

# Promoting a Progressive and Inclusive Islamic Financial System

The Bank remains committed to advancing Islamic finance with focused efforts on supporting a sustained economic recovery, building social and climate resilience as well as empowering halal trade.

In 2020, the Bank dedicated efforts towards advancing Islamic finance in addressing the economic challenges posed by the pandemic. The focus was on enhancing the contribution of Islamic finance towards facilitating economic recovery, building social resilience, promoting climate resilience, as well as empowering trade, business and the digital economy.

The Islamic banking and takaful industry remained resilient and agile against the background of a highly uncertain economic and operating environment. The industry continued to post a healthy growth, gaining further market share of the overall financial system. The industry also recorded strong financial soundness indicators (Diagram 1).

## Cushioning the impact of COVID-19 to businesses and households

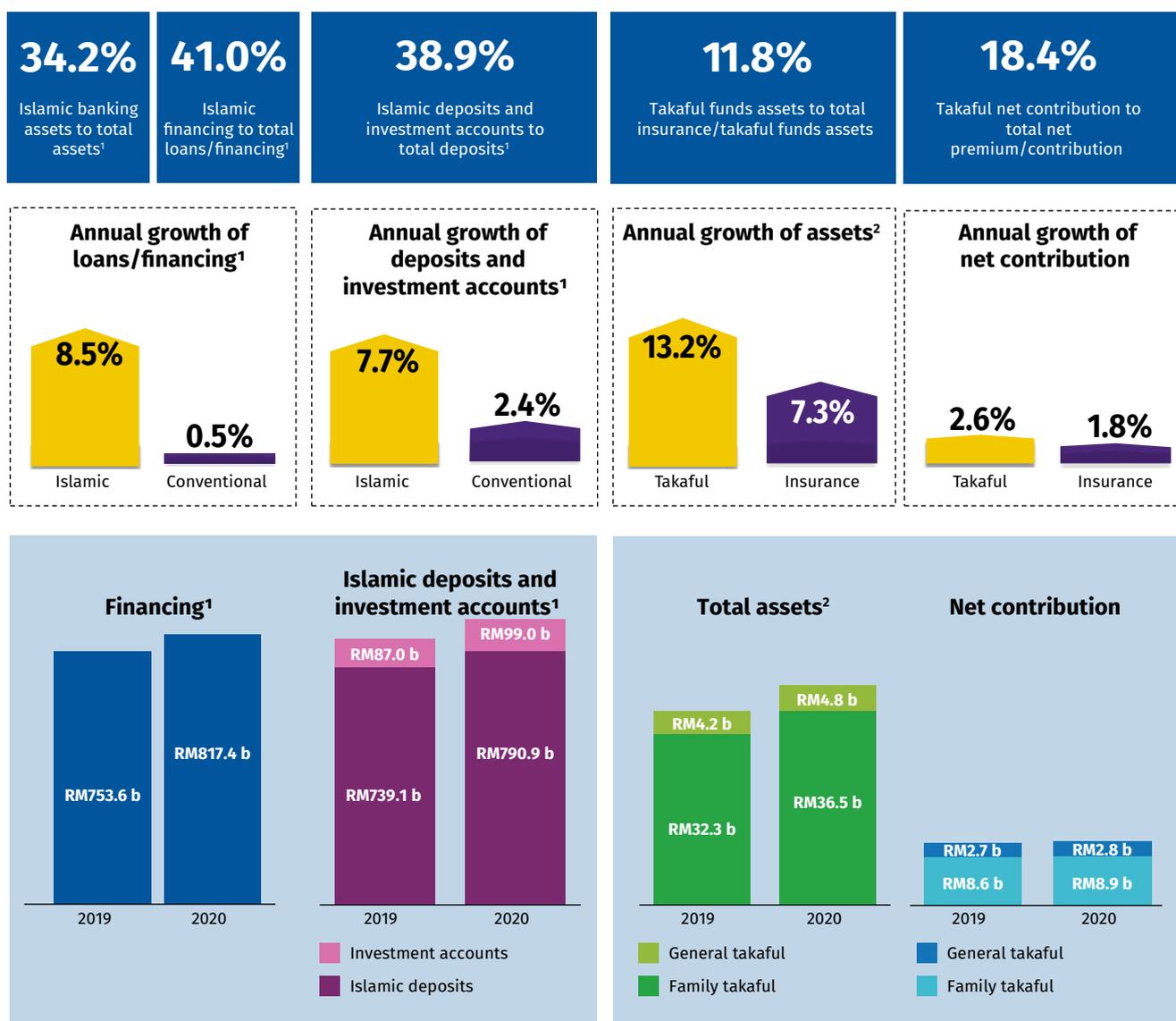
The Islamic banking and takaful industry has been proactive in assisting customers affected by the pandemic. This was supported by an active role of the Shariah Advisory Council of Bank Negara Malaysia (the SAC) which issued key rulings during the year to guide the implementation of assistance

measures in line with Shariah principles. Almost half of the 15 SAC meetings in 2020 were dedicated to discussing Shariah matters related to COVID-19 relief measures. The rulings (Diagram 2) focused on reducing financial hardships experienced by customers affected by the pandemic.

These rulings were also a focal point of discussion at the Centralised Shariah Advisory Authorities in Islamic Finance meeting hosted by the Central Bank of the UAE in May 2020. It brought together 40 Shariah scholars and Islamic finance experts from seven jurisdictions, which have national-level Shariah governance similar to the SAC, and international standard-setting organisations. The discussion helped to enrich mutual understanding within the global Shariah fraternity on different practices, challenges and considerations underpinning the rulings in handling financial assistance programmes, particularly in relation to repricing adjustments following the implementation of deferred payments.

In Malaysia, the Shariah committee of Islamic financial institutions complement the functions of the SAC. In particular, the Shariah committees advise on the application of SAC rulings or standards on Shariah matters that are applicable to the operations, business, affairs and activities of the Islamic financial institutions. Given this important role, the Bank introduced a multi-faceted competency framework in 2020 (Diagram 3) for Shariah committees. The framework further elevates the quality of deliberation of Shariah committees and promote sound decision making at the respective institutions. In 2020, the Bank approved a total of 117 Shariah committee appointments proposed by Islamic financial institutions, comprising 45 new appointments and 72 re-appointments.

