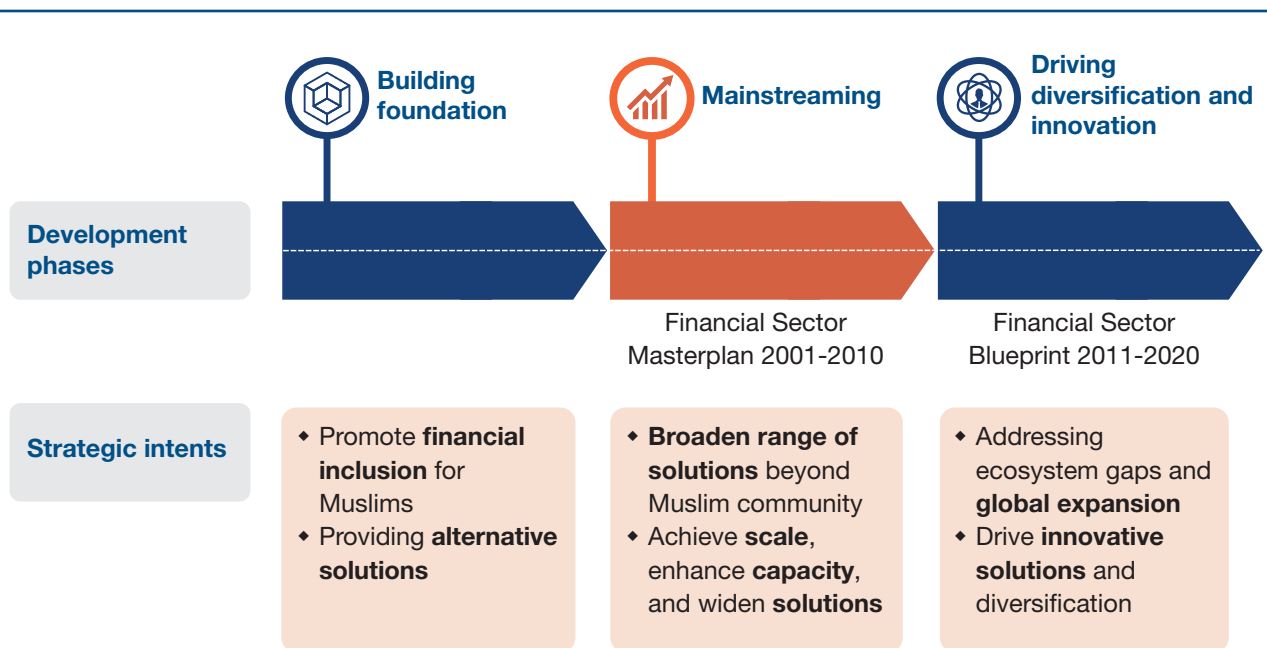


Strategic Thrust 5

Advance value-based finance through Islamic finance leadership

Islamic finance in Malaysia has undergone three broad phases of development over the last four decades – foundation-building, mainstreaming, as well as driving diversification and innovation (Diagram 1).

Diagram 1:
Phases of development over the last four decades



Malaysia's global leadership in Islamic finance is the result of concerted efforts by the Government, financial regulators, and industry players. Over the years, a wide range of initiatives have been advanced – including providing the overall enabling legal and regulatory environment, rolling out structural reforms to align strategies, addressing market frictions and incentives, as well as building long-term capacity. The country has also contributed to the development of global infrastructures to promote Islamic finance development, such as the setting up of the Islamic Financial Services Board (IFSB) and the International Islamic Liquidity Management Corporation (IILM), which are both headquartered in Malaysia.

