Islamic Finance Development

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ISLAMIC BANKING

Performance of the Islamic banking sector

Shariah-compliant financial solutions offered by the Islamic banking industry (including by development financial institutions), continued to support the diverse needs of the economy in 2017. Islamic financing grew by 9.4% to RM605.5 billion (2016: 11.8%) during the year (Chart 4.1), amid a moderate growth of 1.3% in conventional loans (2016: 2.4%).

Islamic financing of businesses sustained its positive growth of 7.8% (2016: 12.2%) and was channelled mainly to the finance, insurance and business services and manufacturing sectors. Business financing was driven by small and medium enterprises (SMEs), which grew by 12.5% (2016: 13.3%), amid the more moderate growth in conventional lending to SMEs (3.1%). Islamic home financing also continued to exhibit strong growth of 17.5% (2016: 16.3%, conventional loans 6.0%), reflecting the growing acceptance of Shariah-compliant home financing solutions.

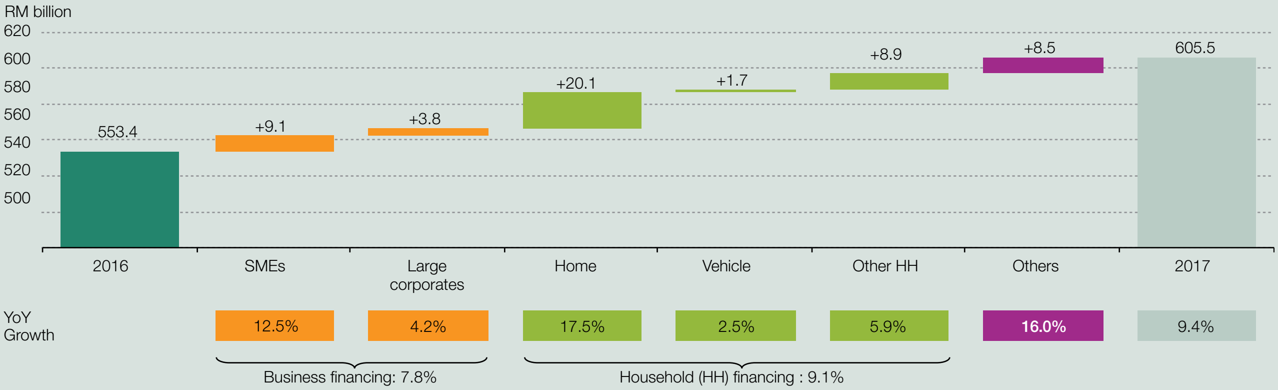
During the year, Islamic deposits and investment accounts expanded by 11.7% (2016: 9.4%) to RM672.6 billion. Of this, investment accounts increased by 6.9%, amounting to RM78.7 billion, reflecting a growing recognition of investment accounts by customers as an alternative investment instrument and further diversification of funding sources by Islamic banks.

Islamic banks remained on a strong financial footing. The industry's common equity tier 1 (CET1), tier 1 and total capital ratios of 13.2%, 13.7% and 17.6% respectively (2016: 13.0%, 13.0% and 16.6%), were well above the minimum regulatory requirements. Asset quality remained sound with a net impaired financing ratio of 0.9% (2016: 1.0%). Sufficient liquidity buffers were maintained, with the industry reporting a liquidity coverage ratio of 149.2% (2016: 124.9%).

In 2017, Islamic banks recorded higher pre-tax profits of RM6.7 billion (2016: RM5.6 billion). This was driven mainly by an increase in net financing income derived from term financing for the purchase of properties. Returns on assets and equity were stable at 1.1% and 14.3% (2016: 1% and 13.1%) respectively.

Chart 4.1: Growth of Islamic Financing

Positive growth of Islamic financing driven by household sector



Source: Bank Negara Malaysia

Development of the Islamic banking sector

Creating an impact on society and economy through value-based intermediation (VBI)

The Islamic banking industry in Malaysia has advanced significantly over the years. From a market share of 5.3% in 2000, Islamic financing now accounts for 34.9% of total loans and financing. Islamic banks also offer a wide range of competitive and innovative products, complementing solutions offered by conventional banks.

VBI aims to achieve the intended outcomes of Shariah in promoting good and preventing harm

While the growing depth and breadth of Islamic finance is an important barometer of progress, equally important is ensuring that Islamic finance delivers a positive and sustainable impact on the community, economy and environment. This vision is being realised through the adoption of VBI by Islamic banks, which reinforces the intent of Shariah to promote good and prevent harm (Diagram 4.1).

VBI is being advanced to bring about a transformation in the business models and day-to-day conduct of Islamic banks. This was captured in a strategy paper that was developed in collaboration with the industry and issued by the Bank in July 2017. The vision under VBI is for Islamic banks to be more impact-driven in the design and offering of products, and in their dealings with customers. Important areas of focus include enhanced assessments of a customer's application for financing, where the traditional credit assessment methodology would be supplemented with an assessment of the positive impact of the financing to the community and the economy. For business financing in particular, such an assessment will be based on a wider set of considerations which may include the potential for the financing to contribute towards generating sustainable employment opportunities and entrepreneurship.