Diagram 1: Growth of Islamic banking and takaful in 2020



Selected key financial soundness indicators as at end-2020

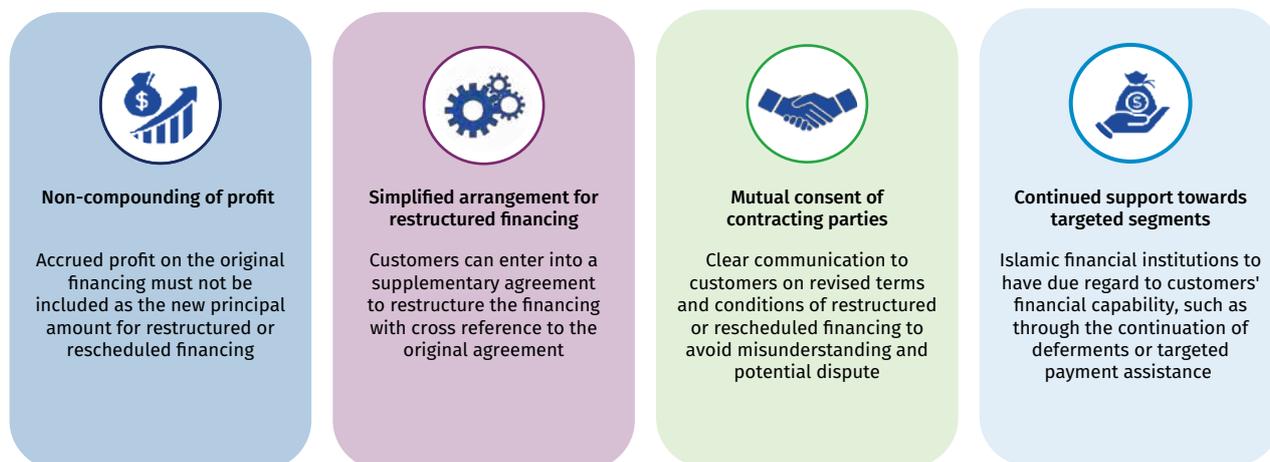
Islamic banking		Conventional banking		Takaful operators		Insurance companies	
18.4%	<b>Total capital ratio</b>	18.5%		234.6%	<b>Capital adequacy ratio<sup>4</sup></b>	217.6%	
137.2%	<b>Liquidity coverage ratio</b>	151.7%		RM1.4 b	<b>Balance of transaction<sup>5</sup> (life/family fund)</b>	RM4.7 b	
0.9%	<b>Impairment<sup>3</sup></b>	1.0%					
0.7%	<b>Return on assets</b>	1.2%					

Notes:

- <sup>1</sup> Includes development financial institutions
- <sup>2</sup> Refers to the total assets of the takaful funds or insurance funds
- <sup>3</sup> Refers to non-performing loans/financing ratio
- <sup>4</sup> Inclusive of retakaful operators and reinsurance companies
- <sup>5</sup> Refers to the excess of net premium/contribution after deducting benefits payouts, agency remuneration and management expenses

Diagram 2: SAC rulings in respect of practices and conduct of Islamic financial institutions in addressing the impact of COVID-19

SAC rulings premised on the principle of *ihsan* (beneficence)...



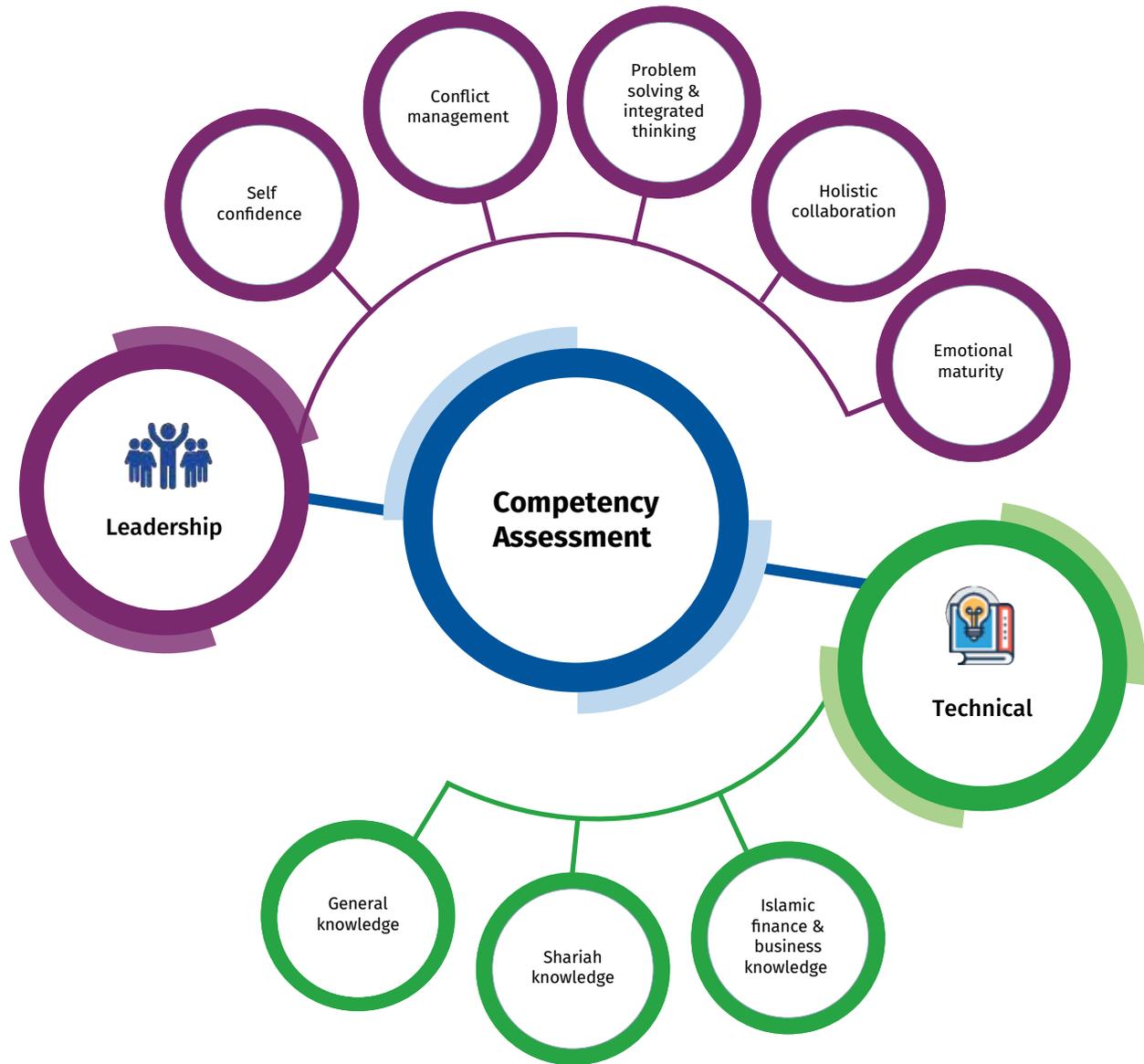
...complement the implementation of relief measures for customers affected by COVID-19

- 1 Broad-based payment assistance**  
Automatic six months deferment for all eligible financing for individuals and SMEs from April to September 2020
- 2 Flexibilities in takaful contribution**  
Optional deferment of family takaful contribution for three months while takaful coverage continues
- 3 Targeted payment assistance**  
Additional assistance to eligible individuals and SMEs