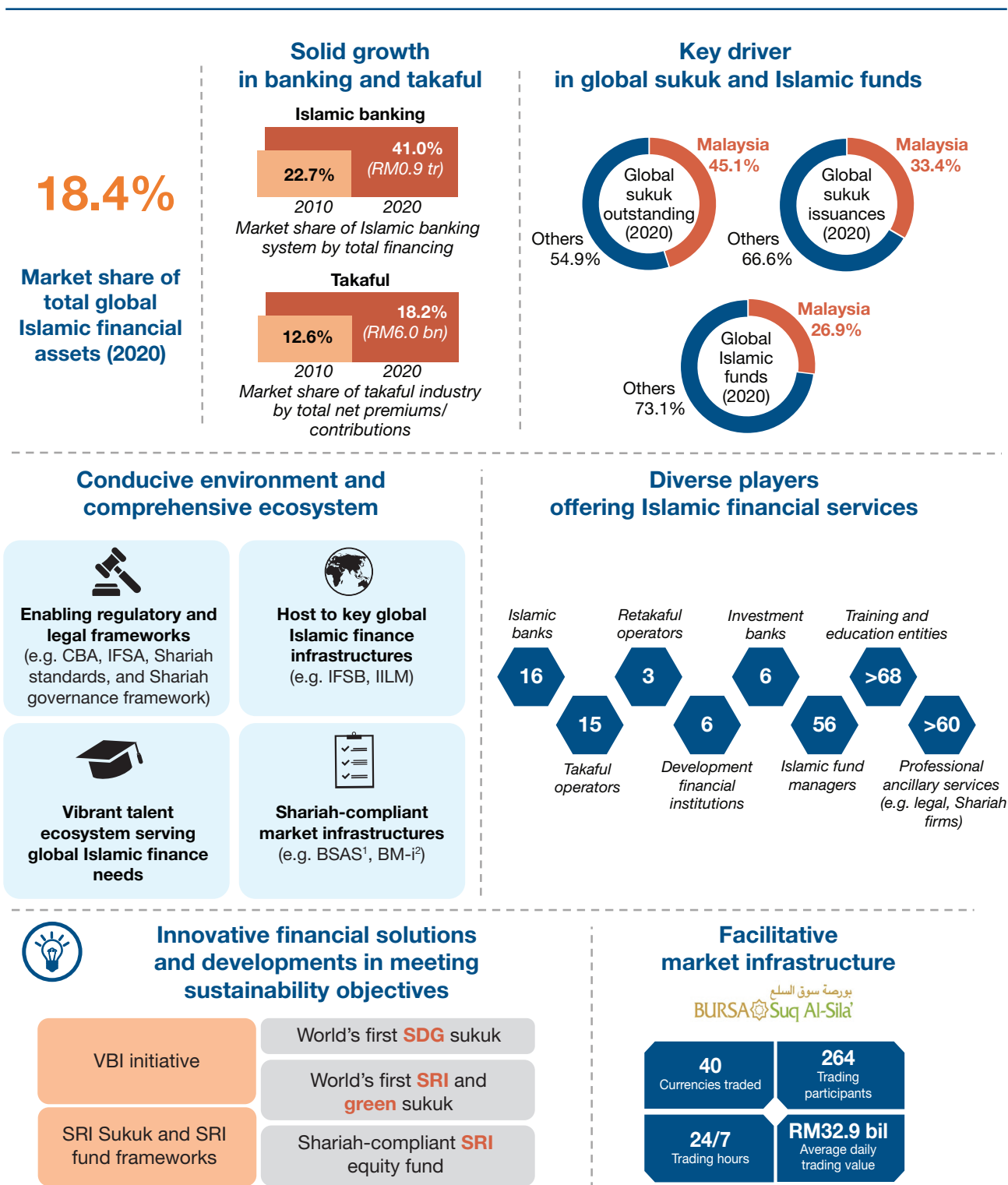
Today, Malaysia enjoys a mature Islamic finance ecosystem with dynamic and resilient players, diverse products, and comprehensive enabling infrastructures (see Diagram 2 for an overview).

As Malaysia's Islamic finance ecosystem continuously adapts to the fast evolving economic and social needs, efforts remain anchored on Shariah principles – aimed at realising a vision of economic growth that is balanced, progressive, sustainable and inclusive (Diagram 3).

Building on these achievements, the strategies for the next five years will seek to leverage Malaysia's well-developed Islamic finance ecosystem, particularly to:

- i. Sharpen Malaysia's proposition as an international gateway for Islamic finance;
- ii. Strengthen policy enablers of value-based finance for greater impact; and
- iii. Mainstream social finance.

Diagram 2:
Highlights of Malaysia's Islamic finance ecosystem



¹ Bursa Suq Al-Sila' (BSAS) is a commodity trading platform specifically dedicated to facilitate Islamic liquidity management and financing by Islamic financial institutions.
² Bursa Malaysia-i (BM-i) is a fully integrated Islamic securities exchange platform with a comprehensive range of exchange related facilities, that incorporate Shariah-compliant features.

Source: Bank Negara Malaysia, MIFC data estimates, Bursa Malaysia, Malaysian Qualifications Agency, the Securities Commission, Refinitiv