The expectation is for such an impact-driven mindset to be embedded within and well-integrated into the risk management practices and product development strategies of Islamic banks. By being more customer-driven, Islamic banks are expected to be more responsive to the unique circumstances of individual customers through the offering of solutions that address their differentiated needs. For example, the practice of complementing financing with financial capability advice is expected to be more prevalent within the Islamic banking industry going forward. Islamic banks, in collaboration with other relevant industry experts, are also expected to offer business and technical skills training to help young and new entrepreneurs better commercialise their ideas. Another approach being considered is to directly link the incentive structures of Islamic banks, not just with the volume and value of financing disbursed, but also with the ability of customers to service the financing over a long horizon. This is expected to lead to Islamic banks and their employees taking a longer-view of the financial well-being and commercial success of their customers.

The implementation of VBI by Islamic banks is industry-driven, factoring in the different levels of readiness and capacity of individual Islamic banks to initiate and sustain the adoption of new business models and internal practices that are consistent

Diagram 4.1

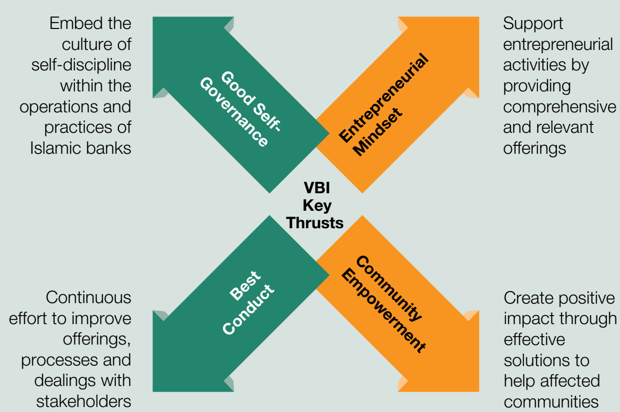
Overview of VBI

What is VBI?

An intermediation function that aims to deliver the intended outcomes of Shariah through practices, conduct and offerings that generate positive and sustainable impact to the economy, community and environment.

VBI shares its purpose with other movements and initiatives in the world of business and finance to deliver economic, social and environmental benefits for wider stakeholders.

However, a number of characteristics set VBI apart:
1. Underpinned by Shariah;
2. Embedded in and integrated with the business model, consistent with long-term shareholder value creation; and
3. Reflected in day-to-day practices and conduct, going beyond philanthropy and employee volunteerism.



Source: Bank Negara Malaysia

with VBI. To support changes by the industry, a Community of Practitioners (CoP) comprising nine Islamic banks was established to spearhead VBI implementation. The CoP serves as an effective platform for members to share knowledge and pursue collective efforts to develop and execute VBI strategies in collaboration with strategic partners beyond the financial fraternity.

The CoP also aims to leverage its connections with established value-based institutions, such as the Global Alliance for Banking on Values and Triodos Bank, to advance the understanding and practice of VBI among Islamic banks in Malaysia. Observations of successful VBI models indicate that they have a number of features in common: leadership-driven strategies and values that are aligned from the top, an enterprise-wide culture that is consistently demonstrated in business plans and operations, and a system that encourages constructive engagements with and accountability to broader stakeholders.

As the VBI initiative progresses to its implementation phase, the immediate focus in 2018 will be on developing tools for operationalisation and performance measurement. Guidance on applications and approaches to VBI will be developed to help Islamic banks navigate implementation challenges associated with different business models and maturity of individual Islamic bank's operations. In addition, a scorecard will be introduced to measure both financial and non-financial progress of Islamic banks towards VBI adoption. This is expected to yield changes in the financing portfolios of Islamic banks, with at least half of new business and personal financing channelled to purposes that are consistent with VBI by 2020. Going forward, further targets will be set upon implementation of the scorecard.

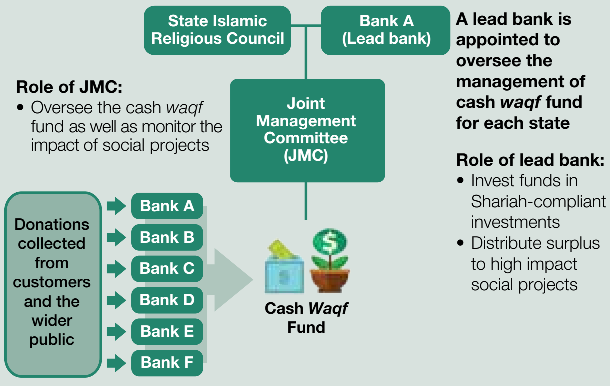
While the industry is still at early stages in its journey towards VBI, there are already concrete examples of VBI being put into action today. For instance, funds raised through investment accounts are being channelled to a variety of purposes, including to provide risk capital for entrepreneurs, such as SMEs. During the year, efforts were directed at aligning and strengthening industry practices to ensure that investment accounts function truly as 'risk capital' instruments. The Bank issued regulatory guidance on the accounting treatment for restricted investment accounts to ensure that cash flows are managed in a way that allows such accounts to be treated off-balance sheet. Focus was also directed at improving product disclosures, strengthening the competency of frontliners in marketing investment accounts and ensuring effective customer suitability assessments.

