

Encik Abdul Rasheed Ghaffour: Value-Based Intermediation (VBI) - propelling Islamic finance

Address by Mr Encik Abdul Rasheed Ghaffour, Deputy Governor of the Central Bank of Malaysia (Bank Negara Malaysia), at the Value-Based Intermediation (VBI) Dialogue, Kuala Lumpur, 24 August 2017.

* * *

Over the years, finance has lifted the lives of many, enabled businesses to grow and helped to fund the construction of public infrastructure that we now depend on. Yet, as the global economy transforms and society evolves, the question as to whether the financial sector is sufficiently serving the needs of the real economy continues to be debated. The evidence from the global financial crisis underlines the need for the financial sector to restore its balance with the real economy. There is a need to rethink, reassess and re-strategise the role and contribution of the financial industry. Undoubtedly, there is an increasing expectation for the financial sector to deliver greater impact to the economy and society.

I am pleased to be here with you today and be part of this important milestone in our Islamic finance journey. The issuance of the Value-Based Intermediation (VBI) Strategy Paper by Bank Negara Malaysia marks the next step to realising the full potential of Islamic finance. On behalf of the Bank, I wish to thank all of you who have devoted time and effort to work with us in this important initiative. Your input has been valuable in designing the strategies and approach to advance VBI as a key thrust in propelling the Islamic finance industry further forward.

Today, I would like to share some of my thoughts on the concept of value-based intermediation. I will begin by giving an account of the achievements of our industry within the past decades. I will then touch on the role of VBI as a catalyst for growth with positive impact and the call for Islamic finance to lead the way in realising the visions and objectives of VBI.

Islamic finance in Malaysia has evolved and grown by leaps and bounds over the last 30 years. Today, we have a well-developed and regulated Islamic finance industry. There are diverse industry players, both local and foreign. Prior to 2000, there were only two Islamic banks and two takaful operators in the country with total market share and takaful penetration rate of less than 5%. Islamic banking assets have now grown to capture more than a quarter of the total banking system while the takaful sector has increased its penetration rate to 14.6% of the population. This is indeed very good progress. In the sukuk segment, Malaysia is also the market leader with market share of more than 50% in sukuk outstanding since year 2000.

On the Bank's part, the Islamic Financial Services Act 2013 was introduced to modernise our regulatory and legal framework in adapting to changing needs of the industry. The issuances of 12 Shariah Standards set clear Shariah parameters to facilitate innovation beyond credit-based products. There are more than 100 competitive financial products — ranging from basic financial services to wealth management; corporate finance; and investment banking. Meanwhile, investment accounts have spurred greater investment intermediation activities. Since its inception two years ago, investment accounts have grown to account for 12% of total Islamic deposits and investment accounts in 2016. Its offering has been further intensified through the operationalisation of the Investment Account Platform which has the potential to mobilise capital to various productive ventures effectively.

The development of the Islamic finance sector is seen not only in the headline numbers, but more importantly in addressing social and environmental concerns. Islamic finance has taken the lead in the space of ethical finance where concepts, such as Sustainable, Responsible, Impact Investing (SRI), have been embraced in pursuit of values beyond financial motivation. An important pioneering example in the Islamic capital market is the issuance of SRI sukuk by

Khazanah that brings greater social impact through the promotion of quality education. Just last month, the first Green Sukuk has also been issued in the country to promote clean and sustainable power supply.

While we have come a long way, now we need to think of 'what's next'? From the Bank's perspective, we believe that the way forward to propel the Islamic finance industry to the next level of growth — if I may, a 'game changer' — should give equal weight to both economic value creation and upholding ethical values. That is why we have embarked on VBI, which is a holistic approach for our industry players to deliver the intended outcomes of Shariah that generate positive and sustainable impact to the economy, community and environment. While VBI shares similarities with concepts such as Ethical Finance, ESG (Environmental, Social and Corporate Governance) and SRI, the distinguishing factor is the central position of Shariah in determining Islamic finance's underlying values, moral compass and priorities.

There are four underpinning thrusts of VBI — entrepreneurial mindset; community empowerment; good self-governance; and best conduct. Through the embodiment of these principles in the business strategies of Islamic banks, there would be greater appreciation on the need to create a positive impact on stakeholders, as called for by Shariah and Islam itself.

The adoption of VBI is expected to further strengthen the element of self-discipline within Islamic banks. A common moral outlook for the ultimate good leads to greater accountability and integrity, resulting in strong consideration on the impact of any decisions made. Islamic banks would be driven to continuously improve their offerings and treatments toward customers and employees, which include fair and transparent disclosure. The more sustainable banking practices that would be developed based on VBI concepts encourage the creation of new business opportunities and provide the foundation for more sustainable returns for Islamic banks over the long term.

