

Promoting a Progressive and Inclusive Islamic Financial System

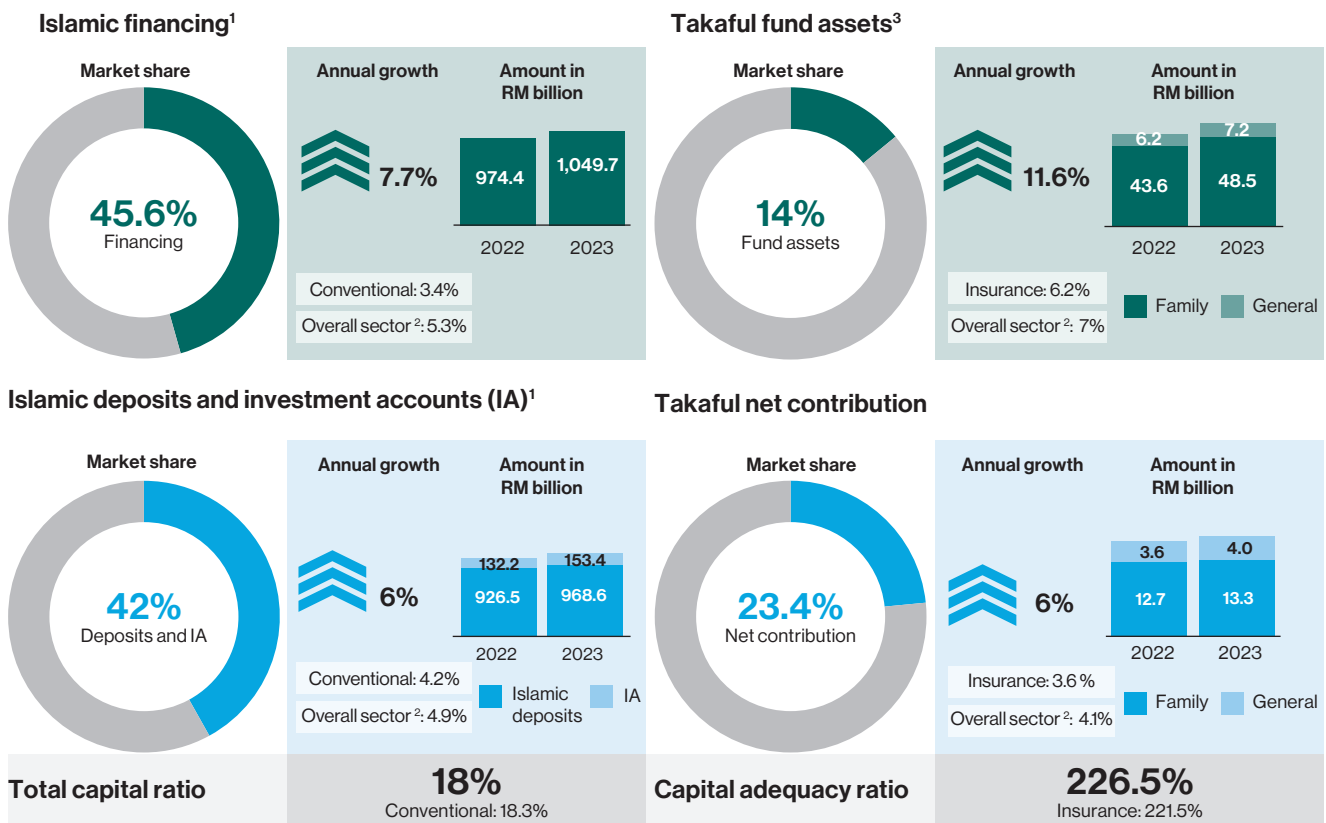
During the year, we focused on strengthening the Islamic finance ecosystem to further support a sustainable, inclusive and diversified economy.

In 2023, Bank Negara Malaysia (BNM) continued efforts to enhance the role and contribution of Islamic finance in supporting socio-economic developments in Malaysia. We collaborated with the Islamic finance industry to increase the adoption of value-based finance to meet the financial needs of consumers and businesses. Specific

initiatives were implemented to spur innovative solutions through industry-led pilot projects and regulatory facilitation. In addition, we continued to pursue strategies towards advancing Malaysia as an international gateway for Islamic finance. This includes deepening Malaysia's Islamic financial markets and international linkages.

The Islamic banking and takaful industries continued to grow in 2023. The Islamic banking industry's share of total financing in the financial system increased from 44.5% in 2022 to 45.6% in 2023 whilst the takaful industry's share of total net contribution increased from 23% in 2022 to 23.4% in 2023. Islamic banking and takaful institutions also remained resilient and well-capitalised (Diagram 1).