The Investment Account Platform (IAP) – which commenced operations in 2016 – is gradually emerging as an important enabling infrastructure to mobilise and channel investment accounts towards funding entrepreneurial ventures. In 2017, funds raised through IAP listings quadrupled to RM95.3 million (2016: RM20.0 million) from four ventures. To provide a more convenient, seamless and efficient experience for new investors, the industry embarked on the development of a multilateral framework for customer on-boarding. Under this framework, IAP banks will mutually recognise each other's customer due diligence practices, thus removing the need for a customer to visit the branch of IAP sponsoring banks to open a new bank account. The framework is expected to be finalised and operational by the first half of 2018.

Another concrete example of VBI in action is the empowerment of local communities, both Muslims and non-Muslims, seen through the growing involvement of Islamic banks in social finance. In September 2017, six Islamic banks entered into a collaboration agreement to develop cash *waqf* (endowment) funds with the State Islamic Religious Councils (SIRCs). Under this initiative, participating Islamic banks will partner with SIRCs of 10 states to modernise the collection of cash *waqf* through their access points, and internet and mobile banking services. Funds collected will be invested in Shariah-compliant instruments. Returns generated from these investments will in turn be channelled to fund projects that promote economic empowerment, education and health (Diagram 4.2). As part of this agreement, Islamic

Diagram 4.2

Cash *Waqf* Fund



Source: Bank Negara Malaysia

Islamic Finance Development

banks have also committed to the development of knowledge and expertise in managing the investment and distribution of *waqf* funds. As part of this commitment, the Association of Islamic Banking Institutions Malaysia will develop a Code of Governance and Transparency for the management of *waqf* funds in 2018 to set benchmark standards for industry practice.

Strengthening institutional capabilities of Islamic banking subsidiaries

Islamic banking subsidiaries play an important role in the Islamic banking sector. The 11 subsidiaries account for 65.7% of the industry's assets and as members of large financial groups, are able to leverage on their groups' shared services functions, such as branch networks, technological platforms and human resources. This flexibility has helped expedite the growth of Islamic finance, allowing for efficient deployment of resources and wider access to banking services for customers.

Islamic banking subsidiaries however remain fully accountable for ensuring that these operational flexibilities do not compromise the Shariah compliance of business practices and product offerings. A development of some concern has been resource sharing practices that are driven solely by operational and cost efficiency considerations, accompanied by under-investments in internal capacity within Islamic banking subsidiaries. This has resulted in higher incidences of Shariah non-compliance and mis-selling of Islamic financial products.

To encourage more optimal outcomes from resource sharing management, the Bank engaged with the senior management of Islamic banking subsidiaries and their respective financial groups during the year to draw commitment from the industry to take specific actions to improve current practices (Diagram 4.3).

Diagram 4.3

Commitments to Enhance Resource Sharing Practices of Islamic Banking Subsidiaries

- Set clear vision, policy and strategy for the Islamic banking business
- Commit to undertaking capacity building initiatives to facilitate future growth
- Provide commitment to focus on Islamic banking business
- Enhance service level agreements to improve shared services functions

Source: Bank Negara Malaysia

These include commitments to support specific strategies for the Islamic banking business and to increase investments to develop capacity within Islamic subsidiaries. The industry is expected to reflect these commitments in the annual business plan and group-level service agreements starting from 2018.

TAKAFUL

Performance of the takaful sector

Sustained domestic demand for Shariah-compliant protection continued to support takaful growth in 2017. The combined net contributions of family and general takaful business increased by 9.5% to RM8.3 billion (2016: 10.5%), while the market share of the takaful industry, in terms of net premiums and contributions, rose to 15.2% (2016: 14.6%).

In family takaful, new business expanded by 10.0% (2016: 8.6%), largely attributable to mortgage term, investment-linked and medical products which accounted for 76.1% of total new business. A number of new and innovative family takaful products were launched during the year. These include three takaful products under *Perlindungan Tenang* (refer to box article on 'Expanding Insurance and Takaful Solutions for the Underserved Segment') which are affordable and designed to support simpler sales and claims processes. In the general takaful sector, business grew by 6.4% (2016: 4.7%), with the motor, fire and personal accident segments commanding 91.3% of total gross contributions.

