Islamic Finance and Inclusive Growth

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Islamic finance can promote ADB's strategic agenda of inclusive growth as a means of achieving its overarching objective of poverty reduction. Inclusive growth is defined as "growth with social equity—that is, a growth process in which all segments of the population can participate and benefit—especially the poor."[1]

To be considered inclusive in this context, growth should reach as many groups in society as possible, particularly the poor and vulnerable.[2] The poor and other frequently excluded groups should thus be afforded the chance to "participate in, contribute to, and benefit from economic growth."[3]

Generally, within the area of financial sector development, Islamic finance can help increase access to financial services of unserved and underserved groups that have abstained from conventional banking services for religious or ethical reasons. Access to financial services is instrumental in allowing poor and low-income households to "take advantage of economic opportunities, build assets, and reduce their vulnerability to external shocks that adversely affect their living standards."[4]

The Malaysia International Islamic Financial Centre stated, in 2014, that half of the world's adult population did not have a bank account.[5] In 2010, around 59% of the adult population was "unbanked" in East Asia and Southeast Asia. Similar figures collected in the same year revealed that 58% of the adult population of South Asia and 48% of the adult population of Central Asia did not have bank accounts.[6] Studies focusing on Asia's Muslim population have shown that a segment of this population abstains from conventional savings accounts because of the interest-borrowing features of these accounts, which is prohibited in Islam. The preference is for

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Islamic finance promotes financial inclusion by offering vehicles for savings, financing, and insurance to large Muslim populations.

[1] ADB. 2014. *Thematic Evaluation Study: ADB's Support for Inclusive Growth*. Manila.
[2] Kuwait Finance House (KFH) Research. 2013. Islamic Finance in Asia: Development, Growth and Opportunities. November. 6.
[3] KFH Research. 2013. Islamic Finance. 6.
[4] KFH Research. 2013. Islamic Finance. 47.
[5] Malaysia International Islamic Financial Centre (MIFC). 2014. *Global Financial Inclusion, Islamic Finance Meets the Challenge*. 16 July.
[6] A. Chaia, T. Goland, and R. Schiff. 2010. Counting the World's Unbanked. *McKinsey Quarterly.* March.

Raising Financial Inclusion through Agents—Malaysia's Experience

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Malaysia, recognizing the importance of financial inclusion in creating sustainable and equitable economic growth, has made great efforts to rapidly expand accessibility to financial services, particularly through the Agent Banking Initiative.

Due in no small part to the initiative, 97% of the country's *mukim* (subdistricts with a population greater than 2,000) now have access points providing financial services, including deposit and withdrawal transactions,[1] up from just 46% in 2011. As a result, 99% of Malaysians today have convenient access to safe, reliable, and affordable financial services, up from 82% in 2011.

The Agent Banking Initiative, which had particular impact in rural areas, is among the strategies outlined in the Financial Inclusion Framework introduced in 2011 as part of the Financial Sector Masterplan 2011–2020 for an inclusive financial system over the coming decade. Guided by this framework, Malaysia has implemented initiatives that advance financial inclusion through four focus areas: providing convenient accessibility, expanding take-up of financial products and services, promoting responsible usage, and enhancing consumer satisfaction.

Agent Banking in Malaysia

Unlike agent banking models in several other countries that are led by telecommunication companies, agent banking in Malaysia is driven by licensed financial institutions under the purview of Bank Negara Malaysia, the central bank. Five financial institutions in Malaysia engage in agent banking, three of them development financial institutions mandated to mobilize savings of small savers as well as agriculture and cooperatives sectors[2]. Generally, the transactions at agent banks are conducted through point-of-sale terminals connected online with the financial institutions in real time.

Compared with traditional branches, the financial institutions reported that agent banking channels delivered cost savings of more than 80%[3] on set-up costs and may lower transaction costs at least by 40%.[4] This enables financial institutions to widen the outreach of financial services

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[1] Other allowable services under the Policy Document on Agent Banking are facilitating fund transfers, opening of savings accounts for Malaysian citizens, loan and financing repayments, and bill payments.
[2] The five banks are: Agrobank, Bank Simpanan Nasional, Bank Rakyat, Maybank, and RHB Bank.
[3] Bank Negara Malaysia. 2012. Box Article: Agent Banking: Advancing Malaysia's Financial Inclusion Agenda. *Financial Stability and Payment Systems Report 2012*. Kuala Lumpur.
[4] Based on experience and data reported by three participating financial institutions of agent banking to Bank Negara Malaysia.

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to areas that previously lacked access to physical financial access points.

With a combined network of 6,902 banking agents nationwide, agent banking has brought tangible benefits to customers, especially those in rural communities. Members of these communities, some of whom previously had to travel up to 140 kilometers to the nearest bank branch, now enjoy access to financial services located within walking distance. This translates into savings in time and cost amounting up to three hours and RM100 ($24) per trip.

