consumers, both Muslim and non-Muslim, that can drive sustainable and inclusive economic growth, and shared prosperity for all, since it is built on globally accepted ethical principles.

Building on the success of the previous conference, which the Central Bank of Kuwait organized in collaboration with the International Monetary Fund in 2015, I believe this event serves as a platform for all industry stakeholders to discuss and highlight the role of Islamic finance in the broader national economic agenda, to facilitate discussions to collectively address industry challenges, and to promote greater global cooperation.

In this respect, I would like to share a few thoughts on how we envision the Islamic finance industry contributing to these objectives. My speech is set to cover three key aspects of this debate. I will start by providing a very brief overview of the global economic environment and challenges that we still face, despite the progress made over the last decade. I will then reflect on how

Islamic finance can be leveraged to address many of these issues, in light of examples from around the world. And finally, I will briefly touch upon what is required to ensure that the Islamic finance industry reaches its true potential.

## **Setting the Context – Global Environment and Challenges**

**Your Excellencies, Distinguished Guests, Ladies and Gentlemen,**

Let me start by reflecting on where we stand today in terms of the global environment and challenges, focusing on three key perspectives: economic growth, financial stability, and social development.

Firstly, ten years on from the unprecedented Global Financial Crisis the global economy has come a long way. According to the IMF, global economic growth has been on the rise. It reached 3.8% in 2017 for the first time since 2011. Unemployment at the global level has also come down, from a high of 6.2% in 2009 to 5.7% in 2017, according to the World Bank.

Secondly, we have seen significant improvement in global financial stability. In general, the global financial system has continued to strengthen, thanks to the implementation of various reforms and regulatory initiatives including Basel III standards, risk-based supervision, enhanced corporate governance, stress testing, and the growing use of macroprudential measures.

Finally, significant progress has also been made on social development in the last decade. For instance, according to the World Bank, the percentage of the global population living in extreme poverty has declined from 15% to less than 10% in the last decade.

Despite the progress that has been made in the last decade, many economic and social challenges still persist, with different economies proving to be vulnerable to emerging risks, slower growth, and volatility in financial markets. Also, the recent economic gains are unevenly distributed across countries, and the economic prospects for many remain challenging.

Let me briefly reflect on some of these challenges.

One of the key factors driving economic volatility is the fluctuation in commodity prices. The impact of declining prices can be devastating for developing countries, with over 95 developing countries depending on commodities for at least 50 percent of their export earnings. On the other hand, a recent IMF study found that the full impact of declining oil prices is not clear, and there may not be a net positive economic impact for the global economy in general.

In any case, volatile commodity prices remain a major concern for the global economy, highlighting the need for countries to invest in diversifying their economies to sustain growth. But this is not an easy task for governments. For example, it is estimated that US\$10 trillion will be required to fund infrastructure projects that are designed to support economic diversification efforts in Asia and MENA by 2020.

Second, there are concerns being raised about the state of financial stability globally. Despite recent regulatory reforms and initiatives, the evolving macro-economic conditions could have implications for financial sector stability.

Consider the case of unconventional monetary policies adopted by major central banks in the wake of the Global Financial Crisis. These policies have been helpful in supporting economic recovery and ensuring market stability after the crisis. However, their unwinding could have serious implications not only for financial markets but also for emerging economies, with a potential risk of capital outflows and exchange rate volatility. Moreover, divergence in monetary policies across the advanced countries would make an orderly exit much more challenging for the global economy.

There is also evidence of excessive risk-taking fueled by record low interest rates. According to the IMF's latest Global Financial Stability Report, several countries and institutions have utilized the low interest rate environment to pile on greater debt. According to the Institute of International Finance, global debt has grown from US\$167 trillion to US\$237 trillion over the last decade, and is now at 318% of global GDP. This translates to a debt of over US\$30,000

per capita. And with current low interest rates projected to increase in the medium term, potentially causing capital outflows and depreciation of domestic currencies in emerging markets, this is likely to create repayment and servicing pressures for institutions and countries.

On the other hand, lower interest rates have also seriously dented banking sector profits in many countries. A study by the IMF pointed out that one third of global banks, with US\$17 trillion in assets, are struggling to sustain profitability.

Third, there are still significant challenges for social development. For instance, unemployment is a major issue for most countries around the world. Today, there are over 200 million unemployed in the world, and a further 200 million are classed as underemployed. Moreover, an additional 600 million jobs will be needed globally in the next 15 years to absorb the projected growth in the global workforce.

