



**Accounting and Auditing Organization for Islamic Financial Institutions
(AAOIFI)**

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Chairman's Speech

By

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Ladies & Gentlemen

In the midst of this current global financial chaos and the presence of a dangerous adverse loop between the real economy and the financial sector, and with the spread of what might be fittingly termed "**The Financial Swine Flu**" which was genetically engineered by the very people to whom we trusted our life savings and hard earned money with, a new financial system is emerging; it is the Islamic banking and finance system.

What we live in today is an innate consequence of the compounded greed of individuals, institutions, and nation states. Individuals who sought more house than the house they can afford, institutions who bet on the demise of each other through the creation of "credit default swaps", nation states who excessively accumulated foreign reserves which impaired the international economic adjustment process.

These macroeconomic imbalances prevailed in the last decade or so resulted in a downward impairment of the term structure of interest rates. This in turn stimulated demand for credit based instruments that achieved the desired yield uplift. Consequently, a revolution in packaging and distributing credit based instruments was underway. It was called "financial innovations". We all believed in the fallacy that these sophisticated tools and instruments would create value. Apparently and in hindsight, the value they created was mostly illusory and in turn was a prelude to the boom in shadow banking which was mainly based on excessive leverage. It was a textbook-style manifestation of **regulatory sabotage**.

This **regulatory sabotage** along with the illusory value creation gave rise to a new mosaic of the world financial landscape. It was a new mosaic that was puzzling for not only regulators but also the investment community as well. It was a perfect case for "irrational exuberance". The premise on which banking was based was changing. Credit intermediation and maturity transformation were taking on new shapes and slowly but surely distancing us from real economic activities and thus causing a detachment between what is real and what is financial. This decoupling notion which is different from the one prevailed at the advent of the crises was the catalyst for what had to come ... a full-blown economic, financial and social imbalance for us to deal with for the next generation.



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As this chapter is still unfolding, one would wonder if any lessons are learned and whether this kind of calamity will be repeated. The answers to these questions rest in the wrinkles of human history; they are no. It is a no to both questions. Few lessons will be learned but soon forgotten and the whole story will be repeated perhaps with different techniques and reasons. It is the human nature that suffers from both greed and chronic insomnia. With the Islamic finance system, those two symptoms are greatly dampened down. Greed is reasonably managed and rationed and insomnia is partially cured. All is done through the imperative existence of the everlasting Shari'a rules and principles that must guide structures, and execution of all financial instruments.

Ladies & Gentlemen

The Islamic Banking & Finance system is here. It is growing and it is here to stay. Our system focuses on allocative efficiency. While macro-prudential function is left to sovereign authorities, our system engages in all aspects of micro-prudential functions and responsibilities. What is permissible and what is not is based on highly ethical and prudent Sharia rules that preserve and create wealth and enhance allocative efficiencies.

While we possess the needed checks and balances to build a sound system, we should be cognizant to the fact that those checks and balances can be easily circumvented and compromised similar to what took place in the conventional finance system. The only way we can prevent this from happening is through the enforcement of well designed standards backed by close regulatory supervision. Our efforts should center on how we better serve the real economy. We believe we can do without those synthetic instruments that contributed in bringing the whole financial system down to its knees. However, we will always be part of the economic cycle. We don't possess a complete immunity from adverse economic conditions, but we are and for sure prudentially well vaccinated.

As this economic crisis generates an opportunity for us to present our case, we emphasize that we would not accept to rise over ailing bodies. We strongly believe that our system possesses as much merit as the conventional finance system. We both thrive to serve our constituents in the best way we can within our equally important and revered value systems. Therefore, our coexistence is a profound and noble mandate for us to work on. Enhancing the economic well being of our constituents will definitely pave the road for better harmony among nations, religions and practices. It is Economics. It is what drives us all.

With this I end my speech. I thank you for listening. God Bless you all.