

Response to feedback received

Value-based intermediation (VBI): Strengthening the Roles and Impact of Islamic Finance

Introduction

In response to the issuance of the Strategy Paper on Value-based Intermediation (VBI) by Bank Negara Malaysia (the Bank) on 20 July 2017, the Bank has received written feedback from respondents with diverse background during the consultation period. The respondents include financial institutions, talent institutions, consultants and individuals, both local and international. An engagement session with the industry representatives was also held to discuss the feedback and suggestions in depth.

The Bank appreciates the feedback and suggestions received during the consultation process. Key comments received and the Bank's responses are provided in the following sections. Relevant comments and suggestions for clarification have been incorporated in the final strategy paper where appropriate.

Bank Negara Malaysia
12 March 2018

1. Definition of Value-based Intermediation (VBI)

- 1.1 There are suggestions for the Bank to review the current definition¹ of VBI. This is due to the fact that creation of values to other stakeholders through business activities will, to a certain extent, have an impact on short-term financial returns,
- 1.2 Current definition of VBI has therefore been revised to emphasise that strengthening Islamic banking industry's focus on creation of positive and sustainable impact to wider stakeholders (environment, community and overall economy) is consistent with the shareholders' sustainable returns and long-term interests.

2. Potential implication of VBI adoption to business modality and risk management

Business modality

- 2.1 Some respondents perceived that risk-sharing model is a better business modality to deliver the intended outcomes of VBI.
- 2.2 The Bank wishes to reiterate that VBI focuses on value and impact creation to key stakeholders, regardless of any business modality adopted by respective financial institutions. The adoption should be tailored to suit Islamic financial institutions' (IFIs) structure (e.g. leveraging or stand-alone model), asset size and business focus (e.g. retail or non-retail focus).

Risk management

- 2.3 Financial institutions highlighted that their existing risk management framework is designed for credit intermediation. This is deemed insufficient in managing the new risk dimension that may arise from the adoption of risk-sharing model or exposure in new growth areas following the adoption of VBI.
- 2.4 The Bank is of the view that the necessity of risk management enhancement should depend on respective IFIs' overall risk strategy. This strategy should be linked to their business modality, as well as exposure to new growth areas in delivering the expected outcomes of VBI.

¹ 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, without compromising the financial returns to shareholders.

3. VBI strategies: Implementation approach

- 3.1 The respondents queried on the Bank's future plan to implement the proposed VBI strategies, specifically the transparency expectation under the Corporate Value Intent (CVI) and the adoption of the VBI scorecard through imposition of regulatory requirement.
- 3.2 The Bank wishes to clarify that at this juncture, implementation of the transparency expectation under the Corporate Value-Intent Framework (CVI) and adoption of the VBI scorecard will be pioneered by members of the VBI Community of Practitioners (CoP)². Adoption of VBI should be driven from a business point of view (competitive advantage) where Islamic banking institutions are expected to implement relevant initiatives based on their level of maturity (willingness and capability).
- 3.3 To further facilitate the adoption of VBI by the industry players, the Bank will highlight several value-based banking practices and offerings from financial institutions operating in other jurisdictions, the common implementation challenges and the proposed interim measures or solutions through the upcoming issuance of the VBI Implementation Guide.
- 3.4 Moving forward, the Bank may consider significant achievements and progression made in the adoption of VBI by financial institutions as part of its assessment of the institution's contribution to financial and economic development.

4. Streamlining adoption of VBI with existing initiatives

- 4.1 The respondents also queried on the underlying rationale of VBI, given that several financial institutions have already embarked on initiatives that share similar aspiration such as the Environmental, Social and Governance (ESG), sustainability reporting, integrated reporting and the equator principles.
- 4.2 VBI aims to provide an effective platform for industry players to:
- learn from each other, specifically on the best market practices;
 - share financial and technical resources in developing the relevant tools such as the VBI Scorecard, awareness campaign and talent development; and
 - enhance the visibility of IFIs' individual initiatives (including product launching) through common strategic messaging and communication.

² Bank Islam, Bank Muamalat, Agrobank, Maybank Islamic, CIMB Islamic, AmBank Islamic, Alliance Islamic, HSBC Amanah and Standard Chartered Saadiq