Customers, particularly businesses and entrepreneurs would benefit from the opportunity to be more involved, in the design of more innovative products and services, that are best tailored to meet their needs and circumstances. Business propositions from new sectors such as the SMEs, would also benefit from VBI-based practices where financing applications would be assessed by Islamic banks based on their potential value creation, not just their credit scores. Society at large also stands to gain from reduced negative externalities as any activities that damage the community and environment would be reduced overtime. The practice of Islamic banks in giving back to society, such as by integrating *waqf* and *sadaqah* within Islamic financial transactions, can also create positive socioeconomic impact in communities. VBI should not be mistaken for corporate social responsibility (CSR). In fact, VBI goes beyond the concept of CSR with a pervasive approach to reconfiguring the way Islamic banking works.

Globally, we can also see value-based concepts being demonstrated in the banking sector, where value-based practices have emerged to restore the role of finance in acting for the greater good. TeamBank in Germany for instance, capitalises on the concept of fairness in its dealings with customers to market its EasyCredit as its primary product proposition. The success of this strategy has positioned TeamBank as the country's third largest consumer finance provider. Equally commendable is Westpac Banking Corporation, the first Australian bank that has incorporated environmental filters in its day-to-day business decisions.

In Malaysia, I believe Islamic financial institutions are now at the right stage of development to drive this important change. It is expected that Islamic banks would take the lead in the VBI initiative and to embrace the new principles in their business strategies and operations. Given the universal nature of VBI, the application and adoption of similar strategies by financial groups which comprise conventional financial institutions would be the next phase of this evolution as we move forward. In time, I believe that the underpinning thrusts of VBI will also be expanded to enhance its relevance to the takaful industry.

Realising the tangible impact of VBI is more of a journey than a fixed destination. However, it is encouraging to note that a number of our Islamic banks have already started applying principles of VBI in one way or another. What is needed now are strategies to realise the full potential and amplify the impact of VBI in creating positive outcomes for shareholders as well as broader stakeholders in Islamic finance. I would like to suggest three critical areas that require immediate attention, for this momentum of change to be sustained.

First, VBI calls for a “transformation of the mind”, a change in how we think and how we act. It takes a long view to recognise returns beyond profits where social and environmental gains are also equally valued. This will represent a major paradigm shift in many institutions. For this, strong and visionary leadership that sets the tone from the top, starting from the board and senior management, is certainly crucial. Far-sighted leadership to transform culture, systems and people will be central to this paradigm shift. To facilitate the process, the recently issued Strategy Paper on VBI will be complemented with an implementation guidance that is currently being developed by the Bank in collaboration with the industry.

Second, VBI will require greater stakeholder activism through increased transparency on its adoption. This is a new initiative and it is imperative that our efforts go hand in hand with creating greater awareness and understanding of key stakeholders. The public sector and advocacy groups play an important role. But customers and business ventures should also play their roles wisely and use the power of their wallets to make informed choices. To catalyse this change, a value-based scorecard will be introduced to realign behaviours and expectations towards the desire to impact the community and the environment in a positive way. The scorecard will capture important dimensions of qualitative performance that are geared towards creating sustainable outcomes by Islamic financial institutions.

The third critical area is adopting a collaborative approach to implementing VBI which will be key to mobilising change. For VBI to work, the desired collaboration has to bring in not just our market players, but also other non-financial stakeholders, to pool critical skills and infrastructure that reside beyond our terrain. By expanding our network, we will be better able to deliver far greater values that otherwise could not be achieved if we were to depend on limited capabilities within the financial industry alone. With stronger collaboration, I believe there will be much more that each individual can learn from one another. In this context, the Community of Practitioners comprising committed Islamic banks, will be instrumental in pioneering advancements in VBI. The Community of Practitioners will serve as the nucleus for other collaborative efforts. Networks to be formed will comprise a diverse group, from ventures and corporates to knowledge and advocacy institutions. Through the exchange of knowledge and experiences, as well as coordinated actions to address implementation issues, the Community of Practitioners can help accelerate the execution and amplify the benefits of VBI. I would also like to thank the panel members that will take part in the Panel Discussion today, which also includes representatives from the Community of Practitioners. We can certainly gain greater insights from the panel members who will elaborate further on the VBI approach and provide interesting perspectives on its implementation.

In conclusion, while the Malaysian Islamic financial sector has made great strides since its inception over 30 years ago, the next growth frontier in Islamic finance is in realising its potential to create greater socio-economic impact. Instilling values in the financial sector strengthens trust of the people which benefits the public at large. The VBI initiative is envisaged to shape proactive behaviour amongst industry players. For the Islamic finance industry, the move towards embracing VBI is another hallmark in our journey to manifest the larger aspiration of Islamic finance. Islamic banks, with its natural affinity towards social justice are well-positioned to lead this agenda and become the prominent and leading agent of positive change. However, the momentum of VBI is only sustainable through collective endeavours that prompt a shift in our paradigm and change in our actions. It is only with our strong commitment that we can translate the VBI vision into reality.

