



**BANK NEGARA MALAYSIA**  
CENTRAL BANK OF MALAYSIA



# **Value-based Intermediation: Strengthening the Roles and Impact of Islamic Finance**

Issued on: 20 July 2017

BNM/RH/DP034–1



# About the Strategy Paper

Bank Negara Malaysia (the Bank) is proposing several strategies that aim to strengthen the roles and impact of Islamic banking institutions (IBIs). The Bank will play a facilitator role in creating an enabling environment for IBIs to adopt relevant practices, offerings and conduct that generate positive and sustainable impact to the economy, community and environment, without compromising the financial returns to shareholders.



This Strategy Paper is **jointly developed** by the Bank, Islamic banking players and other key stakeholders.



The strategies are universally applicable across financial sectors, but the immediate focus will be on the **Islamic banking industry**.



The implementation approach of these strategies will be based on a phased-in approach whereby **the Islamic banking players will determine its own timeline**.



The consultative approach aims to forge **effective collaboration** among key stakeholders through **mutual understanding** of the industry's next strategic direction.

This Strategy Paper sets out the underpinning thrusts of value-based intermediation (VBI) and proposed implementation approach and strategies in advancing VBI as the next strategic direction for Islamic banking industry. The Bank invites written comments on the proposed strategies, including suggestions for particular issues/areas to be clarified or elaborated further and any alternative proposals that the Bank should consider. The written feedback should be supported with clear rationale, accompanying evidence or illustrations as appropriate to facilitate review of this paper.

Responses must be submitted by 31 August 2017 to:

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Jabatan Perbankan Islam dan Takaful (JPIT)  
Bank Negara Malaysia  
Jalan Dato' Onn  
50480 Kuala Lumpur  
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JPIT WhatsApp: +60183640234

Electronic submission is encouraged. Submissions received may be made public unless confidentiality is specifically requested for the whole or part of the submission.

Any queries may be directed to:

Azren Rizuani Aziz [azren@bnm.gov.my](mailto:azren@bnm.gov.my) or 03 2698 8044 (ext.7855)  
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## What the leaders say...

“...the rapid changes and dynamism of the industry require Islamic finance to strive even harder now. True to its name, Islamic finance needs to continuously carve its own branding and distinctiveness to provide wholesome value propositions. On this premise, the next frontier and the major milestone would be positioning Islamic finance to become more prominent and leading agent of positive change for the financial system, and operates within a network economy that is built upon shared values of integrity, inclusivity and sustainability. Greater attention will be devoted to value creation and value-based businesses that reflect the true essence of Islamic finance.”



***Muhammad bin Ibrahim***  
***Governor***  
***Bank Negara Malaysia***



*"Islamic finance has its roots in creating social justice and promoting a values based economy. This initiative championed by BNM will set a new global standard for value-based banking, and has the potential to create a platform for Islamic finance to lead the financial services industry into a new era."*

**Arsalaan Ahmed**

HSBC Amanah Malaysia Berhad



*"Islamic finance, with all its ingrained principles, remains relevant in a world that is increasingly focused on societal and environmental wellbeing which operates within systems of clear governance. Islamic finance is well-positioned to lead inclusive growth that leverages on ecosystem of responsible finance."*

**Khairul Kamarudin**

Bank Islam Malaysia Berhad



*"The time has now come for the Islamic finance to take the leadership role in ensuring all Shariah-compliant financing and solutions are also in line with sustainable development goals which are part of the higher objectives of Shariah. This transformation will further enhance the position of Islamic finance as a value-based financing."*

**Rafe Haneef**

CIMB Islamic Bank Berhad



*"Integrating value based principles into Islamic finance strong fundamentals, leadership and platform will complete the equation for an ethical and a more socially responsible banking environment."*

**Dato' Hj Mohd Redza Shah**

**Abdul Wahid**

Bank Muamalat Malaysia Berhad



*"The inherent principles of fairness and social responsibility which are intrinsically linked to being Shariah compliant, are poised to support the demand for value-based banking. Financial stability, sustainable ecosystem, efficient use of resources and innovation to create new market opportunity resonate with the increase in society's consciousness and thus present an enormous opportunity for Islamic finance."*

**Eghwan Mokhzanee bin  
Muhammad**

Ambank Islamic Berhad



*"Collectively, we have a responsibility to advocate value based governance and make lasting and impactful contributions to the society besides providing opportunities and growth for our business."*





**Dato' Mohamed Rafique**

**Merican bin Mohd Wahiduddin**

**Merican**

Maybank Islamic Bank Berhad

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## **EXECUTIVE SUMMARY**

# Executive Summary



## What's next for the Malaysian Islamic financial industry?

### What is Value-based Intermediation?

*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*



### How does Value-based Intermediation benefit us?



#### Financial Industry

*Greater innovation, enhanced efficiency and effective ecosystem*



#### Customer/Community

*Improved standard of living, fair and transparent treatment*



#### Government

*Realignment of business focus with national agenda*



#### Regulator

*Strengthened financial stability*

### What are the underpinning thrusts?

#### Defining common underpinning thrusts as a basis for collective action

*It is imperative for Islamic banks to ensure their intent, strategy and performance are premised on the underpinning thrusts of value-based intermediation*



### How do we get there?

#### Enabling environment for adoption of value-based intermediation

*Implementation approach will be a phased-in adoption by Islamic banks*

*The Bank, in collaboration with other stakeholders, will promote a conducive environment via various strategies that aim to expedite implementation of this initiative:*



#### Nurturing Potential Champions



#### Enhanced Disclosure



#### Strategic Networking



#### Performance Measurement





# **PART I**

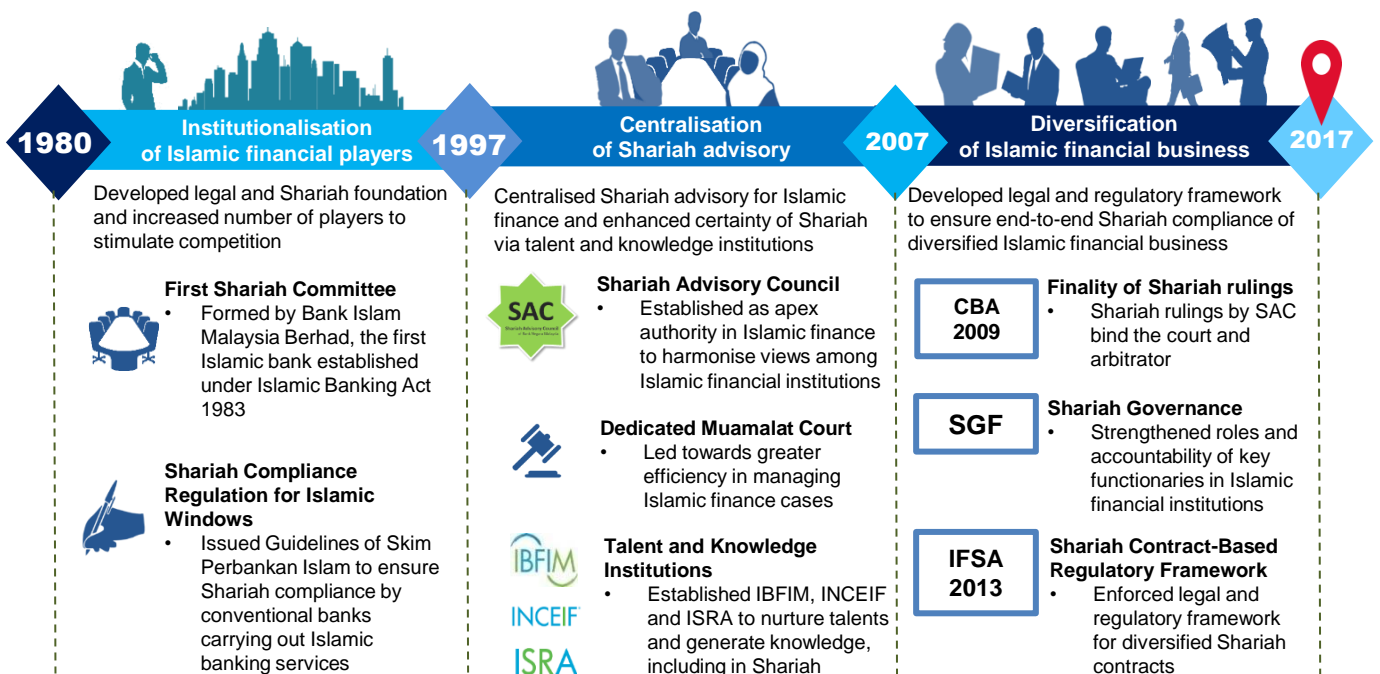
## **Unlocking Full Potential of Islamic Finance**