Diagram 1: Growth of Islamic Banking and Takaful Industry in 2023



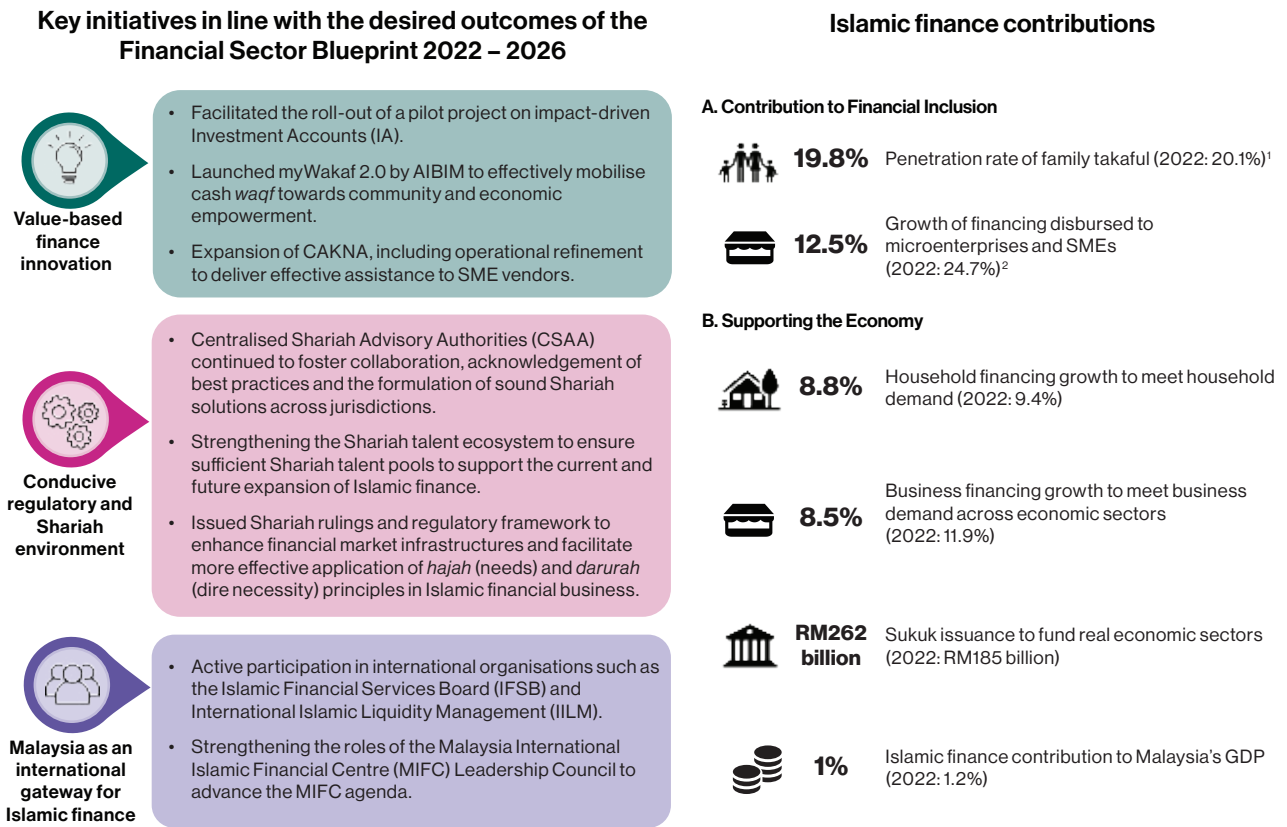
Notes: ¹ Includes development financial institutions.

² Annual growth for overall sector refers to combination of Islamic and conventional sectors.

³ Not inclusive of the shareholders' fund assets.

Source: Bank Negara Malaysia

Diagram 2: Islamic Finance Key Initiatives and Contributions in 2023



Notes: ¹ Family takaful penetration moderated due to lower new business growth as well as increased number of terminated and surrendered certificates.
² Growth in 2022 was higher due to the base effects following the COVID-19 pandemic.

Source: Bank Negara Malaysia, Department of Statistics Malaysia and Association of Islamic Banking and Financial Institutions Malaysia (AIBIM)

This has enabled the industry to continue to accommodate the financing needs of businesses, including small and medium enterprises (SMEs) and households, as well as provide protection coverage (Diagram 2).

impact-driven IA, BNM will be reviewing the Policy Document on Investment Accounts in 2024. This review aims to further harness the potential of IA to support value-based financing flows, while preserving an appropriate risk-proportionate regulatory environment.

Fostering Inclusivity, Sustainability and Positive Social Impact

Impact-driven Investment Accounts

As outlined in the Financial Sector Blueprint 2022-2026, BNM continues to facilitate the development of impact-driven Investment Accounts (IA) for value-based financing. In 2023, a pilot project by an Islamic bank was rolled out to fund investments in Sustainable Development Goals (SDG)-aligned assets in areas such as renewable energy, clean transportation and waste management. This pilot project included a social reinvestment feature where a portion of the investment returns would be channelled to social impact projects, including iTEKAD. More information on iTEKAD can be found in the chapter on 'Promoting a Progressive and Inclusive Financial System'. To further promote

Enhance SMEs' access to financing facilities through CAKNA

In 2023, CAKNA¹ continued to support SMEs that have delivered their government procurement contracts to manage their cash flow. During the year, non-debt funding facilities amounting to RM413.7 million were provided, benefiting 64 SME vendors across ten participating ministries. Ongoing efforts are being made to improve the efficiency of the scheme (i.e. reduce the time needed to process disbursements) and expand the scope and instruments for this facility. This builds on positive feedback received on the scheme. Participating vendors surveyed by BNM have reaffirmed that they have benefitted from competitive rates and the program has helped them with business cash flow management.