Table 1: Landmark Shariah rulings by the SAC in 2020

No	Ruling	Purpose	Intended Outcome
1.	<i>Hajah</i> (need) and <i>Darurah</i> (necessity) Parameters	Guidance for Shariah scholars to determine applicability of Shariah exceptional rules for exigent circumstances faced by modern finance. The guidance ensures Shariah decisions are backed by a well-founded methodology.	<ul style="list-style-type: none"> <li>Consistent application of Shariah parameters in assessing <i>Hajah</i> and <i>Darurah</i> circumstances.</li> <li>Sustained public confidence in Islamic finance.</li> </ul>
2.	Collateralised Commodity <i>Murabahah</i> (CCM)	Broaden range of funding/ liquidity instruments to raise funds and address liquidity needs of Islamic financial institutions.	<ul style="list-style-type: none"> <li>Enhanced liquidity management by Islamic financial institutions.</li> <li>Increased liquidity of Islamic securities held by financial institutions.</li> </ul>
3.	E-wallet as a Shariah compliant payment instrument	Clarification on the Shariah compliance status of e-money with guidance on the essential elements required in structuring Shariah compliant e-wallet.	<ul style="list-style-type: none"> <li>Growth of innovative payment solutions in the market.</li> <li>Enabling ecosystem for Islamic fintech.</li> </ul>

**Diagram 3: Competency framework for Shariah committee members of financial institutions**



### Encouraging inclusive and diverse financial solutions

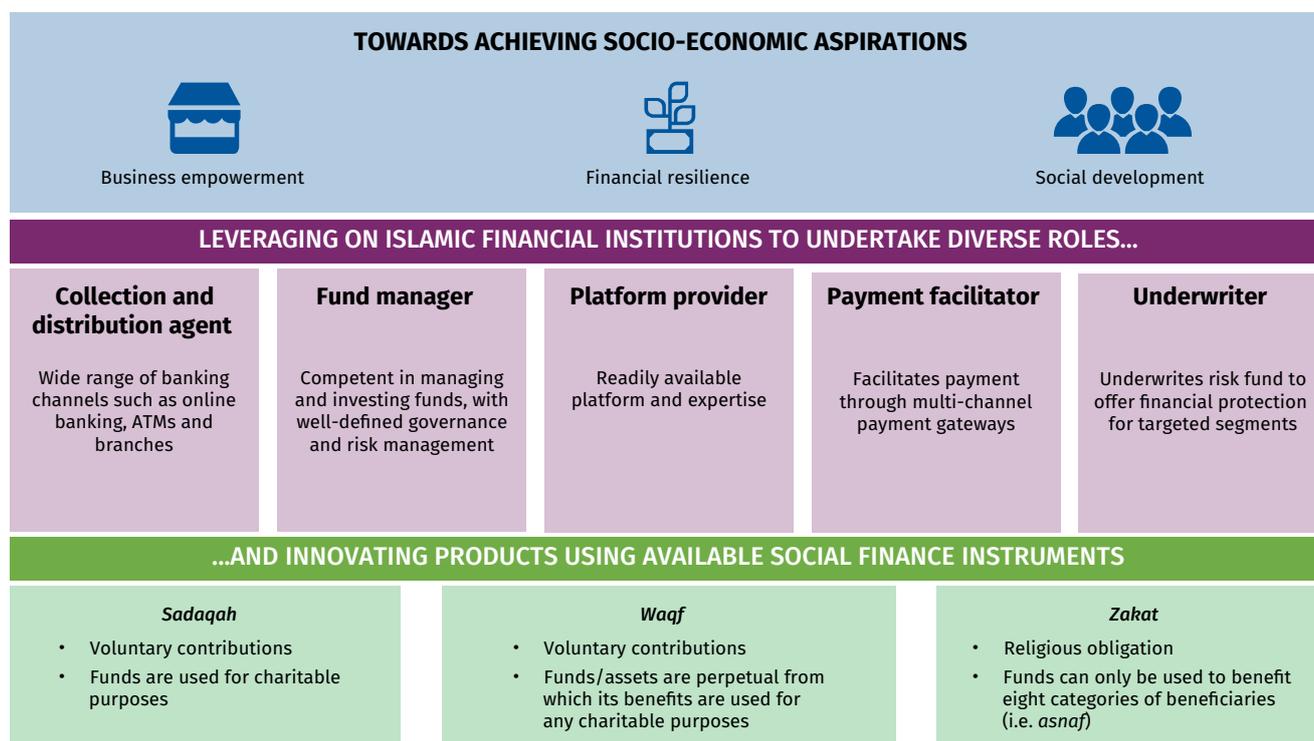
During the year, the Bank focused its developmental initiatives for Islamic finance on three major themes:

- Building social resilience
- Promoting climate resilience
- Empowering trade, business and the digital economy

### Building social resilience

The Islamic banking and takaful industry continued to advance the social finance agenda through product innovation and service improvements (Diagram 4). Social finance refers to financial services that mobilise philanthropic capital using instruments such as donation, endowment (including cash *waqf*) or alms (*zakat*) to deliver tangible social outcomes.

Diagram 4: Financial intermediation using social finance instruments



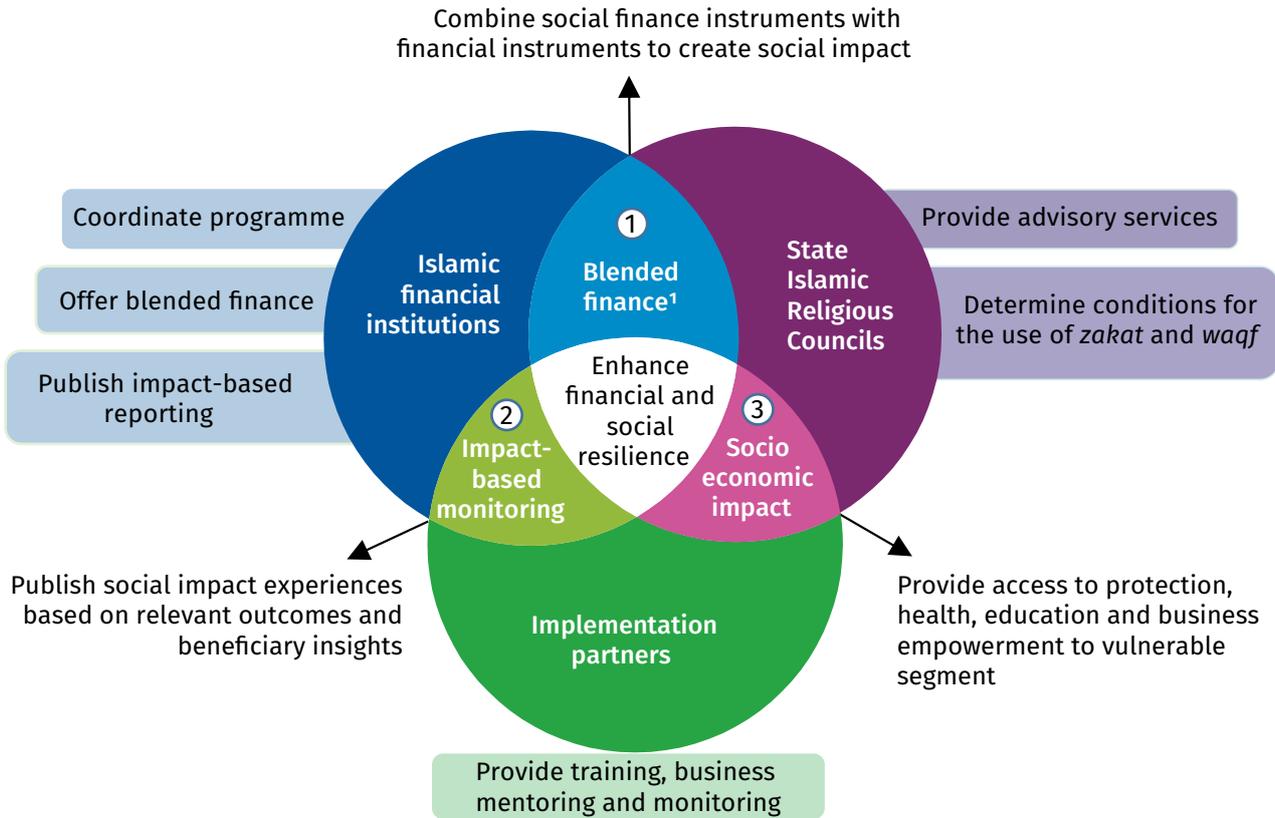
In 2020, the industry introduced new products designed to meet the specific needs of the underserved segment. These include benevolent microfinancing for B40 entrepreneurs funded by donations from corporates and affordable financing programmes to build houses for *zakat* recipients. There was also financial protection for hardcore poor families in the form of *takaful* riders using donation.