Takaful and retakaful operators remained well capitalised, with an aggregate capital adequacy ratio of 209.4% (2016: 205.3%) and capital buffers totalling RM4.0 billion. Takaful risks remained largely unchanged, reflecting a stable business mix and healthy reserve level to meet takaful liabilities. Total takaful fund assets increased by 9.4% (2016: 8.4%) to reach RM29.3 billion, with corporate sukuk, cash and deposits accounting for 69.1% of total takaful fund assets. Profitability of the takaful sector was mixed in 2017. Family takaful recorded higher profits of RM2.6 billion, up 27.2% from 2016 (RM2.0 billion) mainly driven by better investment results. The general takaful sector however recorded weaker profits of RM0.3 billion, down 28.3% from the previous year (RM0.4 billion) on account of higher management expenses and claims payout.

Development of the takaful sector

Developing a conducive ecosystem for innovation and growth

A key focus in developing the takaful sector in 2017 was the positioning of products and services to better meet the protection needs of businesses. In support of Malaysia's aspiration to become a global halal hub, the Bank aims to publish an exposure draft outlining a clear and facilitative regulatory framework for the offering of trade credit takaful in the first half of 2018. This is also in response to the large and growing halal market, estimated at USD2.0 trillion in 2016[1]. As a Shariah-compliant product which complements trade credit insurance, trade credit takaful can help protect businesses from the risk of defaults in international trade, allowing them to further grow their export business. Islamic banks may also use the product as a tool to mitigate credit risk and increase their trade financing capacity.

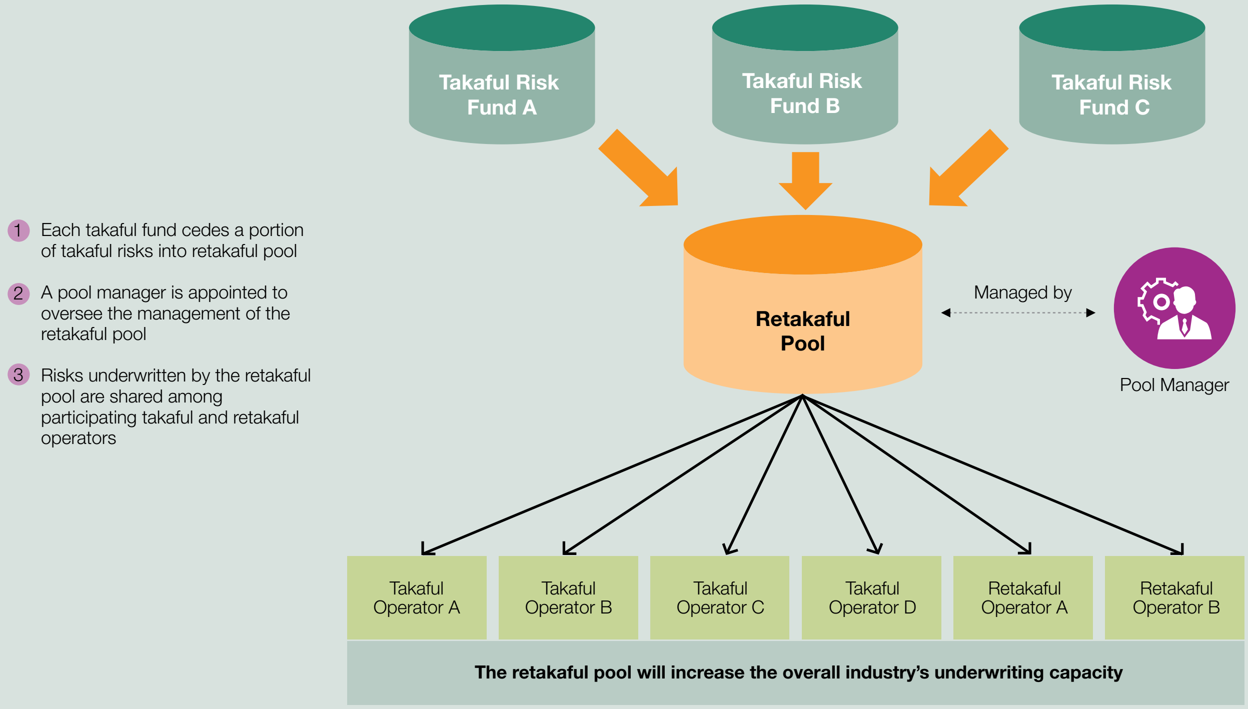
As part of efforts to expedite the process for claiming death benefits, the Bank, in collaboration with the Malaysian Takaful Association (MTA), successfully obtained agreement from the National Registration Department (NRD) to develop an automated mechanism that will allow takaful operators to regularly check the status of policy owners against the national death registry. By leveraging on the NRD's existing infrastructure, requirements for documentation and procedures for verifying claims will also be simplified, thereby expediting the payment of death benefits. This initiative is expected to be operationalised in 2018.

The claiming of death benefits will be made simpler and faster with a new automated mechanism

In the area of retakaful, efforts were directed at developing an industry-wide retakaful pool to expand the underwriting capacity of the general takaful industry, while reducing reliance on conventional reinsurance capacity to support the takaful sector.