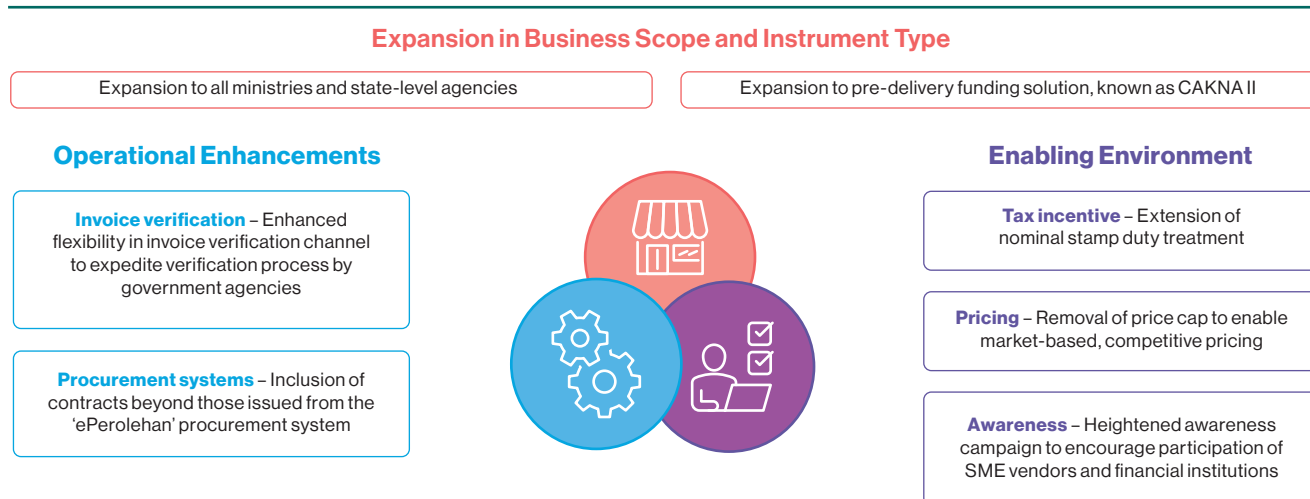
¹ CAKNA is a non-debt funding facility to assist the cashflow position of companies, specifically SME vendors. Further information on CAKNA is available at <https://www.bnm.gov.my/skim-cakna>.

Promoting a Progressive and Inclusive Islamic Financial System

To assist small contractors in meeting their financing needs at an early stage of a contract, the government has expanded the CAKNA's funding structure to cover pre-project delivery funding starting in 2024. Named CAKNA II, projects with value up to RM1.5 million will

have access to contract financing facility² to provide sufficient cash flows to complete the government projects in a timely manner. Diagram 3 summarises these enhancements as well as testimonials from end users of CAKNA.

Diagram 3: Enhancements for CAKNA in 2024 – Expansion and Operational Refinements to Continue Delivering Effective Assistance to SMEs



Testimonials from End Users of CAKNA

'CAKNA helps me to prioritise timely payroll payments'

I always prioritise payroll expense payments, and CAKNA made it possible for me to manage them effectively. I particularly appreciate the reasonable pricing offered by CAKNA and the speed of delivery – we received our funds from the financial institution within two weeks of applying. We have been in the business for 16 years, we started using CAKNA last year and all our ongoing and upcoming government contracts will now use CAKNA.

Business owner provider to MOH¹ and MOE², security and surveillance service

'CAKNA's high liquidity margin is useful for government vendors'

CAKNA eases our month-to-month cash rollover, enabling timely payment of business expenses such as staff salaries. I mostly find CAKNA's liquidity margin to be attractive, in comparison to other providers. We have operated for more than 30 years, we started using CAKNA last year and we are never turning back.

Business owner, food supply and cleaning service providers to MOE² for schools

'CAKNA does not impact my gearing and requires no collateral'

CAKNA is useful for us in maintaining smooth cash flow. We utilised CAKNA for both OPEX and CAPEX amidst our planned overseas business expansion in Saudi Arabia. CAKNA does not impact gearing and requires no collateral. Our company has operated since 2002, we started using CAKNA last year and I encourage other SME vendors to take advantage of the same opportunity.

Operator, IT system development and maintenance to MOHA³

¹ Ministry of Health Malaysia
² Ministry of Education Malaysia
³ Ministry of Home Affairs

Source: Bank Negara Malaysia, interviews with selected SME vendors

² Participating financial institutions have an option to tap into the RM200 million All Economic Sector (AES) facility allocated by BNM under BNM's Fund for SMEs to provide CAKNA II facility to eligible small contractors.

Implementation of Value-based Intermediation

BNM continues to support the industry's effort towards value-based finance initiatives. Most significantly, the Value-based Intermediation Financing and Investment Impact Assessment Framework (VBIAF) working group issued the third cohort of the VBIAF Sectoral Guides for public consultation in May 2023. These documents offer detailed guidance on how to conduct impact-based assessments to manage Environmental, Social and Governance (ESG) risks in various economic sectors. As ESG is incorporated into financing and investment decisions, it provides funding access for SMEs that support sustainable and responsible business practices. It also offers opportunities for SMEs to obtain technical assistance in improving their environmental and social performance. We also continued to build the capacity of the industry for impact reporting through collaboration with experts from international financial institutions.