Financial exclusion also remains a major challenge for many countries. According to the World Bank, an estimated 2 billion adults around the world do not have access to banking services. Moreover, the SME sector, which is a key driver of economic growth and employment in any market, continues to be underserved by the financial sector, particularly in developing countries. It is estimated that 70% of all micro, small and medium-sized enterprises in emerging markets lack access to credit, with the total credit gap being as high as US\$2.6 trillion.

All of these factors have a major impact on global poverty. Around 800 million people continue to live in extreme poverty conditions, having to live on less than US\$1.9 per day.

These are all important macro-level issues which stakeholders will need to address in a collective manner. And it is here that we feel Islamic finance has a role to play globally. Through its distinct value proposition, Islamic finance can help drive inclusive economic growth and strengthen financial stability, which in turn can support social development, as I will explore shortly.

## **Islamic Finance – A Universal Proposition**

**Your Excellencies, Distinguished Guests, Ladies and Gentlemen,**

Financial intermediation has a critical role to play in supporting communities to achieve their ultimate objective, as I outlined earlier. As Thomas Jefferson put it: “The care of human life and happiness.... is the first and only object of good government”. And banking, being the dominant segment of financial intermediation, is the greatest contributor towards achieving this objective.

The conventional banking industry is already playing a major role in this regard. It is a mature and long-established industry, with adequate depth and sophistication. It has the ability to effectively contribute to the global economy given that it employs proper corporate governance and ethics.

On the other hand, modern Islamic finance, including Islamic banking, is at an early stage of its development. Yet the Islamic finance industry provides a universal value proposition for all. Its core values include profit and loss sharing, transactions linked to real assets, a focus on responsible and ethical investments, and prohibitions on speculative transactions, synthetic instruments, and industries that do not benefit the community. These core principles have universal appeal among governments, corporates and consumers, among developed and emerging markets, and for Muslims and non-Muslims alike. Through these core principles, the industry has the potential to support inclusive growth across the value chain, increasing productivity and providing economic and social benefits to the entire society.

Here in Kuwait, we have experienced these benefits first hand. Kuwait has always been a pioneer when it comes to Islamic finance. Looking back, it is impossible to appreciate the birth of the Islamic finance industry without recognizing the tremendous contributions of their late Highnesses the Amirs Sheikh Sabah Al-Salim Al-Sabah and Sheikh Jaber Al-Ahmad Al-Sabah (Rahimahum Allah) for providing a legal environment for Islamic finance in Kuwait.

It was their late Highnesses who supported the late Sheikh Ahmed Al-Yasin (Rahimahum Allah) to realize his vision of establishing an Islamic bank in the mid-1970s, when there was virtually no Islamic finance model to emulate or learn from. Despite this challenge, Sheikh Al-Yasin persisted, with the support of other likeminded individuals, to establish Kuwait Finance House (KFH) – not only the first Islamic bank in Kuwait, but also one of the very first to be established anywhere in the world. He described the challenge of establishing an Islamic bank as being *'like swimming against the tide'*.

The seeds he sowed for the industry have blossomed. And the Islamic finance industry in Kuwait, which started with a single branch and four employees in 1978, has grown today to make up to 40% of the country's banking sector, with five Islamic banks, KD29 billion (US\$96 billion) in assets, 600 branches, and over 12,000 employees.

Leveraging on the examples of Kuwait and other pioneering markets, the global Islamic finance industry has grown exponentially during the last four decades. According to most estimates, the industry now accounts for US\$2.2 trillion in assets. Today there are over ten countries, operating a dual banking model, where Islamic banks hold over 20% of banking sector assets, reflecting their systemic importance. In addition, 44 countries to date have introduced some form of legislation or regulations to support the development of their domestic Islamic finance industries.

Although, the growth of Islamic finance has been impressive over the last four decades, its penetration is still only approximately 2% of the global finance industry. While over 80 countries are implementing some form of Islamic finance, the industry remains small outside of a handful of core markets in the Middle East, North Africa, and South and Southeast Asia.

Still, the Islamic finance industry, with its universal value proposition of inclusiveness, can help address many of today's economic, social and financial challenges, subject to necessary conditions such as implementation of relevant Islamic finance standards, corporate governance, ethics, and proper risk management, to which I alluded earlier.