Further integration of social finance requires Islamic financial institutions to work closely in partnership with State Islamic Religious Councils (SIRCs) and non-traditional partners such as social enterprises and NGOs. The partnership enables each stakeholder to contribute unique expertise, knowledge and resources towards achieving the common goal of enhancing the financial and social resilience of the target groups (Diagram 5). An example of a successful

synergistic partnership of this nature is myWakaf, a digital cash *waqf* platform piloted by six Islamic banks involving eight SIRCs, which managed to raise funds totalling RM7.6 million by the end of 2020. The funds were channelled to finance impactful projects nationwide in healthcare, education and community empowerment (Diagram 6).

The spotlight article on Empowering B40 Entrepreneurs via iTEKAD showcases an example of a pilot programme that utilises social finance instruments to complement existing financial solutions. The Bank will continue to monitor the progress and impact derived from the social finance initiatives by the industry. We will also assess any regulatory or developmental responses that should be considered to strengthen the ecosystem to support a more resilient and vibrant social finance in Malaysia.

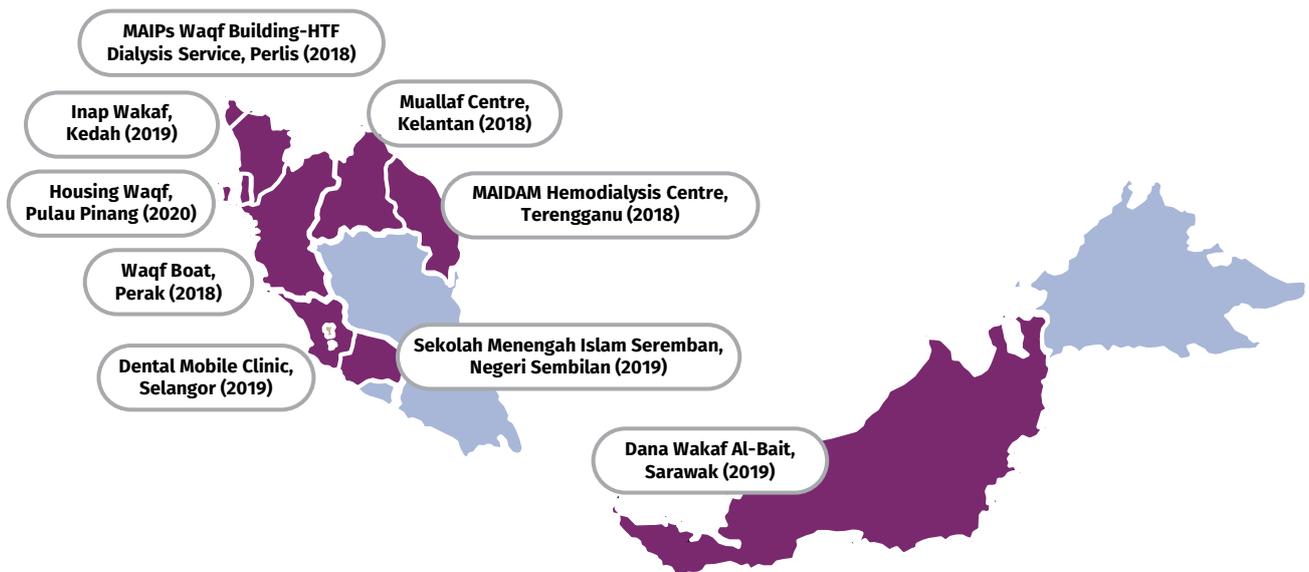
Diagram 5: Integration of social finance and roles of key stakeholders



Notes:

<sup>1</sup> Blended finance refers to the strategic use of development finance for the mobilisation of additional finance including philanthropic funds towards sustainable development. Sourced from OECD (2018), Making Blended Finance Work for the Sustainable Development Goals

Diagram 6: Existing myWakaf projects nationwide



## Empowering B40 Entrepreneurs via iTEKAD

Over the years, the Bank has been encouraging the innovative use of social finance instruments in Islamic finance. These instruments such as *waqf* (endowment), *zakat* (alms) and *sadaqah* (donation) offer unique benefits in addressing the financial needs of underserved communities, especially the lower income group. The pandemic creates opportunities for the Bank to expand social finance initiatives further to minimise the economic impact of the pandemic on employment and micro businesses. The combination of financial solutions with these instruments is complementary to existing financing programmes for micro-entrepreneurs and aims to help them rebuild their livelihoods after experiencing distressing economic changes.

In March 2020, the Bank initiated a pilot programme called “iTEKAD” (which stands for “my determination”). The iTEKAD programme blends social finance with microfinancing and structured training. This programme aims to empower low income micro-entrepreneurs to generate more sustainable income, become financially resilient and subsequently contribute back to the community.

The first pilot programme commenced in Wilayah Persekutuan with three implementation partners namely Bank Islam Malaysia Berhad (BIMB), Majlis Agama Islam Wilayah Persekutuan (MAIWP) and SME Corporation Malaysia (SME Corp).



Minister in the Prime Minister's Department (Religious Affairs) Datuk Seri Dr Zulkifli Mohamad Al-Bakri launching iTEKAD on 14 May 2020 witnessed by Deputy Governor Abdul Rasheed Ghaffour (second from right) and Chief Executive Officer of Bank Islam Malaysia Berhad, Encik Mohd Muazzam Mohamed (second from left)

B40 entrepreneurs face difficulties in accessing formal financial services for a number of reasons. Many are weighed down by lack of business and financial track records, inadequate business and financial management skills, and business activities that tend to be of higher risk. Through incorporating social finance features in financing solutions, B40 entrepreneurs can avail themselves of more funding options beyond debt-based financing to sustain or expand their business. Importantly, the upskilling, mentoring and impact-based monitoring of achievements further increase the likelihood of success in their business ventures and greater financial resilience over the longer term.