# Unlocking Full Potential of Islamic Finance

## What has the industry achieved so far?

- The global Islamic financial industry experienced significant growth in the last two decades with an overall total asset of USD1.88 trillion as at end 2015<sup>1</sup>.
- Offering of Shariah-compliant financial products and services in 50 Muslim and non-Muslim jurisdictions around the world demonstrated that the industry has gained its traction among businesses and individuals from all walks of life<sup>2</sup>.
- In Malaysia, the Islamic finance industry is well supported by comprehensive market infrastructure, robust regulatory framework and dynamic market participants as the industry's key growth drivers.
- Compliance to Shariah has been the focus in ensuring legitimacy of Islamic financial products and services. **Diagram 1.1** summarises Malaysia's journey in building an ecosystem that ensures Shariah compliance in Malaysia.

**Diagram 1.1: Evolution of an ecosystem that ensures Shariah compliance in Malaysia**



1. Islamic Financial Services Industry Stability Report, 2016.  
 2. Global Report on Islamic Finance 2016, "Islamic Finance: A Catalyst for Shared Prosperity?", The World Bank and Islamic Development Bank Group.

# Optimising the potential of Islamic Finance for a meaningful growth

- The market share of Islamic banks in Malaysia quadrupled from 7.1% in 2010 to 28% in 2016.
- However, the decline in its annual growth rate from a double-digit in 2011 (24.2%) to 8.2% in 2016 signals that the Islamic financial industry needs to further explore new opportunities for sustained growth.

## ***Broadening offering mind-set***

- Current offerings of Islamic financial products and services have been structured to meet the needs of customers that demand for Shariah-compliant financial services which are free of prohibited elements such as usury (*riba*) and speculation (*maysir*).
- Current initiatives primarily focus on ensuring that the product structures, features and operational aspects of financial transactions (including services) comply with Shariah requirements as specified in the regulatory framework.
- It is essential that greater emphasise should be given to consider the wider impact of the financial activities.
- More business opportunities could be created if the current paradigm could be shifted to extend beyond compliance, towards delivering value propositions not only to all financial consumers, but to the wider stakeholders within the society and the economy at large.

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## ***Enhanced transparency shapes stakeholders' perception***

- Industry's disclosure has been largely driven by regulation. Existing information and data mainly focus on financial performance (i.e. profitability and asset quality) of industry players.
- Enhanced transparency should include industry players' role and impact to wider stakeholders especially in the non-financial aspects such as facilitation of entrepreneurship, community well-being, sustainable environment and economic growth.
- The comprehensiveness of the transparency will influence financial industry's key stakeholders' perception and decision making.

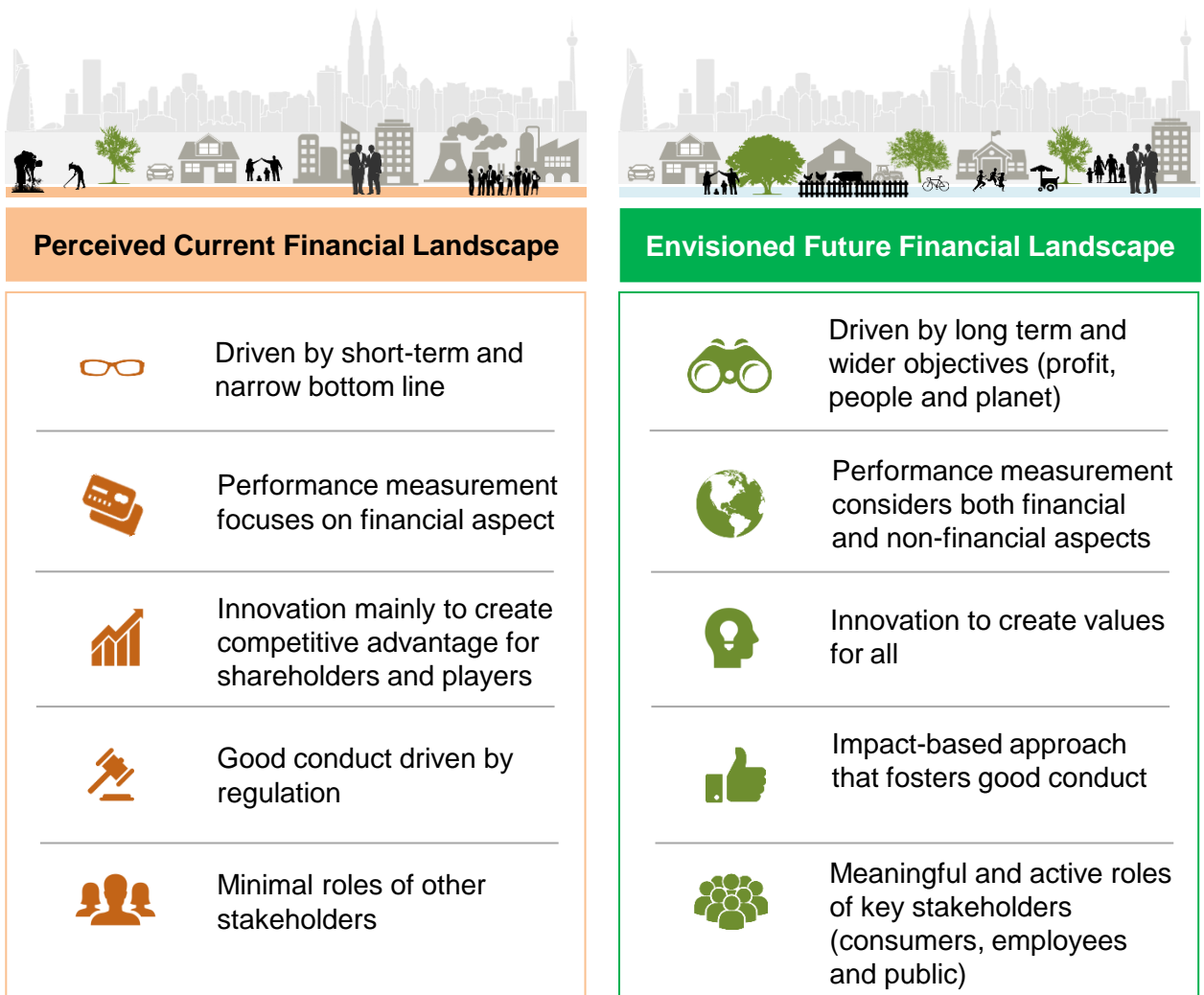
## Where are we heading to?