First, for economic diversification, Islamic financial instruments can play an important role. One Islamic financial instrument used extensively for this purpose is Sukuk. In the last four years alone, Sukuk have been used by over 20 sovereign governments from around the world, Muslim and non-Muslim alike, to raise over US\$100 billion of funding for various projects and initiatives across Africa, Asia, Europe and the Middle East. Sukuk not only help institutions raise funding and deepen capital markets but also help governments build infrastructure and provide support in achieving the Sustainable Development Goals.

Second, we have the impact of Islamic banking on the overall financial stability of a country. Islamic finance can have a positive impact on financial stability through the implementation of its core values such as profit and loss sharing, connectivity of financial transactions with real assets, and the prohibition of speculative transactions, synthetic financial tools and investments in harmful industries. Numerous studies from the World Bank and the IMF have highlighted that Islamic finance offers an inclusive and stable operating model, provided it remains true to its core values and is built on a solid foundation.

Finally, social development is another area where the core principles of Islamic finance can be leveraged. For instance, governments can use Islamic finance for financial inclusion. Many countries introduced Islamic finance during the 1980s and 1990s with the primary motivation of promoting financial inclusion for people who otherwise would have been excluded from the financial system. In recent years, international institutions such as the World Bank and the IMF have increasingly identified Islamic finance as a critical industry to address the issue of financial exclusion across the world. A recent study from Ernst & Young on *Banking in Emerging Markets* shows that Shariah-compliant products – through leveraging the support of appropriate technology infrastructure – can bring up to 150 million unbanked customers into the financial system in the next three years.

The core principles of Islamic finance mentioned earlier are also naturally aligned to the needs of the SME segment. This link has been substantiated by research from various institutions, including the World Bank, which published

a study in 2014 that found that the greater the number of Islamic banks per 100,000 adults in a country, the lower the proportion of SME firms that identified access to finance as a major constraint.

Given the salient features I have discussed, we have to ask ourselves: “What would be the impact, globally, if the industry was able to reach its full potential?” Our empirical analysis indicates that if developed globally, Islamic finance assets could grow to approximately US\$7 trillion in the next decade, based on the best-case scenario. This growth would mean the industry nearly triples in ten years, contributing an additional US\$4 trillion per annum to the global economy, and creating an additional 150 million jobs. But the industry would still remain a fraction of the global finance industry, at approximately 3%. We have to ask ourselves if we are happy to remain a niche segment, or if we are willing to take the appropriate actions to unlock the true potential of the industry.

### **Islamic Finance Building Blocks**

**Your Excellencies, Distinguished Guests, Ladies and Gentlemen,**

The extensive expansion of Islamic civilization across the east and west is reflected in its unique and impressive domes. Symbolically, the Islamic finance industry can be viewed as one of those domes based on solid foundations – i.e., the noble values of Islam – supported by the following four pillars:

- Legislation
- Regulation
- International Islamic Finance Bodies
- Islamic Financial Institutions

This infrastructure sits beneath a dome richly decorated with eye-catching engravings. This is the Islamic finance industry as viewed by its customers and beneficiaries, whether they are individuals or communities.

Building on what I said about the broad and inclusive nature of Islamic finance, in addressing global economic and social challenges we must also recognize that the Islamic finance industry is still at an early stage of its development, and we need to support it with a solid foundation. In this regard, four key pillars are critical, not only in providing an enabling environment for a sustainable and resilient Islamic finance industry, but also in bringing current practices closer to the core values of Islamic finance.

### 1- Legislation and Legal Framework

First and foremost is the role of legislation. It is legislation that drives the direction of the Islamic finance industry in any country, and provides the necessary infrastructure for the establishment, operations and oversight of the industry. It is critical that legislation is flexible and evolves along with the needs of the industry, with an aim to put the industry on the right path to long-term sustainable growth.

In addition to supportive legislation, the role of legal institutions in offering the necessary infrastructure that, among other things, helps protect property rights and enforce contracts is pivotal for the industry. With both social and economic implications, Islamic principles lay great emphasis on honoring obligations and fulfilling commitments. It is not without reason that the longest verse in the longest Surah of the Quran (282: Al-Baqarah), known as the verse of debt (Ayat Al-Dayn), speaks about financial transactions, the rights of the debtor, and the responsibilities of the creditor among other topics. Likewise, Surat Al-Ma'ida opens by speaking about contracts and obligations:

“يا أيها الذين آمنوا أوفوا بالعقود” “O you who believe! Fulfil (your) obligations”. And in Surat Al-Isra:34 we are advised: “وأوفوا بالعهد إن العهد كان مسؤولاً” " And fulfil (every) covenant. Verily, the covenant will be questioned about”.