Diagram 3:
Shariah principles underpinning Islamic finance development efforts

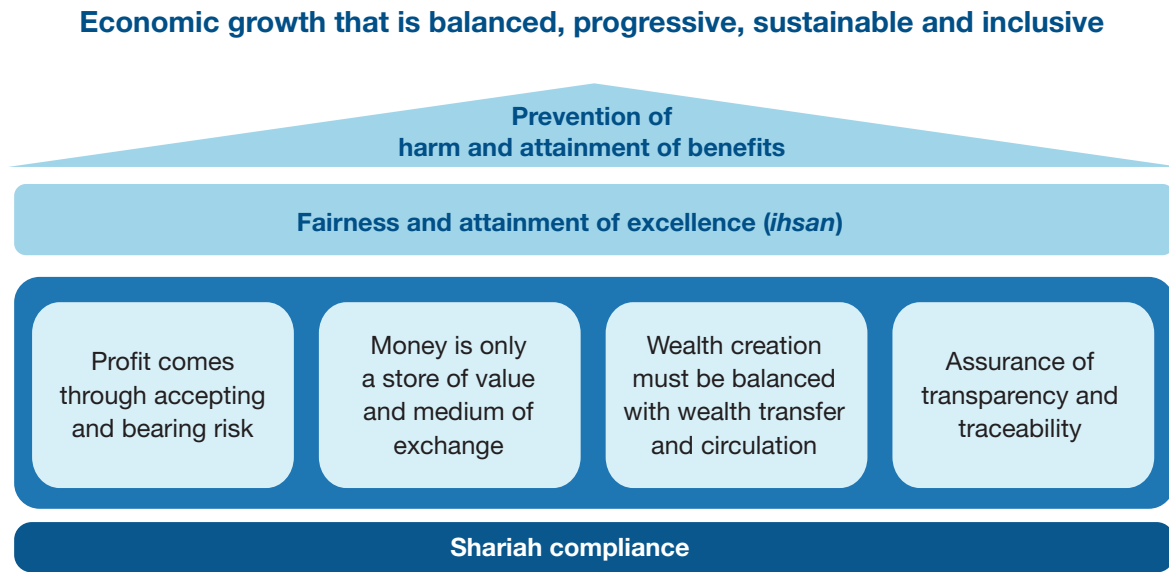


Diagram 4:
Advance value-based finance through Islamic finance leadership

**A**

Sharpen Malaysia's proposition as an international gateway for Islamic finance

- ◆ Strengthen gateway-critical capabilities in Malaysia's Islamic financial industry
- ◆ Promote greater industry leadership
- ◆ Facilitate further deepening of Malaysia's Islamic financial and capital markets

**B**

Strengthen policy enablers of value-based finance for greater impact

- ◆ Develop a more conducive regulatory environment to facilitate the application of diverse Shariah contracts
- ◆ Support the industry's innovation efforts in developing new value-based business models, solutions, and practices
- ◆ Facilitate greater stakeholder activism through higher quality disclosures

**C**

Mainstream social finance

- ◆ Elevate social finance as an integral part of the Islamic finance ecosystem

Strategy 5A

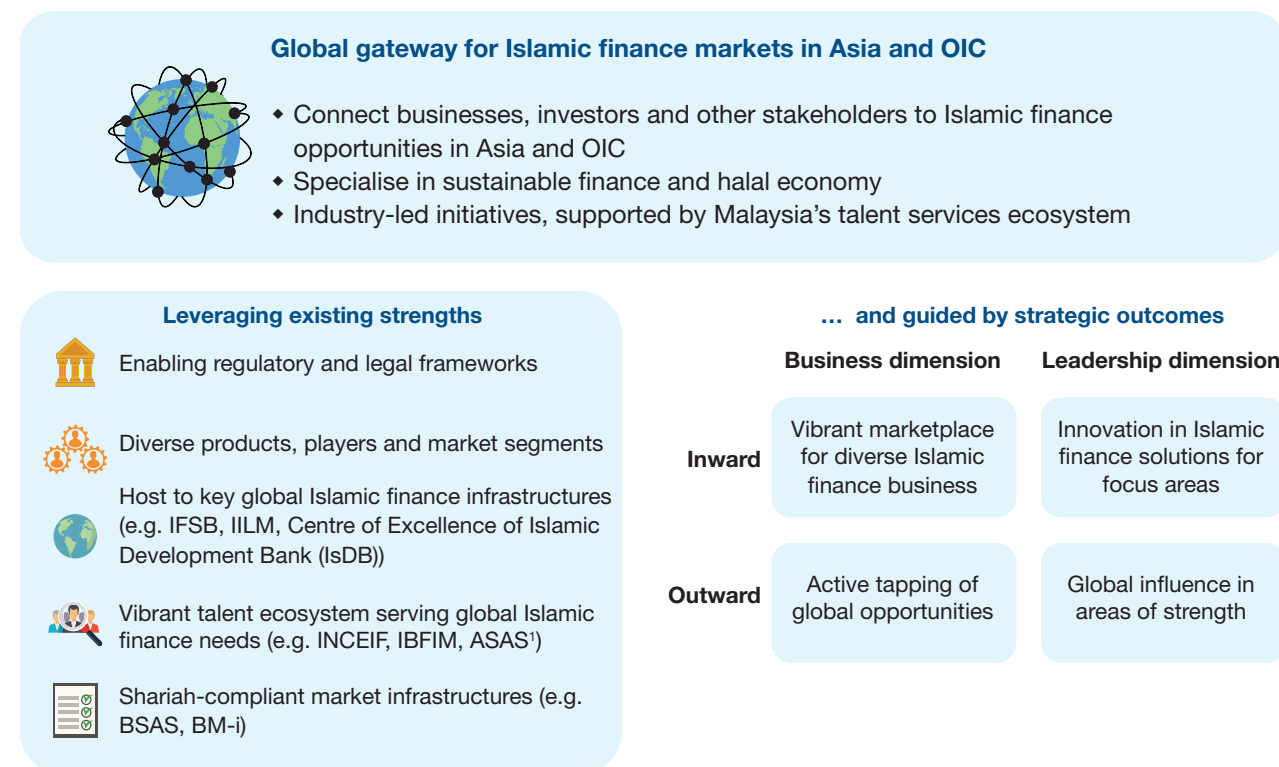
Sharpen Malaysia's proposition as an international gateway for Islamic finance

The global Islamic finance landscape has evolved significantly. Compared to a decade ago, Islamic finance has gained greater prominence in the global financial landscape. Global Islamic financial assets have grown from USD1.6 trillion in 2012 to USD2.7 trillion in 2020¹. Prospects for further growth remain significant, particularly within Asia and Organisation of Islamic Cooperation (OIC) countries. These may arise from untapped market segments, the growing halal business, and demand for more sustainable investments. Alongside the broader digitalisation of financial services, Islamic fintech opportunities are also growing, particularly in developing countries with Muslim-majority populations.

