Standards Implementation – FSB and IFSB

Ravi Menon
Managing Director, Monetary Authority of Singapore

Discussant Remarks at 9th Islamic Financial Stability Forum
Empire Hotel and Country Club, Bandar Seri Begawan, Brunei
27 March 2014

- Thank Brunei Monetary Authority for warm hospitality and efficient arrangements in hosting this meeting.

- Thank IFSB secretariat for opportunity to speak to you, at my first IFSB meeting.

- Share perspectives based on experience as member of FSB Plenary and FSB Steering Committee as well as Chair of FSB Standing Committee on Standards Implementation (SCSI).

    - SCSI's role is to promote implementation of FSB/G20 financial reforms through rigorous implementation monitoring.

    - Employs a variety of tools, including peer reviews and self-assessments.

    - Coordinates with respective standard-setters like Basel Committee, IAIS, and IOSCO on monitoring of sector-specific standards.

- Three observations:

    - One, FSB and IFSB had **very different starting points** in encouraging implementation of standards.

    - Two, FSB and IFSB therefore have **some similar and some different objectives and approaches** in implementing standards.

    - Three, both FSB and IFSB have significant **challenges in area of resources** implementing standards, and can learn from each other.

- **First, different starting points in standards implementation.**

- **FSB was set up to fix the fault-lines exposed by global financial crisis.**

    - Parts of the global financial sector had grown large enough to threaten financial stability, yet were poorly understood and inadequately regulated.

- High-level political commitment needed to address these gaps on an urgent basis, and was provided by the G20.
- And while there are differences in market size and sophistication across the FSB membership, all FSB members are deemed systemically important.
- Hence, full, timely and consistent implementation of financial reforms by all members is necessary to global financial stability. And this has been made an explicit condition of FSB membership.

- Fortunately, **IFSB's starting point is not a crisis**. Islamic finance proved relatively resilient during GFC when compared to its conventional counterpart.
    - Compared to conventional finance, the IF market is very small but it is a much more rapidly growing area**.**
    - And there is significant variation in the level of market development across members.

- **Second, SCSI and IFSB have similar and different objectives and approaches to promoting implementation given different starting points.**

- FSB standards implementation is guided almost solely by objective of **promoting safety and soundness**. IFSB standards implementation also shares this objective.
    - IF is a rapidly growing sector. Global Islamic finance assets grew from less than US$600 billion in 2007 to more than US$1.3 trillion in 2012.[1]
    - Cross-border IF transactions are poised to grow. Recent years have seen an increase in cross-border sukuk-issuance and investment.
    - IFSB standards are needed to address risks idiosyncratic to Islamic finance, such as Shariah non-compliance risk.
    - This will serve to bolster confidence in safety and soundness of IF sector.

- But IFSB's standards implementation is guided by a **broader objective of promoting and growing IF sector through consistency in treatment across jurisdictions**.

- Common standards can help promote cross-border activity by increasing uniformity in the regulatory environment for Islamic finance players globally

[1] *The Rise of Islamic Finance*, Council on Foreign Relations, 30 Jan 2014.

- It follows that there is a difference in approaches between FSB and IFSB.

- Given need for timely regulatory response post-GFC, coupled with the relative homogeneity of its members, SCSI uses peer pressure as its primary tool to promote implementation.

  - Employs structured implementation monitoring mechanisms which increase transparency and accountability.

  - For example, SCSI requires all members to undergo country and thematic peer reviews. Members are also expected to undergo IMF/World Bank FSAPs and publish the results.

  - And FSB and standard-setters have devoted considerable effort into developing **assessment methodologies**. These allow us to assess the consistency of national implementation with international standards. (Level 2 assessment).

- In IFSB's case, a strong emphasis on peer pressure may not necessarily be the most suitable approach.

  - IFSB members face implementation challenges that cannot be overcome simply with peer pressure. For example, expertise and capacity were cited as the second most important challenge in the Standards Implementation Survey.

  - And where Islamic finance comprises only a small part of a jurisdiction's financial sector, cost-benefit implications of a strict implementation of standards could be quite different.

- In IFSB's case, a more risk-based approach may be more sensible. This could entail a combination of:

  - Capacity building activities, which IFSB is already engaged in; and

  - Identifying countries with large Islamic financial sectors to take the lead in enhancing their regulatory and supervisory frameworks, to serve as useful reference points for the more nascent markets.

    - A good starting point might be the IFSB's 2013 Islamic Financial Services Industry (IFSI) Stability Report, which highlights 7 countries with systemically important Islamic finance sectors.[2]

---

[2] Defined as jurisdictions in which the total assets of the Islamic financial services industry make up 15% or more of banking sector total assets. The systemically important jurisdictions are Iraq, Sudan, Kuwait, Saudi Arabia, Qatar, UAE and Malaysia (in that order). In Syria, Bahrain and Yemen, Islamic finance is "potentially systemically important over the mid-term given current growth". Singapore is in 26th place, with Islamic finance comprising less than 1% of total banking sector assets.

        - These are countries in which the total assets of the Islamic financial services industry make up 15% or more of total banking sector assets.

- **Third, both FSB and IFSB face significant resource constraints and can learn from each other.**

    - Standards implementation is a resource intensive affair**.** Transposition of international standards into domestic legislation is only the first step.

        - For standards to have the intended effect, they also need to be enforced through supervisory frameworks. This requires time, as well dedicated supervisory capacity and expertise.

        - Also requires significant resource commitment from market players which must institute new governance frameworks, internal controls, systems and processes.

    - These challenges also apply to IFSB. But IFSB has taken some concrete steps that FSB could learn from, e.g. **direct technical assistance** and **organisation of workshops** as key methods of supporting implementation.

    - It may be useful to explore ways to **streamline** these initiatives to maximise efficiency.

        - For example, one option may be to gather more information on standard-specific challenges and gaps through the annual Standards Implementation Survey. This information can be used to make workshops more targeted and effective.

        - Another option is to prioritise the standards for implementation, based on their relevance for financial stability. This would help national authorities allocate their limited resources more effectively.

- One thing that IFSB can consider as a lesson from FSB is role of **peer learning** in promoting implementation.

    - In the FSB, as in the IFSB, standards are often drafted as broad guiding principles rather than prescriptive rules.[3]

[3] For example, IFSB's Guiding Principles on Shariah Governance Systems for Institutions offering Islamic Financial Services, and Guiding Principles on Conduct of Business for Institutions offering Islamic Financial Services.

        - This is important as it allows national authorities to calibrate reforms to suit their market structure.

        - But it could leave some authorities uncertain of how best to proceed.

    - A key part of SCSI's work is to identify and share good practices and experiences across its membership.

        - This allows SCSI members to draw reference from other countries' experiences and avoid common pitfalls.
        - And where necessary, common challenges can be flagged to the policy setters for more guidance.

    - Similarly, IFSB could encourage greater sharing of good practices and experiences across countries. This could take place through its workshops, or could feed into the e-learning programme that is being developed.

<u>Conclusion</u>

- Let me conclude.

- IFSB's focus on standards implementation is timely.

    - This work will be a learning process.
    - IFSB will need to continue to review its tools to better exercise its mandate.

- Look forward to seeing further progress in implementing a sound regulatory framework for Islamic finance.