The effective implementation of the iTEKAD programme will continue to require strong commitment from all stakeholders as its delivery mechanism is more resource intensive compared to traditional ways of delivering finance.

Given the highly positive experience thus far, the iTEKAD programme will be further expanded in 2021 through the anticipated participation of two additional Islamic financial institutions. These Islamic financial institutions will be providing a wider range of blended financial solutions using a variety of social finance instruments such as cash *waqf* and *sadaqah*. The expansion of the iTEKAD programme will also include more states and new implementation partners who can support the effective delivery of the programme. This in turn will further extend Islamic financial institutions' outreach in social development and resilience initiatives.

Diagram 7: Challenges facing B40 entrepreneurs and key components of the iTEKAD programme

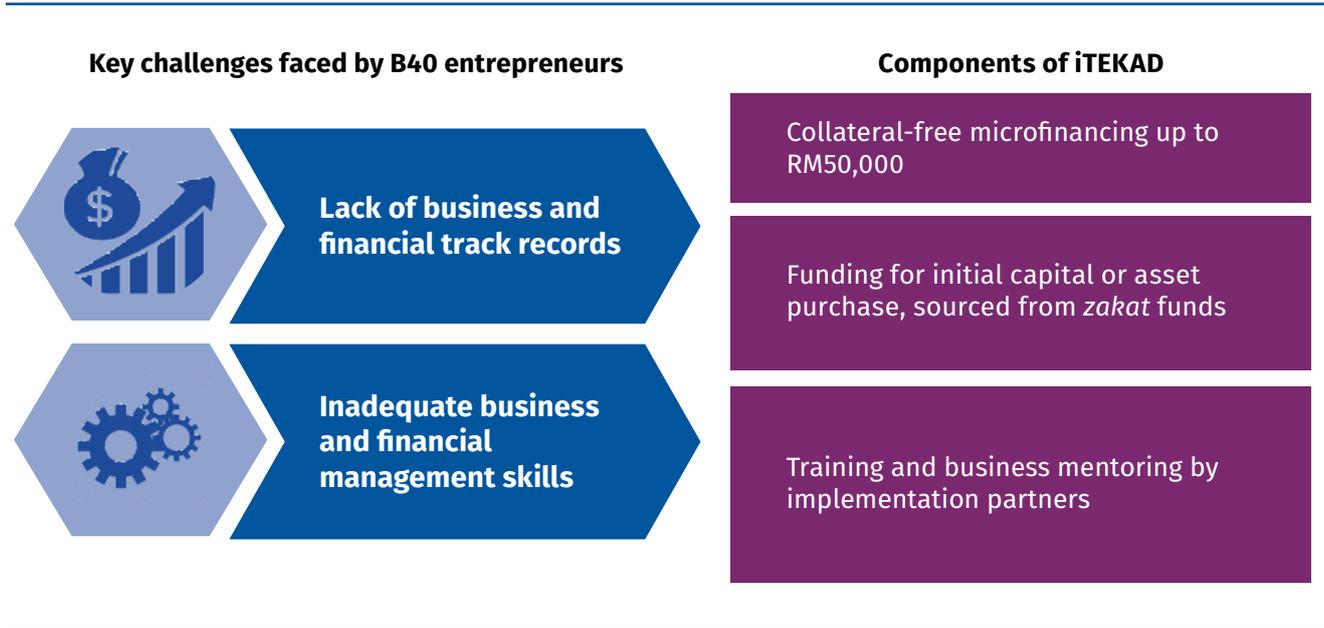


Diagram 8: Features and progress of the iTEKAD programme

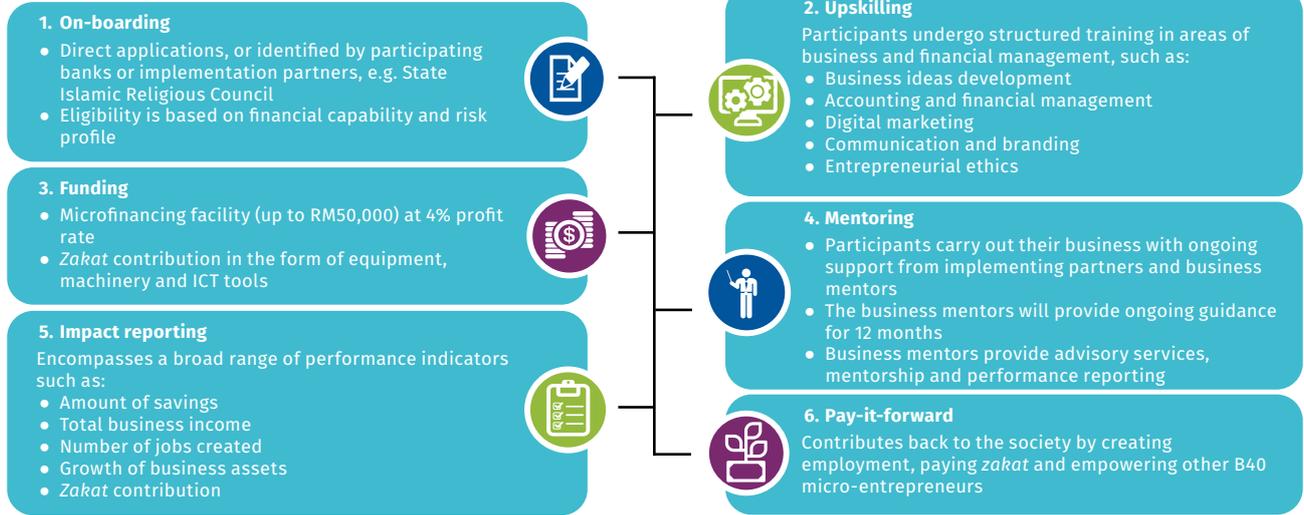
**FEATURES OF iTEKAD**

iTEKAD is a comprehensive social finance programme for B40 micro-entrepreneurs that provides:



**iTEKAD Pilot Programme**

**COMPREHENSIVE CUSTOMER JOURNEY**



**ACHIEVEMENTS IN 2020**

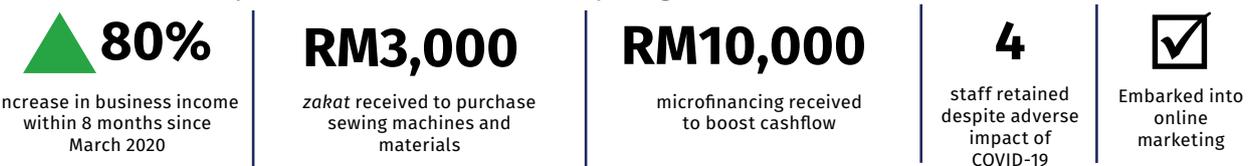
Implementation of iTEKAD through collaboration of Islamic banks with implementation partners resulted in



\*Agriculture, beauty and cosmetics, food and beverages, fashion and clothing, health supplements, IT/telecommunication, manufacturing, retailer, services, sports

**IMPACT**

• A B40 micro-entrepreneur from the fashion industry has grown her business



• A school canteen operator revived her business



• A food entrepreneur retained her business despite a major downturn during the pandemic



*"iTEKAD is a breath of fresh air for my business. The financing provided useful working capital, while guidance from SME Corp is helpful for small businesses like us to survive through the challenges of the pandemic."*  
 Operator of a school canteen business

*"Beyond financing, iTEKAD provides useful guidance for small businesses to manage their business more systematically through the classes and training."*  
 Owner of a restaurant specialising in traditional delicacies

**Promoting climate resilience**

The Bank also lent support to the role of Islamic finance in driving the sustainability and climate resilience agenda for the financial system. This is consistent with the fundamental values of Shariah to prevent harm and promote the attainment of benefits including safeguarding the environment. The intrinsic value of Islamic finance principles is universally applicable in realising a vision of economic growth that is balanced, sustainable and inclusive.