### 2 - Regulation

After legislation comes the key role of regulation, in terms of designing a robust regulatory and supervisory regime. Due to the specificities of Islamic finance, having in place effective regulation is a daunting task, particularly in dual banking systems.

Regulation in this context has two key aspects: the roles played by regulatory authorities and those charged with ensuring Shariah compliance.

Regulators need to strike a balance between establishing and enforcing minimum international standards for sound regulatory and supervisory practices, protecting consumers and safeguarding systemic stability, and at the same time facilitating the growth, innovation and sustainability of the industry.

Moreover, regulators need to address the evolving needs of the industry. In the ever-changing landscape of today's financial industry, regulators must provide a robust framework for addressing issues that stem from innovation, disruptive technologies such as FinTech, cyber-security risk, and other recent developments. They also need to view technology not as a threat to be resisted but as an opportunity to be embraced, though with a clear understanding of the attendant risks and appropriate safeguards.

Furthermore, the Islamic finance industry not only has to be compliant with standard supervisory requirements but must also be in line with Sharia principles. Therefore, supervisors need to promote a strong Sharia governance framework along with effective Sharia auditing and independent oversight.

### 3 - International Islamic Finance Bodies

Supporting the role of regulators, international Islamic finance bodies also have a critical role to play in the regional and global integration of the Islamic finance industry. Institutions such as the Islamic Financial Services Board (IFSB), the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), the International Islamic Financial Market (IIFM) and the International Islamic Liquidity Management Corporation (IILM) play a pivotal role in the global Islamic finance industry, setting standards and providing products and financial instruments that support the growth and depth of the global Islamic finance industry.

The industry today requires an integrated approach between international bodies and standard setters to promote cooperation between Islamic and conventional finance across countries, as well as intra-agency coordination.

International standard-setting bodies also have a role in promoting standardization of products, services and supervisory practices across Islamic finance markets, to promote greater global cooperation and increase consumer confidence in the industry.

It is important that these international Islamic finance bodies coordinate their activities and play a complementary role rather duplicating efforts. In this regard, the platform such as this conference offers provides excellent opportunities for these bodies to collaborate.

#### 4 - Islamic Financial Institutions

Finally, the fourth pillar without which the picture can never be complete is represented by the Islamic financial institutions themselves. It is the market players who translate the principles and thoughts of Islamic finance into reality in the form of products and services. These institutions have to ensure that the products and services they offer are not only Sharia-compliant, but also aligned to the spirit of Sharia and the core principles of Islamic finance. If they adhere to these principles correctly, these institutions will undoubtedly serve to promote inclusive economic growth, social development and financial inclusion.

One of the areas that Islamic financial institutions need to focus on is research and development (R&D). The focus on R&D should bring innovation in introducing new products and services aligned to the principles of Sharia and the needs of the community, and should address the issue of product concentration in their portfolios.

Currently, according to the IFSB, 68% of all Islamic banks' financing assets are concentrated on Murabaha, followed by 14% for Ijara. The other types of Islamic financial products collectively make up only 18% of total financing assets.

This high concentration and lack of product diversification is a key issue for the industry, especially as many of the assets offered under Murabaha are based on commodity Murabaha, which makes only a limited economic contribution due to its structure.

Generally, a key issue has been replication of the conventional banking model by some Islamic banks. Instead of focusing their efforts on building a Sharia-based model, they have adopted a Shariah-compliance strategy solely by tweaking existing conventional products. This approach has resulted in serious deviation from the key principles of Islamic finance and hindered true innovation.

So instead of focusing on Murabaha, for instance, the industry could have more frequently used Salam and Istisna, which involve development of real economic assets and can thus have a significant impact on the economy. Our analysis shows that focusing on these two products would make available approximately US\$800 billion in the next five years for the development of real assets covering key economic sectors including manufacturing, construction, and agriculture. This would also lead to product diversification and greater productivity and inclusiveness, which would have a multiplier effect throughout the wider economy. This is the true spirit of Islamic finance.