The Islamic finance space is thus expected to become more vibrant globally. Increasingly, more countries are looking to develop domestic markets and expand their footprint overseas. This environment creates new opportunities to Islamic finance – such as new cross-border partnerships to realise synergies, including through ‘collaborative competition’ (co-opetition) among established and emerging Islamic financial centres.

Against this backdrop, the Malaysia International Islamic Financial Centre (MIFC) vision and strategy continues to evolve in response to global trends and shifts in real economic needs (Diagram 5).

Diagram 5:
MIFC vision moving forward



¹ Association of Shariah Advisors in Islamic Finance (ASAS).

¹ Source: IFSB (2013, 2021), “Islamic Finance Services Industry (IFS) Stability Report”.

Our strategies aim to sharpen Malaysia's proposition – specifically, to be a **global gateway for Islamic finance markets in Asia and OIC**. This envisions Malaysia connecting Islamic finance opportunities in Asia and OIC markets with businesses, investors, and other stakeholders across the globe – including partnerships with other jurisdictions to advance areas of mutual interest. We will intensify efforts to facilitate industry-led initiatives that leverage Malaysia's Islamic finance ecosystem, including its infrastructure, instruments, expertise, and players. This includes efforts to preserve Malaysia's strengths as a destination of choice for Islamic fundraising and investment activities, as well as a retakaful hub.

In positioning Malaysia's Islamic finance gateway, we will pursue two areas of specialisation:

- First, a greater focus on opportunities in **sustainable finance**. This builds on Malaysia's pioneering work in VBI, which sets out the frameworks and implementation guidance for a holistic approach to financial intermediation. There are also synergies with our efforts on climate and environmental risks – a key piece of the sustainable finance agenda (refer to the chapter "Position the financial system to facilitate an orderly transition to a greener economy").
- Second, greater integration of Islamic finance with the **halal industry**, particularly in financing halal trade and investment. This supports a more

complete solution for the halal value chain. Notably, the global halal trade has enormous prospects (estimated to be worth USD2.4 trillion in 2024²). In realising this potential, the MIFC community can play a role to support halal trade and supply chain activities (e.g. halal certification and logistics). Further, financial institutions may also help nurture local halal businesses into global or regional players.

In supporting these developments, we will continue to provide an enabling policy environment. Realising this vision will require Malaysia's Islamic financial institutions to be agile and in a state of readiness to capitalise on evolving opportunities. Greater industry leadership, as well as targeted public-private partnerships, will thus be crucial. This includes initiatives in the Islamic finance talent ecosystem – which will remain vital to drive expertise development for the gateway's key focus areas, as well as to export Malaysia's education and training services abroad.

In advancing the sharpened vision for MIFC, our strategies aim to:

- i. Strengthen gateway-critical capabilities in Malaysia's Islamic financial industry;
- ii. Promote greater industry leadership; and
- iii. Facilitate further deepening of Malaysia's Islamic financial and capital markets.

i Strengthen gateway-critical capabilities in Malaysia's Islamic financial industry

We are committed to the MIFC agenda and will continue to lead on regulatory and Shariah fronts, as well as facilitate market access for financial institutions

- We will **support efforts to improve the Islamic financial industry's global distribution capabilities** to better tap opportunities outside of Malaysia. These include facilitating Islamic finance activities in other markets by businesses that prefer to use Islamic finance, as well as enabling business matching of halal exports with potential clients abroad (see Diagram 6). To this end, we will enhance Malaysia's connectivity with potential Islamic finance markets to strengthen or realise the distribution potential of financial institutions. These include collaborative efforts to:

- **Facilitate Malaysian financial institutions in expanding their footprint in Islamic finance business** in other markets – among others by engaging with other financial regulators and authorities, either bilaterally or multilaterally, to enable the wider provision of Islamic financial offerings;
- **Promote greater alignment of Islamic finance-related standards and practices**, including through global standard-setting bodies such as the IFSB and bilateral engagements. We will also continue to promote mutual recognition of Shariah and regulatory requirements globally. This includes enhancing the role and structure of the Centralised Shariah Advisory Authorities (CSAA) as the platform to pursue mutual recognition of Shariah application across jurisdictions; and

² Amount projected based on Muslim spending on halal products and services (Source: Dinar Standard Report (2020), "State of the Global Islamic Economy Report 2020/21: Thriving in Uncertainty").