In 2020, we participated in developing detailed guidance (sectoral guides) with the industry via the VBI Community of Practitioners. These sectoral guides, which focus on palm oil, renewable energy and energy efficiency, as a start, will be finalised in the first quarter of 2021. This is part of the industry’s ongoing commitment towards the development of a financial system that supports sustainability and the transition towards a low carbon economy. These sectoral guides will facilitate the practical implementation of measures pursued by the Joint Committee on Climate Change (JC3), including the

principles-based taxonomy (refer to Chapter 2.2 on “Towards a Greener Financial System”) and VBI Financing and Investment Impact Assessment Framework (VBIAF), that were issued in 2019. The sectoral guides outline the environmental, social and governance (ESG) risk considerations in specific economic subsectors/industries and activities. They serve as important tools to assist financing and investment decisions by financial institutions. In 2021, additional sectoral guides will be developed for the manufacturing, construction and infrastructure, as well as oil and gas sectors.

Takaful operators have also started to embrace VBI by aligning their corporate strategies and exploring improvements to business practices and operations. These actions aim to deliver a much bigger positive impact to the economy, community and environment. The development of the VBI framework for takaful is already at an advanced stage. The Malaysian Takaful Association (MTA) expects to issue the framework in early 2021 to guide the takaful industry on VBI adoption.

**Diagram 9: VBIAF Sectoral Guides as key tools to motivate behavioural change in the economy and society**

VBIAF Sectoral Guides provides guidance to financial institutions to incorporate environmental, social and governance (ESG) risk considerations in their financing and investment decision making process

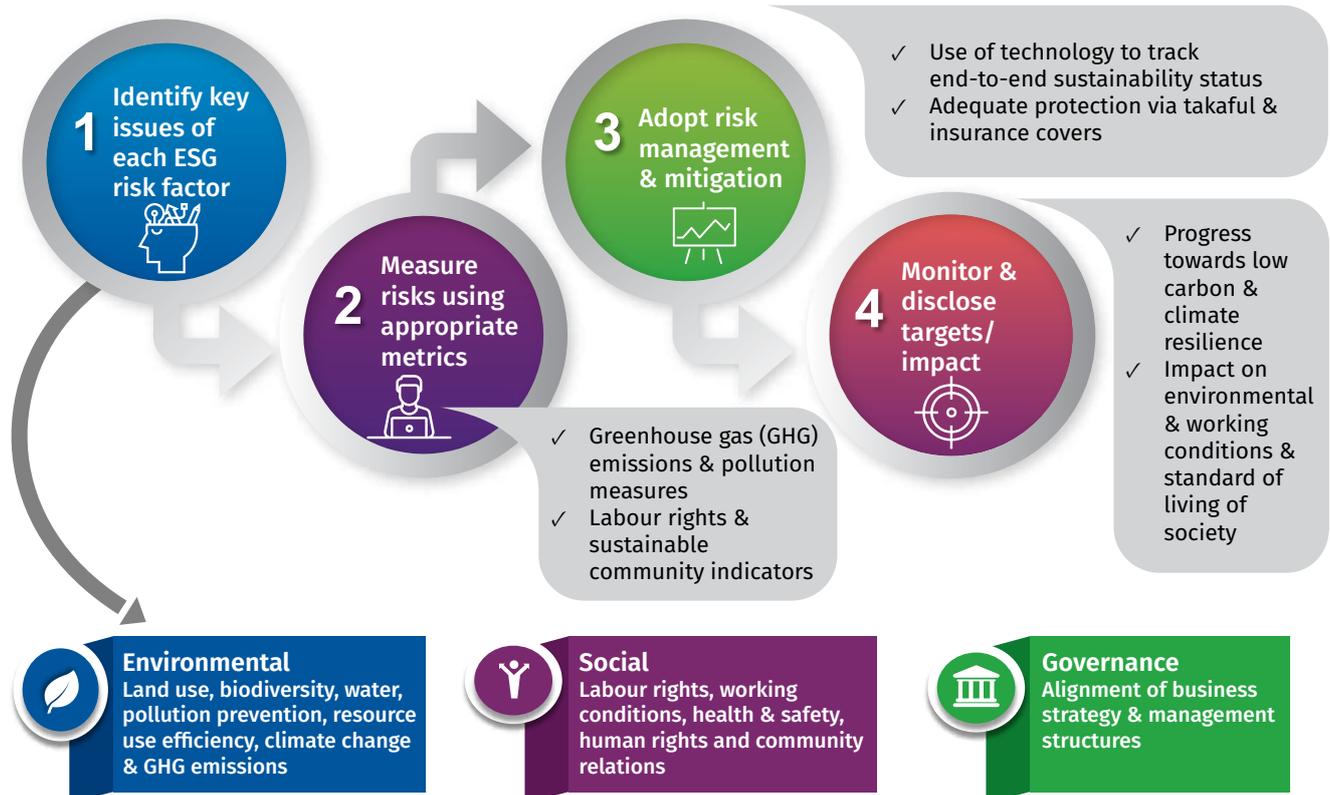
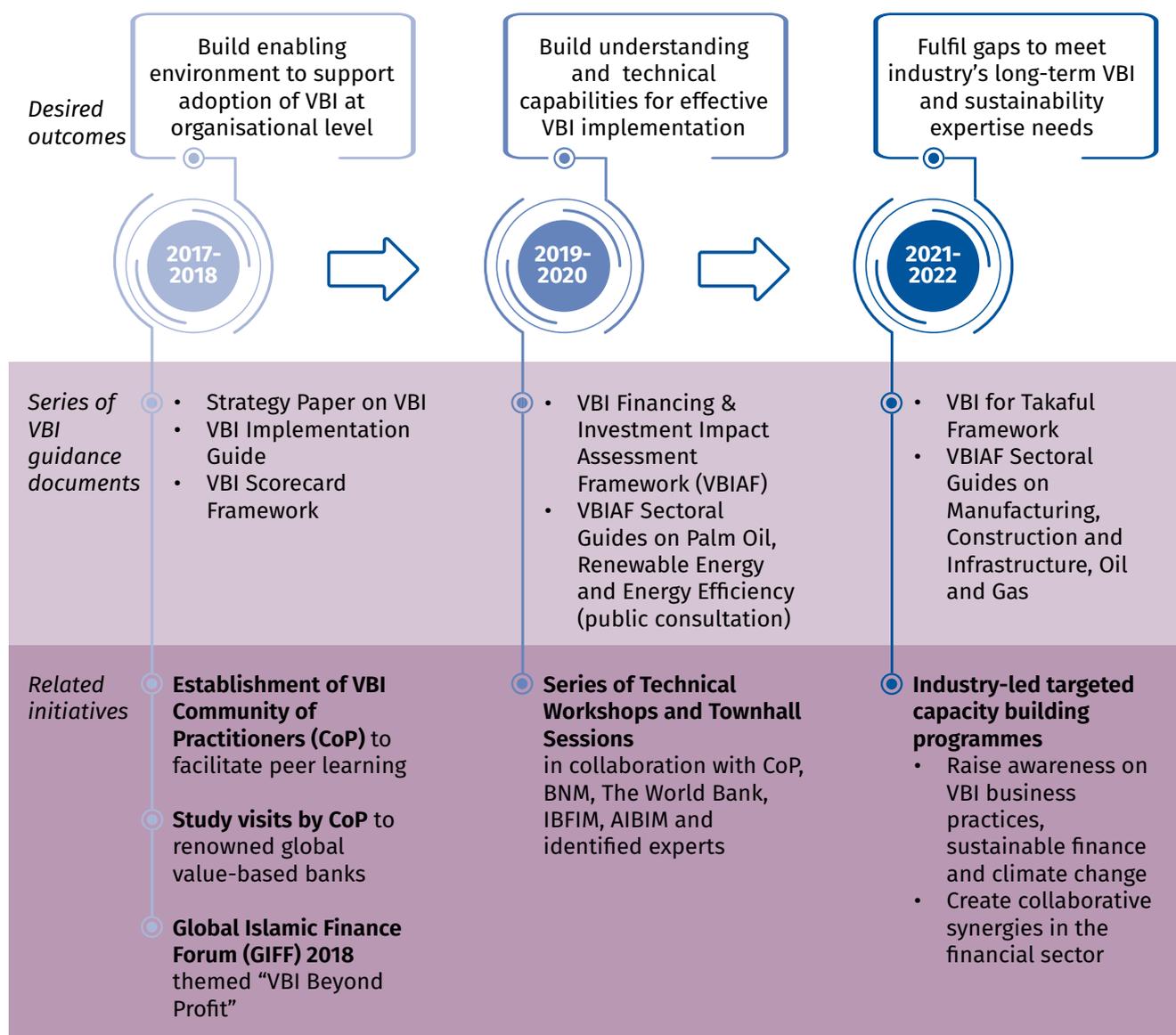