- Moving forward, it is imperative for Malaysia to move the Islamic financial industry to the next level of growth that is sustainable, with clear value proposition.
- **Diagram 1.2** provides a comparison between current perceived landscape and the future end game.

*“Moving on, we need to articulate over and over, on new wealth creation and generation in the 21st century as well as means and measure to create our new market share of the world.”*

**Datuk Dr Mohd Daud Bakar**  
Shariah Advisory Council  
Bank Negara Malaysia

**Diagram 1.2: Current perceived landscape and future end game**





## **PART II**

### **Realigning Focus for Greater Socioeconomic Impact**

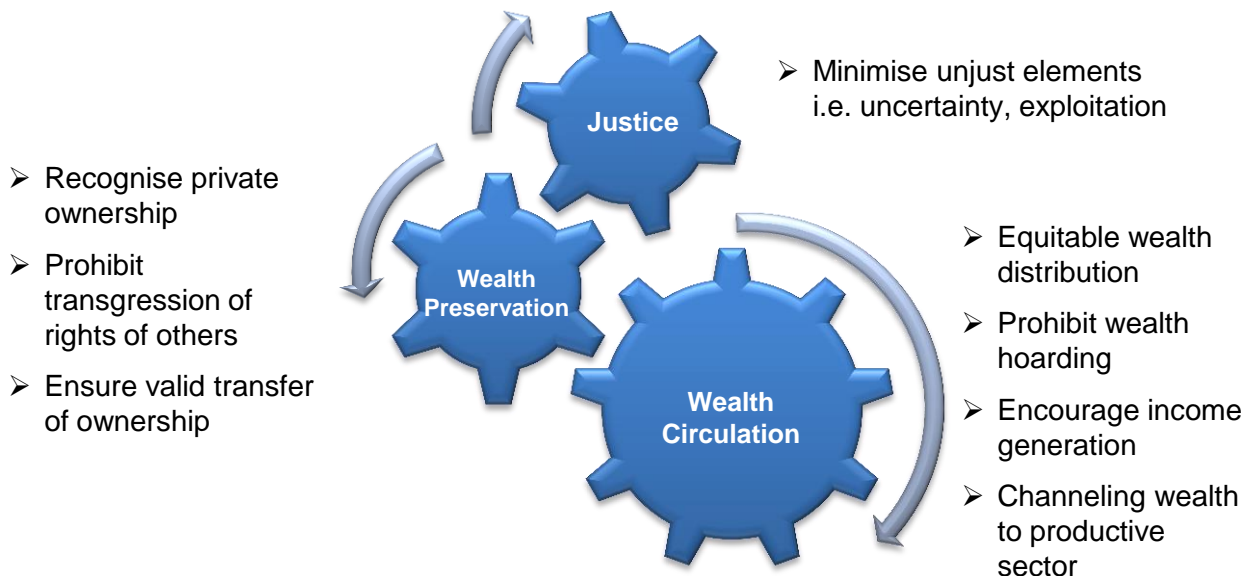
# Strategic Direction: Value-based intermediation realigns focus towards creating greater socioeconomic impact

## What is the next big shift?

**Strategy 1:** Islamic banking industry adopts value-based intermediation as a **common vision** for the industry.

- **Value-based intermediation (VBI)** function 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.
- VBI also emphasises on minimisation and prevention of negative impact arising from Islamic banking industry's practices, conduct and offerings.
- VBI promotes a more holistic observation of Shariah, beyond Shariah compliance, i.e. ensuring Islamic banking offerings and practices not only comply with Shariah requirements but also achieve the intended outcomes of Shariah.
- Intended outcomes of Shariah focus on enhancement of well-being of the people through preservation of wealth, faith, lives, posterity and intellect. In the context of Islamic financial business, preservation of wealth<sup>3</sup> goes beyond its literal meaning since it includes encouragement to generate, accumulate and distribute the wealth in a just and fair manner. **Diagram 2.1** illustrates the intended outcomes of Shariah, specifically in financial transactions.

**Diagram 2.1: Intended Outcomes of Shariah<sup>4</sup>**



3. Imam Al-Ghazali, *Al-Mustasfa fi 'ilm al-Usul*, page 174.

4. See: Dr. 'Izz Al-Din bin Zughbah, *Maqasid al-Shariah al-Khassah bi al-Tasarrufaat al-Maaliyah*, page 253, 273 and 297.

How will VBI change current banking offerings and practices?

There are three (3) key components of VBI:

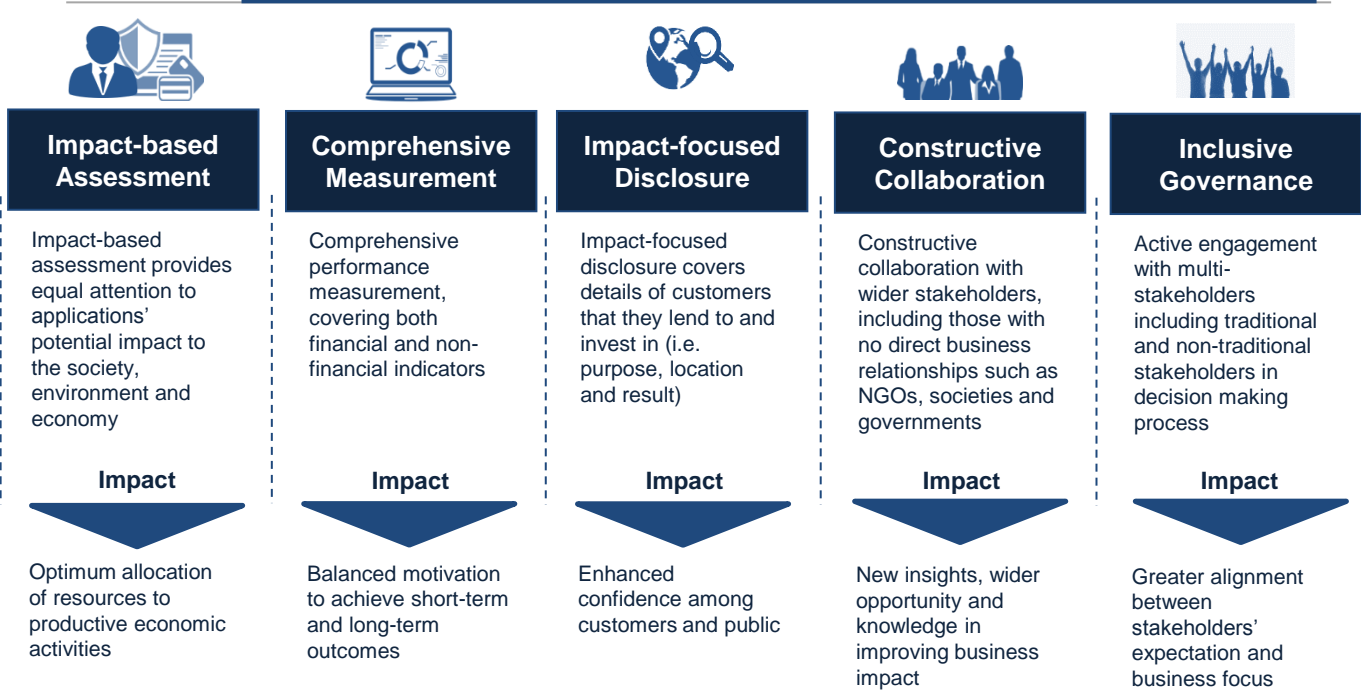
1. Offerings and market segments

  - Introduction of innovative products and services to create greater impact to existing market segment.
  - Impact-driven mindset will drive IBIs to focus on high-impact areas such as new growth areas and underserved segments.
2. Practices

  - Improvement in existing banking practices as illustrated in **Diagram 2.2**.
  - Adoption of innovative practices or techniques such as offtake agreement<sup>5</sup> or supply chain finance to manage risks arising from serving the high-impact areas.
3. Collaboration

  - Enhanced collaboration with strategic partners and stakeholders (beyond the financial community) to leverage on specific skills and infrastructure that are critical but not owned by the IBIs.