In order to strengthen the role of each institution I described under the four pillars, capacity building is critical. There is a need to shift the focus from individual or fragmented efforts to a more collective and coordinated institutional approach to address the needs of the industry.

For any structure, physical or financial, to remain stable and strong, it requires ongoing maintenance. In a similar manner, the industry also requires ongoing capacity building along with continuous research and development. It needs to train professionals and sharpen their skills, enabling them to not only cope, but also drive the growth and development of the Islamic finance industry. In this regard, the role of academic institutions and Sharia scholars is critical.

On the positive side, we are comforted by the fact that Islamic finance education has a strong presence in non-Muslim countries, which demonstrates the universal appeal of Islamic finance. Of the 680 Islamic finance education providers around the world, 34% are in non-Muslim countries.

However, if we look at the role of academic institutions, it is evident that there is a major gap between Islamic finance theory and practice, and that educational institutions are yet to produce 'job-ready' graduates for the industry. Academia has to take a lead in this area, developing curricula that balance the theory of Islamic finance and market-aligned programs while still promoting product innovation and leadership.

Despite some progress in capacity building, we still have a long way to go. As evident from a recent survey conducted by the IFSB, 82% of Islamic finance markets suffer a shortage in qualified talent, while 60% of Islamic finance professional still require further training and skill development.

In addition, one of the key challenges the industry has faced has been the limited number of scholars that sit on multiple Sharia boards. If we look at the industry overall, it seems well balanced, with 1,075 scholars sitting on the board of 1,400 Islamic financial institutions. But a closer examination highlights the problem, with eight scholars having over 30 board seats each. This scarcity is a challenge for the industry, but it doesn't stop here. In fact, this scarcity extends further with three scholars having over 70 board seats each.

This leads to issues in product stagnation and in industry innovation and compliance, among others. It is imperative that all stakeholders come together with Sharia scholars to address this issue for the sake of the overall development of the Islamic finance industry.

**Your Excellencies, Distinguished Guests, Ladies and Gentlemen,**

Given the challenges we face today, it is not possible for any of these four pillars to make a meaningful difference on its own. Each pillar, from legislation to regulation and standards-setting to Islamic financial institutions, has a distinct yet mutually reinforcing role to play. While individually insufficient, collectively these institutions provide a solid foundation for a dynamic and resilient Islamic finance industry and are thus the pre-requisites for its sustainable and inclusive growth.

We are very privileged to have these different stakeholders representing different parts of the world at this conference. And we are confident that the discussions that take place today will lead to actionable recommendations that we can collectively take forward for the development of the global Islamic finance industry, which will in turn drive sustainable inclusive growth and shared prosperity for all. It is necessary to combine our efforts and work collectively to reach such results. Architect Hassan Fathy gives us a great example on the outcome of collective efforts by saying: “One person cannot build a house, yet ten persons can build ten houses”.

**Conclusion****Your Excellencies, Distinguished Guests, Ladies and Gentlemen,**

In conclusion, I would like to go back to what I said at the beginning of this address about the ultimate objective, which is to ensure prosperity, provide high living standards, and promote the broader welfare of society on a sustainable footing. And as it has been demonstrated, Islamic finance can play its due role in supporting the achievement of this objective.

Islamic finance offers a universal proposition to address the key economic and social challenges that we face today, but only if we do it properly, and build the industry on a solid foundation of the key pillars. To this end, each of us has an important role to play in the industry’s development, if the industry is to reach its true potential.



Around 40 years back, establishing an Islamic bank was swimming against the tide, as late Ahmed Al-Yasin described it. However, considerable progress has been made in the last four decades and establishing an Islamic bank is no more a challenge. In fact, the Islamic finance industry has all the institutional support it needs to flourish.

So we need to ask ourselves:

- How do we ensure that Islamic finance plays its due role?
- Are we doing enough to support the industry reach its true potential? And if yes, then
- Why is the industry still only 2% after four decades?

I hope that the discussions by the distinguished panelists and thought leaders that take place today will go a long way in addressing some of these issues, as we work together for the development of the industry.

And I am confident that this conference will produce concrete and strategic recommendations that different stakeholders can take forward and implement to build a strong foundation for a global Islamic finance industry that is ethically right, socially just, financially stable, and economically productive.

Thank you very much.

2/5/2018