Diagram 10: Concerted efforts on capacity building in catalysing VBI adoption across banking and takaful sectors



**Empowering trade, business and the digital economy**

The Bank collaborated with several Islamic banking institutions to explore the deployment of differentiated financial structures to facilitate the liquidity needs of SMEs at different stages of their business operations (Diagram 11). Given that these structures are relatively new to the industry, the Bank facilitated the development of the solutions by providing clarity on regulatory and reporting requirements.

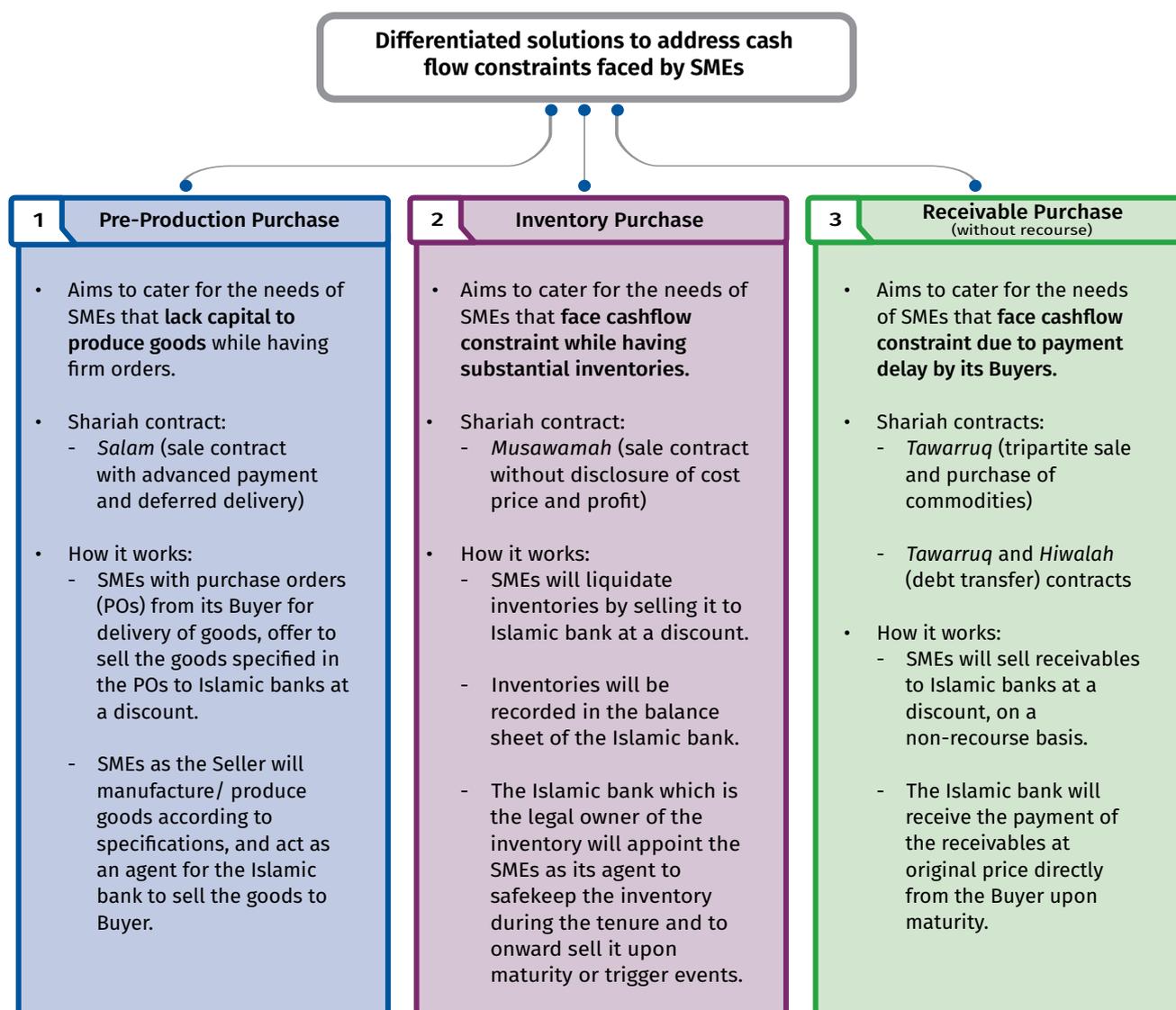
In 2020, the Bank also focused on enhancing the digital marketplace to enable halal certified SMEs to participate in new markets. A key initiative is a strategic partnership between Islamic financial institutions and the Halal Development Corporation

Berhad. This initiative aims to enhance access to financing and takaful protection for halal certified companies registered on the Halal Integrated Platform (HIP). HIP is an online digital advisory and networking platform targeting 5,000 halal certified SMEs and is set to be launched in 2021. In addition, the year saw three Islamic banks launch dedicated facilitation programmes for halal micro businesses and SMEs. These programmes include business advisory and business matching services that connect entrepreneurs to prospective buyers via an e-marketplace. With this initiative, Malaysia's halal certified companies would have better market access and opportunity to expand their businesses in the global halal market space.