Diagram 2.2: What do value-based banking practices look like?



5. An agreement between the project company and the offtaker (the party who is buying the product/service that the project produces/delivers). In a project financing the revenue is often contracted, rather than being sold on a merchant basis. This agreement provides the project company with stable and sufficient revenue to pay its project debt obligation, covering the operating costs and provide certain required returns to the sponsors.

### ***Does VBI reinvent the wheel?***

- It is not completely a new concept. In fact, VBI shares similarities with several well-established concepts such as Environmental, Social and Corporate Governance (ESG), Ethical Finance and Sustainable, Responsible, Impact Investing (SRI), specifically on the intended outcomes.
- The key difference between VBI and these concepts lies on its *raison d'être* (reason for being). VBI relies on Shariah in determining its underlying values, moral compass and priorities.
- VBI intends to focus on:
  - Ensuring application of the established concepts is in line with Shariah; and
  - Emphasising Shariah values or principles that are yet optimally propagated such as entrepreneurship and community empowerment.
- VBI will not start from a zero baseline since IBIs have consciously or unconsciously applied similar understanding and demonstrated several practices. However, it is believed that collective action is needed to amplify its potential and impact.

### ***Is VBI similar to Corporate Social Responsibility (CSR)?***

- CSR is commonly perceived as a cost center, not a profit center<sup>6</sup>, while VBI intends to create new business opportunities which serve new markets, improve profitability and strengthen competitiveness.

### ***Would creating value for others lessen value created for the institution?***

- No. In fact, through VBI a banking institution can create better (more impactful and sustainable) economic value in the long run, if it is driven to create value for other stakeholders.
- There are two main reasons:
  - A commercial entity does not operate in isolation. Issues or challenges faced by other stakeholders such as the community, environment and local economies will, to a certain extent, affect the business entity's capacity to generate value for itself. Therefore, a positive change in the whole ecosystem will create positive impact to business performance<sup>7</sup>.
  - Value created for the commercial entity will not be deemed lesser if it recognises other types of value such as social value, human capital and intellectual property, which goes beyond the generic financial value<sup>8</sup>.

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6. Cost center refers to a department within an organisation that does not directly add to profit but still costs the organisation money to operate. A profit center contributes to profitability directly through its actions.

7. Creating Shared Value, Michael E. Porter and Mark R. Kramer, Harvard Business Review, January-February 2011 issue.

8. The International Integrated Reporting Framework, December 2013, by the International Integrated Reporting Council (IIRC).



## Is VBI only relevant to Islamic financial institutions?

- It is inherent for Islamic financial institutions (IFIs) to drive the adoption of VBI due to the following:
  - The Islamic finance industry in Malaysia is currently operating in a conducive environment, which is well-supported by comprehensive market infrastructure and regulatory framework. Given the current level of industry's maturity, IFIs have the necessary capacity to move to the next level.
  - The Islamic finance industry is well-equipped with a variety of Shariah contracts (beyond the financing and deposit transactions). Optimal application of these contracts has the potential to create and deliver significant impact.
- Given the size of its market share, the Islamic banking players are expected to drive this VBI initiative. Moving forward, the underpinning thrusts of the VBI will be re-visited to enhance its relevance to takaful industry.
- Intended outcomes of VBI are universal in nature, which may also be relevant to conventional financial institutions.

### Cost Benefit Analysis: The National Australia Bank's Case



#### **Abolished overdrawn fees on all NAB personal transactions and savings account**

- Overdrawn account fees of \$30 are charged when a customer's personal transaction or savings account is overdrawn.
- Based on customers' complaint data, such fees recorded the highest number of complaints.
- NAB staff had to deal with customers' complaints which were demotivating and time consuming.
- NAB decided from October 2009, the overdrawn fee will be abolished altogether to improve customers' relation and staff productivity.

#### **Immediate Impact:**



Impact around 700,000 personal transactions or savings account customers per year.



Forgone sum of \$100 mil in revenue every year.

#### **Long-term Value Creation:**



Stronger relationship with existing customers

- Complaints (on fees and charges) dropped by 24% (2011 – 2012)



- Gained more new customers
- Total customers increased by 5.86% (2009 – 2010)

Source: National Australia Bank

# How would value-based intermediation benefit financial institutions?

## Innovation:

- Impact-driven mind-set creates new market opportunity through development of innovative financial solutions that address unserved or underserved segments (e.g. affordable home ownership).

## Efficiency:







- Adapting current practices to enhance impact (e.g. productivity), which include effective use of resources, employees and business partners.

## Effective Ecosystem:

- Improving existing skills, supply chain and supporting institutions or solving common issues faced by communities or other stakeholders, which eventually facilitates business success.

Ultimately, these benefits would improve and enhance IBIs branding image and reputation over time.

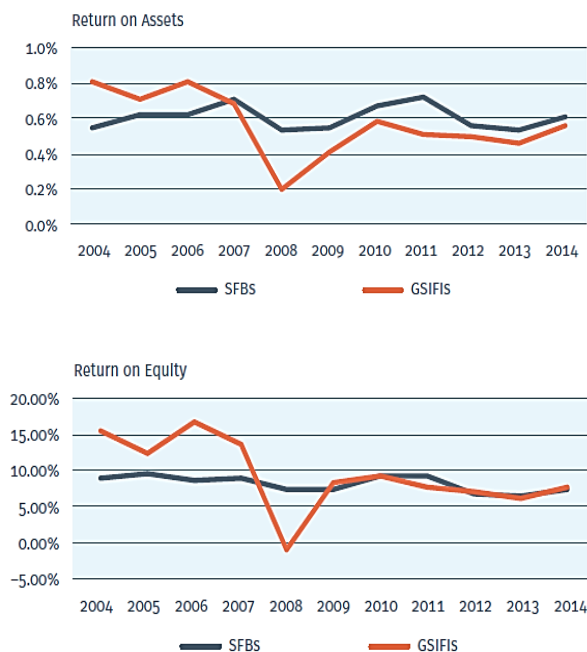
Diagram 2.3: Examples of how VBI benefits financial institutions