Diagram 4.4

Mechanism for Retakaful Pool



Note: The number of participating takaful and retakaful operators is for illustrative purpose only

Source: Bank Negara Malaysia

[1] Source: State of Global Islamic Economy 2017-2018 Report,Thomson Reuters.

The initiative, led by the MTA, enables individual takaful and retakaful operators to combine their capacity to underwrite larger and more complex risks that would otherwise be beyond the risk appetites of individual operators (Diagram 4.4). The enlarged underwriting capacity is expected to result in a reduction in the share of general takaful gross contributions ceded to the conventional reinsurance market, which currently stands at 9.2% (RM236.2 million).

Amendments to the Income Tax Act 1967 were made during the year to allow for the deductions of expenses incurred in managing family takaful funds. The amendment recognises the unique features of the takaful business model and accords regulatory parity in the tax treatment between the takaful and insurance industries.

REGULATORY AND SUPERVISORY FRAMEWORK

The Bank's regulatory priorities in the area of Islamic finance in 2017 continued to be centred on measures to promote end-to-end Shariah compliance and spur greater product innovation in meeting the needs of the economy and society.

Ensuring end-to-end Shariah compliance through Shariah standards

Since 2013, the Bank has worked closely with the Shariah Advisory Council of Bank Negara Malaysia (SAC) to progressively roll out a compendium of Shariah Standards and Operational Requirements. These Shariah standards aim to reinforce the principles of Shariah, while ensuring consistent and effective governance in the application of various Shariah contracts. During the year, standards on *wa`d* (promise) and *kafalah* (guarantee) were finalised, bringing the number of total standards issued to date to 12. In addition, exposure drafts on two new standards, namely *rahn* (pledge) and *bai` al-sarf* (exchange of money), were also published for industry consultation, with the view to finalise the standards in 2018 (Table 4.1 outlines the salient features of these four standards). The completion of the compendium of standards will not only strengthen Shariah compliance and governance, but also enhance public confidence in Islamic financial transactions and encourage a broader range of product offerings to meet the diverse needs of customers.

To encourage greater innovation in takaful product offerings, the Bank conducted a review of the Takaful Operational Framework. The review seeks to provide further clarity on the operationalisation of Shariah contracts – namely *wakalah* (agency), *mudarabah* (profit-sharing), *qard* (interest-free loan), *hibah* (gift) and *tabarru`* (donation) – in the context of takaful business. This includes providing additional guidance on differentiated product features according to the attributes of the contracts. For example, proposed revisions will include a clear demarcation between takaful funds established for the purpose of savings and investment to reflect the relevant contracts applicable for each fund. The review will also clarify expectations on specific responsibilities of takaful operators under these contracts and how they should be remunerated. Greater clarity that is envisaged to follow from the revisions is expected to catalyse the development of products that better meet the protection needs of a wider range of customers. Internal controls over the establishment of sub-funds will also be strengthened to ensure their sustainability and safeguard the interests of takaful participants. The proposed revisions will be issued for industry consultation in early 2018.

Table 4.1

Shariah Standards Issued in 2017

Shariah Contract	***Kafalah* (Guarantee)**	***Wa`d* (Promise)**	***Rahn* (Pledge)**	***Bai` al-Sarf* (Exchange of money)**
Application	Guarantees, standby letters of credit and other forms of guarantees	All types of financing and derivatives	Pawnbroking and secured financing	*Foreign currency deposits, financing or investment*, remittance and bureau de change
Key elements	Ensures clear distinction between the rights and obligations of guarantors and beneficiaries	Specifies elements of a binding *wa`d* and sets out the rights and responsibilities of promisors and promisees	Defines accepted uses of collateral and allowable charges	Clarifies the approach to spot settlement and rate of exchange for currency exchange

Source: Bank Negara Malaysia

Strengthening impact of Shariah governance

The Shariah Governance Framework, first issued in 2010, sets out requirements to ensure that Islamic financial institutions are governed in a way that adheres to Shariah principles at all times. To further strengthen its effectiveness given the growing size, nature and sophistication of the business of Islamic finance, a number of enhancements to the framework were proposed in an exposure draft issued in November 2017. The exposure draft promotes Shariah governance practices that are more effectively integrated within the business and risk processes of Islamic financial institutions. It calls for, among others, the strengthening of responsibilities of the board of directors to include matters concerning Shariah governance, while reinforcing the independence of the Shariah committee in its advisory and decision-making role. The exposure draft further proposes to mandate that each Shariah committee include at least one industry practitioner to allow for practical and commercial dimensions of Shariah issues to be more thoroughly deliberated. Taken together, these proposals aim to elevate the role of Shariah committees in providing sound and innovation-centred Shariah advice to the board and senior management. The finalised policy document is expected to be issued in 2018.

The revised Shariah Governance Framework aims to ensure effective integration of Shariah governance within the business and risk processes of Islamic financial institutions

TALENT DEVELOPMENT

Islamic banks and takaful operators employed 21,398 individuals (2016: 21,601) or 13.0% of total banking, insurance and takaful employees in 2017 (2016: 13.1%). During the year, the sector hired 4,562 new employees (2016: 3,605) and created 787 new jobs (2016: 878). Recognising the importance of talent, the Bank and the industry continued to drive various human capital development initiatives to raise the quality of talent in the Islamic finance industry.