- **Facilitate greater visibility of Malaysia's professional services** (e.g. Shariah advisory) and **talent development** institutions (e.g. INCEIF, International Shari'ah Research Academy for Islamic Finance (ISRA), IBFIM). This aims to further export Malaysia's Islamic finance expertise through cooperative efforts with industry players and the relevant government agencies, such as the Malaysia External Trade Development Corporation (MATRADE) and Halal Development Corporation (HDC).
- We will **facilitate nascent Islamic financial innovations, including to accelerate the scaling up of new products and services**. Our efforts will focus on trade-related solutions, alternative finance models (e.g. blended finance), and sustainable finance. These include repurposing existing seed funding provided by the Bank to Islamic fund management companies (IFMCs) to focus on sustainability and innovative-driven mandates. Meanwhile, the growing market for Islamic fintech will be supported by broader initiatives to foster a vibrant digital financial services landscape – including a conducive environment to test and scale digital innovations (refer to Strategy 3B(i) of “Advance digitalisation of the financial sector”).
- Complementing this, we will continue to **strengthen global partnerships to advance Islamic financial innovations** beyond Malaysia's borders. These include joint initiatives with other international financial centres and multilateral organisations (e.g. the World Bank, United Nations Development Programme (UNDP) and IsDB). Such initiatives can provide critical insights for innovations in Malaysia's Islamic finance ecosystem. Where possible, we will build on these arrangements to identify areas where Malaysia can act as a testbed for innovation to better meet global Islamic finance needs.
- We remain committed to **refine measures towards strengthening Malaysia's global competitiveness as an Islamic finance gateway**. A key outcome will be to support Malaysia as the preferred Islamic finance partner for halal industry growth. To this end, we will explore collaboration with the relevant agencies (e.g. MOF, Malaysian Investment Development Authority (MIDA) and HDC) to create stronger links between Islamic financial services and Malaysia's economic propositions as a leading halal hub, particularly in supporting high value-added sectors and initiatives under the NIA. We will also continue to work alongside other financial regulators such as the SC Malaysia, Bursa Malaysia, and the Labuan Financial Services Authority on complementary strategies that advance the MIFC agenda.



Greater industry leadership
to take MIFC forward

ii Promote greater industry leadership

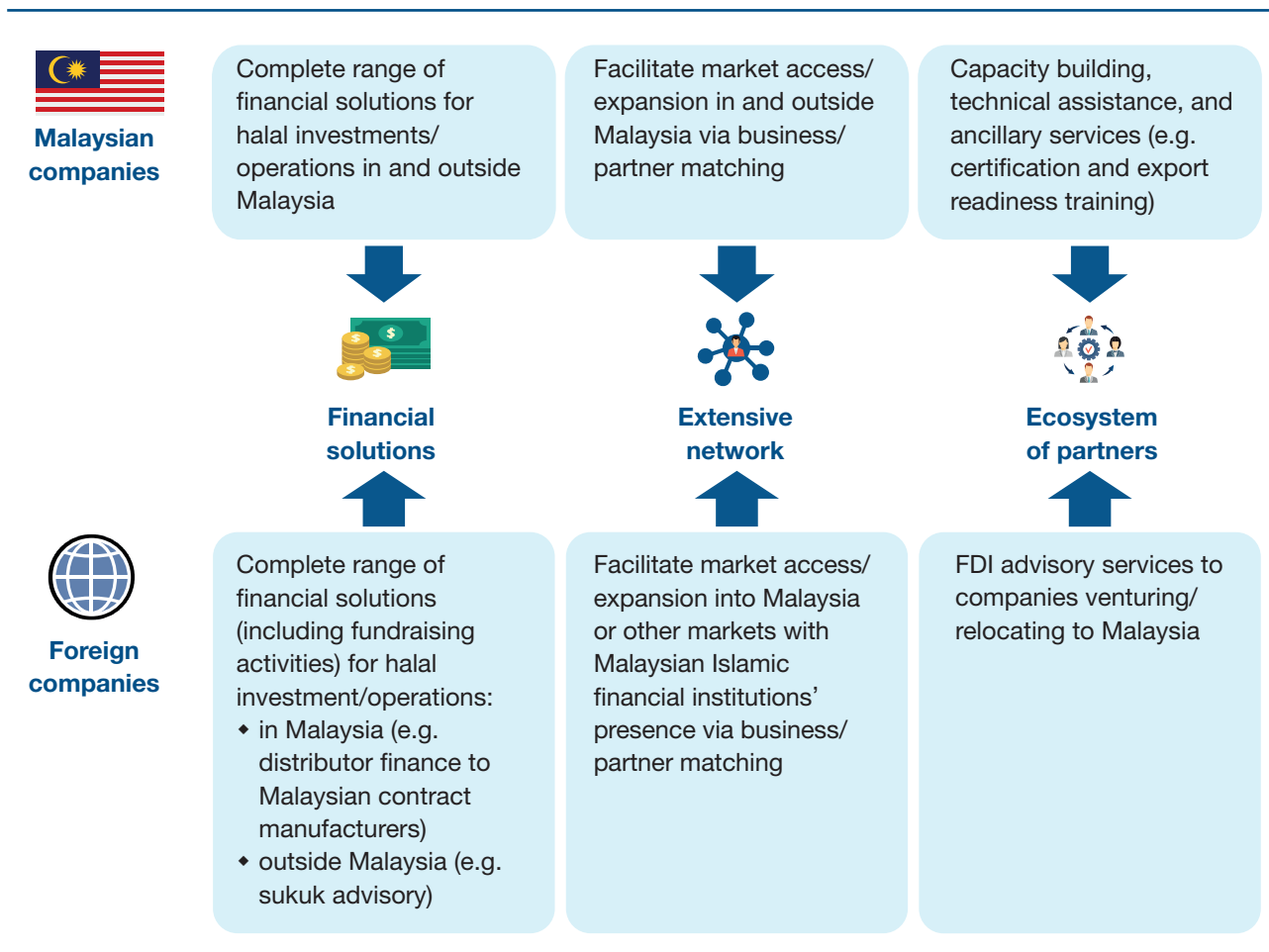
- We will **enhance mechanisms for greater industry leadership**. This includes the review of the MIFC Executive Committee (EXCO) and MIFC communication strategies. In the earlier years of the MIFC agenda, a strong regulatory role – together with the contribution of the MIFC EXCO and industry players – formed the key building blocks for a conducive and vibrant Islamic finance ecosystem.