 	 	 
<b>Bank Islam Malaysia Berhad: Affordable Housing Development</b>	<b>CIMB Group Holdings Berhad: Journey Mapping (CJM) Tool</b>	<b>Agrobank: Program Rakan Ladang BERNAS</b>
<p><i>Al-Waqf Home Financing-i</i> by Bank Islam resulted in the construction of 76 residential and 9 commercial lots on a 9-acre plot in Penang. This project (RM24 mil) was in partnership with Jabatan Agama Islam Pulau Pinang and a property development company.</p> <p>Source: Sustainability Report 2016 of BIMB Holding Berhad, Upholding Values.</p>	<p>It is a structured process to analyse a customer’s step by step journey in using CIMB’s products and services. CIMB Group conducted 10 CJMs which resulted in 14 business process re-engineering projects and lesser customer’s waiting time.</p> <p>Source: <a href="https://www.cimb.com/content/dam/cimbgroup/pdf-files/annual-reports/corporate-report-300317.pdf">https://www.cimb.com/content/dam/cimbgroup/pdf-files/annual-reports/corporate-report-300317.pdf</a></p>	<p>Agrobank, in collaboration with BERNAS launched an initiative to improve productivity of paddy and farmers’ standards of living. Agrobank provides working capital (RM50 mil) to farmers while BERNAS provides free technical consultation.</p> <p>Source: Agrobank allocates RM50mil for PRL BERNAS next year, Berita Harian Online, 7 Dec 2016</p>

## How would value-based intermediation benefit regulator and government?

- Benefits could be realised through better realignment of business focus with the national agenda. For the financial sector, this will result in optimal allocation of financing to the targeted sectors.
- Greater integration and effective collaboration to achieve common goals, as outlined in the various strategic documents such as the SME Masterplan, 11<sup>th</sup> Malaysia Plan, Economic Transformation Programme, UN Sustainable Development Goals and Green Technology.
- Financial stability through strengthening resilience and performance of Islamic banking industry.
  - Sustainability-focused banks (SFBs) create more stable profitability & inclusive growth as compared to the global systemically important financial institutions (GSIFIs)<sup>9</sup>.

**Diagram 2.4: Better performance and less volatility observed in profitability of SFBs**



**Diagram 2.5: Strong and sustained growth of SFBs before and after the global financial crisis**

**Chart: Growth (two time periods)**

	2010-2014	2005-2014
<b>Loans</b>		
SFBs	12.2%	12.4%
GSIFIs	5.4%	7.5%
<b>Deposits</b>		
SFBs	12.0%	12.4%
GSIFIs	5.9%	8.7%
<b>Assets</b>		
SFBs	11.8%	11.7%
GSIFIs	3.5%	7.6%
<b>Equity</b>		
SFBs	12.0%	13.3%
GSIFIs	7.3%	10.9%
<b>Total Income</b>		
SFBs	9.1%	9.5%
GSIFIs	6.8%	5.7%

**Diagram 2.6: SFBs provide higher support to real economy and are funded by more deposits**

	2014		2008		2005	
	SFBs	GSIFIs	SFBs	GSIFIs	SFBs	GSIFIs
<b>Real Economy</b>						
Loans/Assets	75.2%	39.6%	75.7%	39.8%	73.0%	41.8%
Deposits/Assets	78.0%	49.0%	71.6%	43.6%	73.9%	45.1%

9. Research Report on Real Economy–Real Returns: The Power of Sustainability-focused Banking, 2015 by the Global Alliance for Banking on Values (GABV).

## How would value-based intermediation benefit the community and customers?

### Improved productivity and standard of living:

- Financing disbursed is envisaged to empower the community to be self-sustainable in the long run, for example through establishment of their own businesses.

### Fair and transparent treatment:

- Adoption of VBI initiative in the end-to-end operation of an institution also cultivates good and ethical conduct of the business operation. Hence, customers will receive better quality services from the provider.
- Open channels provided to raise complaints or concerns also promotes transparency in doing business. This would lead to greater confidence among customers and public at large.







### Reduced negative externalities:

- Through impact-focused assessment and disclosure, institutions would be more aware of the impact of undertaking certain activities. Any activities that would create damage to the community and the environment for example, pollution or deforestation will be reduced overtime.

*"In Malaysia's robust and progressive economic landscape, we play an intermediation role to ensure successful development and sustainability of the agriculture sector providing agropreneurs with access to suitable financial products and services, supporting financial inclusiveness, bridging the rural-urban divide and elevate the social well-being of the lower income group in the country."*

**Agrobank**

**Diagram 2.7: Examples of how VBI benefits the community and customers**

 <b>AGRO BANK</b> 	 	 
<b>Agrobank: AgroBakti</b>	<b>Vancity: Social Accountability Report</b>	<b>Banco Santander: Reducing Deforestation</b>
<p>Provides working capital financing for person with disabilities to run their agricultural related business, thereby increases income level and provides jobs for persons with disabilities.</p>	<p>Vancity has been adopting a triple bottom line approach to its business - measuring financial, social and environmental performance and reporting these results.</p>	<p>Banco Santander decided to not renew funding to APRIL, a paper firm, until the company implements measures to ensure safety of the environment.</p>
<p>Source: <a href="http://www.agrobank.com.my/en/product/agro-bakti-financing-programme/">http://www.agrobank.com.my/en/product/agro-bakti-financing-programme/</a></p>	<p>Source: <a href="https://www.vancity.com/AboutVancity/News/MediaReleases/Archives/MediaArchive2002/Oct15VancitysSocialAccountabilityReport/">https://www.vancity.com/AboutVancity/News/MediaReleases/Archives/MediaArchive2002/Oct15VancitysSocialAccountabilityReport/</a></p>	<p>Source: <a href="http://www.greenpeace.org.uk/blog/forests/result-santander-stops-financing-forest-destroyer-april-20150226">http://www.greenpeace.org.uk/blog/forests/result-santander-stops-financing-forest-destroyer-april-20150226</a></p>



## **PART III**

### **Defining Common Underpinning Thrusts of Value-based Intermediation**

# Our perspective: Defining common underpinning thrusts of value-based intermediation

## Why do we need a common agenda?

**Strategy 2:** Islamic banking institutions (IBIs) and industry's key stakeholders **mutually define** the **underpinning thrusts** of value-based intermediation as a **basis** for collective action.

- Pursuing business in a way that also benefits society requires a framework that facilitates successful collaborations between key stakeholders<sup>10</sup>.
- This is due to the fact that commercial entities such as IBIs do not operate in isolation. Productivity level of the IBIs may be affected by challenges, which may arise from or persist due to complex combination or omissions of actions by their stakeholders.
- In this regard, it is imperative for IBIs to ensure that the intent, strategy and performance of their Islamic financial businesses are premised on the underpinning areas of VBI that will eventually create values to the stakeholders.
- Coordinated efforts among IBIs and industry's key stakeholders are crucial for effective and impactful implementation of VBI.
- The following four (4) underpinning thrusts serve as a preliminary guidance, and may expand over time depending on the collective understanding and implementation of VBI industry wide (**Diagram 3.1**).