The Islamic finance talent development landscape in Malaysia offers a wide and comprehensive range of solutions, spanning higher education, research, training and consultancy services, which are globally-recognised. In meeting the global demand for Islamic finance talent, not just of today but into the future, efforts continue to be scaled up to further strengthen the talent development ecosystem in Malaysia – anchored mainly by the International Centre for Education in Islamic Finance (INCEIF), International Shariah Research Academy (ISRA), IBFIM[2], Chartered Institute of Islamic Finance Professionals (CIIF) and Association of Shariah Advisors in Islamic Finance Malaysia (ASAS). Over the years, these institutions have contributed towards enlarging the pool of Islamic finance professionals and deepening expertise through various programmes and initiatives (Diagram 4.5).

Following the work of the Steering Committee for Transformation of the Islamic Finance Education Landscape (an industry-led task force established in November 2016 with members drawn from senior management and board members from financial institutions and academia), the Bank introduced a number of reforms which were anchored on two key thrusts to meet the talent needs of the industry.

The first thrust was to enhance the quality of talent development offerings, not just to increase their technical rigour, but to also ensure industry relevance and a high level of professionalism. This aimed to support the creation of a high-calibre talent pool to drive and sustain the industry's future growth and development. Moving in this direction, INCEIF piloted an action-based learning (ABL) approach in its modules during the year as a precursor to its full adoption in the Master of Science in Islamic Finance programme in January 2018. Under the ABL approach, case studies and simulations will feature more prominently in the classroom. Students will also be assigned field projects and assignments with partnering organisations, where they will work on real-world issues and challenges, thus equipping students with greater applied knowledge and practical skills such as critical thinking, problem solving and effective communication skills. To date, INCEIF has secured the commitment of 22 commercial, non-profit and public sector institutions as ABL-partner organisations.

In addition to industry-relevant content, equally important were efforts to elevate the level of professionalism within the industry. To meet the professional development needs of the Shariah fraternity, ASAS launched the Certified Shariah Advisor (CSA) and the Certified Shariah Practitioner (CSP) qualifications in November 2017. These were the first comprehensive professional qualifications developed for Shariah professionals working in the Islamic

[2] IBFIM was previously known as 'Islamic Banking and Finance Institute Malaysia'.

Diagram 4.5

Contributions of Islamic Finance Talent Institutions

International Centre for Education in Islamic Finance (INCEIF)

Established in 2006

INDUSTRY IMPACT

Sustainable supply of Islamic finance talent
- *1,585 graduates from 72 countries*

Top contributor for Islamic finance research
- *400 research papers and publications (more than 50% listed in Scopus/SCI[1])*

Industry-relevant content
- *Adoption of action-based learning methodology to expose students to leading industry practitioners*

THOUGHT LEADERSHIP

Extensive participation by faculty in industry
- *75% of faculty sit in various boards and advisory roles*

Reference point for other universities
- *49 textbooks produced, of which seven adopted by 23 universities*

REPUTATION

Local and global recognition of academic excellence
- *46th in Asia in RePEc[2] ranking*
- *Rated 5 (Excellent) in the Emerging University category by SETARA[3]*

International Shariah Research Academy (ISRA)

Established in 2008

INDUSTRY IMPACT

Top contributor for Islamic finance research
- *Over 200 research projects with more than 90 papers published*

Global repository for Shariah knowledge
- *Over 2,000 fatwas and 500 articles in i-Fikr portal*

Close linkage between industry and academia
- *Content developer for Educator's Manual on Shariah Standards issued by the Bank*

THOUGHT LEADERSHIP

Extensive dissemination of research output
- *Over 300 conference presentations worldwide*

Reference point by other universities
- *ISRA textbooks used by over 70 universities*

Promotion of global harmonisation of Shariah standards
- *Joint research with Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) to encourage harmonisation of Shariah standards globally*

REPUTATION

Global recognition for intellectual contributions
- *Winner of Islamic Economic Award in the Islamic Economic Knowledge Infrastructure category*

Industry-led training institute in Islamic finance (IBFIM)

Established in 2001

INDUSTRY IMPACT

Upskilling of the Islamic finance workforce
- *More than 100,000 certification holders*
- *Over 1,700 training programmes, events and seminars*

Active publication
- *96 IBFIM publications*

Close linkage between industry and academia
- *Academic collaboration with 27 universities and colleges*

Association of Shariah Advisors in Islamic Finance Malaysia (ASAS)

Established in 2011

INDUSTRY IMPACT

Elevating the professionalism of Shariah advisors
- *Over 300 members*

Continuous professional development
- *Over 20 training programmes, events and conferences*

Professional qualifications for Shariah personnels
- *Cerfified Shariah Advisor (CSA) and Certified Shariah Practitioner (CSP)*