The feature article on 'Realising Value-based Intermediation (VBI) Vision: Five Years After Introduction' delves deeper into the implementation progress of VBI since its introduction.

Advancing halal trade and business

Islamic financial institutions continue to support halal businesses in Malaysia. To date, nine Islamic financial institutions have established dedicated halal trade programmes in collaboration with the Halal Development Corporation (HDC). These programmes offer technical and financial assistance to support local halal businesses in becoming competitive global or regional players, especially those in Halal Industry Masterplan 2.0 (HIMP 2.0) priority sectors.³ In 2023, the number of participating Islamic banks in HDC's Halal Integrated Platform⁴ grew from five to ten Islamic banks.⁵ Notably, five of these banks collectively pledged additional funding of RM2.67 billion to support the development of the halal industry in Malaysia.⁶ Further, a dedicated protection solution was also launched for halal-certified businesses in

September 2023. This protection solution aims to protect halal-certified businesses from the risk of sudden or unforeseen withdrawal of halal certification⁷ by the relevant authorities.⁸

Mobilisation of cash waqf through myWakaf 2.0

Since the roll-out of myWakaf in 2017, the platform has collected over RM8.4 million⁹ of cash waqf funds, and directed financing towards projects in health, education and community empowerment. An enhanced myWakaf 2.0 was launched during the Kuala Lumpur Islamic Finance Forum (KLIFF) on 20 September 2023. The platform's enhanced scope and objectives place stronger emphasis on community and economic empowerment. The enhanced platform also establishes a more cohesive monitoring system to track the progress of the projects. These improvements support further scaling up of the myWakaf initiative through a multi-bank arrangement. The construction of 14 solar dome dryers for fishermen and farmers was selected as the first multi-bank project to be implemented throughout Malaysia. More projects will be announced by AIBIM in the near future.



Governor Abdul Rasheed Ghaffour together with AIBIM members during the launch of myWakaf 2.0

³ Food and beverages, pharmaceuticals, cosmetics and personal care, ingredients, modest fashion, medical tourism, medical devices, Muslim-friendly hospitality, logistic services and Islamic finance.

⁴ Halal Integrated Platform is a one-stop centre housed under HDC which offers a wide range of solutions (financial solutions, technical assistance and market access) to halal-certified SMEs. See BNM Annual Report 2021 (Diagram 12: Illustration of Halal Integrated Platforms Mechanism). Islamic financial institutions offering dedicated halal trade programmes are not necessarily listed in HDC's Halal Integrated Platform.

⁵ Bank Islam Malaysia Berhad, Standard Chartered Saadiq Berhad, Alliance Islamic Bank Berhad, Hong Leong Islamic Bank Berhad, HSBC Amanah Malaysia Berhad, Public Islamic Bank Berhad, CIMB Islamic Bank Berhad, OCBC Al-Amin Bank Berhad, Bank Muamalat Malaysia Berhad and Small Medium Enterprise Development Bank Malaysia Berhad (SME Bank).

⁶ A pledge by the five Islamic banks was announced at the World Halal Business Conference held in December 2023.

⁷ This includes legal costs, third party liability, product liability and the cost of a product recall.

⁸ Department of Islamic Development Malaysia, State Islamic Religious Councils (SIRCs) and State Islamic Religious Departments.

⁹ There are nine participating Islamic banks in collaboration with 11 SIRCs supporting this initiative.

Conducive Shariah Framework and Ecosystem Enablers

The role of the Shariah Advisory Council of Bank Negara Malaysia (SAC) is to issue Shariah rulings and deliberate contemporary issues in Islamic finance

The SAC plays a critical role in the development of Islamic finance in Malaysia. The issuance of Shariah rulings and deliberations on contemporary issues in Islamic

finance by the SAC provides certainty in the conduct of Islamic financial business. This, in turn, supports financial stability and public confidence in the system. In 2023, the SAC continued to address a range of issues relevant to Shariah applications. Rulings issued during the year provided clarity on the permissibility of several new Islamic financial transactions and arrangements (Diagram 4), helping to secure certainty and encourage continuous innovation in the development of Islamic financing solutions.

Diagram 4: Summary of Shariah Deliberations by the SAC



Product Innovation

Payment for the purchase of gold and silver via Buy Now Pay Later (BNPL) platform

- Gold and silver in the form of jewellery are not subject to currency exchange (*bai` al-sarf*) requirements.
- Both are categorised as commodities and can be transacted on a deferred payment basis.

Alternative structure of credit card-i based on *bai` al-dayn*

- The proposed structure was not accepted by the SAC because it does not meet the key requirements for the sale of debt (*bai` al-dayn*).



Market Infrastructure

Dematerialisation of global certificates for sukuk and unlisted debt securities in Malaysia

- SAC approved the proposal to replace the physical global certificates with an electronic format.

New mechanism for Intraday Credit Facility (ICF) based on sale and buy back agreement (SBBA)

- The settlement of ICF can be either on the same day or extended to the next RENTAS business day.