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*It is imperative for IBIs to ensure that the intent, strategy and performance of their Islamic financial businesses are premised on the underpinning thrusts of VBI that will eventually create values to the stakeholders*

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**Diagram 3.1: Underpinning thrusts of VBI**

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10. Mark R. Kramer and Marc W. Pfitzer, "The Ecosystem of Shared Value", Harvard Business Review (Article Strategy)

# Proposed Underpinning Thrusts of VBI

## 1. Entrepreneurial Mindset

- The first key focus area is premised on greater involvement in facilitating entrepreneurial activities through holistic offerings by IBIs, which include financing and proactive support i.e. advisory, market infrastructure and business network.
- Seizing the opportunity to offer holistic offerings to entrepreneurial activities will eventually boost IBIs' innovation through development of new products, tools and business models to assist and support businesses and entrepreneurs.
- Apart from that, IBIs would have a better understanding on multitude of challenges faced by businesses that go beyond access to credit, which may include poor management, inadequate technology and limited market accessibility. Therefore, offering an opportunity for IBIs to design and tailor their offerings and services accordingly.
- Entrepreneurial activities have a special place in Islam that it is specifically illustrated in a hadith narrated by al-Tirmidhi, *"Nine out of ten sources of income come from business activities"*. In upholding the entrepreneurial spirit as promoted in Islam, it is fundamental to develop a supportive and proactive environment for businesses and entrepreneurs.

How to measure?

Possible indicators include:

- Percentage of financing disbursed to identified sector/new growth areas
- Number of innovative product launched for business sector/SMEs
- Number of initiative to support business sector/SMEs
- Number of first time banking customers (financial inclusion)
- IBIs' contribution to an improved efficiency and productivity level of business entity (customers)

### The Village



Provide space and facilities (such as free Wi-Fi, meeting rooms and networking area) for business customers and community partners to connect with clients and other members in their supply chain.

Source: <https://www.nab.com.au/business/the-village>

### Payment Convenience for Petty Traders



Low-cost payment terminal initiative enables Malaysian SMEs and micro-enterprises to accept electronic payments, benefiting from mobile electronic transactions to grow their business.

Source: BIMB Holdings Berhad Sustainability Report 2016

## 2. Community Empowerment

- Empowering communities through provision of financial solutions that create positive impact.
  - In the context of social obligation (*fard kifayah*), those who are capable have the responsibility to assist those who are not capable via effective distribution of wealth. Therefore, an IBI can play a significant role in creating socioeconomic impact for the communities<sup>11</sup>.
  - Balanced consideration between commercial and social aspects should provide a central lynchpin for the IBI in navigating its strategic decisions, thus creating the practice of giving back to society, beyond corporate social responsibility activities.
  - This can be achieved through development, funding and implementation of effective solutions for issues faced by the communities, which aim to create positive impact to the communities and new business opportunities for IBIs.
  - An example includes the integration of *waqf* and *sadaqah* within Islamic financial transactions<sup>12</sup>.
- How to measure?
- Possible indicators include:
- Number of innovative products and services introduced for the community
  - Number of community-based projects driven by IBIs
  - Number of individuals benefitted from community-based projects
  - Social impact indicators e.g. enhanced standard of living

### Financing for underserved market



Offer low-cost micro financing solution to the underserved market using *sadaqah* or *waqf* funds as alternative sources of fund.

### Scholarships for future talent



Offer scholarships and internship programs to nurture future talents which are consistent with the business requirements e.g. for the agriculture and renewable energy sectors.

Source:  
[http://www.santander.com/csags/Satellite/CFWCSancomQP01/en\\_GB/Corporate/Sustainability/Santander-Universities/Santander-committed-to-Higher-Education.html](http://www.santander.com/csags/Satellite/CFWCSancomQP01/en_GB/Corporate/Sustainability/Santander-Universities/Santander-committed-to-Higher-Education.html)

11. Economic Development and Islamic Finance, Zamir Iqbal and Abbas Mirakhor, 2013 International Bank for Reconstruction and Development/The World Bank.
12. Community empowerment initiative for Islamic financial institutions, Abd Aziz et al (Dec 2015), ISRA Islamic Finance Space Issue 04.



### 3. Good Self-Governance

- Inculcating organisational discipline (self-restraint) and ensuring meaningful participation of all stakeholders in the governance framework.
  - There are two (2) main components:
    - Inclusive governance: Any decision made by an IBI will not only impact its shareholders, but also the extended stakeholders including the customers and investors. Hence, inclusive governance requires IBIs to proactively engage their stakeholders in key decision making process, akin to the principles of consultation (*istisharah*). Such holistic consultation provides IBIs with better perspective, insights and expectation that will determine or influence the outcome of their business plans.
    - Self-governance: Culture of self-discipline embedded within the operations and practices of IBIs. In line with the principles of righteousness (*ih-san*) from the Shariah perspective, this would result in greater accountability and integrity of the IBI driven by the common moral outlook for the ultimate good.
  - Thus far, governance in practice has been driven primarily by regulations. Moving forward, it is envisaged that the IBIs would embrace good self-governance proactively without relying solely on regulatory interventions.
- How to measure?
- Possible indicators include:
- Number of engagement/consultation with other stakeholders
  - Trend of internal fraud cases
  - Compliance to relevant global standards e.g. ESG and Integrated Reporting

#### Examples of Good Self-governance



Establish effective and convenient platform (managed by the third party) for stakeholders to provide feedbacks or report complaints. This will encourage staffs to do the right thing when dealing with customers, suppliers and other stakeholders.



Develop an open channel that facilitates continuous consultation with employees, which focuses on highlighting concerns and ideas to improve internal management of the institution.

## 4. Best Conduct<sup>13</sup>

- Best conduct refers to an adoption of practices that improve IBIs' offerings, processes and treatments toward their stakeholders (including IBIs' customers and employees).
- It is a behaviour that is driven to achieve continuous improvement, in order to enhance satisfaction of stakeholders.
- IBIs aim to provide efficient services to address public needs while ensuring rights of shareholders and stakeholders are protected.
- Safeguarding the rights of stakeholders via fair and transparent disclosure for all transactions and decisions by the IBIs is also another demonstration of best conduct. All financial transactions shall be conducted in such a manner that important information is made available to the contracting parties. Any information asymmetry will lead to potential disputes.
- Shariah has clearly outlined a set of rules to protect the interest of the contracting parties, including prohibition of unjust dealings associated with usury (*riba*), minimisation of uncertainty (*gharar*) that is caused by lack of information as well as avoidance of unintended disputes due to unfair and oppressive contractual terms.

- Freedom of contract has been the fundamental element in contractual relationships between an IBI and its customers.

### Examples of Best Conduct



Provide financial hardship advisory and financing repayment options for struggling borrowers.



Staff performance evaluation is linked to his or her success in proactively improving customers' financial health.



Impact-focused disclosure covers details of clients that they lend to and invest in (i.e. purpose, location and result).

### How to measure?

Possible indicators include:

- Number of customers' and employees' complaints
- Customer and employee satisfaction index
- Enhanced level of transparency
- Staff turnover rate
- Quality of after-sales service
- Amount of time spent by staffs for VBI initiative
- Costs of training spent to improve staff's efficiency

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13. 'Good self-governance' focuses on an institution's internal decision making process and governance infrastructure, while 'best conduct' refers to an institution's treatment towards its stakeholders (customers, employees, public and investors).



## **PART IV**

### **Creating Enabling Environment for Value-based Intermediation Adoption**

# Implementation approach: Strategies aim to create enabling environment for IBIs to adopt value-based intermediation

## How do we get there?

- Implementation approach of this initiative will be a phased-in adoption by industry players based on each institution’s own timeline.