Takaful players have also pivoted innovatively in their offering of products and services amid COVID-19 challenges. Many have upgraded their self-service customer touchpoints and digitised system infrastructures to support takaful business operations and improve customer experience. In tandem with increasing consumer awareness on health protection, we have observed further expansion of digitally-enabled health care and preventive services such as telemedicine, wellness apps and wearables. Several digital offerings were introduced to cater for traditionally excluded segments as well. These include coverage for children with learning disabilities, usage-based protection and micro SMEs on e-commerce platforms.

In 2020, the Bank facilitated the admission of a peer-to-peer takaful model into the Financial Technology Regulatory Sandbox. This new takaful model based on *tà'awun* (mutual assistance) and *wakalah bi al-ujrah* (appointed manager with a fee) contracts is currently being live-tested for one year with a maximum of 10,000 participants. The offering is distributed through a mobile app. It provides death benefit coverage on a mutual assistance basis, involving equal sharing of the actual claims amount upon death among the participants. The mobile app also includes features such as simple on-boarding, nomination and claims processes for the convenience of participants.

**Diagram 11: New financial structures to meet the liquidity needs of SMEs across different stages of the business cycle**



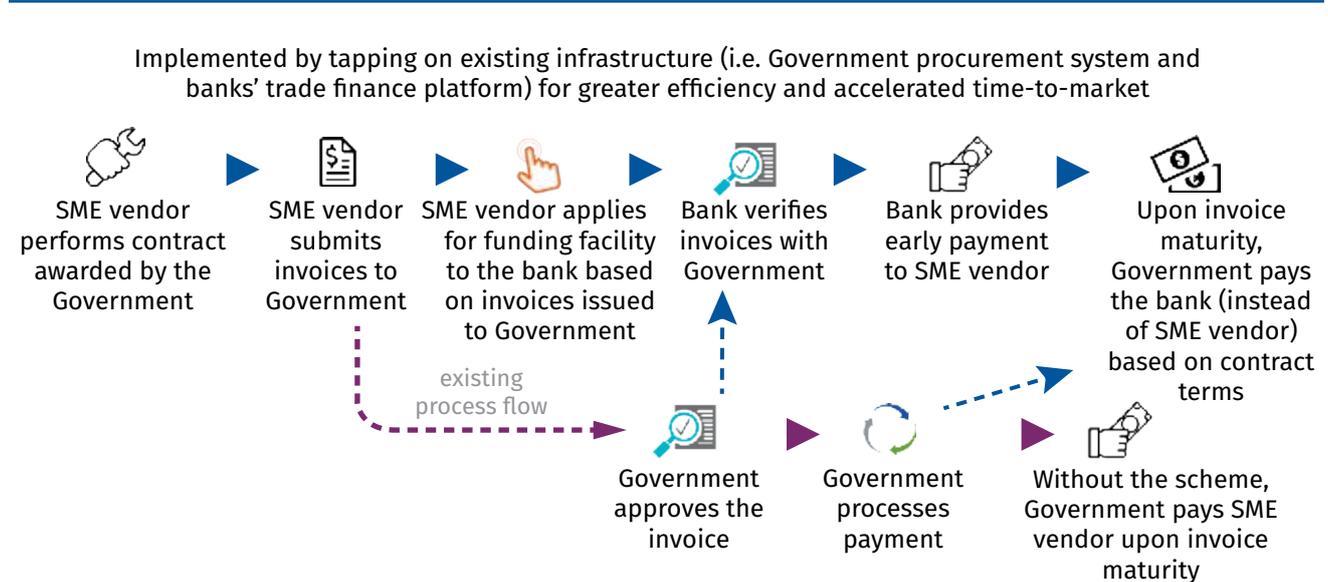
## Liquidity Facility for Government Vendors

The liquidity scheme is structured, on a pilot basis now, to ease cash flow constraints faced by businesses. It allows eligible SME vendors of public procurement contracts to obtain accelerated payment pending actual payment by the Federal Government. The scheme involves the sale or transfer of outstanding invoices owned by SME vendors to participating banks. The structure benefits SME vendors in the following ways:

- **Does not increase leverage of the vendors** given that the facility involves a true sale of payment rights on invoices to the bank, effectively transferring the payment claims from the vendors to the Principal. As such, under the facility, banks will have limited recourse on the vendors, unlike a financing or a loan structure; and
- **Competitive pricing** in view of the fact that the facility is provided based on the credit standing of the Government as the Principal instead of the credit assessment of the vendors.

The pilot will commence in the first quarter of 2021 involving four Islamic banking institutions and four participating Ministries. The Ministries involved are Ministry of Health, Ministry of Education, Ministry of Higher Education, and Ministry of Communications and Multimedia. These Ministries will act as the Principal parties, and the arrangement covers the supply and services contracts awarded by the Federal Government. Upon completion of the pilot programme, the scheme will be expanded to include participation of more banking institutions and Principals including those from the private sector. The scheme will also consider a wider range of contracts such as work-related procurement contracts as well as diverse types of facilities including pre-financing structures.

Diagram 12: Accelerated payment to Government SME vendors via the Pilot Liquidity Scheme<sup>1</sup>



### Key Benefits to SME vendors

- ✓ **Provides quick liquidity**, enabling SME vendors to better manage their financial requirements and advances to meeting new demands/orders
- ✓ **Does not affect gearing** of SME vendors
- ✓ **Competitive pricing** based on standing of Government as Principal
- ✓ **Enhances accessibility** to banking facilities including for small enterprises
- ✓ **No collateral** required

Notes:

<sup>1</sup> The pilot liquidity scheme known as CAKNA is a financing facility by Islamic banks for vendors that have obtained Government contracts for supplies and services

We also strengthened engagements with government agencies and the business community, particularly in the halal industry, together with Islamic finance providers. For example, key information on Islamic finance solutions is now available in the Malaysia External Trade Development Corporation (MATRADE)'s Beginner's Guide to Exporting, as well as Jabatan Kemajuan Islam Malaysia (JAKIM)'s *Manual Prosedur Pensijilan Halal Malaysia (Domestik) 2020*. This will help promote greater awareness and acceptance of Islamic financial solutions among halal certified companies.

### Going forward

In 2021, we will continue our efforts to develop a progressive and inclusive Islamic financial system. We will sharpen our focus across three major areas, namely, social resilience, climate resilience and business empowerment. This will entail further diversification in Shariah-compliant financial solutions to address market gaps, and innovative approaches in meeting the evolving needs of the society and economy. These developments, together with the value-based focus of the industry, will contribute towards further strengthening the Islamic financial sector and enhancing its contribution to Malaysia's socio-economic growth and development.