With the more mature Islamic financial industry and the rapidly evolving landscape of global opportunities, greater industry stewardship is needed going forward. In sharpening Malaysia's proposition as an Islamic finance gateway, we see our role as focusing more on being a facilitator or partner in broader industry-wide efforts.

In the near term, we will work with the industry to **reform existing mechanisms and platforms** to be more agile, and to better position industry champions to drive critical agendas for MIFC. These include efforts to further:

- Enhance Malaysia's position as an **Islamic fundraising and investment destination**;
- Strengthen **distributional capabilities** and expand **market access** for players to provide Islamic finance solutions;
- Enhance the role of Islamic finance to **support Malaysia's national halal agenda** (see Diagram 6); and
- Encourage cohesive efforts by education and training providers in sustaining Malaysia's position as a **leading a knowledge centre for Islamic finance globally**.

Diagram 6:
Examples of possible Islamic finance offerings as a gateway to the halal economy



iii Facilitate further deepening of Malaysia's Islamic financial and capital markets³

Efforts to improve Malaysia's Islamic financial and capital markets will be continuously pursued

- We will continue to **promote Malaysia as the centre for origination, issuance, and trading for sukuk**. This will leverage our comparative advantage in sukuk advisory, particularly in structuring and innovation, to tap into the growing sukuk trends, including sustainable sukuk in line with MIFC's focus areas. This will also be achieved through the continued deepening of the domestic hedging market and strengthening of domestic players' global distribution capabilities to further enhance Malaysia's ability to attract a larger and broader foreign investor base. Such efforts will further improve Malaysia's propositions as the preferred destination for Shariah-compliant fundraising and investment, complemented by a facilitative framework for the issuance and subscription of ringgit and foreign currency-denominated sukuk in Malaysia.
- We will continue to **enhance best practices and standards in the Islamic money and capital markets**, in line with international standards. To this end, we will continue to promote collateralised Islamic transactions and support the implementation of collateral management practices. As part of these efforts, we will work towards the recognition of additional Islamic instruments for close-out netting (e.g. collateralised commodity *murabahah*) and greater adoption of Islamic derivatives agreements (*tahawwut*) among interbank players⁴.
- We will continue to **review and improve the structure of Islamic instruments** to promote greater Shariah acceptance and to leverage the diversity of Shariah contracts. This includes efforts to promote a wider range of Islamic risk management tools, including derivatives, to investors. We envision that this measure will lead to increased vibrancy in the Islamic derivatives market, and subsequently contribute to the expansion of Islamic finance and share of Islamic financing in the onshore financial market.

Strategy 5B

Strengthen policy enablers of value-based finance for greater impact

As we advance SDGs in financial development, the Islamic financial sector can play a key role. Islamic finance is uniquely aligned to the growing calls for a responsible and ethical model for financial services, given the fundamental values of Shariah to prevent harm and promote the attainment of benefits – including to improve well-being through wealth preservation, wealth circulation, and justice.

Building on this, we introduced key frameworks in recent years – namely, VBI in 2017 and VBIT in 2021. Complemented by implementation guidance, these frameworks outline how Islamic finance solutions and practices can support a more positive impact on the economy, community, and environment.

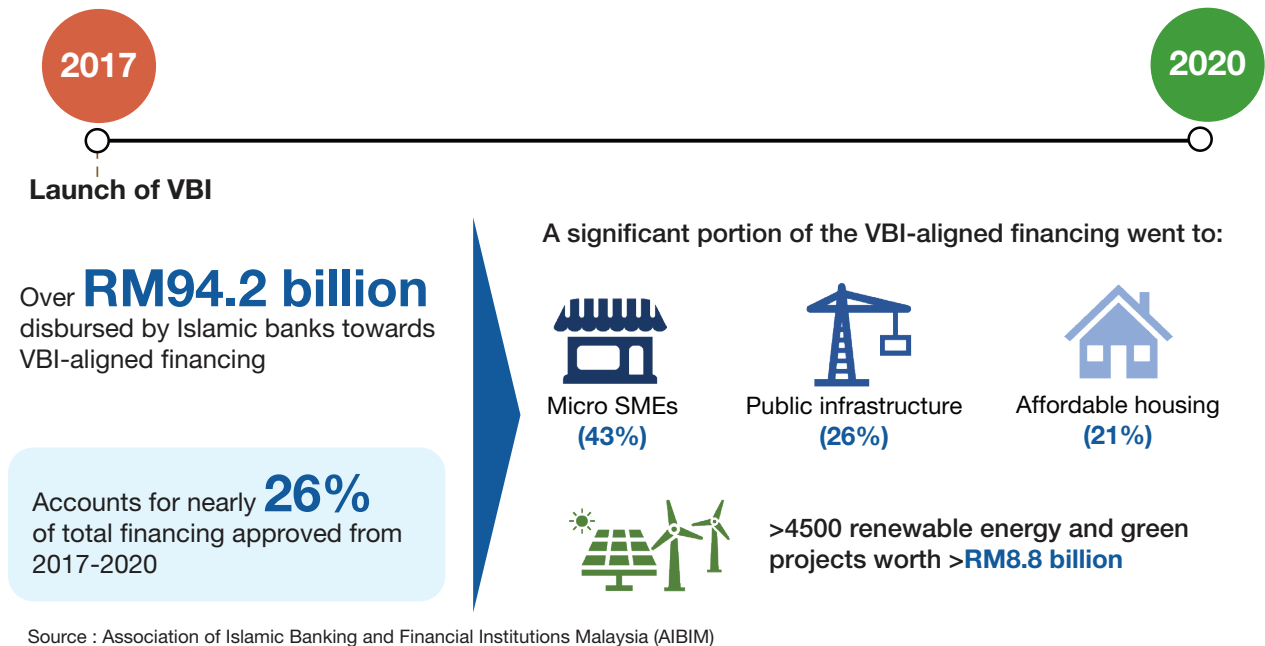
Islamic financial institutions have made steady progress since then, delivering value-based finance solutions to a growing number of individuals and businesses in recent years (see Diagram 7). The impact of VBI is also evident in the halal industry. Halal businesses have benefited from the comprehensive suite of financial solutions in expanding their operations beyond the domestic market, complemented by the provision of business advisory and ancillary services.