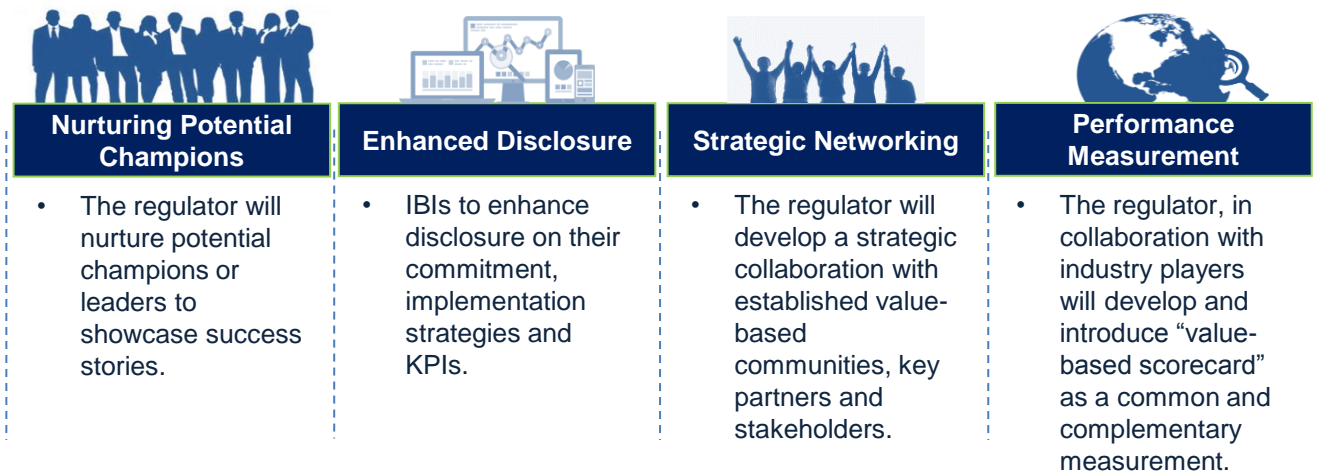
### What does a phased-in adoption mean?

- All IBIs that wish to pursue this initiative are expected to indicate their respective commitment and timeline that are based on their level of readiness, as part of the annual business plan discussion with the Bank.
- The Bank, in collaboration with other stakeholders, will promote a conducive environment through the following strategies (illustrated in **Diagram 4.1**), that aim to expedite implementation of this initiative.

*All IBIs that wish to pursue this initiative are expected to indicate their respective commitment and timeline that are based on their level of readiness, as part of the annual business plan discussion with the Bank*

- IBIs will create significant positive and sustainable impact if they embrace this mindset voluntarily, guided by their understanding and practical experience.

Diagram 4.1: Four key strategies to create enabling environment for VBI implementation



**Strategy 3:** Regulator, in collaboration with industry players, nurtures “**potential champions**” to showcase success stories of VBI.

- Several willing market leaders will initiate and drive momentum in implementing this initiative.
- Greater visibility of these leaders’ success will likely attract more institutions to become ‘committed adopters’.

*What are the underlying motivations for potential champions?*

- Consistent with the institution’s strategic direction to enhance branding (reputation) and performance.
- First-mover advantages in the industry.

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***Greater visibility of these leaders’ success stories will likely attract more institutions to become ‘committed adopters’***

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- In assessing the IBIs’ level of readiness in adopting VBI, there are two criteria to be considered, namely willingness and capacity.



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### Willingness

- Already embarked on several initiatives that share similar aspiration of VBI (e.g. leading innovation and sustainability initiatives)
- Current leadership and shareholders demonstrate positive inclination towards VBI

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### Capacity

- Safe and sound institutions from supervisory perspective
- Stable and strong financial performance

**Strategy 4:** Islamic banking institutions to **enhance disclosure** on their intent in adopting VBI, supported with implementation strategy and performance report.

- Enhanced transparency enables relevant stakeholders to react accordingly (**stakeholders' activism**) as well as to project positive sentiment and perception. It will also allow the key stakeholders to make an **informed decision** given that more information on VBI is made transparent.
- There will be two levels of transparency expectation as part of the enhanced disclosure strategy:
  - Minimum** transparency expectation for VBI. This transparency expectation is known as **Corporate Value-Intent (CVI)** (illustrated in **Diagram 4.2**).
    - Potential champions disclose important and relevant information and data for VBI initiative. Implementation Guidance will further outline these transparency expectations.
  - Additional information or data that goes beyond VBI minimum transparency** expectations may be disclosed by potential champions on voluntary basis.

*What to disclose in the CVI?*

- Potential champions are expected to provide information on the following:
  - Their intent/commitment to adopt VBI, supported by the relevant implementation strategies and
  - The key performance indicators (KPIs). Potential champions are expected to disclose self-assessment progression of these implementation strategies.

**Diagram 4.2: Corporate Value-Intent (CVI)<sup>14</sup>**



14. Details of the Corporate Value-Intent will be clarified in the Implementation Guidance that will be issued later (tentatively in December 2017).

*How would CVI promote adoption of VBI?*

- Well-informed stakeholders will realign their expectations accordingly and be able to consider such information in their financial decision making process.
- Improved reputation of IBIs through positive brand reinforcement.
- Market forces and competitive environment will naturally expedite the implementation of VBI.

*What are the differences between CVI vs. current corporate values, vision and mission?*

- Current corporate values demonstrate an institution's operating philosophies or principles that guide its internal conduct and relationship with its customers, partners and shareholders, while CVI focuses on realigning organisational direction with objectives of Shariah.
- Current corporate values are usually disclosed in the mission statement or in the institution's statement of core values, while CVI is expected to be backed by an effective implementation plan and measurable KPIs.

**Strategy 5:** Regulator, in collaboration with Islamic banking institutions, will develop and introduce “**value-based scorecard**” as a common and complementary measurement of success for industry.

- Value-based scorecard redefines the parameter of success by considering both financial and non-financial aspects (illustrated in **Diagram 4.3**).
- The non-financial aspects may include facilitation of entrepreneurship, improved treatment towards employees, customers and public as well as enhanced community’s standard of living.

*How does the recognition of an institution’s progression in the non-financial aspects (which forms part of overall performance measurement) promote adoption of VBI?*

- More comprehensive performance measurement that recognises the institution’s progression in the non-financial aspects can shape positive and proactive behaviour among industry players.
- A competitive environment encourages industry players to compete in creating positive and sustainable impact to their wider stakeholders.

**More comprehensive performance measurement that recognises the institution’s progression in the non-financial aspects can shape proactive behaviour among industry players**

**Diagram 4.3:**

**Value-based Scorecard Components**

**Basic Requirements**

- Compliance to Regulations
- Intentions/Commitments
- Reporting Transparency

**Quantitative Factors**

- Financial Viability
- Real Economy Focus
- Community Focus
- Environmental Focus

**Qualitative Elements**

- Strategic Direction
- Leadership
- Talent Development
- Governance
- Conduct

100

**Overall Performance Index**

0



Supported by **micro-indicators** for specific areas and initiatives – link to respective institutional strategy