New mechanism for Funding Facility for Retail Payment Settlement (FRPS)

- SAC approved the mechanism for ownership transfer and constructive possession in sale and purchase transactions under the FRPS.

Transaction of switch auction for Malaysian Government Investment Issue (MGII)

- SAC approved the mechanism for MGII switch auction to assist the government in restructuring its debt profile and creating more liquidity in the market.

Research on fundamentals of money from modern economy and Shariah perspectives

- Aims to support the Shariah assessment on Central Bank Digital Currency (CBDC) proof-of-concept and implementation.



Industry Practices

Review of industry application of *tawarruq*

- Landscape review of the *tawarruq* application by Islamic financial institutions.
- Aims to address concerns about its nature and re-align it with the intended objective of cash facilitation.

Ceding out of takaful risk to insurance companies

- Takaful/retakaful operators are not allowed to cede out their risks to insurance/reinsurance companies except due to *hajah* (needs).

Issuance of Policy Document on *Hajah* and *Darurah*

- Issued on 3 January 2024, it outlines the requirements and expectations of BNM on the application of *hajah* (needs) and *darurah* (dire necessity).

Practices of anticipatory hedging and its general parameters

- Anticipatory hedging can be practiced to manage risk when there is a high probability that the actual exposure will materialise in the future.



Shariah Non-Compliance (SNC)

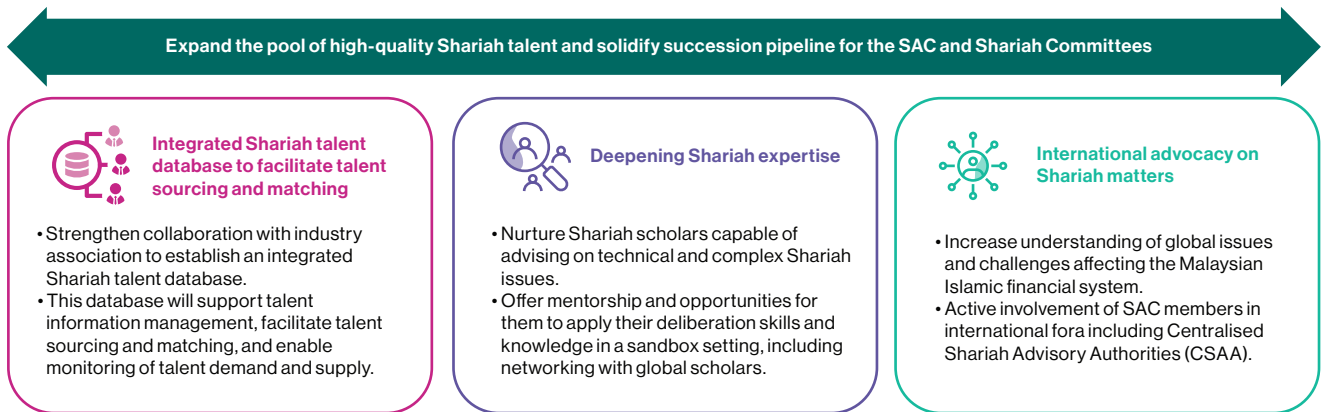
Rectification plan for SNC incident – ceding out of takaful risk to insurance/reinsurance company

- SAC acknowledged BNM's authority in taking the necessary punitive enforcement and supervisory actions to address SNC event.

SNC incident – financing of asset under construction based on sale of rights for *bai` inah* (sale and buy back) contract

- The application of the sale of rights in the incident is considered a serious SNC as customers do not possess absolute rights over the asset during the transaction.

Diagram 5: Strategies to Strengthen Shariah Talent Ecosystem from 2023 Onwards



Source: Bank Negara Malaysia

Strengthening Shariah talent ecosystem

In 2023, BNM collaborated with key stakeholders to develop strategies to strengthen the Shariah talent ecosystem. These strategies aim to widen the talent pool and solidify the succession pipeline for the SAC and Shariah committees (see Diagram 5). This is to ensure that the SAC and the Shariah fraternity are able to keep pace with the developments, innovations and emerging trends in the Malaysian economy and financial system. A deep understanding of these issues is essential to enable them to apply Shariah principles more effectively.

Strengthening Malaysia’s Position as an International Gateway to Islamic Finance

Malaysia continues to be recognised as one of the leading markets in Islamic finance¹⁰ globally. During the year, we pursued efforts to deepen Islamic financial markets and strengthen international collaboration in Islamic finance.

Deepening Malaysia’s Islamic financial markets

In 2023, BNM continued to drive the deepening of Malaysia’s Islamic financial markets with a focus directed towards developing the collateralised funding and derivatives markets.

In October 2023, BNM published the Exposure Draft on Islamic Collateralised Funding to seek feedback from the industry on the proposed rules and requirements in relation to Islamic financial instruments used in the Islamic Interbank Money Market (IIMM). These include sell and buyback (SBBA) and collateralised commodity *murabahah* (CCM) transactions used to source and provide funding for liquidity management in the IIMM. The proposed rules and requirements aim to promote sound risk management and compliance with Shariah principles by Islamic banks when engaging in such transactions. The policy document will be issued in 2024.