Regulatory Framework

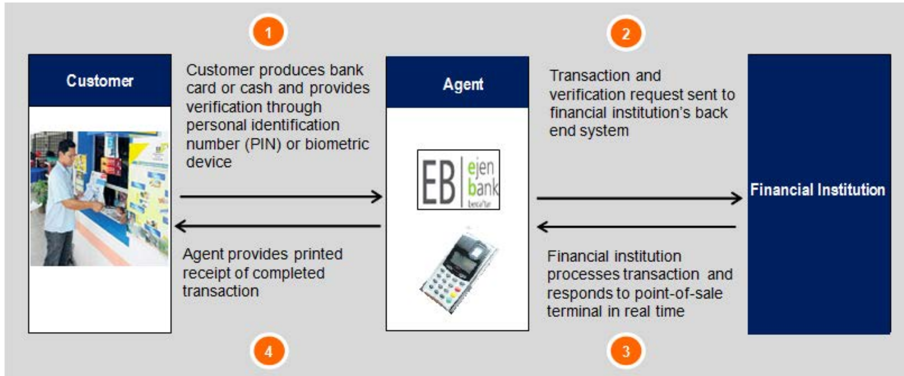
Bank Negara Malaysia monitors the agent banking system, first introduced in 2012, and the agent banking regulatory framework outlines requirements for financial institutions in the areas of governance and oversight, management of agents, customer protection, awareness, and education. The framework was enhanced in April 2015 to allow agents to open savings accounts on behalf of financial institutions through online real-time systems and biometric identity verification.[5]

The framework aligns interdisciplinary stakeholders in agent banking to enable reliable, safe, and sustainable delivery of the service as well as to provide a basis for assessing risks and to implement regulations proportionate to the risks identified. Financial institutions implementing the agent banking initiative are expected, among other things, to observe the following:

- Financial institutions retain the ultimate responsibility and accountability for all agent banking activities.

- All transactions by agents, including verification of customer identity, must be conducted through a device connected online in real time with the back end system of the financial institution. Verification of identity using both the national identification card (MyKad) and thumbprints has been effective, with no cases of fraud reported since implementation in 2012.

Figure 1: Flowchart of an Agent Banking Transaction



Note: For deposit and withdrawal transactions, both agent and customer must have an account with the financial institution
Source: Bank Negara Malaysia

- The agent bank only facilitates transactions on behalf of the financial institutions. For instance, the agents merely perform preliminary know-your-customer verification and the decision to approve the customer's application for the opening of savings remains with financial institutions. Pending completion of know-your-customer verification by financial institutions, the accounts opened by agent banks have lower transaction limits and fewer services.

- Financial institutions are to perform continuous surveillance and assessment of agent banks and periodically review the overall agent banking initiative.

Performance of Agent Banking

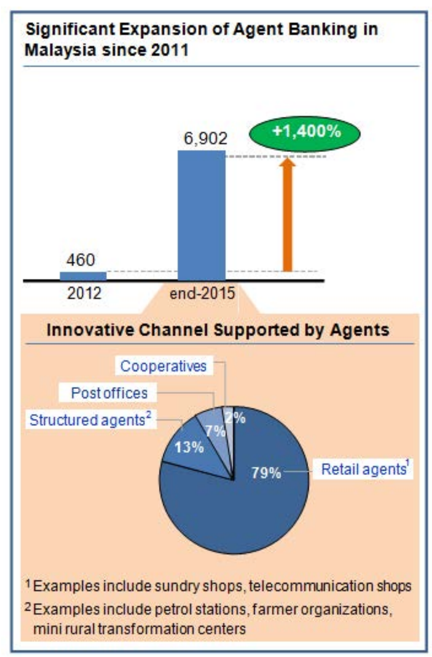
Since the implementation of agent banking initiatives in 2012, 6,902 agent banks have been appointed nationwide by the end of 2015, facilitating 63 million transactions amounting to RM5.7 billion. Most of these transactions involved bill payments (59.2%; RM3.4 billion) and cash deposits and withdrawals (28.1%; RM1.6 billion). Furthermore, April 2015 enhancements to the agent banking regulatory framework enabled agents to open over 13,600 new accounts by the end of the year.

There has been a significant increase in convenient accessibility, measured through the availability of financial access points at the *daerah* (district) and *mukim* levels. All 144 districts and 97% of the 886 subdistricts now have access to essential financial services, with a target of 98% by 2020. This widespread availability of agents has resulted in an increase in the volume of financial transactions conducted through agent banks from three million in 2012 to 63 million in 2015.

Moving Forward

Bank Negara Malaysia remains committed to expanding financial inclusion. The agent banking initiative will continue to be supported with the development of other innovative delivery systems, financial products that are responsive to the needs of the underserved, as well as effective education, support, and protection for financial consumers.

Figure 2: Growth in the Number of Agent Banks



Source: Bank Negara Malaysia

[5] In addition to allowable services under the Guidelines on Agent Banking (2012), namely accepting deposits, facilitating withdrawals, fund transfers, bill payments, and financing repayments.