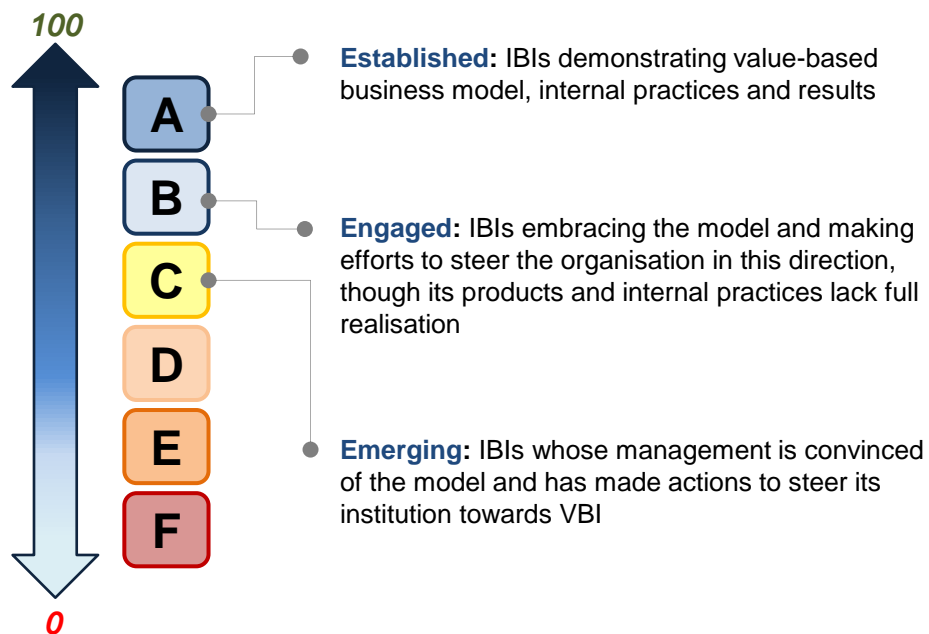
*Note: Adapted from the scorecard of the Global Alliance for Banking on Values (GABV)*



### What is the implementation approach?

- Phased-in adoption approach – to allow IBIs to familiarise with the measurement and collect relevant data in a timely manner.
  - Phase 1: IBIs use the scorecard as a **self-assessment tool** that identifies gaps or areas that require more attention as well as measures their improvement.
  - Phase 2: The scorecard will be publicly disclosed to allow stakeholders to **compare** performance of IBIs.
- Proactive rating approach is adopted, i.e. the non-performing IBIs will be classified as “emerging adopter” – to manage potential negative perception on certain IBIs which are not performing very well (illustrated in **Diagram 4.4**).

Diagram 4.4: Proactive Rating Approach



Note: Adapted from the scorecard of the Global Alliance for Banking on Values (GABV)

**Strategy 6:** Development of **effective networking** through establishment of Community of Practitioners (CoP) as well as strategic collaboration with established value-based community, key partners and stakeholders (illustrated in **Diagram 4.5**).

- Strategic networking aims to link all relevant stakeholders to amplify impact beyond capability of financial institutions. With this extensive network identified, it is envisaged that the implementation of VBI will be more holistic and comprehensive.
  - The VBI network consists of six key clusters, with the Community of Practitioners (CoP) acting at the inner core of the network.
  - The CoP consists of IBIs who indicate interest to become early adopters of VBI. The Bank will play the role of a facilitator.
- The CoP facilitates adoption of VBI through:
    - Promotion of industry-wide knowledge exchange;
    - Establishment of a single reference point to discuss and resolve implementation issues; and
    - Implementation of strategic industry-level projects that demonstrate principles of VBI – to allow leading IBIs to assist others and ensure effective collaboration with relevant agencies (rather than separate arrangement by individual IBIs).
  - Creating awareness to the consumers and public at large on VBI is viewed as crucial to ensure concrete understanding and greater appreciation on how IBIs could bring positive impact into their lives, in addition to serving their financial needs.

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***Strategic networking aims to link all relevant stakeholders to amplify impact beyond capability of financial institutions. With this extensive network identified, it is aimed for the implementation of VBI to be more holistic and comprehensive***

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- Other five key clusters identified to advocate the concept of VBI include:

i. Knowledge providers

- Develop new research, ideas and training that can be helpful in facilitating adoption of VBI and developing the right talent.

ii. Network institutions

- Share relevant knowledge and experience on value-based best practices.
- Provide input and feedback on proposed implementations e.g. value-based scorecard based on expertise.

iii. Government and policy bodies/agencies

- Influence strategic direction of IBIs to incorporate element of VBI.
- Create pressure group and promote stakeholders' activism.
- Strengthen the ecosystem (demand and supply) required for IBIs to implement VBI.

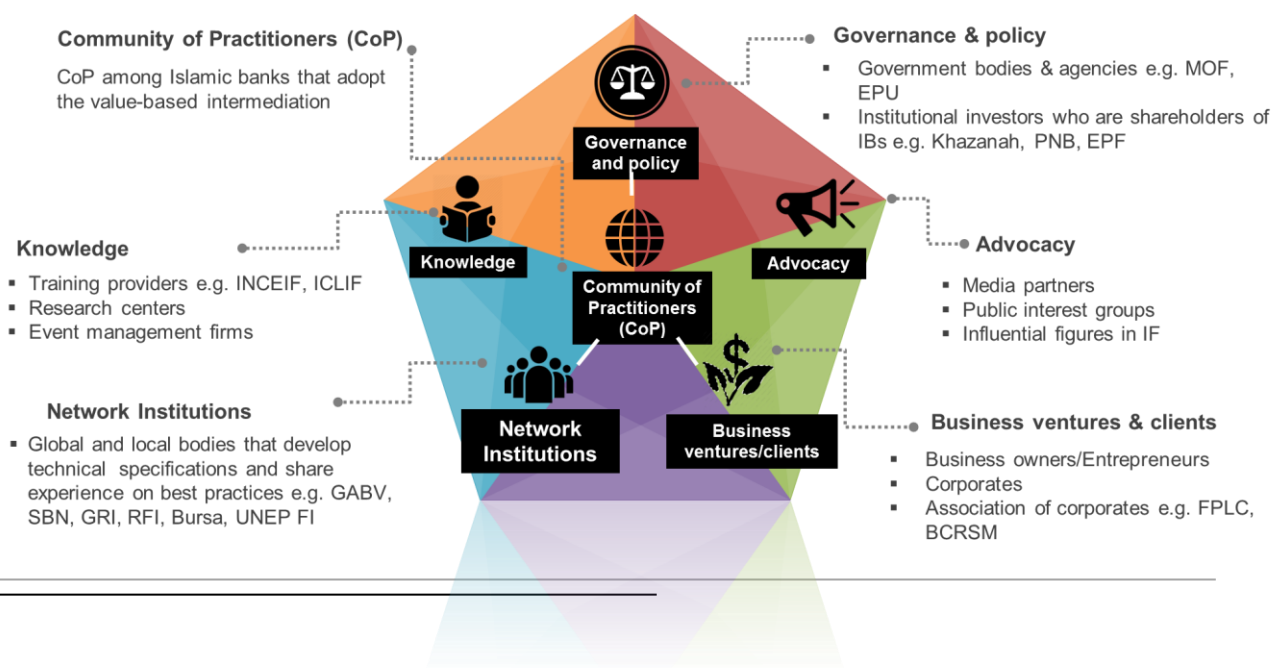
iv. Advocacy group

- Broadcast success stories and increase public awareness and activism on VBI.

v. Business ventures and clients

- Strengthen the ecosystem (demand and supply) in terms of corporate investors with aligned value propositions.

**Diagram 4.5: Value-based intermediation network**



*The Bank acknowledges the contribution of the founding members of Community of Practitioners (comprising Bank Muamalat Malaysia Berhad, Bank Islam Malaysia Berhad, HSBC Amanah Malaysia Berhad, Agrobank and CIMB Islamic Bank Berhad) in developing and finalising the Strategy Paper.*