Chartered Institute of Islamic Finance Professionals

Established in 2015

INDUSTRY IMPACT

Elevating the professionalism of Islamic finance practitioners
- *Over 800 members*

Professional qualifications for Islamic finance
- *Chartered Professional in Islamic Finance (CPIF) (to be introduced in 2018)*

[1] Scopus is the largest abstract and citation database of peer-reviewed literature while SCI (Science Citation Index) is a citation index produced by the Institute for Scientific Information. Indexed journals are considered to be of higher scientific quality as compared to non-indexed journals
[2] RePEc is a central index of economics research, including working papers and journal articles
[3] Malaysia Rating for University and University College Excellence by Ministry of Higher Education

Source: International Centre for Education in Islamic Finance (INCEIF), International Shariah Research Academy (ISRA), IBFIM, Association of Shariah Advisors in Islamic Finance Malaysia (ASAS), Chartered Institute of Islamic Finance Professionals (CIIF) financial industry. The CSA is intended for practitioners with Shariah degrees while the CSP is designed for Shariah practitioners without formal Shariah qualifications. Going forward, these qualifications will be made a prerequisite for Shariah committee members and key Shariah personnel in Islamic financial institutions, including Islamic windows.

For non-Shariah practitioners, the Chartered Professional in Islamic Finance (CPIF) qualification by CIIF, was announced in December 2017 to raise the bar for professionalism and ethics in the Islamic finance industry. The CPIF offers two specialist tracks, namely Islamic banking and takaful, building on common foundational modules. Enrollment is targeted to commence in the first half of 2018 (Diagram 4.6).

The CSA, CSP and CPIF will elevate the level of professionalism in the Islamic finance industry

The second thrust of talent reforms pursued by the Bank was to improve coordination and cooperation among the five talent institutions. This was to ensure a coherent and optimal approach to talent development to meet the industry's current and future talent needs. A Strategic Coordination Committee, comprising representatives from the Bank and heads of the five entities, was established to develop strategies to raise the quality and range of talent offerings available to meet the needs of the Islamic financial sector. The Committee will address gaps and overlaps in offerings and maximise operating and financial synergies across the entities. Niche areas for individual institutions will be identified to leverage and further amplify the unique strengths of each institution.

In addition to specific enhancements to individual talent institutions, a number of other initiatives were also pursued during the year to enhance the suite of talent offerings. At the board level, a specialised Islamic finance training programme for directors of financial institutions will be launched in the first half of 2018. Building on the core foundations on corporate governance set out in the Financial Institutions Directors' Education programme, this new programme aims to equip directors with an appreciation and knowledge of Islamic finance value propositions by incorporating practical perspectives of Shariah governance, business opportunities in Islamic finance and the risks pertinent to Islamic financial transactions in the programme.

Diagram 4.6

Islamic Finance Professional Qualifications

Background

CSP	CSA	CPIF
Shariah personnel without Shariah degrees	Shariah personnel with Shariah degrees	Other Islamic finance practitioners
To produce Shariah advisors and officers with comprehensive and applied knowledge in Shariah, legal and finance practice		To produce versatile Islamic banking and takaful professionals with ability to assume wide-ranging responsibilities

Learning outcomes of each programme level

CSP	CSA	CPIF
		Level 4 Management level competencies in Islamic finance practices and operations
Level 3 Application of skills and knowledge in practical scenarios	**Level 3** Application of skills and knowledge in practical scenarios	**Level 3** Core competencies in specific areas of practice i.e. banking or takaful
Level 2 Knowledge in Islamic finance business practices with exposure to research methodologies in Shariah	**Level 2** Knowledge in Islamic finance business practices with extensive exposure to classical texts in Shariah	**Level 2** Knowledge in accounting and ethics, as well as an introduction to either banking or takaful operations
Level 1 Foundations in Shariah and/or law and finance	**Level 1** Foundations in law and finance	**Level 1** Basic understanding of the operating environment, Shariah, economics, legal and products

Source: Association of Shariah Advisors in Islamic Finance Malaysia (ASAS), Chartered Institute of Islamic Finance Professionals (CIIF)

The Bank also continued to focus efforts on embedding Shariah standards within the Islamic finance education curriculum. In this regard, the Bank continued the development of the Educator's Manual for two more Shariah contracts, namely *musharakah* (profit and loss sharing) and *tawarruq* (asset purchase on a deferred basis with subsequent sale to third party for cash), adding to the first manual on *murabahah* (cost plus profit) released in 2016. These manuals are expected to be issued in the first half of 2018. The series of manuals aim to expose students of higher learning institutions to the practical workings of Shariah contracts by expounding the theoretical foundations currently set out in the core curriculum. Two universities have already embedded the Educator's Manual within their academic syllabus. As a next step, a Train-the-Trainers programme will be conducted by IBFIM to equip faculty with the requisite foundations for delivering the content to students. The Bank is also pursuing efforts to expand the adoption of these manuals to a larger number of universities in and outside Malaysia.