In December 2023, the collateralised *murabahah*, an Islamic funding instrument secured by collateral,¹¹ was accorded statutory recognition for its close-out netting mechanism under the relevant laws.¹² This recognition provides legal certainty on the applicability of the close-out netting mechanism, which is vital for managing risks in collateralised *murabahah* transactions. On Islamic derivatives, the issuance of the SAC ruling on the permissibility of anticipatory hedging subject to specified parameters is expected to spur the development and market liquidity of the Islamic derivatives market. These efforts aim to further increase Shariah-compliant transactions, which will further deepen Malaysia’s Islamic financial market.

¹⁰ Malaysia retained its first place in the overall ranking, for the 11th consecutive year based on the ICD-LSEG Islamic Finance Development Indicator (IFDI) Report 2023. Malaysia also ranked first in four sub-categories, namely, financial performance, governance, awareness and sustainability.

¹¹ A Shariah-compliant financing secured by assets in which the financier has the right to sell the asset should the client fail to repay the financing - <https://www.bnm.gov.my/-/introduction-of-collateralised-murabahah>.

¹² Central Bank of Malaysia Act 2009, Financial Services Act 2013, Islamic Financial Services Act 2013 and Netting of Financial Agreements Act 2015.

Centralised Shariah Advisory Authorities continue to strengthen global connectivity and foster mutual recognition in Shariah

BNM established the Centralised Shariah Advisory Authorities (CSAA) forum¹³ in 2018 to foster greater connectivity and mutual recognition in Shariah. Since then, the CSAA forum has grown to be an important platform for central Shariah boards. The platform facilitates networking, collaboration and the sharing of best practices among central Shariah boards. This helps to strengthen their capacity to address emerging issues in Islamic finance. To date, there are 20 countries with central Shariah boards (2022: 18 countries; 2018: 7 countries) with varying institutional structures. The Shariah resolutions discussed during CSAA also serve as a reference for international

standard-setting bodies and international organisations on current and emerging Shariah issues.

In September 2023, the fifth CSAA meeting was jointly hosted by BNM and the Participation Banks Association of Türkiye (Türkiye Katılım Bankaları Birliği, TKBB) in Istanbul, Türkiye. The meeting discussed key developments in Shariah governance as well as rulings (*fatwa*) on emerging issues. The meeting agreed to strengthen CSAA's governance to better meet its objectives and secure wider participation from countries across the globe. The meeting also discussed the importance of including VBI and sustainability considerations, i.e. impact on the economy, environment and people, in ascertaining Shariah rulings (*ijtihad*).



The meeting which was co-chaired by Prof. Dr. Ashraf Md. Hashim, Chairman of BNM SAC and Prof. Dr. Abdullah Kahraman, Board Member of TKBB Central Advisory (Shariah) Board, recorded the highest participation since the first CSAA meeting with more than 50 delegates from 15 participating countries.



BNM's SAC members, Datuk Prof. Dr. Akram Laldin and Dr. Ahmad Basri Ibrahim, presented two main papers on BNM's 'Shariah Decision-making Framework' and 'Takaful Operational Framework' respectively, which received positive feedback from the audience on the comprehensiveness and rigorousness of the framework coverage.



¹³ CSAA is a forum established to strengthen global connectivity and foster mutual respect on Shariah views across jurisdictions.

Active participation at key international events and platforms

Being part of the global Islamic finance community, BNM continued to participate in international and regional forums such as the Islamic Financial Services Board (IFSB), the International Islamic Liquidity Management Corporation (IILM) and the OIC-COMCEC Central Banks Forum. This included active participation in strategy and technical committees that aim to shape the development of international standards for Islamic finance. BNM also continued to share our knowledge and expertise to build the capacity of regulatory bodies in other partner jurisdictions (see Diagram 6).

Fostering industry leadership of the Malaysia International Islamic Financial Centre (MIFC) agenda

The MIFC Leadership Council (MLC) was established in 2022 to lead efforts in solidifying MIFC’s propositions as an international gateway for Islamic finance. This includes improving the competitiveness of Malaysia’s Islamic finance industry, deepening financial linkages and delivering more impactful financial innovation.

In 2023, the MLC focused its efforts on starting work to identify strategic priorities and innovations to pursue by engaging with industry associations and players, ministries, government agencies and strategic partners that form part of the MIFC ecosystem stakeholders. A dedicated secretariat has been established to support the roles of MLC and work is underway to incorporate the MLC Secretariat as an independent legal entity to exercise its mandate with greater flexibility and independence. The MLC will be outlining its priorities and the corresponding strategies in a Position Paper that will be published in the second quarter of 2024. Identification of MLC Impact Projects that will spur new innovation and further demonstrate the contribution of Islamic finance to the economy will be finalised this year for execution.

On the international front, MLC also pursued global advocacy and engagements to build greater linkages between Malaysia and other jurisdictions. In 2023, the MLC focused on engaging ecosystem players in the United Kingdom, Türkiye and the United Arab Emirates.

Diagram 6: Key International Collaboration and Participation in 2023

Continuous commitment towards global Islamic finance regulatory development

- o Member of IFSB Council, Deputy Chairperson of Executive Committee (until August 2023) and Member of Technical Committee. For more details on BNM’s participation at the IFSB, see the chapter on ‘International Engagements’.
- o Member of the IILM Governing Board, Member of Board Executive Committee, Chairperson of Board Audit Committee and Member of Board Risk Management Committee.
 - BNM, along with other members, has intensified efforts to identify potential solutions that could expand IILM’s business operations in issuing high-quality Shariah-compliant liquidity instruments.

Active participation at key international events and platforms

- o Co-hosted with the Statistical, Economic and Social Research and Training Centre for Islamic Countries (SESRI), a workshop on ‘Promoting Islamic Social Finance and Accelerating the Growth of Halal Value Chain Ecosystem’ in Kuala Lumpur. The workshop is funded by the COMCEC Project Funding, in collaboration with Bank Indonesia, the Saudi Central Bank (SAMA) and the Central Bank of the Republic of Türkiye (CBRT). The event was attended by delegates from 15 countries.
- o Participated in two international discussions:
 - 5th Meeting of the OIC-COMCEC Central Banks Forum.
 - 19th Meeting of the Standing Committee for Economic and Commercial Cooperation (COMCEC) Financial Cooperation Working Group.
- o Promoted the role of Islamic finance in advancing sustainable finance at Joint Committee on Climate Change (JC3) conference and international sustainability event i.e. COP28.

Capacity building and knowledge sharing

Continued engagement to assist industry participants and regulatory bodies in other jurisdictions as part of our continuous efforts to promote knowledge sharing and capacity building in Islamic finance. Among jurisdictions engaged in 2023 include Kazakhstan, Türkiye, Russia and Uzbekistan.

2024 highlight

BNM in collaboration with the Ministry of Finance, government agencies, other regulatory authorities and multilateral organisations will organise the Global Forum on Islamic Economics and Finance (GFIEF) on 28 – 29 May 2024 in Kuala Lumpur. GFIEF will gather renowned international and local speakers to discuss emerging issues in the current economics and socio-economics landscape for future Islamic economics growth.

Source: Bank Negara Malaysia



BNM co-hosted a workshop on 'Promoting Islamic Social Finance and Accelerating the Growth of Halal Value Chain Ecosystem' with SESRIC in Kuala Lumpur, which was participated by delegates from 15 countries.

Among others, the MLC pursued collaboration with strategic partners in these markets towards advancing Islamic finance including in areas such as sustainability, Islamic fintech, financial markets development and expertise sharing to foster stronger international cooperation.

Going Forward

Our priorities in 2024 are to build on Malaysia's strong Islamic finance ecosystem. As the Islamic financial system continues to mature, there is significant potential for the industry to support Malaysia's economic transformation and deliver impactful solutions that can

address the current and future needs of the economy and society. To this end, we will continue to focus our efforts on three areas:

- Encouraging value-based finance innovation that embeds the fundamental values of Shariah. This will involve optimising Islamic finance to support the funding and risk protection needs of the economy and the region as we transition to a greener, more sustainable ecosystem.
- Providing a more conducive regulatory and Shariah environment to accelerate market development.
- Continuously strengthening Malaysia's proposition to tap global opportunities and deepen the domestic Islamic financial market.

VBI encourages Islamic banks to offer more innovative products and services that are impact-driven. This is evident in three areas:

- First, greater focus on net zero and green financing to ensure a sustainable path towards a high-value green economy. Based on the latest VBI report released during the Joint Committee on Climate Change (JC3) conference in October 2023, Islamic banks have disbursed a total of more than RM16.5 billion to net zero and green financing in 2022, a growth of over 2.3 times from 2021. The financing was disbursed, among others, to fund green buildings and renewable energy projects. Currently, it stands at 6.5% of total financing by Islamic banks and is expected to grow further given the rise in financing needs in these sectors.
- Second, more avenues have been explored to support financing needs for Small and Medium Enterprises (SMEs) and micro-SMEs (MSMEs). As of 2022, Islamic banks disbursed RM3.4 billion of net zero and green financing as well as RM24.1 billion of financing for socio-economic development⁵ specifically for SMEs and MSMEs.
- Third, mobilisation of philanthropic and social finance funds (*zakat* and *waqf*), via blended finance solutions has been a growing focus. Social finance provides the opportunity to build financial resilience among the *asnaf*⁶ and the poor. From 2017 to 2022, RM411.8 million was intermediated for various alms (*zakat*), donations (*sadaqah*) and charity programmes including iTEKAD and myWakaf initiatives. iTEKAD, for example, has assisted more than 6,000 low-income microentrepreneurs, comprising *asnaf* and B40 individuals.⁷ Various programmes initiated by Islamic banks to empower microentrepreneurs include financial advisory, access to microfinance, training and business coaching as well as halal certification assistance.

Diagram 2: Examples of Impact-driven Offerings by VBI CoP

Financial solution anchored on creating positive impact

A growing number of Islamic banks are offering various solutions to generate sustainable impacts on the economy, community and environment while delivering financial returns.

An impact investment account invests in renewable energy, green financing, clean transportation, clean water and sanitation as well as other sectors that contribute to creating sustainable cities and communities. In addition, 2.5% of the investment return will be contributed to *zakat*.

A low carbon transition facility provides financial support for both capital expenses and operational funding to enforce sustainable practices for SMEs across various industries.

A financing facility for solar installation is offered to SMEs to facilitate the purchase and installation of solar on business premises.

Source: AIBIM (2022) Value-based Intermediation Report: Emerging to Engaging and Bank Islam Malaysia Berhad website

Progressive Efforts Undertaken by Industry Players

An important demonstration of VBI's collective effort is the issuance of the Value-based Intermediation Financing and Investment Impact Assessment Framework (VBIAF) Sectoral Guides⁸ to facilitate the implementation of an Environmental, Social and Governance (ESG) impact-based risk assessment. So far, three cohorts of sectoral guides have been issued to provide sector-specific guidelines that assess the impact of financing and investment activities on ten sectors.⁹ These sectoral guides are also in line with BNM's Climate Change and Principle-based Taxonomy (CCPT). Effective implementation of VBI, complemented by a better understanding and measurement of climate and environment has the potential to address contemporary issues that the financial system and the world are facing.

⁵ Refers to financing extended to sectors that will improve the impact on social aspects under this category, such as education, public infrastructure, MSMEs, etc.

⁶ A group of people worthy of receiving zakat contribution such as the destitute and poor.

⁷ For more information, please refer feature article on 'iTEKAD: An Ecosystem Approach in Scaling Up Social Finance'.

⁸ VBIAF Sectoral Guides serve as an in-depth impact-based risk management toolkit to guide financial institutions in implementing VBIAF in the sectors.

⁹ First cohort (palm oil, renewable energy and energy efficiency) and second cohort (oil and gas, construction and infrastructure and manufacturing) were issued in 2021 and 2022, respectively. The third cohort (agriculture, mining and quarrying, road transportation and waste management) were released for consultation in May 2023 and is pending finalised issuance in the first half of 2024.

VBI has also expanded its relevance to the takaful industry. The Malaysian Takaful Association (MTA) introduced the Value-based Intermediation for Takaful (VBIT) framework and roadmap in 2021 and 2022, respectively. VBIT carries the aspiration to achieve inclusive protection for the underserved and unserved segments of society. Efforts to improve the quality and value of offerings are already taking place, such as widening affordable coverage to the poor at a lower price and introducing the *sadaqah* feature as part of product design.

As part of its VBIT priorities, the takaful industry also aims to improve its impact measurement practices. For this, MTA is currently developing a Maqasid al-Shariah Scorecard (MSS). MSS will identify key performance indicators and outcomes in line with the intrinsic values of Islamic finance. The scorecard is expected to be piloted with several takaful operators in 2024.

VBI is also consistent with the global movement towards a more sustainable economy. The goals of inclusive economic development, environmental conservation and social advancement are part of Shariah principles. These goals are universal in nature, consistent with the UN Sustainable Development Goals 2030 and aligned with the 'Ekonomi MADANI' framework. New developments such as the introduction of the Maqasid Al-Shariah Guidance by the Securities Commission Malaysia in 2023 and the call among Islamic finance community to adopt the '*Tayyib* (good) concept' further reinforce the importance of increasing adoption of VBI within the financial sector. These developments provide a strong and clear impetus to accelerate its implementation.

Increasing Adoption of VBI Requires Enduring Industry Commitment

While these positive steps have been encouraging, challenges such as a lack of understanding of VBI principles and application among key stakeholders, the need for group-wide strategy alignment and data limitations to accurately measure impact still exist and may continue to impede further progress of VBI. As such, more efforts need to be made by the industry to address these challenges. Among others, this includes assessing the need for longer-term investment in shared infrastructure and technology, such as leveraging on fintech and artificial intelligence to make impact-driven data gathering or analysis easier and more effective. Increase in public disclosures in various reports will demonstrate the industry's leading role in serving the needs of society and the broader economy. Diagram 3 summarises the roles of shareholders in advancing VBI implementation.

BNM is committed to provide an enabling environment to support the growth of VBI. This includes developing a more conducive regulatory environment that will also facilitate the application of diverse Shariah contracts. At the same time, BNM will continue to facilitate the industry's efforts to innovate and develop new value-based business models, solutions and practices.

Diagram 3: Roles of the Stakeholders in Advancing VBI Implementation



Regulatory bodies

- Provide the appropriate regulatory facilitation for value-based finance implementation to better support innovations, such as the novel application of Shariah contracts.
- Facilitate improvements in the quality and usefulness of impact-based disclosures.



Implementation partners

(including professional services and talent entities)

- Enhance collaboration with financial institutions to provide training and financial assistance to vulnerable communities.
- Continuously enhance talent capabilities through upskilling and learning infrastructures.



Financial institutions

- Integrate corporate value intent into Islamic financial institutions' business operations and practices.
- Improve comparability and quality of disclosures including exploring pertinent infrastructure and capacity building to improve impact-based reporting.
- Continue innovation efforts in developing new value-based business models, solutions and practices.



Institutional investors and shareholders

- Transition towards impact investing that creates positive environmental and social benefits.
- Explore VBI-aligned investment opportunities offered by financial institutions.



Government and state agencies

- Leverage VBI-aligned products and services in realising national agenda and priorities to improve Malaysia's long-term economic prospects.

Source: Bank Negara Malaysia