In the coming years, we envision Islamic financial institutions leading efforts to widen the adoption of value-based finance across the financial sector. These efforts include developing innovative solutions and refining business practices towards greater social, economic, and environmental resilience – underpinned by more refined measures of value and impact.

³ These efforts will be pursued in collaboration with the Securities Commission, consistent with the Capital Market Masterplan 3 (CMP3).

⁴ Initiatives will be geared towards greater adoption of *tahawwut* agreements by interbank participants and consequentially expanding the adoption to other markets and players.

Diagram 7:
Overview of VBI-aligned financing (2017 - 2020)



To advance these goals, we will prioritise these strategies:

- Develop a more conducive regulatory environment to facilitate the application of diverse Shariah contracts;
- Support the industry's innovation efforts in developing new value-based business models, solutions, and practices; and
- Facilitate greater stakeholder activism through higher quality disclosures.

We will continue to provide the appropriate regulatory facilitation for value-based finance implementation



i Develop a more conducive regulatory environment to facilitate the application of diverse Shariah contracts

- We will **strengthen the Shariah regulatory framework** by aligning the application of Shariah contracts with their underlying wisdom (*hikmah*). This includes setting out clear considerations for financial institutions in adopting certain arrangements in exceptional circumstances (e.g. ceding takaful risk to conventional insurers or reinsurers due to capacity constraints), in line with the *hajah* principle⁵.

Another desired outcome is for financial institutions to use more diverse Shariah contracts, thereby enabling value-based finance to serve a wider range of economic and social needs. This may call for a reconsideration of the use of *tawarruq*, which is presently a dominant Shariah contract for Islamic finance products in Malaysia's Islamic finance landscape.

- We will **explore the potential recalibration of existing regulatory requirements to cater to the broader application of *ta'awun***⁶ in takaful, guided by clear Shariah parameters. Current regulations restrict the transferability of distributable surplus across takaful funds in meeting the capital requirements, due to separate fund ownership for takaful. An expanded application of *ta'awun* may allow distributable surplus in a takaful fund that is sufficiently capitalised to support shortfalls in another takaful fund.

Similarly, a broader application of *ta'awun* can facilitate greater wealth circulation within the wider society. For example, the utilisation of distributable surplus in takaful funds may potentially be channelled to provide takaful coverage to lower-income households, thereby improving their financial resilience. In exploring the expansion of *ta'awun* application, key considerations would be to promote benefits to the wider society while preserving the interest of takaful participants.

ii Support the industry's innovation efforts in developing new value-based business models, solutions, and practices

Innovation, particularly through the application of diverse Shariah contracts, is an important enabler of value-based finance

- We will leverage enhancements to our existing Regulatory Sandbox to **better support innovations in value-based finance**, such as novel applications of Shariah contracts. These may arise from enhancements to the scope of *hajah* application, as well as from the exploration of new takaful business and operating models that support value-based protection (refer to Strategy 3B(i) of Chapter 3 – “Advance digitalisation in the financial sector”).

- We will **support further diversification of Investment Account (IA) offerings by Islamic banks** to mobilise new sources of funds for value-based financing, particularly initiatives to develop **impact-driven investment instruments**. This will align with broader efforts to facilitate banks' participation in non-debt finance solutions (refer to Strategy 1B(ii) of Chapter 1 – “Fund Malaysia's economic transformation”). IA offerings will need to evolve in tandem with heightened competition in the retail investment space, such as from equity crowdfunding and P2P financing. To widen the appeal of IA offerings among eligible investors, there is a need to expand the underlying assets beyond traditional financing. This may include mezzanine financing and venture capital that can also support VBI-aligned outcomes. We will continue to support industry efforts on that front where appropriate, including addressing regulatory frictions and facilitating the development of enabling infrastructure as necessary.

⁵ *Hajah* is defined as a situation of exigent circumstances that will cause or is likely to cause a detrimental impact to the safety and soundness of the Islamic financial institution, thus necessitating a temporary exception of a Shariah ruling. Further details are accessible in Bank Negara Malaysia's “Discussion Paper on Hajah” (2021) at https://www.bnm.gov.my/documents/20124/938039/Discussion_Paper_on_Hajah.pdf.

⁶ *Ta'awun* refers to the cooperation among a group of individuals in a takaful fund to mutually aid each other to meet certain needs, as collectively agreed in a takaful contract. Further details are accessible in Bank Negara Malaysia's “Shariah Resolution in Islamic Finance” (2010) at https://www.bnm.gov.my/documents/20124/761709/shariah_resolutions_2nd_edition.pdf/3844f55b-8c0f-23ea-5a2a-9874dc416a04?t=1593546461329.

iii Facilitate greater stakeholder activism through higher quality disclosures

With meaningful disclosures on impact, stakeholders can engage with financial institutions to address gaps and accelerate impact creation

- We will **facilitate improvements in the quality and usefulness of impact-based disclosures**. Our priority here is to foster a more conducive environment for effective stakeholder activism.

As it stands, Islamic financial institutions do provide impact-based disclosures under VBI. However, there is room to further enhance the information published – including to ensure the continued integrity of such disclosures, and better align them with international practices. This can foster greater confidence among

key stakeholders (e.g. investors and financial consumers) to evaluate, compare, and differentiate practices in VBI, thereby nudging the industry to continuously improve – while supporting greater visibility of VBI initiatives beyond national borders.

In collaboration with the VBI Community of Practitioners and VBIT Steering Committee, we will provide **guidance on reporting metrics that improve comparability and quality of disclosures**. A major focus will be to mitigate the risks of ‘impact washing’⁷ in these disclosures, which may include reducing the subjectivity or discretion accorded to certain parameters. The guidance will also be aligned to the phases of individual financial institutions’ VBI implementation which vary across the industry⁸, and complement the existing principles of sustainability reporting and initiatives on climate risk disclosures.

Strategy 5C

Mainstream social finance

Social finance refers to financial structures or business models that aim to deliver tangible social outcomes by mobilising philanthropic capital. Such capital includes Islamic social finance instruments such as *sadaqah* (donation), *waqf* (endowment) and *zakat* (alms). In recent years, we have worked closely with the industry and other stakeholders to encourage greater integration of social finance in the Islamic finance ecosystem.

Moving forward, social finance is envisioned to play a greater role, with Islamic finance leading the way – complementing public sector finance,

commercially-driven financial solutions, and corporate social responsibility (CSR) activities of the financial institutions to promote greater social resilience. To unlock the potential of social finance, our strategies will aim to elevate social finance as an integral part of the Islamic finance ecosystem.

The box article on “Social finance as an enabler of social development in Malaysia” provides further details on the social finance landscape as well as recommendations for other social finance actors on unlocking the potential and amplifying the impact of social finance.



We will adopt a nurturing approach to support financial institutions’ explorations to better integrate social finance within their businesses

⁷ Impact washing refers to a process in which impact-focused initiatives claim to be aligned with and contribute to development objectives without providing meaningful supporting evidence (Source: OECD (2021), “OECD-UNDP Impact Standards for Financing Sustainable Development”).

⁸ There are four phases towards the full implementation of VBI, namely Initiating, Emerging, Engaged, and Established (Source: Bank Negara Malaysia (2018), “VBI Implementation Guide”).

i Elevate social finance as an integral part of the Islamic finance ecosystem

- We will **support a range of finance models that promote impactful social outcomes**. This reflects how the optimal models can vary based on individual player's risk appetite, capacity, operational readiness, business strategy, and the evolving needs of financial consumers. Generally, we will **facilitate both blended finance and funding escalator models** (refer to Diagram 1 under the box article, "Social finance as an enabler of social development in Malaysia") to address financing, investment, and protection gaps in the market. This may include providing funding for specific financing facilities and facilitating collaboration between actors from the private and public sectors. Blended finance models refer to the combination of commercial funding (e.g. microfinancing) and philanthropic capital (e.g. *zakat* or *sadaqah*) to fund beneficiaries based on adjusted risk acceptance criteria. Funding escalator models, on the other hand, refer to the incubation of beneficiaries using social finance funds as they develop their creditworthiness and business track record, upon which they graduate to source for commercially-driven funding. Social finance funds are also mobilised to extend financial protection to low-income households as a form of safety net in the event of calamity.
- We will **enable a conducive regulatory environment for diverse business models**, recognising that social finance solutions could be delivered by a range of players. This builds on emerging interest among industry players to enter this space – be it as part of their existing mandates (e.g. DFIs), CSR initiatives by incumbents, or as a primary business strategy (e.g. digital players with a social finance focus). As part of these efforts, we will **facilitate the roll-out of more impactful pilot programmes for social finance**. These programmes will guide efforts to enhance regulations to remain fit-for-purpose, particularly to scale tried-and-tested social finance solutions. For example, these may include tailoring capital and liquidity rules to better reflect the risk profile of such activities (e.g. proportionate credit risk requirements for group-based lending using concessional funds and simplified liquidity requirements for ring-fenced donations).
- We will collaborate with the industry to **develop better measures of value and impact** in promoting more transparent disclosures of social finance. This strategy will be pursued together with impact-based disclosures for value-based finance, as outlined under strategy 5B(iii).