REGIONAL AND INTERNATIONAL INTERLINKAGES

Malaysia remained a leading global hub for Islamic finance in 2017. It is home to the world's third largest Islamic finance market by assets and the largest sukuk market with a 51.0% share of global sukuk outstanding, amounting to USD202.2 billion. In terms of product innovation, a significant milestone for the Malaysian sukuk market was achieved during the year with the world's first two green sukuk issuances amounting to RM1.25 billion for funding solar energy projects. The green sukuk were issued under the Sustainable Responsible Investment Sukuk Framework developed collaboratively by the Bank, the Securities Commission Malaysia and the World Bank to provide a facilitative fundraising ecosystem to meet the needs for green and other sustainability projects. Malaysia was ranked first in the Islamic Finance Development Indicator by Thomson Reuters and the Islamic Corporation for the Development of the Private Sector (a member of the Islamic Development Bank Group) in their Islamic Finance Development Report 2017. This was in recognition of Malaysia's achievements in the development of effective market infrastructure, diverse players, a deep Islamic finance talent pool and robust legal, regulatory and Shariah frameworks conducive for the sector's growth and development.

At the global level, the Bank continues to be an active advocate for the development of Islamic finance, particularly in the area of Shariah. Through its SAC, the Bank supports efforts to promote harmonisation and mutual respect of Shariah opinions expressed across Islamic financial systems. The SAC, which celebrated its 20th anniversary in 2017, has played an important part in the development of Islamic finance in Malaysia (Diagram 4.7). The SAC has produced several path-breaking Shariah rulings which have

Diagram 4.7

Key Contributions and Decisions by the SAC towards Developing the Islamic Finance Industry

Public confidence Endorsement by renowned *fiqh* scholars that Islamic financial products are fully Shariah-compliant	• Permissibility of sale and buy-back arrangement with specified conditions and parameters • Permissibility of takaful model based on *wakalah* (agency) contract
Legal certainty Important source of reference for courts and arbitrators, while reducing risk of commercial disputes	• Reference made to the SAC for seven court cases and one arbitration case in ascertaining Shariah rulings • Shariah standards as key reference for courts and arbitrators
Product innovation Publication of more than 500 binding rulings and 12 Shariah standards, which serve as building blocks for product innovation	• Approved the use of hybrid contracts (e.g. *musharakah mutanaqisah* - diminishing partnership) which enabled the introduction of innovative products • Clarity on definition and differentiation between Islamic deposits and investment accounts • Permissibility of *al-ijarah thumma al-bai`* (leasing followed by sale)
Level the playing field Mitigates inconsistencies that lead to competitive distortions between Islamic and conventional financial institutions	• Establishment of an appropriate mechanism for late payment charges by Islamic banks using *gharamah* (penalty) and *ta`widh* (compensation) concept • Treatment for *ibra`* (rebate) in Islamic financing based on sale-based contracts

Source: Bank Negara Malaysia

not only instilled customer and market confidence, but have also catalysed a number of industry innovations. The SAC's endorsement of the application of *al-ijarah thumma al-bai`* (leasing followed by sale), for example, has allowed the offering of more competitive vehicle financing solutions by more than 15 Islamic banking institutions. Another area is the ruling on the imposition of late payment charges by Islamic banks using *gharamah* (penalty) and *ta`widh* (compensation) which has allowed Islamic financial institutions to operate on a level playing field with their conventional counterparts. During the year, two publications were launched in conjunction with the SAC's anniversary, namely a compilation of SAC resolutions from 2011 until 2017 and a compilation of 12 Shariah standards issued by the Bank. In addition, in January 2018, the Bank rolled out a new SAC website (www.sacbnm.org) which provides convenient access to all SAC rulings and the Shariah governance framework in Islamic finance. This website serves as a key repository for detailed *fiqh* (Islamic jurisprudence) decisions and underlying reasoning of the SAC rulings, including the rulings made in developing the 12 Shariah standards published by the Bank to date. Efforts are underway to make these digital and physical publications available in key languages, including English and Arabic.

In the area of takaful, the Bank organised a roundtable discussion at the sidelines of the 24th Annual Conference of the International Association of Insurance Supervisors in Kuala Lumpur. The Bank shared its experiences in building a progressive takaful sector, including the development of a comprehensive and robust Shariah governance framework. Participants expressed keen interest to understand the similarities and differences of takaful and insurance (in particular, mutual insurance), and the advantages of having full-fledged takaful operators as opposed to takaful windows.

Apart from regulators, the private sector also plays an important role in expanding the frontiers of Islamic finance at the global level. Over 100 professional ancillary services firms currently offer a wide spectrum of services including in the areas of Shariah, legal, accounting, tax and training in Malaysia. Given their depth and breadth of experience in developing the Islamic financial sector in Malaysia, these firms are well-positioned to help meet the growing need and interest of other jurisdictions wishing to make inroads into Islamic finance. Among key contributions by such firms include pioneering the development of the world's first Shariah standard on gold, in collaboration with the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI).