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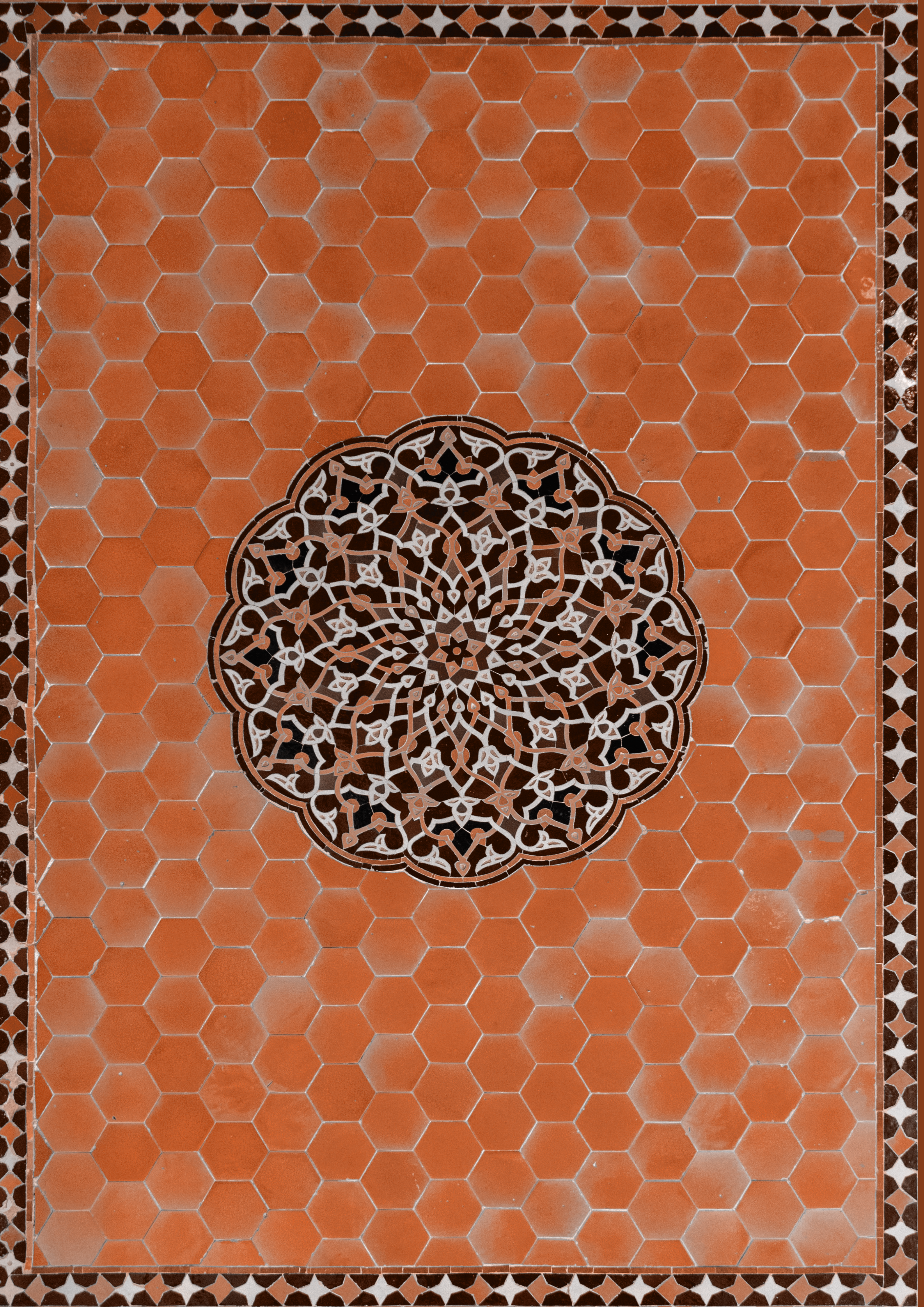
CASE STUDIES ON

Innovations in Islamic Finance



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Acknowledgment

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Foreword

United Nations Development Programme (UNDP) and the Islamic Development Bank (IsDB) have a long-standing partnership which has evolved and strengthened over the years. The partnership builds upon UNDP's and IsDB's commitment to cooperate in shared priority areas such as crisis response and recovery, poverty reduction, private sector development, capacity-building, and knowledge-sharing. In 2016, the Global Islamic Finance and Impact Investing Platform aimed at strengthening Islamic finance & Impact investing as leading enablers of the global thrust towards implementation towards the SDGs. This investment platform launched its Green Sukuk Initiative in 2018, in collaboration with the Securities Commission Malaysia. To date, the initiative has provided technical assistance to Turkey, Uzbekistan and Pakistan and more are in the pipeline.

In 2019, we renewed our commitment with a launch of joint action plan to strengthen collaboration in support of national efforts to achieve the Sustainable Development Goals (SDGs). This action plan has led to UNDP Country Office for Malaysia, Singapore and Brunei Darussalam, the Innovative Financing Lab, UNDP Country Office for Indonesia and IsDB Kuala Lumpur Center of Excellence's first joint local partnership. The inaugural collaboration aimed at showcasing and promoting innovative solutions in Islamic Finance and MSME development – two areas where Malaysia and Indonesia can offer their expertise and experiences to support other countries in their own development quest.

This report is written in simple language for all regulators, practitioners, academicians, students, and other related parties who have an interest in Islamic finance development. It provides readers with a brief description of selected innovative Islamic financial practices, namely on digital sukuk for retail buyers, value-based intermediation (VBI), fintech applications in Islamic social and Islamic microfinance.

Indeed, there are huge opportunities for governments, and the Islamic finance industry to serve those being left behind. New financial models and innovations are emerging targeting previously excluded populations with affordable and accessible services. In this report, readers will see how Islamic finance and Islamic social finance services can allow people to lead more resilient and secure lives. We hope that the featured case studies will spark interesting conversations across UNDP and IsDB member countries keen in curating innovative ideas and developing stronger eco-systems for their own Islamic Finance and Islamic Social Finance sectors.

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Abbreviations

AAOIFI	: Accounting and Auditing Organization for Islamic Financial Institutions
ABSINDO	: Asosiasi BMT Seluruh Indonesia / Association of Indonesian BMTs
AFSI	: Indonesian Islamic Fintech Association
AI	: Artificial Intelligence
AIIMAN	: AIIMAN Asset Management Berhad
BAZNAS	: Indonesian *Zakat* Authority
BI	: Bank Indonesia
BKD	: Bank Kredit Desa / Village Credit Bank
BMT	: *Baitul* Mal wat *Tamwil*
BNM	: Bank Negara Malaysia
BPR	: Bank Perkreditan Rakyat / Conventional Rural Bank
BPRS	: Bank Pembiayaan Rakyat Syariah / Islamic rural banks
BRI	: Bank Rakyat Indonesia / People's Bank of Indonesia
BWI	: Badan Wakaf Indonesia / Indonesian *Waqf* Board
CAGR	: Cumulative Annual Growth Rate
CPIAM	: CIMB Principal Islamic Asset Management
CSR	: Community Social Responsibility
CVI	: Corporate Value-Intent Disclosure Framework
DOS	: Department of Statistics
CSR	: Community Social Responsibility
GCC	: Gulf Cooperation Council
GDP	: Gross Domestic Product
GIEI	: Global Islamic Economy Indicator
GIFR	: Global Islamic Finance Report
i-REITs	: Islamic Real Estate Investment Trusts
IFCI	: Islamic Finance Country Index
IFDI	: Islamic Financial Development Indicators
IFSB	: Islamic Financial Services Board
IILM	: International Islamic Liquidity Management Corporation
IKD	: Digital financial innovation
IKNB	: *Shari'ah* Non-Bank Financial Industry
INKOPSYAH	: Induk Koperasi Syariah / Association of Shari'ah Cooperatives
JAWHAR	: Department of *Waqf*, *Zakat* and Hajj

KNEKS	: Komite Nasional Ekonomi dan Keuangan Syariah / National Committee for Islamic Economy and Finance
KNKS	: Komite Nasional Keuangan Syariah / National Islamic Finance Committee
KSPPS	: Koperasi Simpan Pinjam Pembiayaan Syariah / Islamic Saving and Loan Cooperatives
LAZ	: Lembaga Amil *Zakat* / *Zakat* Amil Institution
LKM	: Lembaga Keuangan Mikro / Microfinance Institution
LKMS	: Lembaga Keuangan Mikro Syariah / Islamic Microfinance Institution
LKS-PWU	: Islamic Financial Institution-Recipient of Cash *Waqf*
MDEC	: Malaysian Digital Economy Corporation
MFI	: Microfinance Institution
MOF	: Ministry of Finance
MSME	: Ministry of Small and Medium Enterprises
MUI	: Majlis Ulama Indonesia / Indonesian Ulema Council
NGO	: Non-Governmental Organization
NLG	: Natural Language Generation
OJK	: Otoritas Jasa Keuangan /Financial Service Authority
P2P	: Peer-to-Peer
PBMTI	: Perhimpunan *Baitul* Mal wat *Tamwil* Indonesia / Indonesia BMTs Association
PENJANA	: The National Economic Recovery Plan
PINBUK	: Pusat Inkubasi Bisnis Usaha Kecil / Centre of Micro Enterprise Incubation
PUSKOPSYAH	: Pusat Koperasi Syariah / Regional Centre for *Shari'ah* Cooperatives
PTEs	: Public Trust Entities
PWS	: Perbadanan Wakaf Selangor
SC	: Securities Commission Malaysia
SDGs	: Social Development Goals
SIMBA	: Baznas Information System
SIRC	: State Islamic Religious Council
SME	: Small and Medium Enterprises
USP	: Unit Simpan Pinjam / Savings and loan unit
UOB	: United Overseas Bank
UPZ	: Unit Pengumpulan *Zakat* / *Zakat* Collection Unit
VBI	: Value-Based Intermediation
VBIAF	: VBI Investment and Financing Impact Assessment Framework
YWM	: Yayasan Wakaf Malaysia
ZISWAF	: *Zakat*, Infaq, Alms and *Waqf*

Preamble

Islamic finance (IF) and Islamic social finance (ISF) are two broad frameworks within the innovative financing landscape that have proven to offer great potential for supporting sustainable development given their fundamental emphasis on environmental, social, and corporate governance criteria to generate positive societal impact.

IF refers to the provision of financial services based on moral principles and backed by a set of values based on legal framework of Islam (*Shari'ah* Islamic law). While focus on IF has been largely on what it prohibits, many overlook the development potential that it allows or advocates for:

- filling in the financial gap in addressing humanitarian crises in conflict-stricken or climate disaster locations, whereas developing countries annually need USD5-7 trillion to keep their SDG ambitions on track.
- ensuring a close link between the real economy and financial sector, where investments are made into real economic activities.
- emphasizing principles of morality and ethics in business conduct, in a larger legal and ideological context than the ESGs; and
- advocating the sharing of risk and reward between investors and investees, or creditors and borrowers without any elements of *riba'* or usury.
- upholding the economic principle of freedom of action and collective responsibility, where motivations for economic activity should meet not only one's own needs but also contribute to the good of the society.

IF has the potential to contribute to sustainable development in at least three dimensions. Firstly, it aims to foster greater financial inclusion, especially of large, underserved Muslim populations who may avoid conventional interest-based financial institutions because of the prohibition of riba (interest) by the Islamic law. Secondly, its emphasis on asset-backed financing and risk-sharing means that it could provide support for small and medium-sized enterprises in developing OIC countries, as well as investment in public infrastructure. Finally, its risk-sharing features and prohibition of speculation suggest that IF may, in principle, pose less systemic risk than conventional finance. The principles of risk-sharing and the strong link of credit to collateral means that Islamic bank is well-suited to the financing of SME and start-ups, thereby potentially contributing to more inclusive growth[1]. These features make Islamic financial instruments a potentially transformative new source to finance the SDGs, through its ability to stimulate economic activity and entrepreneurship, increase financial inclusion and social stability - all of which are consistent with the 2030 Goals. Islamic financial services such as Islamic microfinance, *sukuk* and *takaful* are equally entrenched in socio-economic justice principles.

ISF covers Islamic traditional instruments based on philanthropy (such as *zakat*, *waqf* and *sadaqah*) and cooperation (such as *qard* and *kafala*). All transactions must support the overall goal of Islamic law (*Maqasid*), promote welfare (*Maslahah*) and prevent harm (*Mafsadah*). From the perspective of human development, an economy should ensure growth and stability with equitable distribution of income, where every household earns a respectable income to satisfy basic needs. The system of mandatory wealth redistribution based on levels on wealth thresholds has little tolerance for uncharitable-ness or avoidance culture and the impact of this redistribution has proven in many countries to create huge value-added for capacity building and social justice. Indeed, a small upward push in *zakah* and *waqf* mobilization in many countries could generate enough funds to meet the resources gap for poverty eradication. Such resource raising was a clear possibility in countries that were proactive in reforming their respective Islamic social finance sectors through creating enabling regulatory and policy environment and building capacity through network of supporting institutions. In the wake of COVID-19 mobility restrictions, more and more are being pursued to expand digitalization of IF and ISF services, and this is one area of innovation that must be closely pursued.

This report covers selected case studies in the Islamic finance and social finance ecosystem in Malaysia and Indonesia. These case studies document eco-building requirements and innovative solutions which were able to strengthen the two systems' effectiveness, coverage and transparency – particularly in its integration with the digital economy. Development practitioners may find useful insights from the case studies featured in this report in developing their own strategies and action plans to suit their own needs, unique features, level of financial infrastructure and market readiness.

1 *Islamic Finance and the UNDP: Partnering for the SDGs* (2016), Aamir A. Rehman

1. Introduction

1.1 State of Play: Islamic Finance in the World

According to the *State of the Islamic Economy Report 2022*, despite the continued uncertainty related to the pandemic COVID-19, the global Muslim spending in 2022 is forecasted to grow by 9.1% for the Islamic economy sectors. All related Islamic economy sectors, except travel, have returned to pre-pandemic spend levels by the end of 2021. Muslim spending is forecasted to reach USD2.8 trillion by 2025 at a four-year Cumulative Annual Growth Rate (CAGR) of 7.5%. Specifically, Islamic finance assets are estimated to have grown to USD3.6 trillion in 2021, up 7.8%, from USD3.4 trillion in 2020 (DinarStandard, 2022). A summary of the global Islamic economy for 2019-2024 is shown in Figure 1.1.

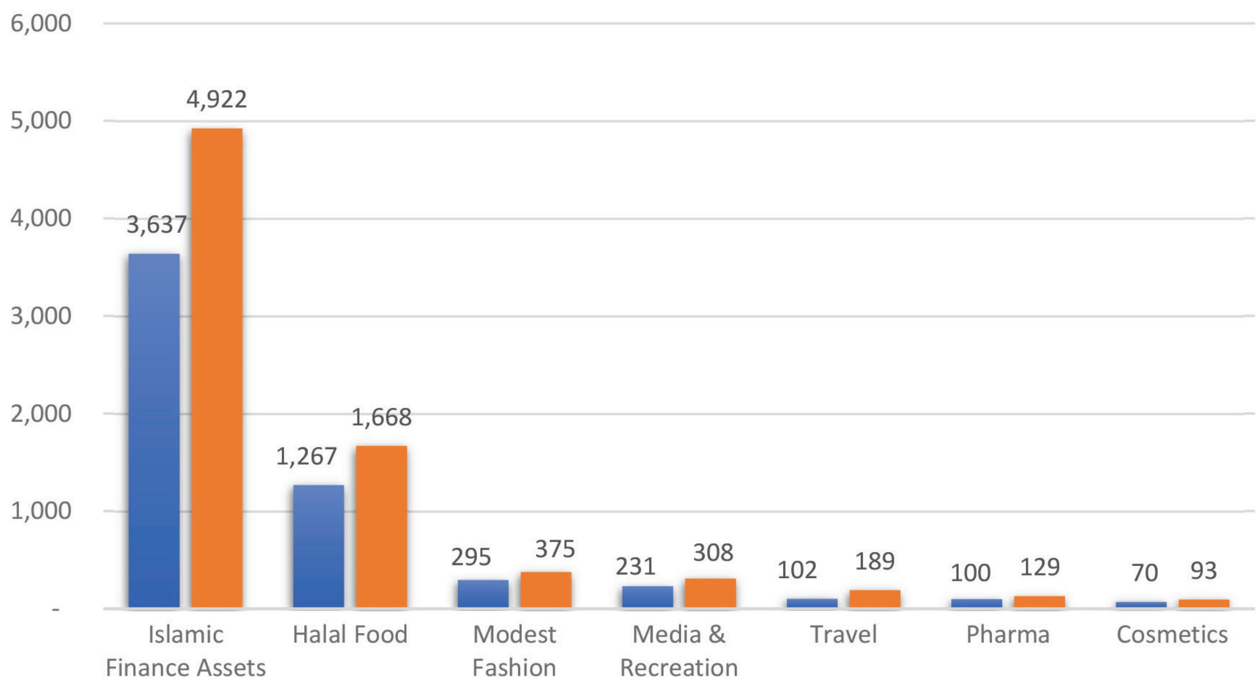


Figure 1.1: Global Islamic Economy 2021-2025

Source: *State of the Islamic Economy Report 2022* (DinarStandard, 2022)

Meanwhile, the *Islamic Financial Development Report 2021* highlights the growth of Islamic finance assets with a significant, continuous rise from USD1.975 trillion in 2014 to USD3.374 trillion in 2020, and a projected reach of almost USD5 trillion in 2025 (see Figure 1.2).

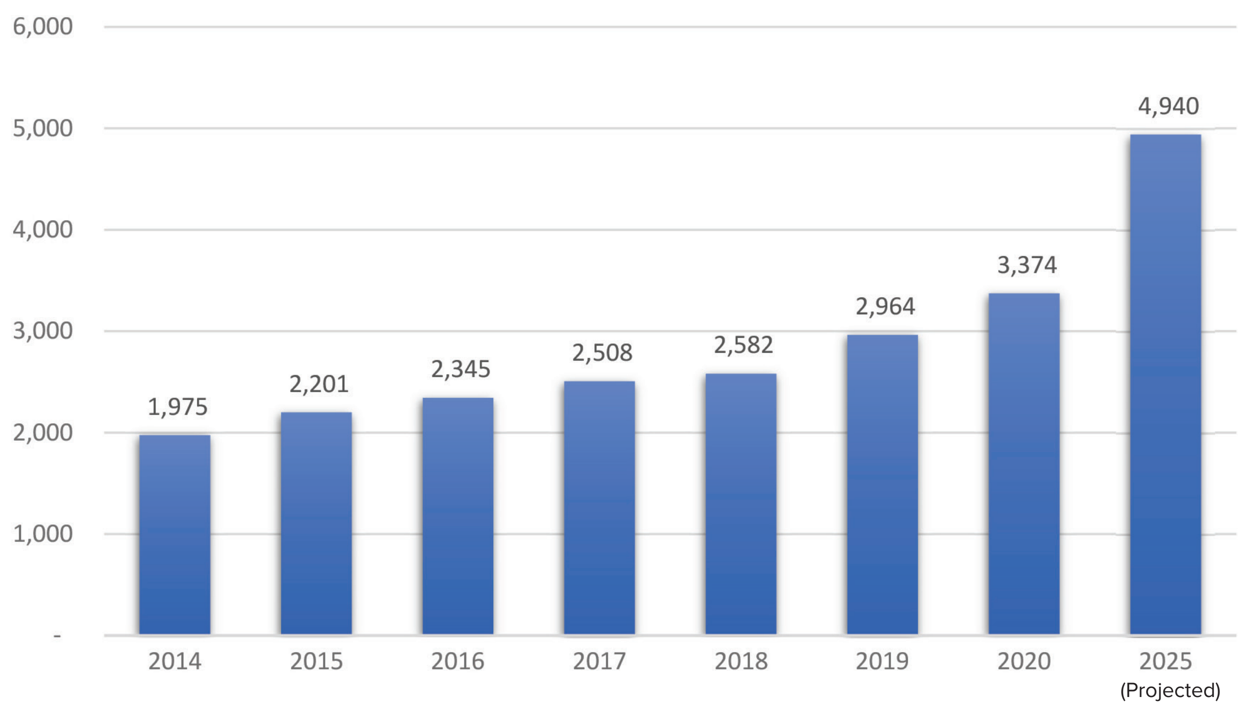


Figure 1.2: Islamic Finance Assets Growth

Source: *Islamic Financial Development Report 2021 (ICD-REFINITIV, 2021)*

In terms of Islamic finance assets distribution in 2020, about 70 percent (USD2.349 billion) is under the Islamic banking sector, followed by 19 percent (USD631 billion) under sukuk, five percent (USD178 billion) under Islamic funds, four percent (USD154 billion) under other IFIs and the remaining 2 percent (USD62 billion) under *takaful* sector (see Figure 1.3).

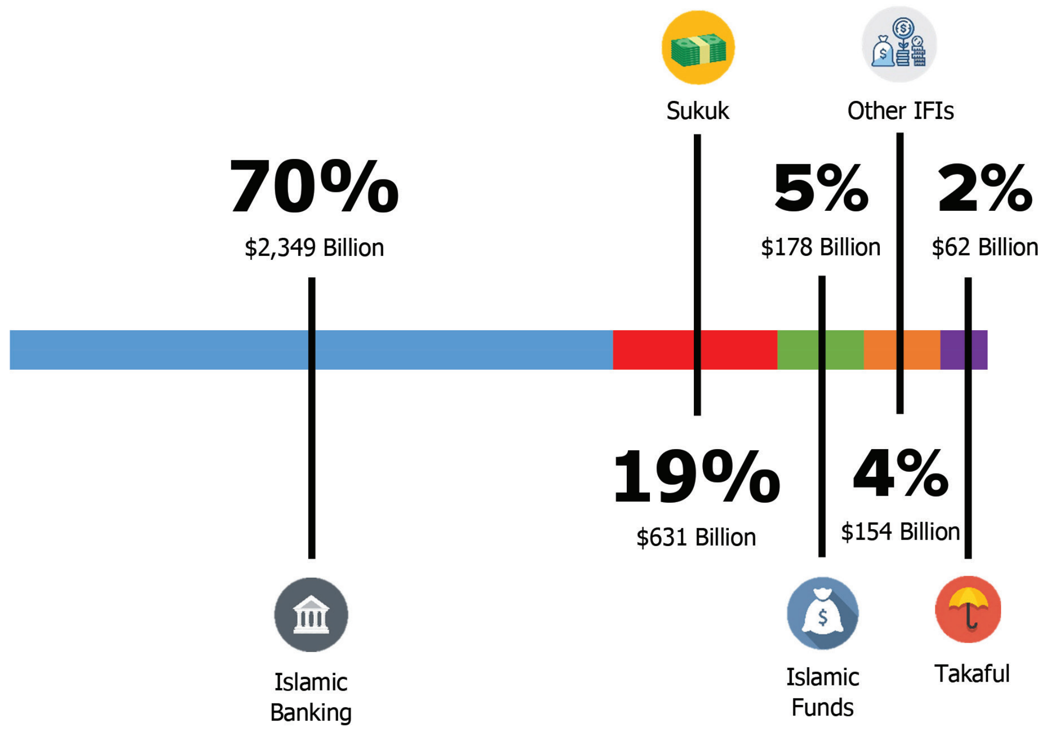


Figure 1.3: Islamic Finance Assets Distribution in 2020

Source: *Islamic Financial Development Report 2021* (ICD-REFINITIV, 2021)

In 2020, the global Islamic finance ecosystem comprised about 1,595 IFIs around the world; with about 1,235 *Shari'ah* scholars representing IFIs throughout the world. Total expenditures on Corporate Social Responsibilities of these IFIs reached USD1.28 billion. Lastly, about 844 Islamic finance events have been organised and more than 11,856 news on Islamic finance had been released (ICD-REFINITIV, 2021).

1.2 Innovation in Islamic Finance

Financial innovations transform traditional financial and banking markets into highly sophisticated markets featuring high degrees of liquidity and a wide array of instruments to share and transfer various sources of risk. Three basic financial innovation activities pertain to the objecting of enhancing liquidity, transferring or de-risking of financial contracts, and generating greater revenue to the financial institution (Figure 1.4).

Figure 1.4: Financial Innovation Basic Activities

Source: *Alamad* (2017)

Financial innovation can be viewed as a process of building complex instruments utilising basic building blocks or unbundling and repackaging different components of existing financial instruments, e.g., return, price risk, credit risk etc. However, Islamic finance innovators incorporates in their innovation approach the ability to offer a new perspective, framework, and product to the public, and not simply a creative replication of existing products presented as *Shari'ah* compliant. In other words, while innovations are a given when designing Islamic financial products or services to ensure that they do not contravene *Shari'ah* rules in any way, they must also contribute to manifesting Islamic values in financial practices better: helping society achieve economic justice, minimising inequality in hopes of leading said society to real prosperity. The following Figure 1.5 highlights some expectations on innovations in Islamic finance.

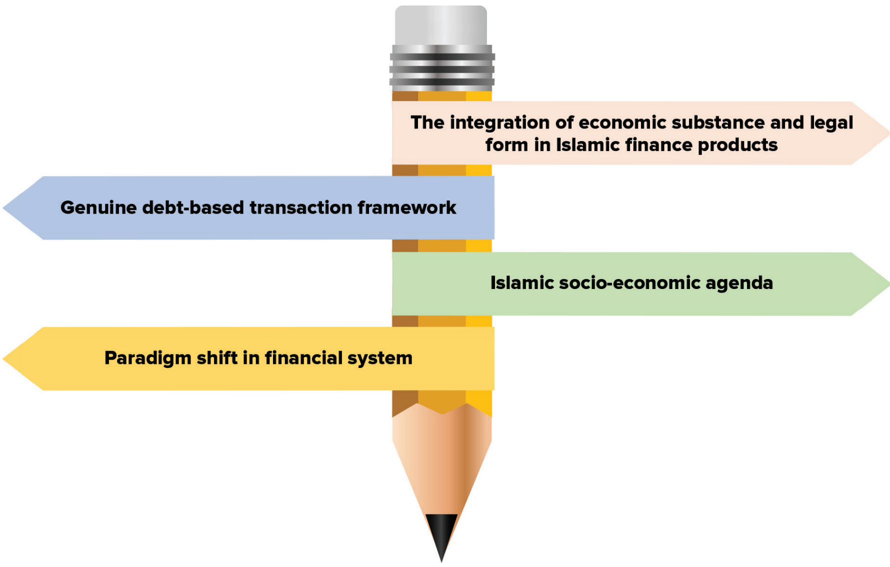


Figure 1.5: Expectations on Innovation of Islamic Finance

Source: *Laldin & Furqani* (2016)

Islamic finance first began to be introduced to the market in 1990's through a limited number of services, predominantly deposit-taking and retail financing schemes, both of which were aimed to provide non-interest options to Muslim bank customers. Today, through innovations Islamic finance is a fully integrated financial system which spans continents. Much of the expansion is concentrated in emerging markets, particularly in countries with Muslim majorities, but has now becoming more widespread in Europe and the Far East.

Modernisation of the Islamic finance practice has been driven in part by digital advances in customer services and management. While there has been some pushback from more conventional customers, many of whom would prefer to conduct their business in a traditional brick-and-mortar bank, the digital revolution has been picking up momentum particularly during the COVID-19 lockdown phases. New services such as online and mobile banking and payment services have become mainstreamed. Islamic financial institutions are also responding to the emergence of digital currencies and the blockchain which underpins them.

Digital technology is changing the financial services landscape. As customers continue to seek faster and more personalized services from banks, robotics, and automation have emerged as viable tools. Robo-advice, for example, can be both cost and time effective. Aside from fintech, other Islamic microfinance models have had a larger impact over the last couple of years. Platforms such as micro-*takaful* and social finance have gained traction. There is a burgeoning demand in Muslim-majority countries like Malaysia and Indonesia for fintech products and services – and trends where companies are investing massively in digital technologies to cope with the huge demand from governments and corporations. Companies need to introduce new *Shari'ah*-compliant financial products that can help Islamic banks become more efficient when navigating complex transactions (Summerfield, 2017). The following Figure 1.6 portrays a depiction of the complexity within the fintech framework in Islamic finance.

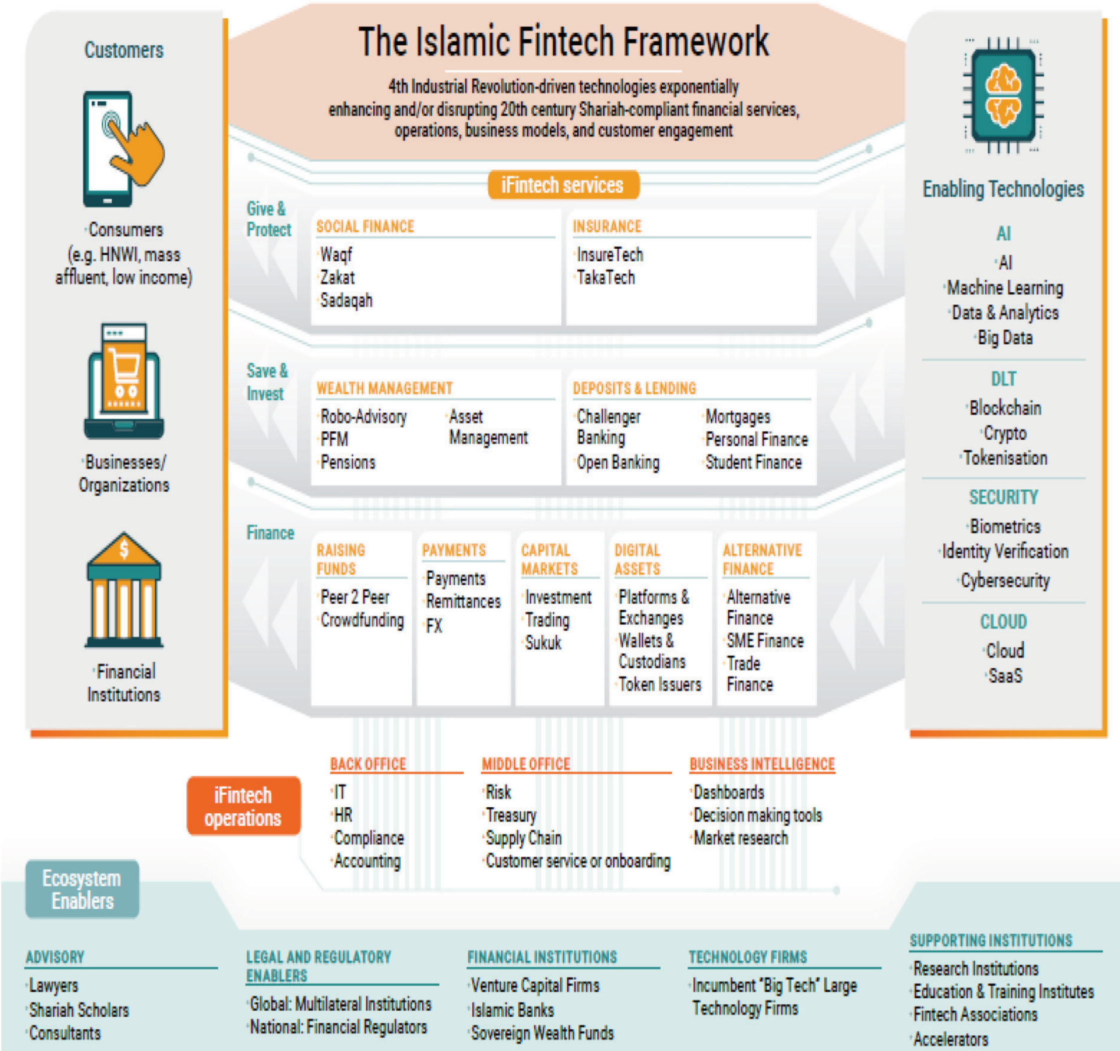


Figure 1.6: Islamic FinTech Framework

Source: *Global Islamic FinTech Report 2021* (DinarStandard, 2021)

Engagement between enablers, customers and enabling technologies is undoubtedly critical for Islamic finance to fulfil its potential and grant the scale, access, and outreach it needs to connect with would-be customers in developing markets. Islamic finance is increasingly considered as an alternative source of funds for many companies, particularly as the industry embraces fintech. Thanks to the nascent appeal of fintech, the Islamic finance model will continue to go from strength to strength.

1.3 Islamic Finance's Development in Malaysia

Islamic finance in Malaysia has undergone three broad phases of development over the last four decades – foundation-building, mainstreaming, as well as driving diversification and innovation, which is shown in Figure 1.7.

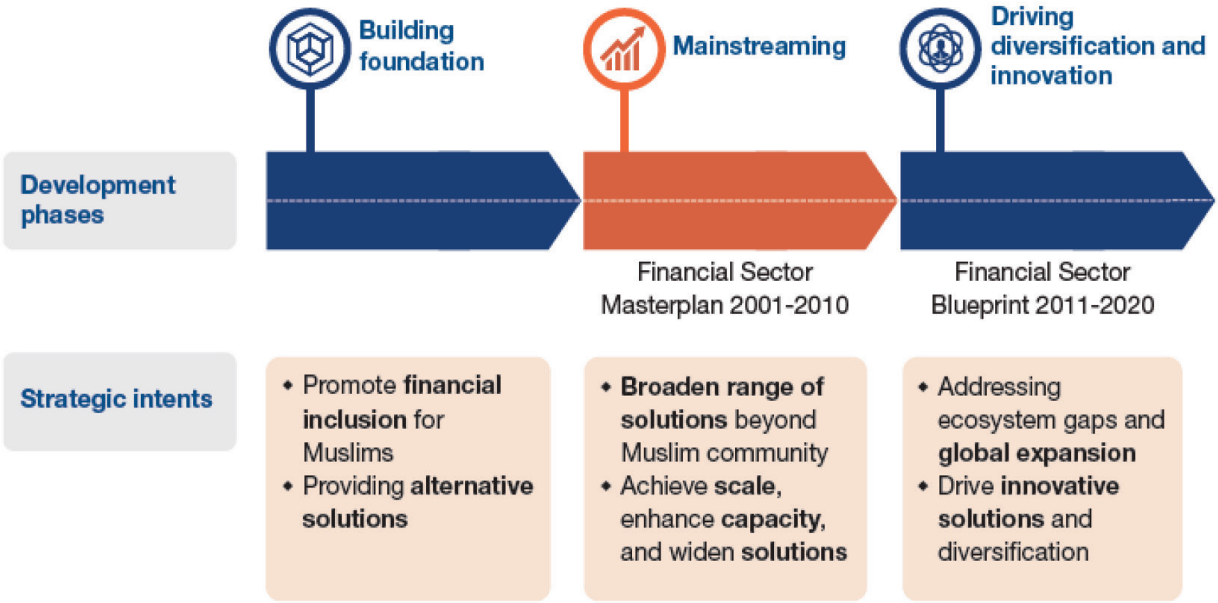


Figure 1.7: Phases of Development Over the Last Four Decades

Source: *Financial Sector Blueprint 2022-2026* (BNM, 2022)

Malaysia's global leadership in Islamic finance is the result of concerted efforts by the government, financial regulators, and industry players. Over the years, a wide range of initiatives have been advanced – to set up the overall enabling legal and regulatory environment, rolling out structural reforms to align strategies, addressing market frictions and incentives, as well as building long-term capacity of the financial industry players. Malaysia has also contributed to the development of global infrastructures to promote Islamic finance development, such as the setting up of the Islamic Financial Services Board (IFSB) and the International Islamic Liquidity Management Corporation (IILM), which are both headquartered in Malaysia. Today, Malaysia's mature Islamic finance ecosystem features dynamic and resilient players, diverse products and enabling infrastructures (see Figure 1.8).

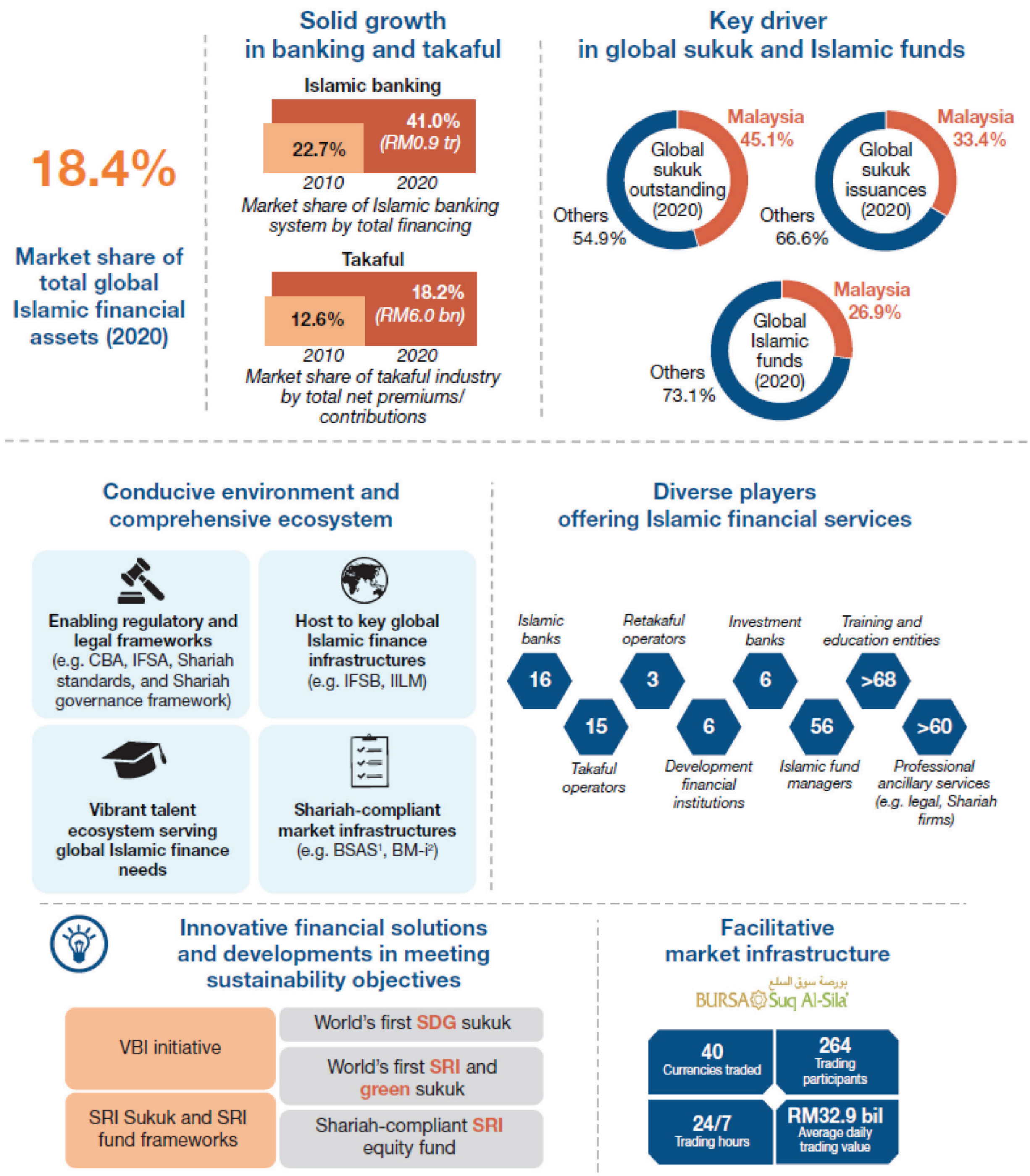


Figure 1.8: Highlights of Malaysia's Islamic Finance Ecosystem

Source: *Financial Sector Blueprint 2022-2026* (BNM, 2022)

Malaysia's reputation as the leader of Islamic finance in the world is well-established. For instance, in the last three years Malaysia maintained its top five positions in the Islamic Finance Country Index (IFCI) by the *Global Islamic Finance Report*. Malaysia; topping the index in 2016, 2017, 2018, 2019 and 2020. The report also placed Malaysia at the top of the list in terms of developing a coherent and comprehensive Islamic financial policy, contributed by the issuance of IFSA 2013 and other Islamic finance guidelines and frameworks developed by Bank Negara Malaysia (BNM) and Securities Commission Malaysia (SC) (GIFR, 2021).

Table 1.1: Top 5 Most Developed Countries in Islamic in 2020

Countries	2021 Score	2020 Score	2019 Score	2021 Rank	2020 Rank	2019 Rank
Malaysia	80.01	83.33	81.93	3	1	1
Indonesia	83.35	82.01	81.01	1	2	2
Iran	79.73	79.99	79.03	4	3	3
Saudi Arabia	80.67	66.01	60.65	2	4	4
Pakistan	60.23	53.12	36.88	5	6	10

Source: *Global Islamic Finance Report 2021* (GIFR, 2020)

The *State of the Islamic Economy Report* placed Malaysia as the global leader in development of Islamic ecosystems for eight consecutive years starting from 2013 (see Figure 1.9). Malaysia also topped the Global Islamic Economy Indicator (GIEI), for example in 2020, for its success in developing its Islamic financial sectors (DinarStandard, 2020).

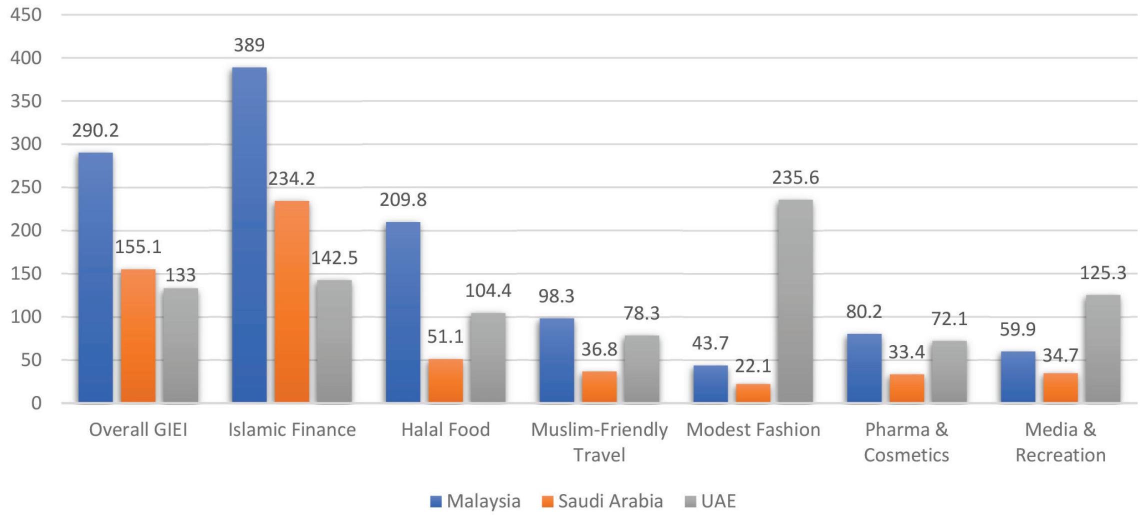


Figure 1.9: Top 3 Most Developed Countries in Islamic Economy in 2020/2021

Source: *State of the Islamic Economy Report 2020/2021* (DinarStandard, 2020)

The *Islamic Financial Development Report 2021* ranked Malaysia first with the score of 114, Indonesia in second place with a score of 76. Islamic Financial Development Indicators (IFDI) also show that Malaysia is leading in quantitative development, knowledge, awareness, and governance in this sector (See Figure 1.10) (ICD-REFINITIV, 2021).

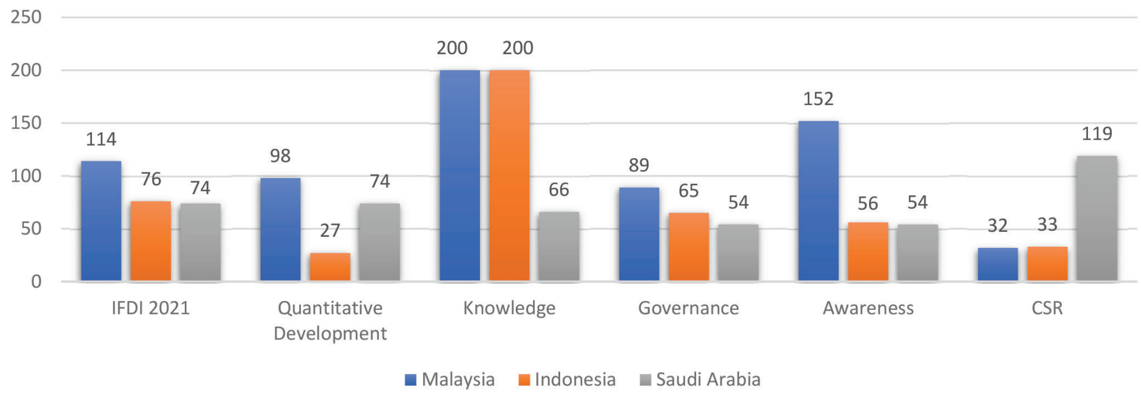
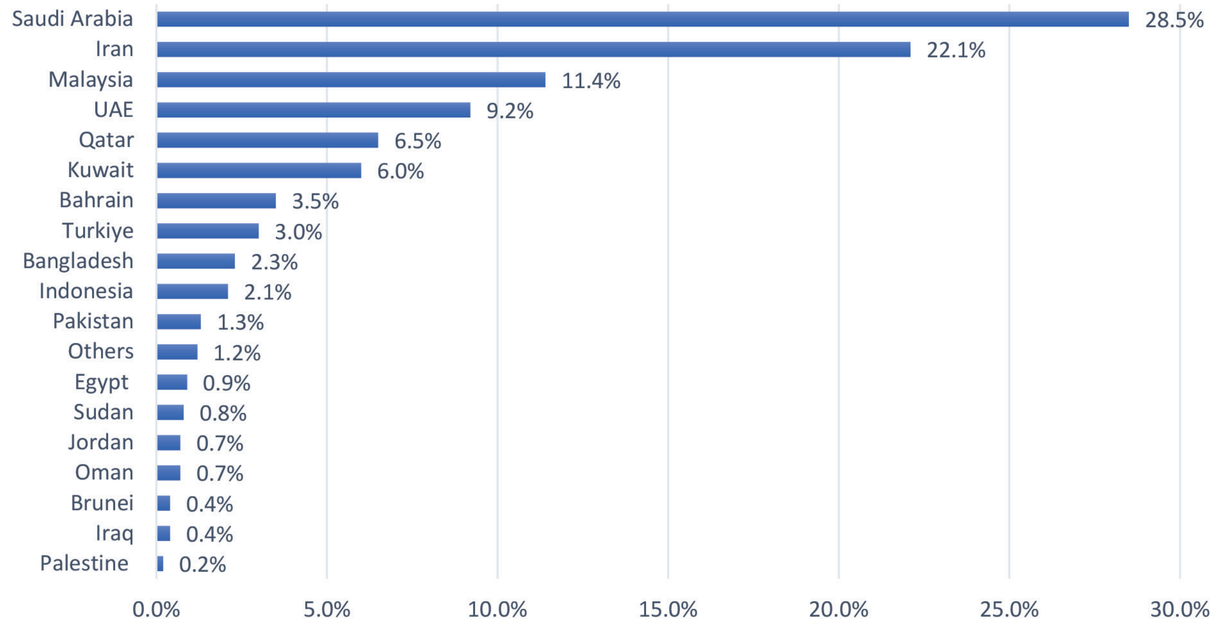


Figure 1.10: Top 3 Most Developed Countries in Islamic Finance in 2021

Source: *Islamic Finance Development Report 2021* (ICD-REFINITIV, 2021)

The *Islamic Financial Services Industry Stability Report 2021* produced by the Islamic Financial Services Board (IFSB), Malaysia was the third biggest country in terms of Islamic financial assets with approximately 11.4% from the total global Islamic financial assets. Besides, Malaysia also is the biggest *sukuk* market with the approximate 47.3% of the total *sukuk* in the world (see Figure 1.11) (IFSB, 2021).



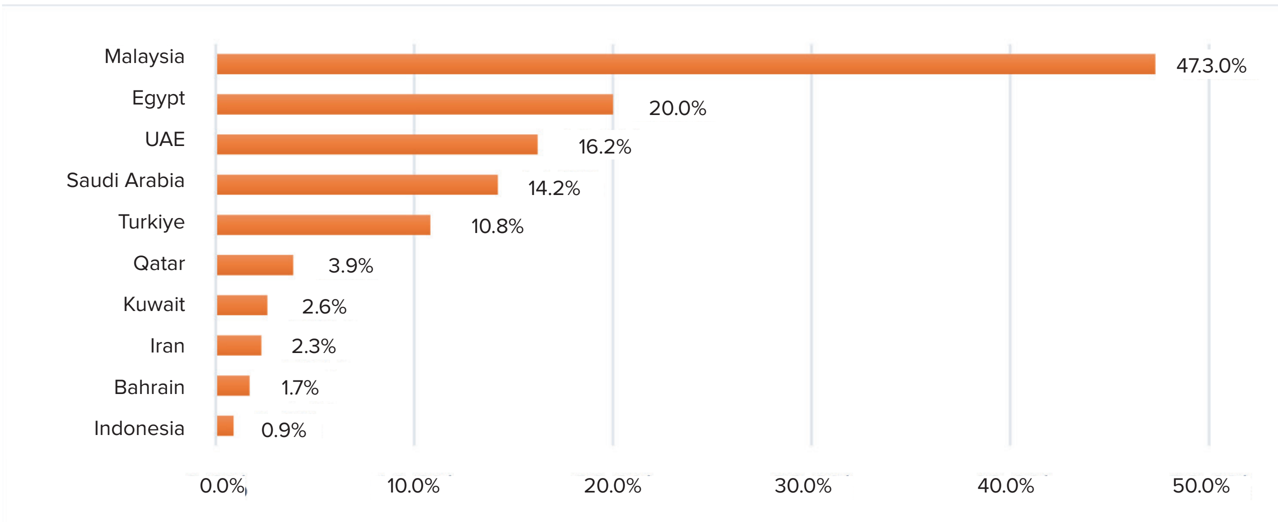


Figure 1.11: Share of Global Islamic Banking Assets and Global Sukuk Market 2021

Source: *Islamic Financial Services Industry Stability Report 2021* (IFSB, 2021)

1.4 Islamic Finance's Development in Indonesia

Indonesia is one of the countries with a strong presence within the Islamic finance industry and often highly ranked in the world rankings. The Islamic Finance Development Indicator (IFDI) 2021 ranked Indonesia at 2nd place, with an increasing score on the aspects of knowledge and CSR. Meanwhile according to the State of the Global Islamic Economy Report 2020-2022, Indonesia is ranked 4th in the Global Islamic Economy Indicator Score Rank in the 2020/2021 edition (see Figure 1.12 below).

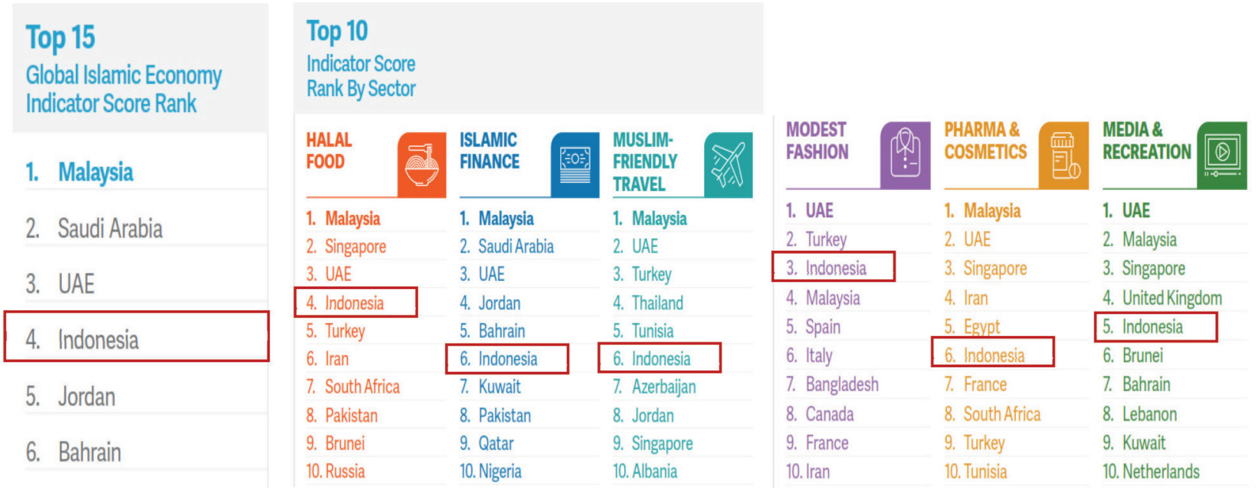


Figure 1.12: Top 5 Most Developed Countries in Islamic Economy in 2020/2021

Source: *State of the Islamic Economy Report 2020/2021* (DinarStandard, 2020)

Similar to Malaysia, Islamic Finance industry began to flourish in Indonesia in the 1990s and has since grown in leaps and bounds. The first Islamic Bank was established in 1991, Bank Muamalat Indonesia, the first Islamic insurance company, PT Syarikat Takaful Indonesia in 1994, and the first Shari'ah mutual fund product was rolled out by PT Danareksa Investment Management in 1997. Through these and other milestones, Indonesian Islamic Finance eco-system has progressed into a comprehensive one as seen today (Figure 1.13).

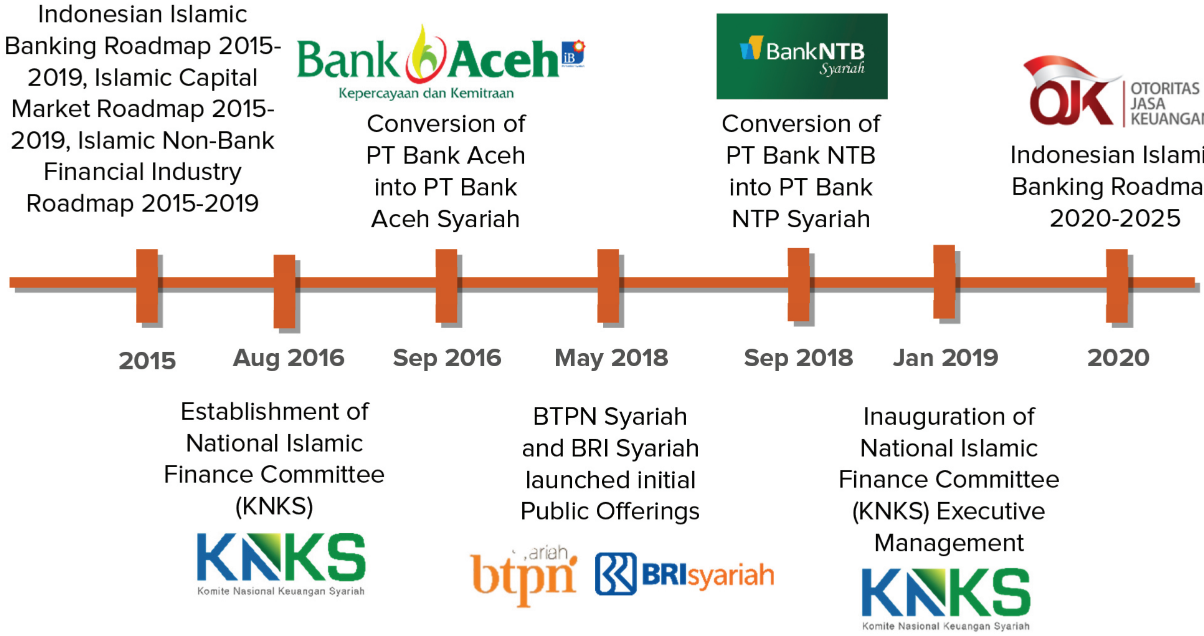


Figure 1.13: Milestone of the Indonesian Islamic Finance Industry

Source: *Indonesia Islamic Banking Development Roadmap 2020-2025* (OJK, 2020)

The Indonesian Islamic finance business has grown significantly, even though it is still relatively modest on a national basis. In terms of development, Indonesia's Islamic finance industry differs from that of other nations such as Malaysia and the Gulf Cooperation Council (GCC) countries, which place a greater emphasis on investment banking and Islamic financial products. Its industry is primarily focused on the retail banking segment. Today Indonesia has the largest Islamic financial service institutions and Islamic finance customers in a single jurisdiction, as well as Shari'ah People's Financing Banks (BPRS) and informal Islamic microfinance institutions.

Indonesia's Islamic Finance eco-system components are illustrated in Figure 1.14 below. The Indonesian *Shari'ah* Financial Services Sector consists of three subsectors, namely, *Shari'ah* banking, *Shari'ah* non-bank financial industry (IKNB) (consisting of insurance, financing companies, other *Shari'ah* non-bank institutions), and *Shari'ah* capital market (consisting of state Sukuk, Sukuk corporations, and *Shari'ah* mutual funds). Indonesia's total Islamic financial assets (excluding *Shari'ah* shares) stood at USD138.18 billion (Rp2,050.44 trillion) in 2020.

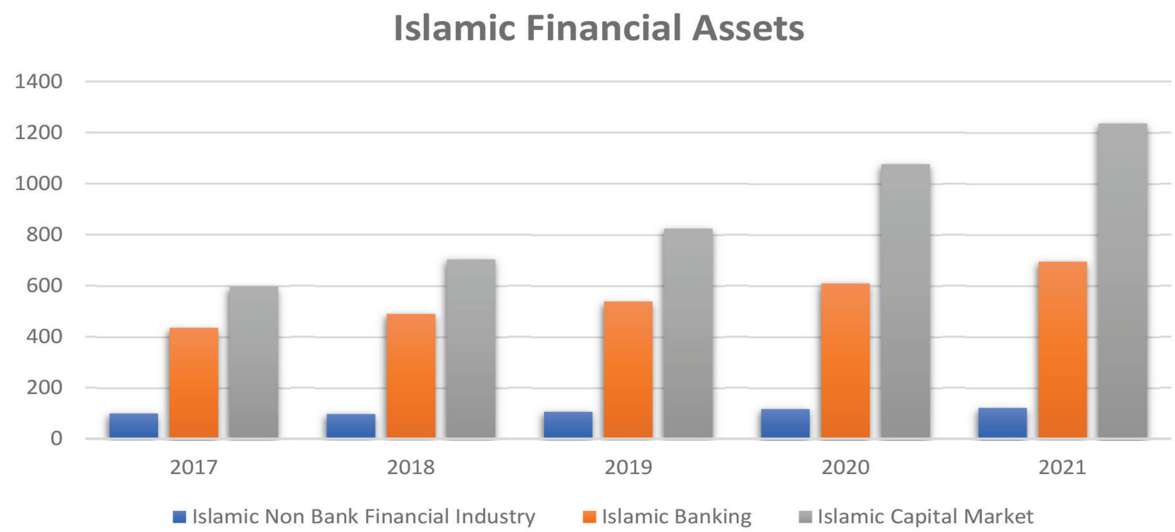


Figure 1.14: Growth of Indonesian Islamic Financial Assets (trillion Rupiah)

Source: *Financial Services Authority* (2021)

Indonesia's Islamic financial assets grew 13.82 percent year on year to USD138.18 billion (Rp2,050.44 trillion) in the second year of the COVID-19 epidemic, up from USD121.4 billion (Rp1,801.40 trillion) the year before. The Islamic Capital Market, which has the biggest percentage of Islamic financial assets (60.27 percent), grew at the fastest pace of 14.83 percent among other sectors. Islamic banking, which now accounts for 33.83 percent of all Islamic financing, increased by 13.94 percent. In the meantime, *Shari'ah* IKNB, which accounts for 5.90 percent of total Islamic financial assets, grew by 3.90 percent. This is shown in the following Table 1.2.

Table 1.2: Indonesian Islamic Financial Assets 2021

Islamic Financial	Market Share to National Finance	Share of Islamic Financial Assets	Assets (Trillion Rupiah)	Number of Institution/instruments
Islamic Banking	6.74%	33.83%	693,80	12 Islamic Commercial Bank
				21 Islamic Business Unit
				164 Islamic People's Financing Bank (BPRS)
Islamic Non-Banking Financial Industry	4.25%	5.90%	120,81	59 Takaful
				33 Islamic Financing Company
				6 Venture Capital
				10 Islamic Pension Fund
				105 Other Islamic non-Bank financial industry
Islamic	17.37%	60.27%	1.235,83	1 Islamic Investment Management
				60 Islamic Investment Management Unit
				69 State Sukuk (outstanding)
				189 Corporate Sukuk (outstanding)
				289 Islamic Mutual Funds (outstanding)
Total	10.16%	100%	2.050,44	

Source: *Financial Services Authority* (2021)

In 2019, the Indonesia Islamic Banking Roadmap 2015-2019 was launched marking the beginning of a new chapter in Indonesia's Islamic banking journey. The market share of Islamic banking assets climbed to 6.24 percent in September 2020, up from 4.87 percent in 2015. Changes in global conditions, macroeconomic conditions, technology, demography, and the micro-economy, all have influenced Indonesia's financial environment creating opportunities for Islamic banking to gain a bigger market share. A new vision for 2020-2025 was launched immediately to spur Indonesia's Islamic banking growth. The new roadmap is illustrated in Figure 1.15.

Opportunities and Challenges

Rapid advancement of technology and digitalization	Economic growth in the halal sector	Increasing religious awareness amongst people
Strengthening Islamic Banking Identity 1. Strengthening Shari'ah values implementation 2. Developing unique and competitive Shari'ah compliant products 3. Strengthening capital and efficiency 4. Accelerating Islamic Banks' digitalization	**Encouraging Synergy Within Islamic Economic System** 1. Synergy with Halal Industry 2. Synergy among Islamic Financial Institutions 3. Synergy with Islamic Social Financial Institutions 4. Synergy with Government Ministries and agencies 5. Increasing public awareness within the Islamic economic eco-system framework	**Strengthening Licensing, Regulation and Supervision** 1. Accelerating the licensing process through technology adoption 2. Developing credible and effective regulations 3. Strengthening capital and efficiency

Enablers

Leadership and Change Management	HR Quality and Quantity	Information Technology Infrastructure	Sectoral/Inter-Department Cooperation and Collaboration

Figure 1.15: Direction of Development of Indonesian Islamic Financial Services Sector

Source: Adopted from *Indonesia Islamic Banking Development Roadmap 2020-2025* (OJK, 2020)

2. Case Study 1: Retail Sukuk

2.1 Malaysian Sukuk Prihatin: Background

The COVID-19 pandemic has caused an unprecedented global economic impact of significant magnitude. Many sectors of the economy, specifically the tourism, hospitality, and aviation sectors, had temporarily ceased operations due to movement control policies which led towards economic slowdown in many countries. The Malaysian economy recorded massive losses since the lockdown was enforced in March 2020, while more than 40 percent of small and medium sized enterprises in the country reported financial unsustainability, affecting livelihood of more than one million employees.

In response to the COVID-19 crisis, the government launched the National Economy Recovery Plan known as PENJANA which adopts the 6R strategy (Resolve, Resilience, Restart, Recovery, Revitalize and Reform). A huge stimulus package of USD8.06 billion (RM35 billion) was allocated to fund economic recovery initiatives. The focus was to rebuild the economy by providing temporary subsidies and cash assistance to low-income households, reducing unemployment, facilitating growth of digital business, and improving confidence of consumers and investors.

To raise funds for the stimulus package the government issued two long term sovereign sukuk worth USD943 million (RM4.1 billion) in 2020. In addition, a national trust account was established, Kumpulan Wang COVID-19 (COVID-19 Consolidated Fund) to receive contributions from the public and institutions to fund public health expenditures including to support the country's vaccination programs. Given tight fiscal conditions due to lower oil prices in the global market, mobilization of resources from new sources, including direct from the public via non-tax measures need to be explored. Hence, a retail Shari'ah debt instrument, Sukuk Prihatin, was rolled out in August 2020, to rally public contribution in supporting the national COVID-19 response and rebuilding costs.

Through the sukuk, the government aimed to raise USD115 million (RM500 million) which would then be channelled to Kumpulan Wang Amanah COVID-19 to support three specific government initiatives (Figure 2.1). In just a one-month of its launch (18 August 2020 – 17 September 2020), the Sukuk was oversubscribed by up to USD151.7 million (RM660 million).

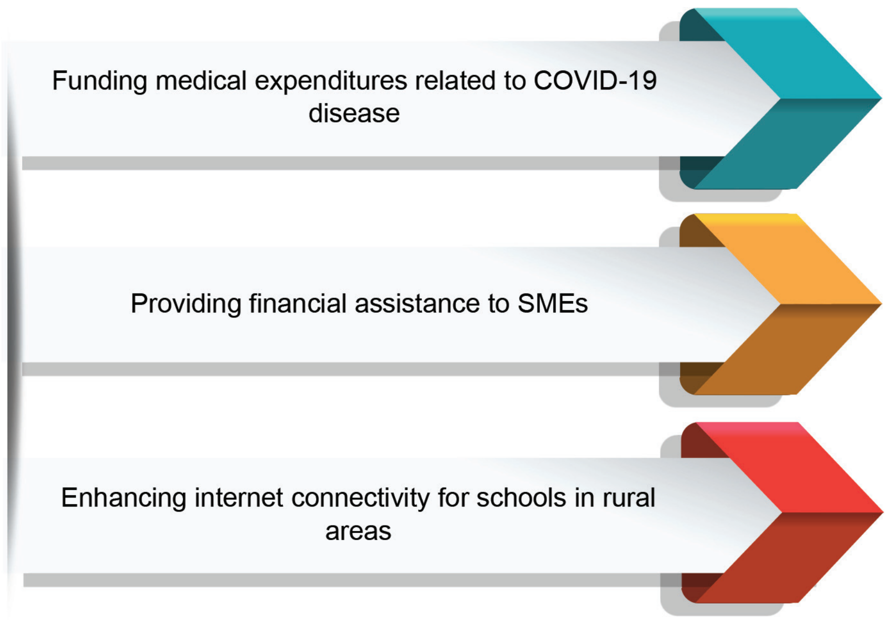


Figure 2.1: Three Specific Initiative by Sukuk Prihatin

Source: *Sukuk Prihatin Knowledge Pack* (MOF, 2020)

Sukuk Prihatin is regarded as an important innovation for Malaysia because this is the first time in Malaysia a retail sukuk is offered to individuals and corporate investors and via a digital platform. The online subscription is a commendable achievement and strengthens Malaysia's position as the leading country in the global Islamic fintech index (DinarStandard, 2021).

2.2 Key Players - Institutional Enablers

Institutional enablers involved in the issuing of Digital Sukuk (Sukuk Prihatin include the Ministry of Finance (MOF), Central Bank of Malaysia (BNM), Malaysian Stock Exchange (Bursa Malaysia) and a network of selected commercial banks.

2.2.1 Role of the Ministry of Finance

The government of Malaysia is the issuer of Sukuk Prihatin. MOF represents the government in the issuing process and acts as the obligor of the Sukuk.

2.2.2 Role of the Bank Negara Malaysia (BNM)

BNM facilitates the commodity murabahah transactions forming the underlying contract of the Sukuk structure. BNM acts as the agent on behalf of sukukholders and MoF, undertaking commodity murabahah transaction in the Bursa Suq al-Sila' platform.

2.2.3 Role of the Bursa Malaysia

Bursa Suq al-Sila' is a platform where commodity trading is transacted. The platform is managed by Bursa Malaysia.

2.2.4 Role of Distribution Bank

Maybank as the largest banking institution in the country had been appointed as the primary distribution bank. As the primary distribution bank, Maybank's main task was to coordinate the subscription, collect proceeds and consolidate data from all other 26 distribution banks. Nine of the 26 banks were foreign banks but incorporated in Malaysia. All distribution banks created their own websites to promote and facilitate Sukuk Prihatin subscription from retail customers. Table 2.1 below shows the list of banks that were involved in the distribution of Sukuk Prihatin.

Table 2.1: Sukuk Prihatin's Distribution Banks

No.	Name of Bank	No.	Name of Bank
1.	Affin Bank Berhad	15.	Hong Leong Bank Berhad
2.	Bank Pertanian Malaysia Berhad (Agrobank)	16.	HSBC Bank Berhad
3.	Alliance Bank (Malaysia) Berhad	17.	Industrial and Commercial Bank of China (Malaysia) Berhad
4.	Al-Rajhi Bank (Malaysia) Berhad	18.	Malayan Banking Berhad
5.	AmBank (Malaysia) Berhad	19.	MBSB Bank Berhad
6.	Bank Islam Malaysia Berhad	20.	MUFG Bank (Malaysia) Berhad
7.	Bank Muamalat Malaysia Berhad	21.	Mizuho Bank (Malaysia) Berhad
8.	Bank Kerjasama Rakyat Malaysia Berhad	22.	OCBC Bank (Malaysia) Berhad
9.	Bank of China (Malaysia) Berhad	23.	Public Bank Berhad
10.	Bank Simpanan Malaysia Berhad	24.	RHB Bank Berhad
11.	BNP Paribas Malaysia Berhad	25.	Standard Chartered Bank (Malaysia) Berhad
12.	CIMB Bank Berhad	26.	Sumitomo Mitsui Banking Corporation (Malaysia) Berhad
13.	Citibank Berhad	27.	United Overseas Bank (Malaysia) Berhad
14.	Deutsche Bank (Malaysia) Berhad		

Source: *Sukuk Prihatin Knowledge Pack* (MOF, 2020)

2.3 Sukuk Prihatin Process Flow and Subscription Platform

Sukuk Prihatin is structured based on commodity murabahah contracts, more commonly known as *bay' tawarruq*. The sukuk issuance involves a few steps as illustrated in the diagram. First, sukuk holders will appoint Bank Negara Malaysia (BNM) to act on their behalf to undertake a commodity murabahah transaction. Then, BNM will purchase commodities from Bursa Suq al-Sila' on a spot basis. Upon completion of the purchase, BNM on behalf of the sukuk holders will sell the commodity to the Malaysian government at cost plus mark-up price to be paid on a deferred payment basis. The government of Malaysia then issues Sukuk Prihatin to sukuk holders as evidence of ownership of the commodities and the proceeds are used to pay the purchase price. The following Figure 2.2 highlights the Sukuk Prihatin underlying contract structure.

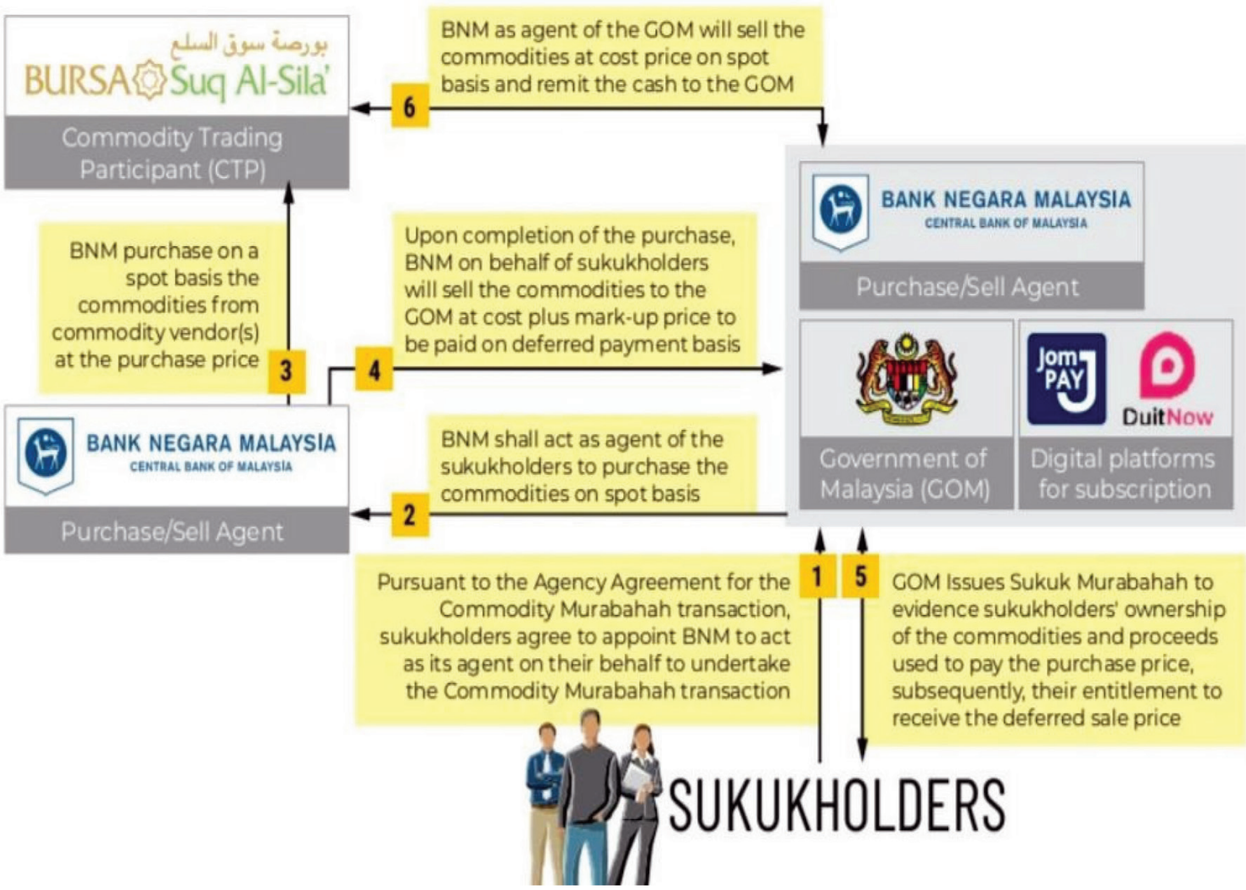


Figure 2.2: Sukuk Prihatin Sukuk Structure

Source: S*ukuk Prihatin Knowledge Pack* (MOF, 2020)

Because of its digital nature, Sukuk holders were not issued a physical certificate upon Sukuk Prihatin's subscription. An application for the Sukuk Prihatin is considered received when a completed transaction notice appeared on the screen after the payment was completed. Sukuk holders may download a copy of the transaction notice from the distribution bank's online banking platform. The applicant was only considered a successful Sukuk holder of the Sukuk Prihatin after the applicant received the subscription notice.

The proof of application and the subscription notice must be kept by sukuk holders as a record. Sukuk holder receives a monthly e-statement via the e-mail address registered by the applicant during the application from the Primary Distribution Bank. This e-statement is essential to the Sukuk holders for tax claim purposes (equivalent to a tax voucher). Figure 2.3 illustrates the process flow of a Sukuk Prihatin subscription. Further Sukuk Prihatin subscription information is in Table 2.2.

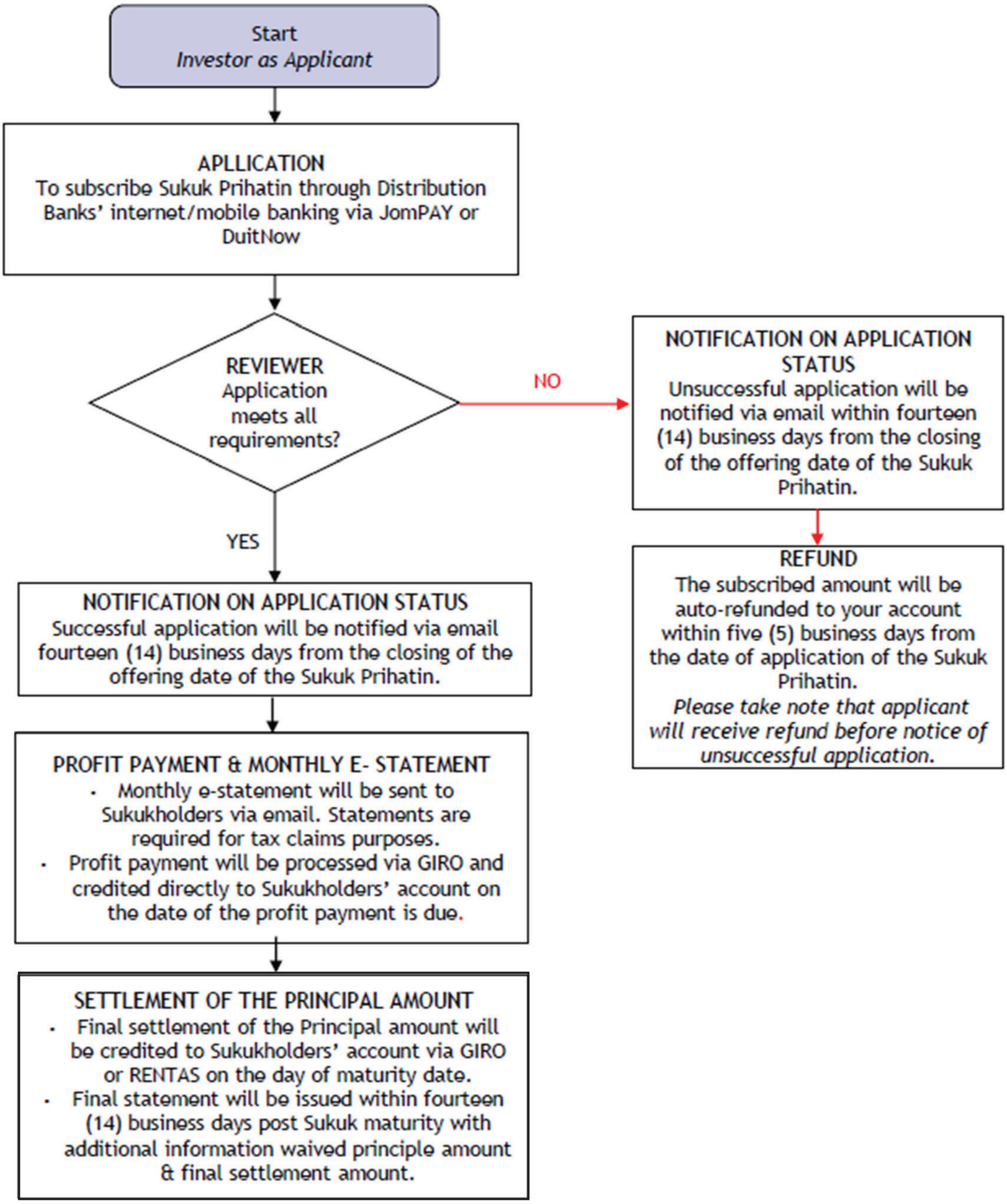


Figure 2.3: Sukuk Prihatin Process Flow

Source: S*ukuk Prihatin Knowledge Pack* (MOF, 2020)

Table 2.2: Sukuk Prihatin Subscription Information

Aspect	Details
Return	Two percent profit rate per annum payable quarterly over two years period.
Eligible Investors	All Malaysian who are above 18 years old, a company, corporation, cooperative, foundation, sole proprietorship, partnership, association or other incorporated bodies operating in the country.
Subscription	The minimum amount of sukuk subscription is USD115 (RM500). Additional investment in multiples of USD23 (RM100). No maximum subscription limit.
Shari'ah Compliant Endorsement	*Shari'ah* Advisory Council of Central Bank of Malaysia.
Platform	JomPAY or DuitNow (internet online banking channels)
Sukuk Certificate	Proof of Application and the Subscription Notice.
Report	Monthly e-statement via e-mail registered. e-statement can be used for tax claim purposes (equivalent to tax voucher).
Unique Feature	Sukuk Holders can waive the principal amount due (in part or in full) on maturity date, as contribution to COVID-19 relief measures.

Source: *Sukuk Prihatin Knowledge Pack* (MOF, 2020)

The illustration on how the profit is calculated and distributed to investors is in Figure 2.4.

PROFIT PAYABLE CALCULATION FORMULA

Profit Rate ("PR") x Nominal Value ("NV") x (1/Frequency of payment) x (Actual/Actual)

Assumptions:

PR : 2.0% per annum

Nominal Value : USD230 (RM1,000)

PROFIT PAYABLE CALCULATION ILLUSTRATION

= 2.0% x USD230 (RM1,000) x (365 days / 365 days)

= USD4.6 (RM20.00)

Since profit is paid quarterly, the profit payment per payment period is:

= USD4.6 (RM20.00) x (1/4) x (90 days / 90 days)

= USD1.15 (RM5.00)

Figure 2.4: Sukuk Prihatin Profit Payable Illustration

2.4 Success Factors, Challenges, and Impact

2.4.1 Impact of Sukuk Prihatin

The main objective in issuing Sukuk Prihatin is to provide a platform for the people to contribute towards assisting those severely affected by the COVID-19 pandemic. The government intended to rally the public's spirit of togetherness in facing and overcoming the health and economic crisis of the COVID-19 pandemic. Support for Sukuk Prihatin was evidently high as it was oversubscribed by 1.32 times in just one month period of offer.

Although the return offered is modest (2 percent) compared to the previous retail government issued Sukuk Merdeka (5 percent), many people were committed to invest in the Sukuk Prihatin. This shows that the success of Sukuk Prihatin in gaining the confidence of the people resulted from the inclusion of a charitable element paired with the investment instrument for the recovery of the economy. The return is slightly higher than the average fixed deposit dividend rate offered by local banks (1.8 percent) during the pandemic. Hence, Sukuk Prihatin was considered an acceptable investment for risk-calculated types of investors.

Funds raised under Sukuk Prihatin are mobilized into the following specific areas as shown in Figure 2.5.

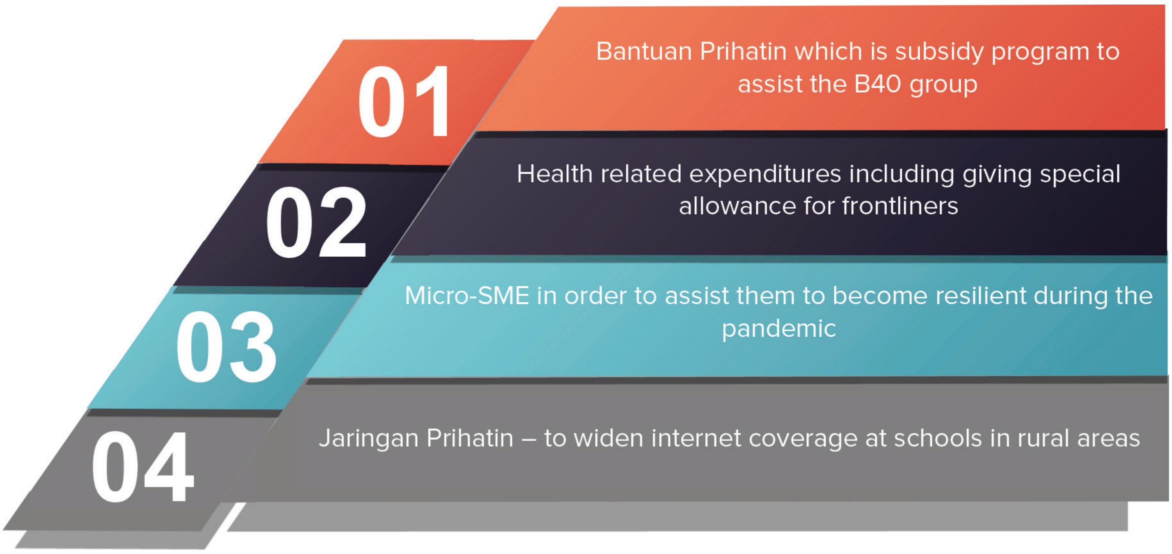


Figure 2.5: Sukuk Prihatin Focus Area

Source: *Sukuk Prihatin Knowledge Pack* (MOF, 2020)

"*Among the programs under* COVID-19 *fund are for People's Concerned Aid (Bantuan Prihatin Masyarakat) for the B40 group, wage subsidy program and more importantly all the health-related expenditure which is directly related to* COVID-19*, for example to purchase all the supplies, payment of the allowance to the frontliners, and also all the medical devices, items, equipments, and also all expenditures related to the* COVID-19 *pandemic. On top of that, grants or funding to micro SMEs and Internet for all (Jaringan Prihatin) program which is to widen the internet coverage for the rural school. So overall in terms of successfulness, we managed to collect USD137.9 million (RM600 million) Sukuk Prihatin and transferred to this* COVID-19 *fund so we can say that all these objectives were well fulfilled and managed to achieve the objective*"

(Ministry of Finance Malaysia Officer 1)

Source: *Islamic Finance Case Studies Focus Group Discussion (2022)*

In practice, Sukuk Prihatin funds are combined with other government resources into the COVID-19 Consolidated Trust Fund (CTF). The government monitors and assesses the impact of financial assistance distributed to various groups in the society and they are published on the MOF website as PRIHATIN's implementation report or Laksana on a weekly basis.

Impact of Sukuk Prihatin and other COVID-19 responses falls under many of The Sustainable Development Goals (SDG) targets for Malaysia; SDG 1, SDG 2, SDG 3, SDG 4 and SDG 8 (Figure 2.6).

Figure 2.6: Sustainable Development Goals Linked to Sukuk Prihatin

Source: *Islamic Finance Case Studies Focus Group Discussion (2022)*

Cash assistance provided to the low-income households helped them cope with income shortfall and emergency needs. A significant amount of funds from the Sukuk Prihatin were also allocated to provide special allowances to more than 2.5 million COVID-19 front liners. Assistance was also directed at closing the digital gap between demographics and regions that have access to modern information and communications technology (ICT), which particularly affected students during school and university closures. As of September 2021, 26,197 SMEs have benefited from various financial assistance including Special Relief Facility (SRF), Automation and Digitalization Facility (ADF) and Agro Food Facility (AFF).

Various factors led to Sukuk Prihatin's success (Figure 2.7). Firstly, the retail offering came at a timely juncture when the economy is weak and individual and corporate investors were looking for a good investment channel to invest in. Being a government issuance, the Sukuk was considered inherently less risky than corporate issuances. Secondly, the method of subscription via commercial bank's online platforms allowed the public to easily apply to purchase the Sukuk, the process not unsimilar to how bank customers can apply to open a savings or current account online. There was no requirement for applicants to present their applications and documents physically at the bank, since the country was already in full lockdown mode when the Sukuk was issued. Thirdly, Sukuk Prihatin's nature as a social impact bond (also known as a social benefit good or social bond) is a type of financial security that provides capital to the Government to fund activities that create better social outcomes in the immediate and medium term. More importantly, it created a partnership between the public, private and voluntary sectors to help solve the country's challenges through a clear focus upon delivering the outcomes desired in its battle against COVID-19.

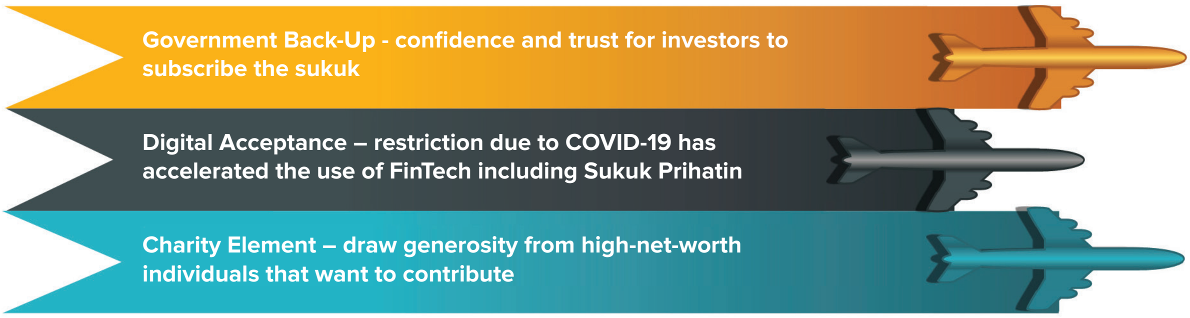


Figure 2.7: Strengths of Sukuk Prihatin

Source: *Islamic Finance Case Studies Focus Group Discussion (2022)*

"*In terms of the impact I think Malaysian sukuk has made an impact on the economy and society. The bond market, in general we are 3rd in Asia and as far as sukuk is concerned we are still leading as far as the issuance is concerned as well as outstanding sukuk in the world*"

(Securities Commission of Malaysia Officer 1)

Source: *Islamic Finance Case Studies Focus Group Discussion (2022)*

The Sukuk's issuance and promotion were not without its challenges. While it provides a low-risk and philanthropic investment opportunity to the public, the sukuk came out amidst a number of competing investment products. The digital issuance modality also may have restricted participation among rural population, senior citizens or groups with limited digital access and literacy (Figure 2.8):

Competing Investment Products	Restricted Access Among Digitally-challenged groups

Figure 2.8: Challenges of Sukuk Prihatin

Source: *Islamic Finance Case Studies Focus Group Discussion (2022)*

2.4.2 Governance of Sukuk Prihatin

Sukuk Prihatin is a form of Government Investment Issuance (GII) issued under the *Government Funding Act of 1983*. The Act authorizes the Minister of Finance to receive investment on behalf of the government. Proceeds from Sukuk Prihatin were pooled into the *National Trust Fund for* COVID-*19* (Kumpulan Wang Amanah COVID-19). This special fund was specifically set-up for collecting and disbursing Sukuk Prihatin.

The Parliament of Malaysia also approved amendments to the *National Trust Act in 2021* to allow the usage of National trust fund for COVID-19 purposes. Established in 1988, the national trust fund was created as a reserve/savings for future generations. Traditionally the main source of the trust fund is oil royalties and fee - the total sum accumulated is USD4.807 billion (RM20.9 billion). The national trust fund is supervised by a board of trustees appointed by the Minister of Finance, whereas its administration and operations are conducted by BNM.

"*As a regulator, we have provided legal as well as regulatory framework to ensure there is no uncertainty and no legal impediment as far as the sukuk market is concerned. Legal and regulatory framework, Capital Market and Services Act 2007 (CMSA) is actually the main Act regulating capital market. We have put in place the Shari'ah governance framework, a robust Shari'ah governance framework, in terms of providing international Shari'ah advisory council established under the securities commission act Malaysia. And we also have the individual Shari'ah advisors which are required to be appointed to structure any Islamic product not just sukuk*".

(Securities Commission of Malaysia Officer 2)

Source: *Islamic Finance Case Studies Focus Group Discussion (2022)*

The Ministry of Finance and BNM are the key entities that govern the utilisation of Sukuk Prihatin proceeds. Undoubtedly, integrity and transparency are critical in managing the national trust funds. To ensure that the national trust funds are managed for the best interests of the nation, all expenses are recorded in the financial report of the federal government. These are then audited by the national audit department and tabled in parliamentary sessions.

"*In terms of tax aspect, we have a facilitative tax framework – Tax Neutrality Provision to facilitate the Shari'ah compliance transaction. In terms of cost, it's the same as bond so that has been very helpful in developing the sukuk market as well. Another tax aspect is in terms of tax incentives that are given based on the different structure as well. However, the players can actually go on without relying on the incentives purely because the demand is available. Therefore, sukuk market has actually grown and will continue to grow in the future because we have a conducive ecosystem*"

(Securities Commission of Malaysia Officer 2)

Source: *Islamic Finance Case Studies Focus Group Discussion (2022)*

2.5 Indonesian Retail Sukuk: Green Retail Sukuk

Retail Sukuk (SR) was first issued in Indonesia in 2009 with an Ijarah Sale and Lease Back contract through book building method. The tenor offered is medium term between 3 to 3.5 years and maximum purchase of SR is limited to IDR5,000,000,000 (five billion rupiah) per person. In November 2019, the government again issued savings sukuk in Indonesia, namely the ST-006 savings sukuk series which is the first retail sukuk instrument with a green theme.

The Green retail sukuk ST-006 was offered to the public through a three-week public placement exercise with a return rate of 6.75% ((floating with floor). Total volume of purchase orders for retail green sukuk ST-006 was IDR1,459,880,000,000 which involved a total of 7,735 investors. Profile of the investors are can be seen in Figure 2.9, in terms of age, type of work and region. More than 51.7% of the sukuk holders are from the millennials (3,950 investors) while the Generation Z (under 19 years) who invest in ST-006 is 21 investors (Rp3.56 billion) with an average Generation Z purchase of Rp169 million.

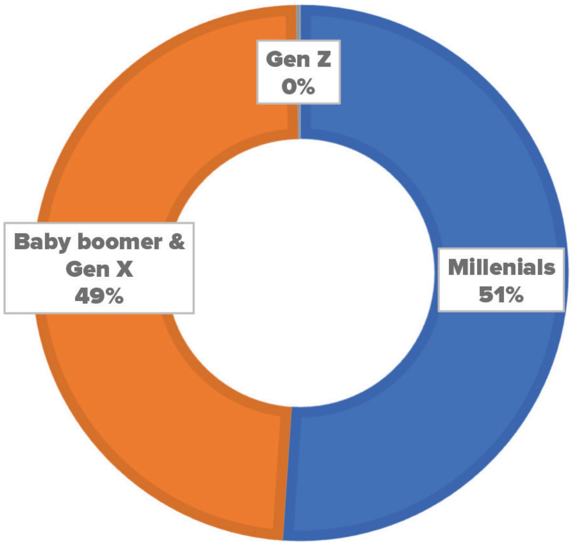


Figure 2.9: Composition of ST-006 sukuk holders

Source: *Studi Mengenai Green Sukuk Ritel di Indonesia*, 2022

The high demand for the retail sukuk shows Indonesia's millennial generation's interest in investing in Islamic government securities. The issuance of the green retail Sukuk facility – structured under the Wakalah concept – was done in collaboration with 23 partners including Bank Central Asia, HSBC Indonesia, Bank Mandiri, Bank Negara Indonesia, Permata Bank, Modalku, Danareksa Sekuritas and Investree.

Proceeds from the Sukuk will be used to finance and refinance environmentally friendly projects, targeting five areas of the global Sustainable Development Goals (SDGs) such as innovation and infrastructure, clean and affordable energy, and sustainable communities.

For the green-themed instrument, a sukuk issuance has a number of advantages compared to a conventional issuance. The first is the similarity of issuance structure, green bonds or sukuk require existence of underlying assets. Another reason is legal – Law Number 19/2008 on Islamic Government Securities stipulates that Islamic government securities be issued for budget financing that includes project financing, whereas Law Number 24/2002 on Government Securities (conventional) does not regulate that conventional bonds be used for project financing. The third reason – a very compelling one – is that the country has had substantial experience in issuing green Sukuk, having done so in the global market in 2018 and 2019. This time around, leveraging on this past experience, the Indonesian government is tapping the domestic market with a green retail Sukuk, a unique issuance and the first of its kind.

Another one of the advantages of domestic green sukuk with a Rupiah Denomination is the avoidance of exchange rate risk. By borrowing funds from the public, the government is protected from exchange rate risk in the event of fluctuations in the exchange rate of the Rupiah against foreign currencies, especially US Dollars. As such, the by tapping into the domestic retail market, the sukuk is also expected to help strengthen domestic financial system stability. The Green Retail Sukuk ST006 is unique in that it was issued using a green framework, in which the underlying assets are green projects already marked as Climate Budget Tagging in the national budget. The issuance will also follow the existing green framework mechanism, which includes green impact reporting.

The issuance was not without challenges – the green retail Sukuk paper was issued at the time when global economy was faced with various challenges even prior to COVID-19, with central banks including Bank Indonesia (BI) cutting rates up to four times since the start of 2019.

The return for retail government Sukuk therefore tends to also be lower, as the Central Bank of Indonesia's (Bank Indonesia) rate is used as the reference rate. Hence, the sukuk's appeal lies in its promise to contribute to combating the impact of climate change, as a complementary objective to financial returns. Extending the sukuk issuances to beyond institutional investors, the Government of the Republic of Indonesia through the Ministry of Finance were in view that a retail sukuk issuance should also be put in place.

The issuance of retail green sukuk series ST-006 also suffered from a decrease in volume orders and the number of investors compared to the previous ST series. This could be attributed to the high frequency of issuance same year (four issuances in 2019 alone), lack of effective socialization efforts and the long-standing issue of an underdeveloped sukuk investor base. These factors need to be considered by issuers for future retail green sukuk issuance. Apart from that, an analysis regarding the timing of a good issuance is also required, taking into account the conditions economy, market confidence, and demand conditions for other investment instruments.

Positive impacts of the green retail sukuk on the economy are numerous. Other than promoting initiatives to reduce greenhouse emissions and preserving the environment, the revenue generated contributed to fiscal capacity of the government. More importantly, the retail nature of the issuance allowed the government to reach new customer groups, namely green investors so as to broaden the domestic investor base and create greater awareness of importance of climate or green finance in the sustainable development agenda.

The government applied the same principles for monitoring and reporting processes and reporting as the Indonesian global green sukuk. However, in reaching out to its retail sukukholders, brief information related to location, project objectives, planned work and effects physical aspects of its implementation, green urgency sukuk, budget allocation for green projects, types of projects funded, project locations, and impacts generated are channelled through methods such as electronic mail, social media and websites, as well as through short videos, YouTube, television, and newspapers. It is necessary to allocate time and socialization methods in accordance with the target investors. As an illustration, for millennial customers, socialization involving influencers on social media and discounts or incentives are considered more effective than outreach done via face-to-face interactions. Meanwhile, for large customers in banking, seminar methods and face-to-face communication are still the most preferred and effective method of promotion.

3. Case Study 2: Malaysian Value-Based Intermediation (VBI)

3.1 Background

Value-Based Intermediation (VBI) is a unique regulator-industry initiative by Central Bank of Malaysia and Association of Islamic Banks in Malaysia (AIBIM) to address Malaysian Islamic banks' lack of impact on climate, environmental as well as general sustainable development issues and challenges. BNM and Association of Islamic Banks in Malaysia (AIBIM) are the responsible parties for VBI implementation and monitoring for all banks in Malaysia. VBI was introduced in 2017 and became fully implemented by 2018. In March 2018, a Strategy Paper on Value-based Intermediation (Strategy Paper) was issued by Bank Negara Malaysia in collaboration with the members of the VBI Community of Practitioners (CoP). CoPs consists of several Islamic banks who agreed to participate in the VBI initiative.

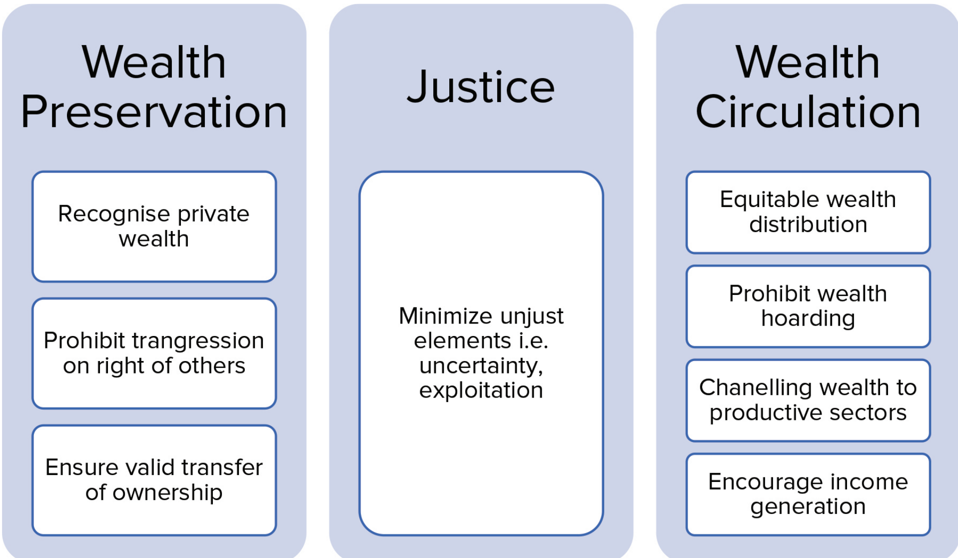
VBI is essentially an intermediation function that aims to deliver the intended outcomes of *Shari'ah* through practices, conduct, and offerings that generate positive and sustainable impact on the economy, community, and environment, whilst being consistent with the shareholders' sustainable returns and long-term interests (BNM 2018). VBI is an initiative to not only benefit the Islamic financial industry by ensuring greater innovation, enhanced efficiency, and an effective ecosystem, but also the customers and stakeholders.

3.1.1 VBI and Sustainable Development Outcomes

VBI offers an intermediate function that not only ensures compliance to *Shari'ah* practices and outcomes, but also comply with SDGs that are beneficial to the community and environment. SDGs that are in-line with VBI objectives are SDG 7 - Affordable and Clean Energy, SDG 8 - Decent Work and Economic Growth, SDG11 - Sustainable Cities and communities and SDG 13 - Climate Action. VBI and SDGs are therefore interrelated. VBI reporting by its CoP members show that financing flows are slowly shifting toward sectors and industries that are involved in providing affordable and clean energy, developing sustainable cities and communities and those involved in climate.

VBI activities are intended to promote justice, wealth preservation and wealth circulation, in-line with Maqasid *Shari'ah* principles that minimises unjust elements such as, uncertainty and exploitations. VBI recognises private ownership, prohibits transgression of rights of others and ensures valid transfer of ownership. In promoting circulation of wealth in the society, wealth hoarding is prohibited, halal income generation is encouraged, and wealth is channelled to only the productive sectors to generate income that can be distributed to the poor and needy (see Figure 3.1).

Figure 3.1: *Maqasid Shari'ah* **- Wealth Preservation, Justice and Circulation.**



Source: *VBI: Strengthening the Roles & Impact of Islamic Finance* (BNM, 2018b)

3.1.2 VBI Underpinning Thrusts

VBI has four underpinning thrusts as shown in the following Figure 3.2.

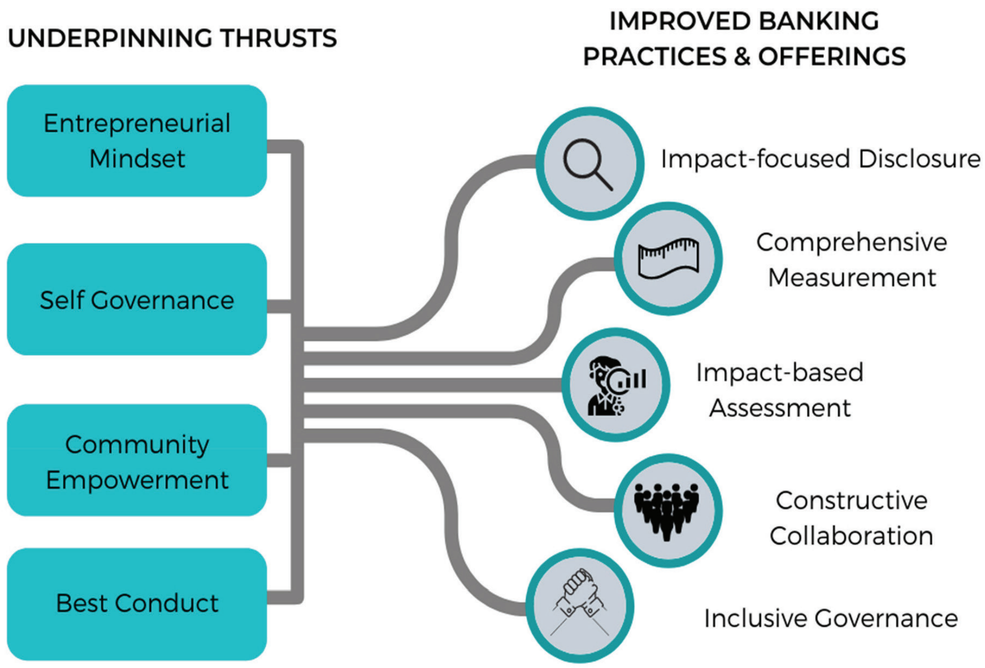


Figure 3.2: VBI Underpinning Thrust.

Source: *VBI: Strengthening the Roles & Impact of Islamic Finance* (BNM, 2018b)

The above underpinning thrusts act as guiding principles issued by BNM and are consistent with *Shari'ah* principles. IFIs are expected to conduct their business in the best manner, practice good self-governance with an entrepreneurial mindset that can empower the community at large and add value to all stakeholders.

It is envisaged that the four underpinning thrusts will improve banking practices and offerings. This will be achieved through adopting inclusive governance, constructive collaboration, impact-based assessment, comprehensive assessment, and impact-focused disclosure practices. Ultimately, the main aim is to improve banking practices and offerings to all stakeholders.

3.1.3 VBI Enablers

For IFIs to achieve the above goals, BNM has created a number of enablers. Among them are establishing CoPs, VBI implementation guide, VBI Investment and Financing Impact Assessment Framework (VBIAF), and sectoral assessment guide. Important milestones in the VBI roll out:

1. BNM in 2018 issued three guidance documents for CoPs, namely VBI implementation guide, VBI Investment and Assessment Framework (VBIAF), and VBI Scorecard. Based on the guidelines, Islamic Financial Institutions (IFI) are required to describe their VBI initiatives in their annual reports, publications, websites, and other public forums.
2. In 2019, BNM began a discussion paper on climate-change and principles-based taxonomy, since then IFIs have begun to track their VBI activities and initiatives according to the principles-based taxonomy.
3. BNM in 2020 then issued three VBIAF sectoral guides: Palm Oil, Renewable Energy (RE) and Energy Efficiency (EE), followed by sectoral guides on Oil & Gas, Construction & Infrastructure and Manufacturing in March 2022.
4. Within the Sectoral Guides, recommendations for impact-based risk management guidance & tools were also included.

a. Identification: ESG risk & transmission

- Identifying ESG impacts and risk transmission across various stages of the industry cycle

b. Measurement: Risk metrics & risk score

- Assigning appropriate risk score/ level for each of the impact metrics/indicators

c. Mitigation: Risk mitigation & remedial measure

- Setting up broad mitigation strategies and remedial measures in the context of the outcomes and how they will support the overarching ESG strategies

Based on these frameworks and guidelines, CoP's disclosure practices were enhanced and strengthened through Corporate Value-Intent Disclosure Framework (CVI). CVI provides a structured mechanism to formulate the strategic intent in delivering *Shari'ah* propositions - including on the establishment of a robust VBI risk management system covering areas such as governance, risk identification, risk measurement, monitoring and reporting. Last but not least, VBI scorecard provides a structured management tool that guides self-assessment on effectiveness and achievement of strategies and IBIs performance in delivering *Shari'ah* propositions (see Figure 3.3).

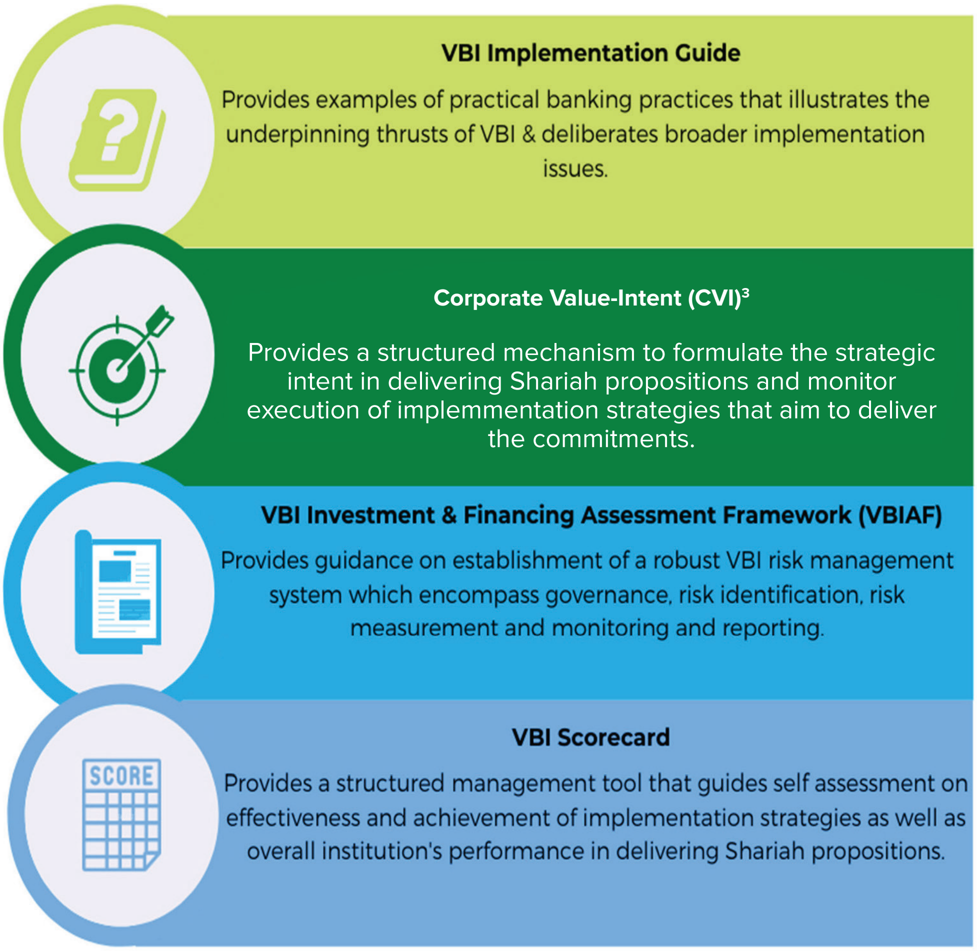


Figure 3.3: VBI Implementation Guide, CVI, VBIAF & Scorecard

Source: *Implementation Guide for VBI* (BNM, 2018a)

BNM facilitates the implementation of VBI by promoting proactive transparency on the optimal set of information in order to bring about the intended reaction (market discipline) from relevant stakeholders towards existing banking practices and offerings. The role of BNM and the Association of Islamic Bank Malaysia (AIBIM) in driving the acceptance and practice of the VBI products cannot be over-emphasized. VBI eco-system can be summarized in Figure 3.4.

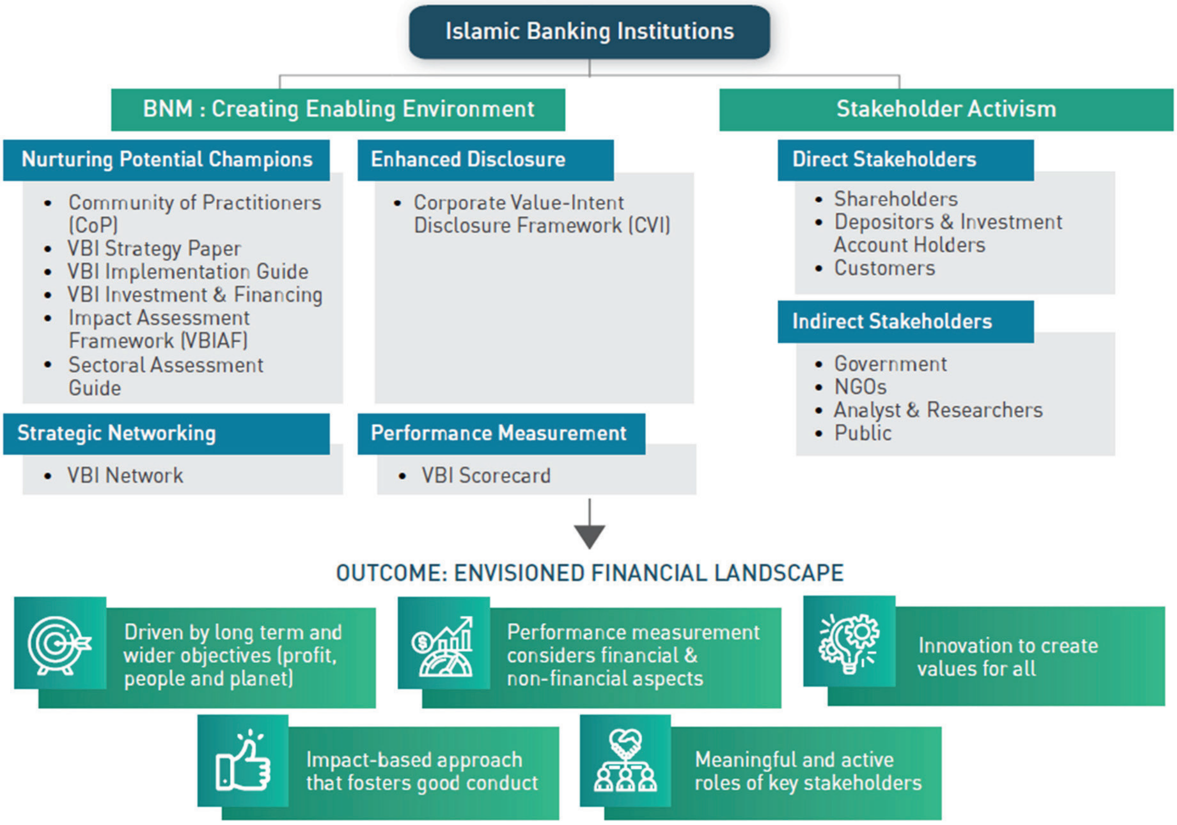


Figure 3.4: VBI Enablers

Source: *Implementation Guide for VBI* (BNM, 2018a)

3.1.4 Positive Impact from VBI

The following are positive VBI:

i. Impact-Based Assessment

VBI ensures that all approved projects go through an impact-based assessment. More attention is given to the applications' potential impact to the society, environment, and economy. The emphasis is on the potential impact rather than merely a project for profits only. Thus, VBI gives a positive impact to the society, environment, and economy.

ii. Comprehensive Measurement

Comprehensive performance measurement covers both financial and non-financial indicators. In-line with the current professional and industry practice, performance measurement in VBI covers both financial and non-financial sectors. A best indicator of the IFIs performance is through both indicators – financial and non-financial. Non-financial information relates to protection of the environment and community engagement.

iii. Impact—Focused Disclosure

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

iv. Constructive Collaboration

IFIs undertake constructive collaboration steps with wider stakeholders beyond their traditional ones, for example CSOs, state religious authorities and government agencies.

v. Inclusive Governance

Islamic financial institutions are expected to engage actively with multi-stakeholders including traditional and non-traditional stakeholders not just in getting information or ideas, but also in the decision-making process.

VBI has also provided a positive experience for the IFIs in many ways. Among them are:

i. **Innovation** – creates an impact-driven mind-set amongst its personnel, looking at new market opportunity through development of innovative financial solutions that address unserved or underserved segments (e.g., affordable home ownership). This is necessary especially during a pandemic like COVID-19.

ii. **Efficiency** – ensures optimal allocation of credit which prioritises business activity that delivers impact to wider stakeholders. Managing any negative externalities arising from such activity will minimise potential costs due to legal and/or reputational risks faced by IBIs.

iii. **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 IFIs branding image and reputation over time.

Figure 3.5 below compares the current and future financial landscapes due to VBI. Future financial landscape is driven by long term and wider objectives, performance measurement that considers both financial and non-financial, creating values for all through innovation, impact-based approach that fosters good conduct, and involving all key stakeholders in the decision making.

Perceived Current Financial Landscape	Envisioned Future Financial Landscape
Driven by short-term and narrow bottom line	Driven by long term and wider objectives (profit, people and planet)
Performance measurement focuses on financial aspect	Performance measurement considers both financial and non-financial aspects
Innovation mainly to create competitive advantage for shareholders and players	Innovation to create values for all
Good conduct driven by regulation	Impact-based approach that fosters good conduct
Minimal roles of ohter stakeholders	Meaningful and active roles of key stakeholders (consumers, employees and public)

Figure 3.5: Current Perceived Landscape and the Future End Game

Source: *VBI: Strengthening the Roles & Impact of Islamic Finance* (BNM, 2018b)

3.2 Key Players and Institutional Enablers

Key players in driving VBI's adoption are BNM and AIBIM. One of the key motivations for the initiative is to improve corporate governance and disclosure practices by IFIs on approved financing projects. Projects approved for financing must adhere to a number of conditions. This was done with the help of the Community of Practitioners (CoPs) adopting the VBI in their financing models and reporting.

The VBI Community of Practitioners, or "CoP," is a collaborative forum for industry players to proactively advance the VBI agenda. Bank Islam Malaysia Berhad, Bank Muamalat Malaysia Berhad, Bank Pertanian Malaysia Berhad (Agrobank), CIMB Islamic Bank Berhad, and HSBC Amanah Malaysia Berhad were the first five Islamic banks within the CoP. The CoP was formally created in 2017 with nine Islamic banks as members and as of 2021, 58 percent of AIBIM member banks, or 15 in total, are members of the CoP.

BNM, AIBIM and CoPs play an important role in ensuring VBI objectives are achieved. BNM as a regulator has developed a VBI implementation guide, VBIA, and a sectoral assessment guide. These guides and frameworks help CoPs to implement VBI in their individual banks. Other countries can implement VBI if the central banks take the lead role to provide frameworks and guidelines for IFIs to report their financial activities.

In carrying out this mandate, the following values have been made as the guiding principles for CoP members.

1. Openness & Transparency:

    - Fair and transparent disclosure on each IBI's intent in adopting VBI to all relevant stakeholders to avoid any information asymmetry.
    - Gain insights, opportunity and knowledge on areas of business improvements through wider, more constructive collaboration with NGOs, societies and government, among others.
    - Active, meaningful and inclusive stakeholder engagements as part of the governance for decision making process.

2. Responsible:

    - IFIs must be a "good citizen" bank by becoming an enabler of stakeholders' aspirations. This includes: –
    - Government: Low carbon target, SDG 2030 and Paris Accord
    - BNM: Responsible and professional conduct in a financial service provider, fair dealings, inclusive financing, enhanced financial literacy.

3. Promoting Islamic economy by using VBI as the driver/ enabler

    - Community empowerment through provision of financial solutions that create positive impact to the triple bottom line.
    - Self-governance via embed of the culture of self-discipline within the operations and practices of Islamic financial institutions.
    - Best conduct practices in IFIs' offerings, processes and treatment toward their stakeholders to ensure efficient services delivery.

4. Diligence & Resourcefulness

    - To strategically plan VBI implementation via a holistic framework where both industry and individual banks work towards a smooth gradual transition to be a values-based institution end-to-end.
    - To implement a performance matrix for financial and non-financial aspects.
    - To plan and conduct strategic networking with relevant key stakeholders to acquire information and insights presently beyond the capacity and capability of our member banks.

3.3 Success Factors and Challenges

3.3.1 Impact of VBI - Aligned Financing (2017-2020)

Ever since VBI was implemented in 2017, IBIs have improved in a number of areas including financing for the green environment and energy sectors. For the period 2017-2020 IBIs have intermediated over USD35.8 billion (RM155.6 billion) in VBI related/aligned initiatives by creating impact as Figure 3.6 to Figure 3.9 below:

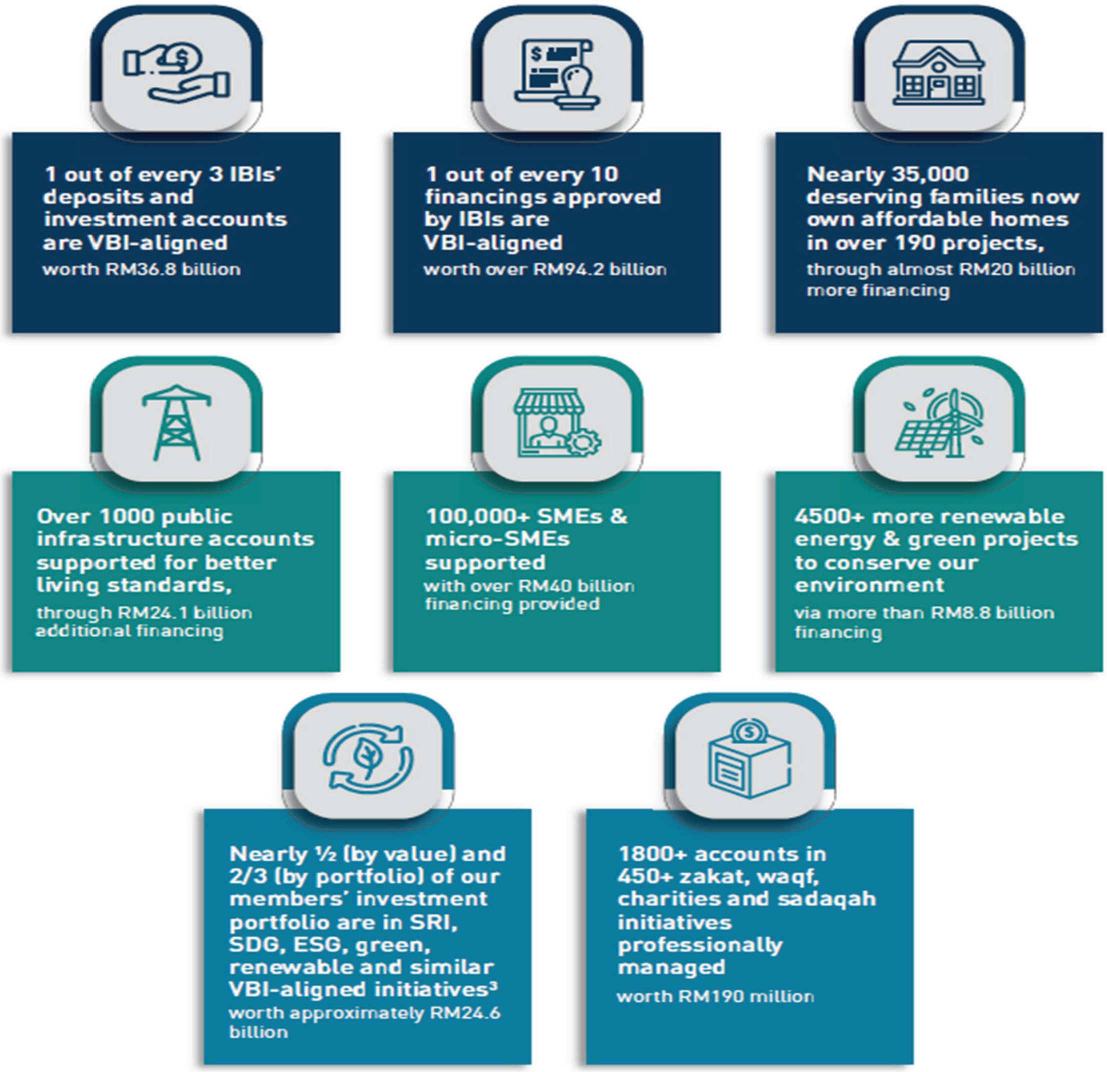


Figure 3.6: Impact of VBI related/aligned initiatives

Source: *VBI Preview Report 2017-2020* (AIBIM, 2020)

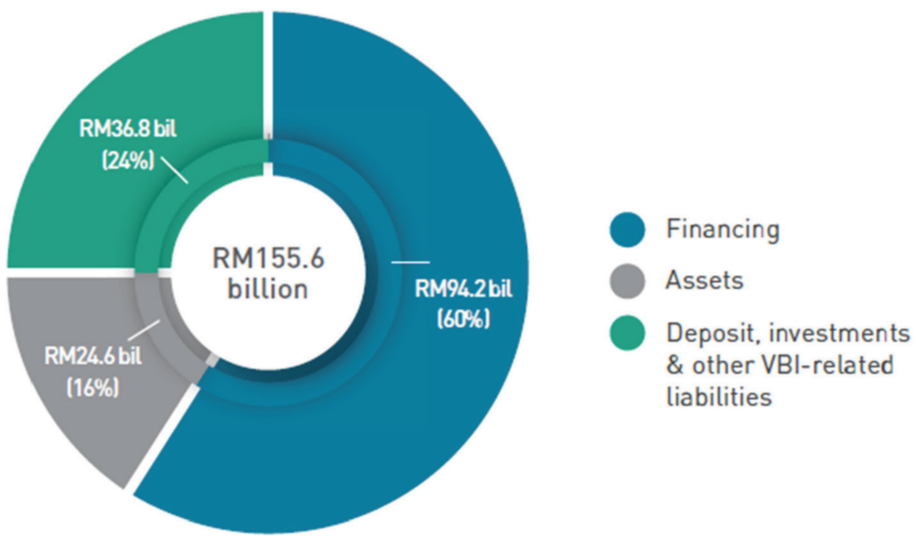


Figure 3.7: Funds Intermediated with VBI

Source: *VBI Preview Report 2017-2020* (AIBIM, 2020)

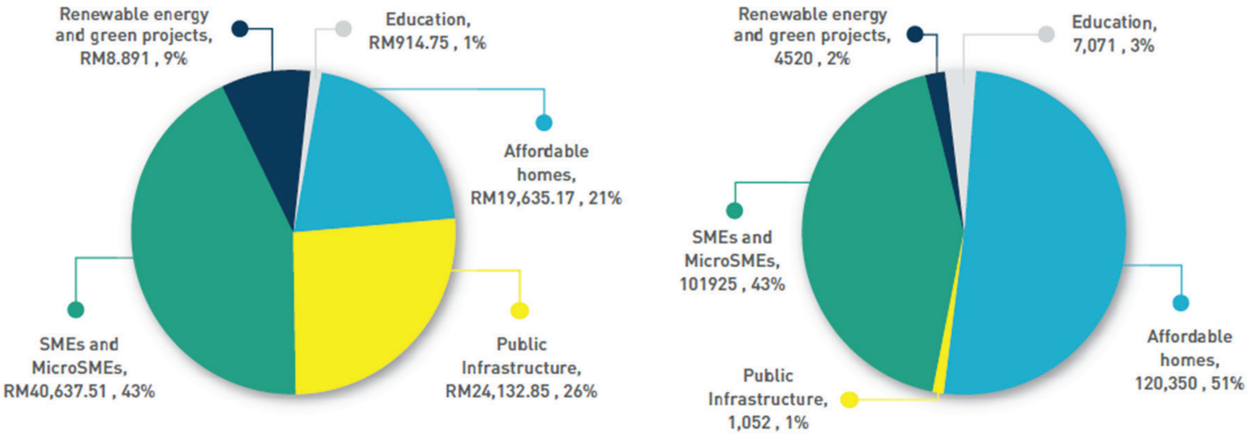


Figure 3.8: VBI Financing

Source: *VBI Preview Report 2017-2020* (AIBIM, 2020)

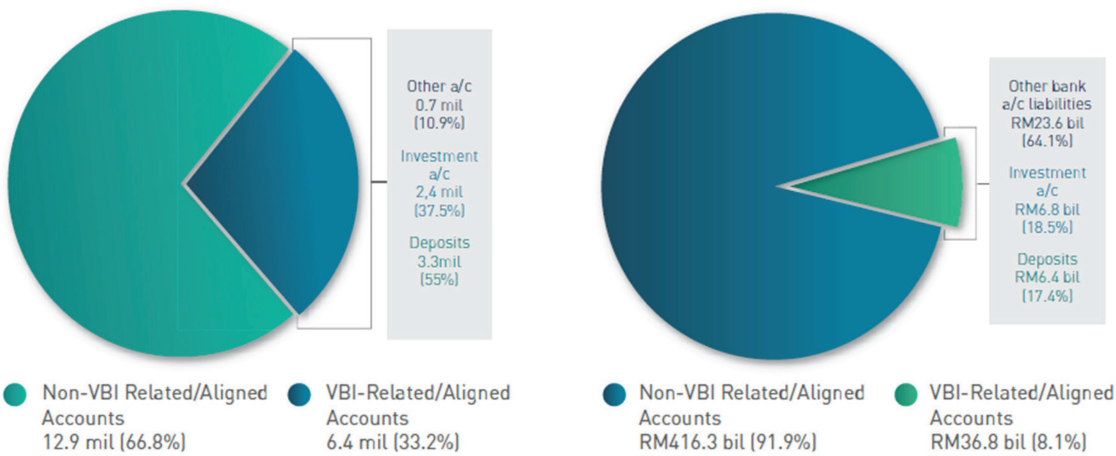


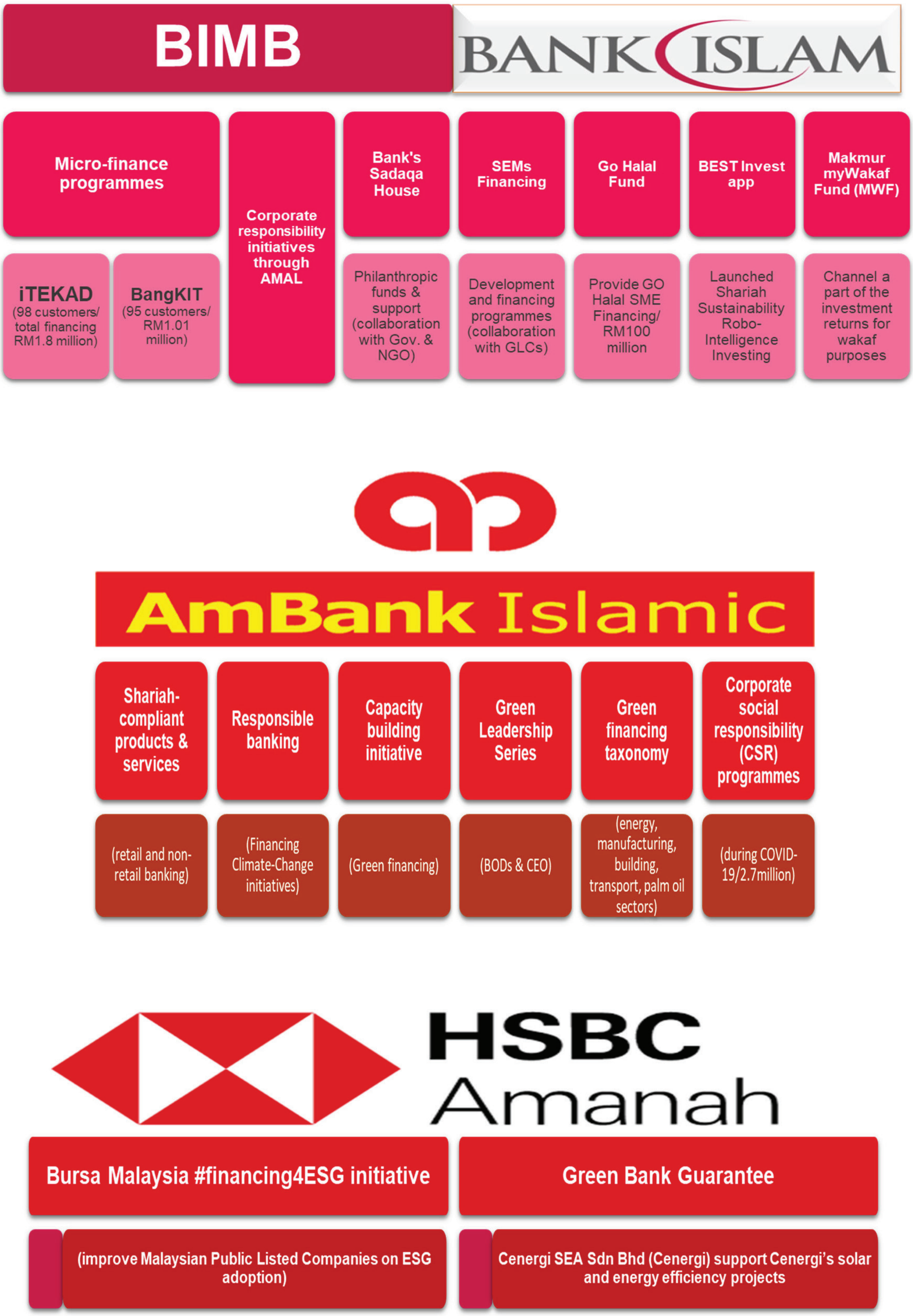
Figure 3.9: VBI Deposits and Investment Account

Source: *VBI Preview Report 2017-2020* (AIBIM, 2020)

In November 2016, Bank Islam Malaysia Berhad (BIMB) Investment launched the first fund in the country that integrates *Shari'ah* and ESG principles in the investment decision-making process – the BIMB-Arabesque-i Global Dividend Fund 1. And in 2020, Nomura Islamic Asset Management has established an in-house taskforce to comply with VBI outcome. In addition, AIIMAN Asset Management Berhad (AIIMAN) and CIMB Principal Islamic Asset Management (CPIAM) are two fund houses that have embraced the ESG trend to spur investor demand for *Shari'ah*-compliant funds.

3.3.2 VBI Flagship Projects by CoP Members

The following Figure 3.10 presents VBI initiatives, activities or projects by CoP members that also fulfil SGD goals mentioned above.



Maybank Islamic

Environmental sustainability considerations	Green Technology Financing Scheme (GTFS)
Risk Acceptance Criteria (RAC) for high ESG risk industries such as Palm Oil, Oil & Gas, Forestry & Logging and Mining & Quarrying.	Facilitates financing to green technology companies

OCBC Al-Amin

Financing renewable energy projects	Sustainability-linked financing	Syndicated Shariah Compliant sustainability-linked financing
large scale solar photovoltaic and rooftop solar power plants	To meeting specific sustainability targets in relation to their environmental, social and governance initiatives	OCBC Al-Amin lead arranging role/USD800 million

PUBLIC ISLAMIC BANK

Solar Plus BAE Personal Financing-I	Energy efficient vehicle (EEV) campaign
Special financing package with attractive rates to finance rooftop solar panel	AITAB Hire Purchase-i Financing

Figure 3.10: VBI Initiatives by CoPs

Source: *Islamic Finance Case Studies Focus Group Discussion and annual reports (2022)*

Box 1: iTEKAD 2.0 by Bank Islam, Bank Muamalat and CIMB Islamic Bank Berhad

iTEKAD is a social finance pilot programme that combines investment and financing elements with micro-SME training, business mentorship, and impact monitoring. By 2021, three Islamic banks have rolled out their iTEKAD offerings, all aimed to better serve the low-income households. iTEKAD offers seed capital through an affordable microfinancing arrangement. What makes the iTEKAD programme innovative is that the financing facility is often coupled with social finance funds, either *zakat* or *waqf,* (which are therefore non-repayable and can be used for capital expenditure. The latter helps to effectively reduce credit exposure of the iTEKAD borrowers. Recipients also receive structured entrepreneurship, employment guarantee and financial management training to ensure a more holistic understanding, skills and knowledge in managing their venture efficiently and sustainably. iTEKAD's success hinges upon close collaborations with partners such as State Islamic Religious Councils, government agencies, private sector (which provided training and upskilling opportunities as well as job guarantees in some cases), social enterprises, universities and non-government organisations. The Government also provided a grant allocation in 2023 of RM20 million to augment the seed capital component offered by participating banks in iTEKAD.

Participating Bank	Offering	Programme Structure
BANK ISLAM	iTEkad Microfinancing	Returned *zakat* and microfinancing facility
بنك معاملات Bank Muamalat	iTEKAD Mawaddah	Returned *zakat* and two-tier mudarabah investment
CIMB ISLAMIC	CIMB Islamic Rider Entrepreneur Programme	Internal CSR grant, cash *waqf* and micro-financing facility

As at the end of 2021, the iTEKAD programmes run by the three banks have benefitted 172 microentrepreneurs across 15 business sectors. Sixty percent of the microentrepreneurs are women. Impact indicators include:

Business Growth	• increase in value of average monthly sales • increase in business asset value
Financial Resilience	• business income saved per month • diversified forms of savings
Employment	• sustained operations (self-employed) • employee retention
Digital Upskilling	• online sales • e-wallet payment for business transactions • official websites with secured payment gateway

Table 3.1: Breakdown of Social Finance Offerings in Malaysia within iTEKAD

Fund Providers	Type of Funds		Social Finance intermediated by financial institutions			Digital Tools	Network Partners
Funding			Business Model			Supporting Infrastructures	
			Bank Islam	Bank Muamalat	CIMB Islamic		
Contributors		Donation	Seed Capital, Microfinancing, and training		Safety net protection and training	Institutions' mobile apps: • Financial Institutions • State Islamic Religious Councils (SIRCs) • Social Enterprises • Non-govern-mental organisations (NGOs)	Philanthropic capital collected and distributed through changemakers: (NGOs, Social Enterprises, Foundations)
Donors		Waqf and endowment	Direct Integration	Indirect Integration			
Investors	Philanthropic Fund		Blended Microfinancing	Funding Escalator	Blended Protection		Channeling waqf and zakat funds to socioeconomic projects: (SIRCs, Government Agencies)
		Zakat	Risk absorbent capital	Risk absorbent capital (incubate at start-up/micro level)	Risk absorbent capital (Covers self, family and micro business)	• E-wallet (offered by approved providers)	
Government Grants			+	+	+		
Financial Institutions (returned zakat/CSR)			Microfinancing +	Mentoring +	Mentoring +	• QR code	Seamless collaboration and transparency with distributed ledger technology: (Fintech)
Corporates (CSR funds)	Commercial Fund	Social Investment Account	Mentoring	Financing (Graduated SME level)	Voluntary employment	Payment Gateway	

Source: *Financial Sector Blueprint 2022-2026* (BNM, 2022)

3.3.3 VBI Scorecard (Measurement and Reporting)

VBI Scorecard is a strategic management tool that captures the commitment, implementation strategies (including practices) and key performance indicators (results) of an Islamic banking institution in advancing the VBI agenda. Figure 3.11 explains the objectives of the VBI scorecard. The scorecard measures IFIs strategic planning process, performance assessment and effective communication of the VBI activities. In the strategic planning process, IFIs must realign their current business priorities and practices with key underpinning VBI thrusts.

Performance assessment is based on relevant information and data that can measure progression of IFIs in advancing VBI. Finally, the scorecard measures effective communication by the IBIs to all stakeholders regarding the impact and value creation to the economy, community and environment.

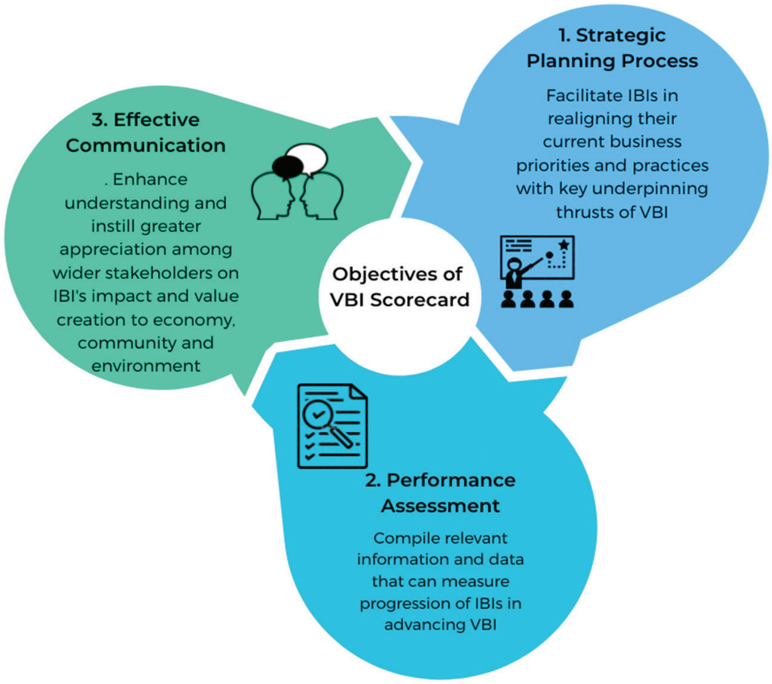


Figure 3.11: Objectives of VBI Scorecard

Source: *Implementation Guide for VBI* (BNM, 2018a)

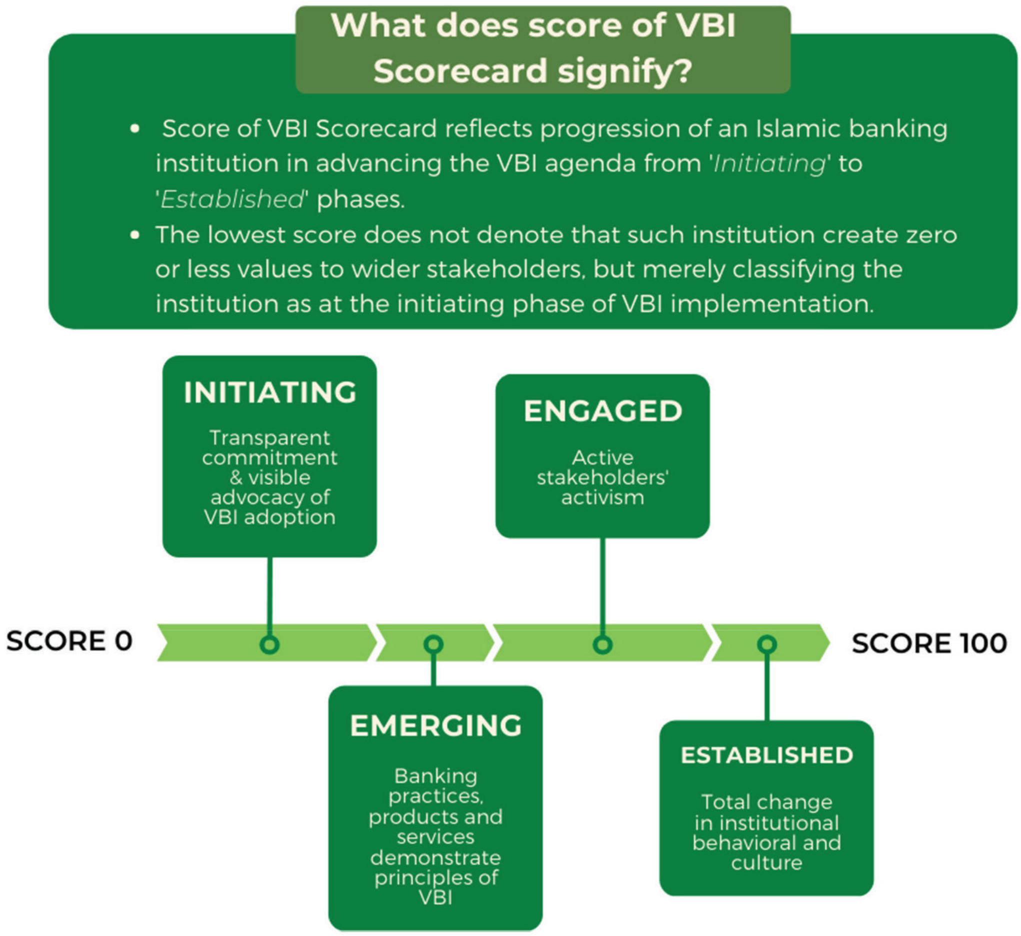


Figure 3.12: VBI Scores

Source: *Implementation Guide for VBI* (BNM, 2018a)

VBI scorecard is made up of two main components, i.e., performance and efforts. Performance is measured by IFIs financial sustainability, level of support to real economy and value creation to wider stakeholders. On the other hand, efforts are measured by leadership, organisational structure, management systems, products and services, human resource tools and performance reporting.

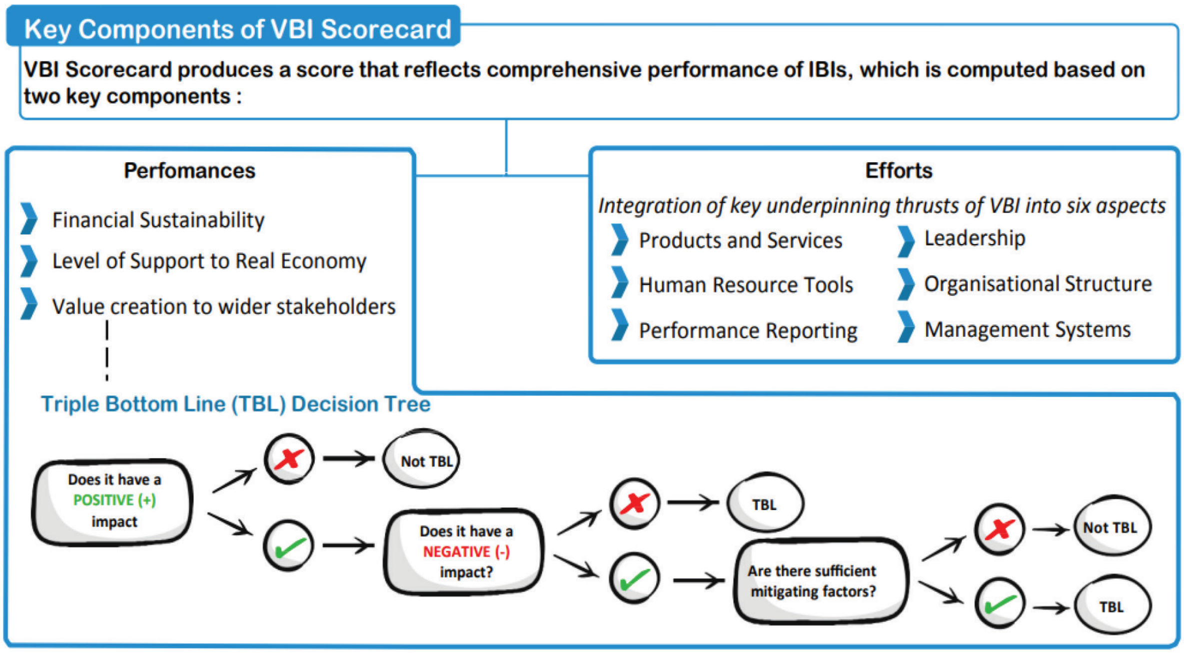


Figure 3.13: Key Components of VBI Scorecard

Source: *Implementation Guide for VBI* (BNM, 2018a)

3.3.4 VBI Implementation Challenges and Issues

According to CoP members interviewed, internal and operational challenges and issues in delivering VBI include structural and institutional constraints within the implementing bank that are not readily aligned to the VBI recommendations. For instance, in achieving the social impact desired, banks are committing to serve a greater number of clients that would have been considered 'high risk' or lacking credit history. Implementation of the VBI scorecard is another area which can be challenging primarily because of the novelty of measurement and management of impact (Figure 3.14).

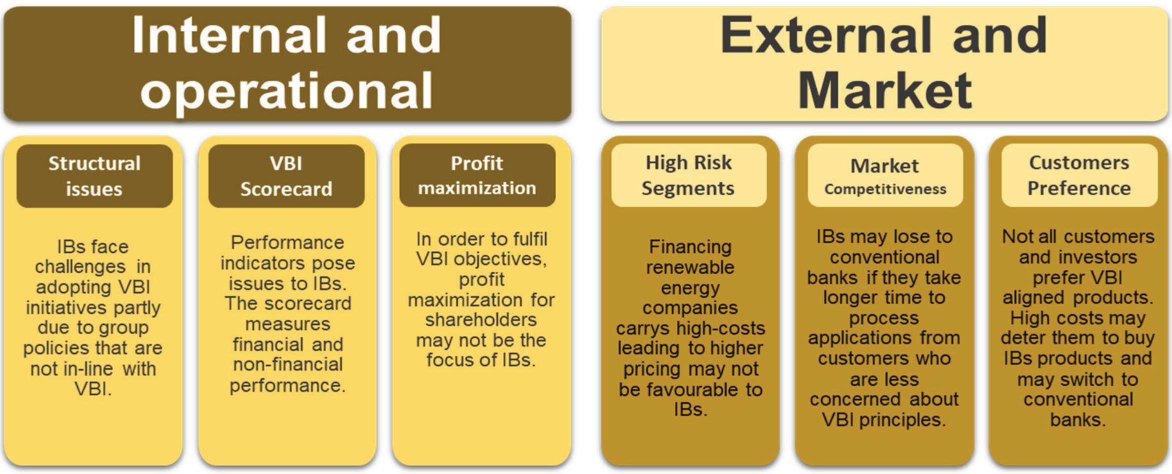


Figure 3.14: VBI Challenges and Issues

Source: *Islamic Finance Case Studies Focus Group Discussion (2022)*

3.3.5 Lessons Learnt

A number of lessons can be drawn from the Malaysian VBI experience:

1. Role of the Central Bank

Although the VBI concept was officially introduced in July 2017 by Bank Negara Malaysia (BNM), the notion of financial sustainability and inclusivity was first broached in the Financial Sector Blueprint 2011–2020 (FSBP), the second 10-year masterplan released by BNM in 2011. The Framework was further strengthened via the issuance of the Financial Inclusion Strategic Plan (Revisited) 2017-2020, which identified six game changers to further facilitate progressive and sustainable financial inclusion including establishing a greater role for IFIs to be angle investors with the participation of CSOs and other entities.

2. Commitment of the CoP Members

As of October 2021, there were 15 CoP members, double the number from 2017 when VBI was first launched. All of the CoP members are Islamic financial institutions. The members also participated in collaborative activities with the business community to support their funding needs in line with sustainable practices, engagement with government ministries and agencies to promote greater alignment of financial sector policies and strategies with the national approach of sustainability, and organisation of awareness programmes.

3. VBI Framework and Guidelines

The banking industry benefitted from a comprehensive framework that spells out implementation steps, stakeholders map, rules for public disclosure and impact tracking methods. The framework and implementation guidelines are supported by other developments spearheaded by BNM such as the Climate Change & Principle-based Taxonomy issuance, the Joint Committee on Climate Change (JC3) establishment. The issuance of 6 sectoral guidelines further facilitated the implementation of ESG impact-based risk assessment framework by financial institutions in the day-to-day financing and investment decisions.

4. Collaboration and Impact Assessment

For Islamic social finance related products such as iTEKAD, my*Waqf*, my*Zakat*, multi-stakeholder coordination and collaboration are critical to lower search and distribution costs, as well as to promote greater public confidence in the disbursement and governance of funds. Financial indicators for VBI-related activities are made clear and standardized, as reflected in fund intermediation reports by AIBIM members The indicators cover all aspects of banks' operations such as financing, assets/investments, liabilities and value-added services.

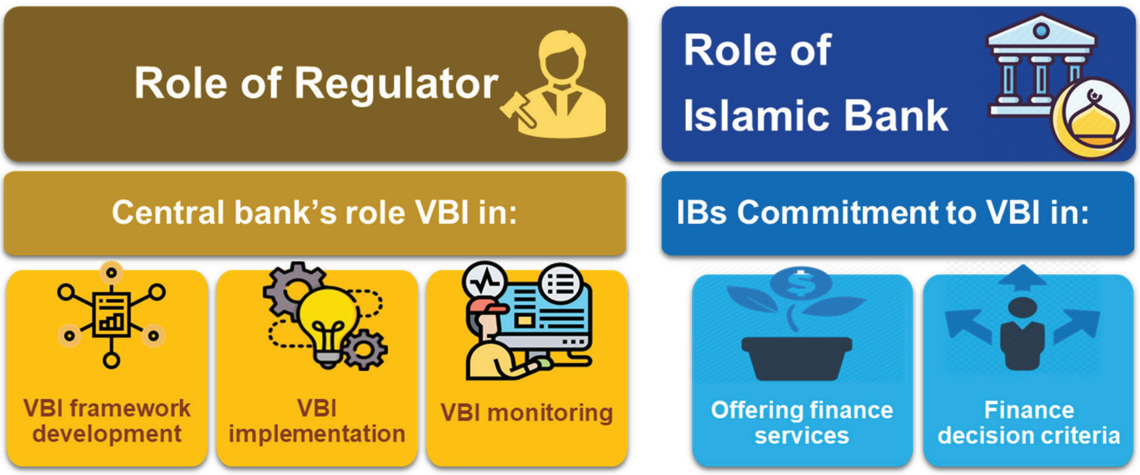


Figure 3.15: Best Practices

Source: *Islamic Finance Case Studies Focus Group Discussion (2022)*

3.3.6 Potential for Value Based Intermediation in non-banking sectors

The impact of VBI has been well recognised. Non-banking entities that can benefit from the same approach to increasing social and environmental impact of their funds include:

a. Islamic Social Finance – State Islamic Religious Councils (SIRCs) and *zakat* and *waqf* institutions.

b. Co-operatives – Islamic Coops.

c. Public Trust Entities (PTEs) – Tabung Haji, PNB, YAPEIM and others.

While each type of entities has their respective mandates, governance structure, rules and regulations, the VBI approach can be a game changer to accelerate their transition to sustainable and inclusive practices. For example, in respect to having a measurement framework to assess and benchmark the CoP's VBI implementation. This can be done by reviewing comprehensiveness and clarity of established internal policies and practices, complemented by broad stakeholder survey and impact analysis.

4. Case Study 3: Fintech In Islamic Social Finance

4.1 Background

The digital economy in Malaysia and Indonesia is the key driver for economic empowerment and growth. Use of digital technology in the daily lives of the people expanded even more dramatically during the COVID-19 pandemic when movement control orders were enforced. Fintech's adoption in Islamic social finance space is particularly an interesting area of innovation, promising greater access, coverage, efficiency and governance benefits to all stakeholders involved.

Malaysia's Information and Communication Technology (ICT) has amassed USD66.47 billion (RM289 billion), accounting for 19.1% of GDP in 2019. The *Global Islamic Fintech Report 2021*, Malaysia was ranked at the top of the list based on the GIFT index. The GIFT index includes 32 factors across five different categories (talent; regulation; infrastructure; Islamic fintech market and ecosystem; capital) for each country of Islamic fintech development and ecosystem (e.g., active Islamic fintech community and presence of several Islamic FinTech; regulatory support; a thriving fintech sector; and a ready talent pool from developed Islamic finance and technology sectors). Malaysia leads the other 64 countries in terms of capital growth and fintech ecosystem conduciveness (DinarStandard, 2021) (See Figure 4.1).

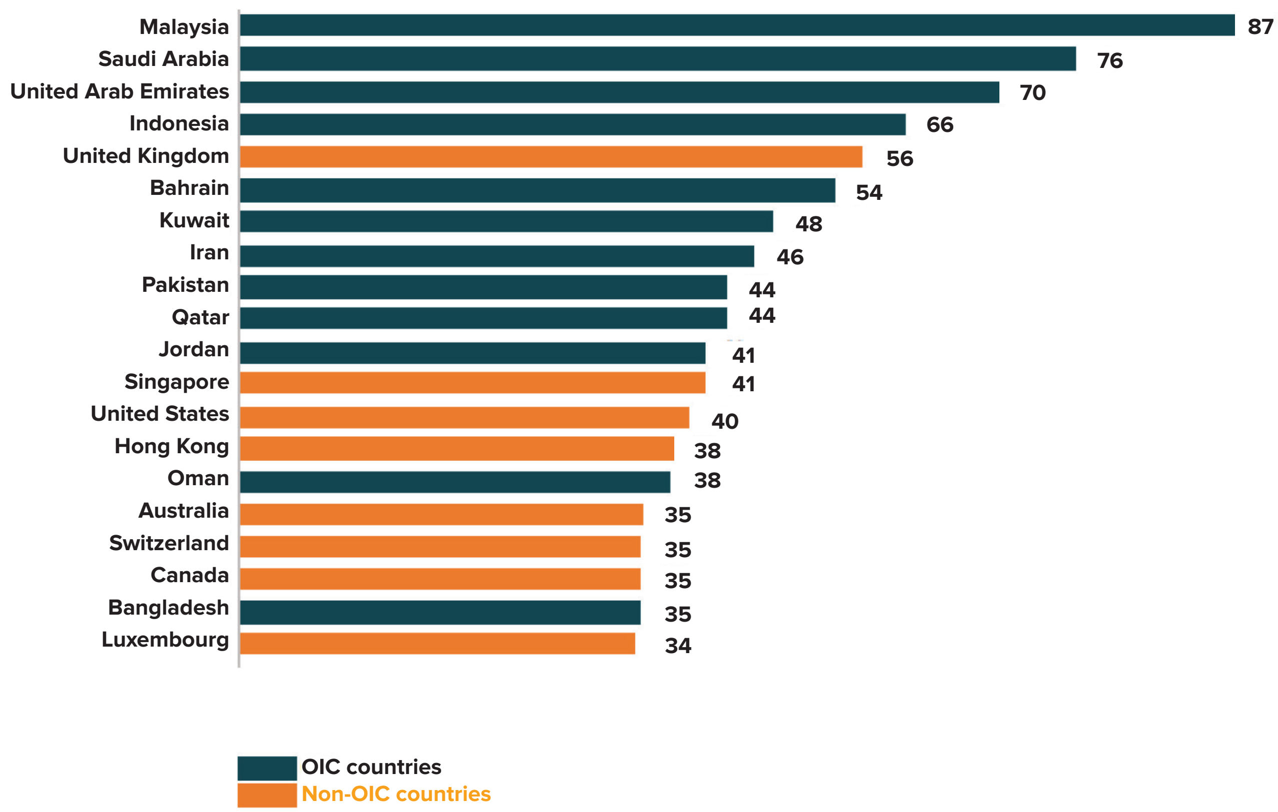


Figure 4.1: Top 20 Countries by GIFT Index Scores

Source: *Global Islamic Fintech Report 2021* (DinarStandard, 2021)

To enhance the Malaysian fintech ecosystem, BNM is working to support seamless integration of existing frameworks – such as the sandbox – with other initiatives, both at the industry and national level. This will establish an extensive network of key stakeholders that can connect fintech start-ups to a comprehensive suite of support facilities, ranging from capacity-building resources to market access opportunities. BNM's contribution will build on various existing initiatives available, including those under the Malaysia Digital Economy Corporation (MDEC) and the newly formed Malaysian Report Accelerator for Technology and Innovation (MRANTI) (EPU, 2021).

Moving forward of Islamic social finance, the BNM recognises the importance of multi-stakeholder efforts including promoting shared infrastructures and supporting national developmental priorities. They recommend developing shared infrastructures or making better use of existing ones, such as by making them interoperable – to reduce barriers to social finance offerings (BNM, 2022). Examples of such infrastructures include:

- A shared data repository of target groups for social finance programmes, which can support better risk-informed profiling of beneficiaries and the channelling of funds to unmet groups.
- A network of credible implementation partners – that are vested in social outcomes and have strong relationships with 'at-risk' communities – can act as a support system to build trust and encourage participation in the financial system.
- An integrated dashboard optimising mobile-based interfaces that facilitates real-time funding updates and impact disclosures. This can address key information gaps on the social finance landscape, including on readily available opportunities for willing stakeholders to contribute funds or volunteer other resources (See Figure 4.2).

Diverse platforms in the ecosystem			
Public sector-led	Private sector-led		
SIRCs	Industry initiatives	Financial institutions[1]	Fintech companies
♦ States have different apps to mobilise *zakat* and cash *waqf* with varying features e.g. • Real-time updates on collection, disbursement, and food bank for each mosque • *Asnaf* application and monitoring progress • Basic fund payment capabilities	♦ MyWakaf: Cashless fund-raising of *waqf* for eligible socioeconomic projects identified by participating financial institutions and SIRCs ♦ MyZakat: Pool returned *zakat* from participating financial institutions to support low-income microentrepreneurs in partnership with AIM and AKPK	♦ Programme allows both direct contribution from the public or from existing customers (via charitable riders) ♦ Each platform has its own network of NGOs and changemakers depending on financial institutions' appetite and qualifying criteria (e.g. track record, services, faith-based NGOs) ♦ Partnerships with SIRCs based on established individual financial institution's relationship	♦ Tulus: Payment gateway for *zakat* that connects 10 SIRCs and contribution of *waqf, sadaqah,* and *infaq* to partner agencies (e.g. Islamic charities, NGOs, and changemakers) ♦ Finterra technology provider: Smart contract linked with specific *waqf* projects involving various stakeholders

Figure 4.2: Overview of the Diverse Islamic Social Finance Platforms Available in Malaysia

Source: *Financial Sector Blueprint 2022-2026* (BNM, 2022)

With regards to the sustainable development goals (SDGs), the ISFs goals are directly in line with four sustainable development goals (SDG). This includes SDG 1, SDG 2, SDG 3, and SDG 4. The adoption of FinTech by ISFs will support SDG 9 especially, sub-SDG 9.5 which emphasises on report and upgrading the technological capabilities of the industrial sector (see Figure 4.3). Fintech adoption by Malaysian ISFs indicates sustainable development goals (SDGs) can be achieved and will be benefited by all stakeholders.

Figure 4.3: Sustainable Development Goals Linked to Adoption of FinTech by the Islamic Social Finance in Malaysia

4.2 Key Players and Institutional Enablers

In Malaysia, the administration of *zakat, zakat fitrah, baitulmal*, *waqf* is decentralised along state lines, hence each of the state's religious matters are governed by their own *Majlis Agama Islam Negeri* or the State Islamic Religious Council (SIRC). Each of the 14 SIRCs is established based on the Federal Constitution in accordance with Schedule 9 List 2. While the administrative framework is the same across all SIRCs, all SIRCs will have their own legal consultative councils (or Fatwa committees) and report directly to their respective state rulers (Aziz & Ali, 2018). In 2004, the Department of *Waqf*, *Zakat* and Hajj (JAWHAR) was established to coordinate *zakat* and *waqf* administration in general (Figure 4.4).

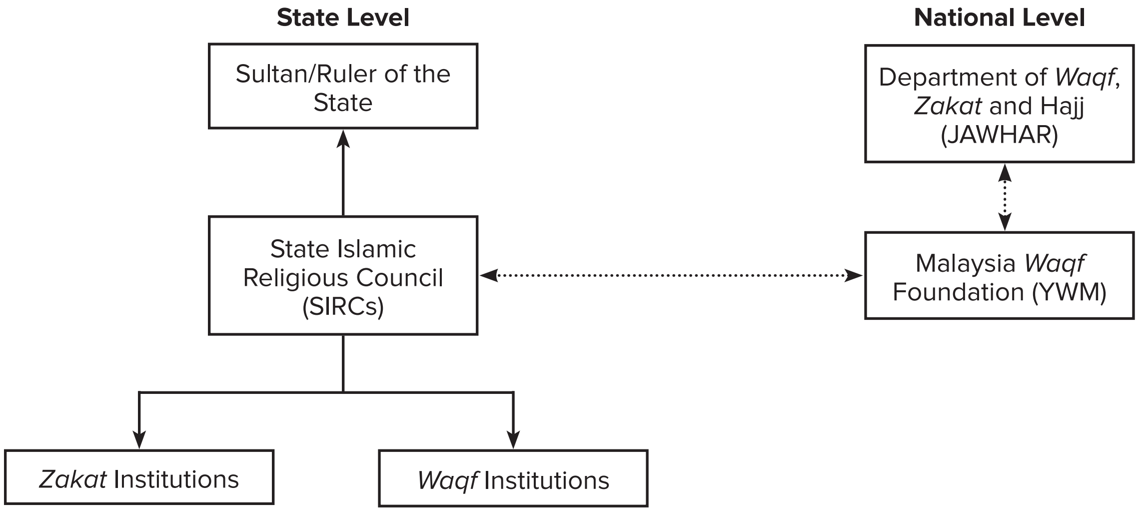


Figure 4.4: ***Zakat*** **and** ***Waqf*** **Governance Structure in Malaysia**

Source: *JAWHAR*

In administrating day-to-day transactions (collection and distribution), there are in total 17 *zakat* institutions and 14 *waqf* institutions which is one for each state in Malaysia. These *zakat* and *waqf* institutions can be categorised into corporations and non-corporations. Besides, for *zakat* institutions, there are also several institutions that are separated due to functions either for collection and/or distribution of the funds. Regardless of this difference, both types are still under SIRCs jurisdictions. The details for categorisations and functions of *zakat* and *waqf* institutions in Malaysia are listed at the end of the report in the Other Annexes.

4.3 Success Factors and Challenges

4.3.1 Growth of Fintech in Islamic Social Finance

The current adoption of fintech by Islamic social finance institutions (*zakat* and *waqf*) in Malaysia for collection; distribution; other managing and reporting process, started back in 2017. The most widely used type of fintech services is for collection of payments on behalf of SRICs but has been extended, particularly during COVID-19 to interactive mobile application. For example, an app for the public to donate to a food bank programme allows beneficiaries (*asnaf*) to check stock level at the mosque/store where the food bank is situated via the app. If the stock is available in the food bank, the beneficiary (asnaf) can use their Identification card to be verified so that the *zakat* office can issue the necessary food bank vouchers to the beneficiary.

The adoption of fintech in Islamic social finance is mainly focused on the *Zakat* and *Waqf* collection rather than distribution. The level of e-payment varied from posting the bank account number, to providing more than one method of e-payment (i.e., FPX online payment; QR code payment; e-wallet). Some Islamic social finance institutions (e.g., MAIWP *Zakat* Collection Centre) uses an online portal/mobile app for the distributions process. However, the use of fintech for reporting and transparency purposes is relatively still limited (Table 4.1) compared to other areas of fintech adoption.

Table 4.1: *Zakat* & *Waqf* Institution Fintech Adoption

Zakat & *Waqf* Institution	Collection	Distribution	Managing & Reporting
Majlis Agama Islam Johor (MAIJ)	FPX Payment Online Portal (eMAIJ)	Online	-
Majlis Agama Islam Negeri Kedah	Online Banking SnapNPay JomPay	Online	-
Lembaga *Zakat* Negeri Kedah (LZNK)	FPX payment Online Agent (Boost, MyEG, UMobile, Layar Sutera, Dapat Vista)	Online/Apps	Real-time statistic
Majlis Agama Islam Kelantan (MAIK)	FPX payment JomPay (Debit Card) MIGS (Credit Card)	Online/Apps	Real-time statistic
Majlis Agama Islam dan Adat Istiadat Melayu Perak (MAIPk)	FPX payment JomPay Online banking (M2U) Mobile Apps (GoPayz & SnapNPay)	Online/Apps	Real-time statistic
Majlis Agama Islam dan Istiadat Melayu Perlis (MAIPs)	FPX payment Online Banking (M2U, Bank Islam, CIMB)	Online	Basic info.
Majlis Agama Islam dan Adat Istiadat Melayu Terengganu (MAIDAM)	Mobile Apps (*Tulus*) FPX payment, JomPay, Online Banking (Bank Islam, M2U, CIMB Clicks, iRakyat, RHB, Affin Islamic, Ambank)	Online/Apps	Basic info.
Majlis Agama Islam Melaka (MAIM)	Mobile Apps (MelakaPay/Boost) FPX online payment	Online	Basic info.
Pusat *Zakat* Melaka (PZM)	Mobile Apps (MelakaPay/Boost) Online Banking, FPX online payment Simple Pay Gateway	-	Basic info.
Majlis Ugama Islam dan Adat Resam Melayu Pahang (MUIP)	FPX Payment	Online	Real-time statistic (*waqf*)
Pusat Kutipan *Zakat* Pahang (PKZP)	Mobile Apps (SNAPNPAY, PahangGo GoPayz), FPX online payment	-	Basic info.
Wakaf Pahang	FPX Payment		Real-time statistic
Majlis Agama Islam Wilayah Persekutuan (MAIWP)	Mobile Apps (Boost) FPX online payment	Online/Apps	Real-time statistic
Pusat Pungutan *Zakat* MAIWP	Online Banking, Online Portal (Pos Online, senangPay, MyEG, PayHalal, MyPay, Elzar*Shari'ah*, Al-Amil), E-Wallet (Boost, Shopee, GoPayz, Tulus, MAE, TheNoor), Mobile Apps (My*Zakat*)	-	Basic Info
Pusat Wakaf MAIWP	Mobile Apps (SnapNPay, ToyyibPay) Online Portal (RediPay)		Basic Info
Majlis Agama Islam Negeri Sembilan	FPX payment Debit & Credit Card, JomPay	Online	Real-time statistic
Zakat Pulau Pinang	Online Banking, JomPay Mobile Apps (GoPayz)	Online	Basic info.
Pusat *Zakat* Sabah MUIS (PZS-MUIS)	FPX payment, MIGS payment, Mobile Apps (MAE,Boost, Shopee, Tulus, SnapNPay), MyEG	Online/Apps	Real-time statistic
Tabung *Baitul*mal Sarawak (TBS)	Online Banking, MyEG	Online	
Lembaga *Zakat* Selangor (LZS)	Mobile Apps (*Zakat*Selangor), Online Banking, JomPay Touch n Go, Debit & Credit Card	Online	Basic Info
Perbadanan Wakaf Selangor	FPX Payment Online Banking		Basic Info

Source: *SIRCs' Websites*

Fintech adoption in the managing and reporting processes can be categorized into two groups. First, a basic level of fintech adoption (capture, store data, produce basic infographic). Second, more advanced level of fintech adoption where automated analysis using artificial Intelligence (AI) and using natural language generation (NLG) to understand and process the huge amount of data about beneficiaries' needs and convert it into useful information and indicators (Figure 4.5).

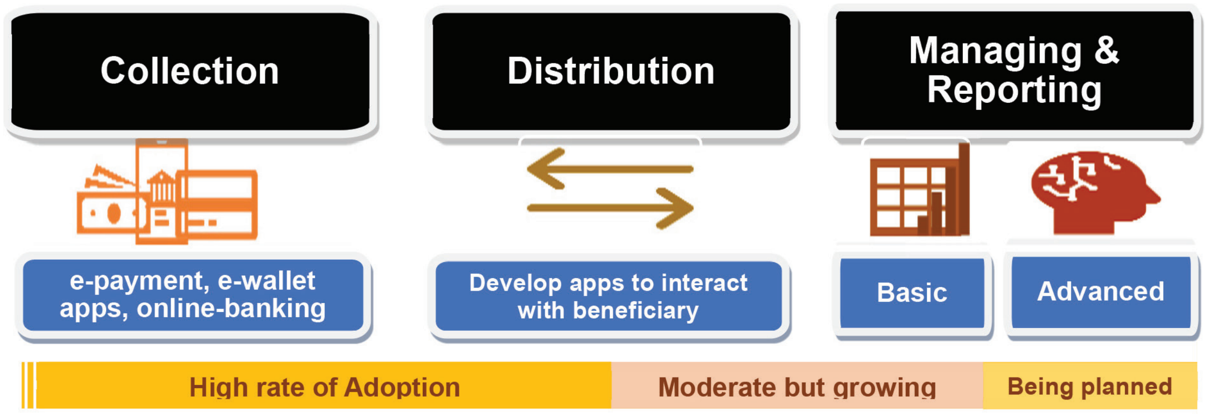


Figure 4.5: Fintech Adoption in Islamic Social Finance in Malaysia based on the Functions

Source: *Islamic Finance Case Studies Focus Group Discussion (2022)*

Box 2: Kedah State Zakat Authority

LEMBAGA ZAKAT NEGERI KEDAH

Kedah State *Zakat* Authority [Lembaga *Zakat* Negeri Kedah (LZNK)] is one of the most progressive users of fintech for its operations. Fintech has been applied in collections; distribution; transparency and reporting functions, and LZKN has also collaborated with fintech start-up and agents. Some highlights in LZKN's experience:

- The digital transformation in LZNK took place as early as 2017.
- The LZNK has many digital initiatives (e.g., food bank system application, kiosk machines for *zakat* payment).
- The LZNK received the outcome of the adopting fintech in process in terms of increasing the collections, reducing the operation expenses, enhancing the transparency and gaining donors' trust and beneficiaries' satisfaction, and enhancing the decision-making process by using real-time data.
- The LZNK has been able to create a digital work culture where humans interact with machines.
- The LZNK established a *zakat* internationalization report centre. This report centre main roles are (conducting report on *zakat*, collaborating with academic institutions; organizing conferences and trainings events) to improve the LZNK and other Islamic social finance institutions in Malaysia and other Muslim countries in general.

4.3.2 Impact of Fintech Adoption in Islamic Social Finance

The FGDs experts' view on the impact of the adoption of fintech by Islamic social finance institutions (*zakat* and *waqf*) in Malaysia can either be observed in the current Islamic social finance performance or it has potential impact in the near future.

> "*The use of fintech in PPZ MAIWP to approach payers has been used as best as possible. The online system has been used extensively. In addition, we also use internet banking. The zakat managers also support the implementation of FinTech.*"
>
> **(MAIWP *Zakat* Collection Centre Officer)**

Source: *Islamic Finance Case Studies Focus Group Discussion (2022)*

> "*The usage of cashless technology is a zakat policy in Pahang. The usage of fintech is growing more common, with digital receipts replacing cash payments, and the elderly increasingly accepting, mastering, and employing the technology.*"
>
> **(MUIP *Zakat* Centre Officer)**

Source: *Islamic Finance Case Studies Focus Group Discussion (2022)*

> "*The Lembaga Zakat Kedah (LZNK) began its digital makeover in 2017. The implementation had changed our working procedures, working culture, customer experience, reducing errors, reducing unnecessary costs, paperless as well as accurate and in time decision-making.*"
>
> **(Kedah *Zakat* Council Officer)**

Source: *Islamic Finance Case Studies Focus Group Discussion (2022)*

> "*The potential of the zakat distribution efficiency, measured by the level of implementation connected to the use of fintech in collecting, administering, and distributing by Pulau Pinang, not even more than 50 percent at the moment.*"
>
> **(Pulau Pinang *Waqf* Officer)**

Source: *Islamic Finance Case Studies Focus Group Discussion (2022)*

> "*Some of the zakat institution, they tried to map it, and have live monitoring. Lembaga Zakat Negeri Kedah (LZNK) has this kind of mapping where they can see within their state, where the fund is coming from and where it is going to. But what they can see it from the high level.*"
>
> **(INCEIF FinTech Expert)**

Source: *Islamic Finance Case Studies Focus Group Discussion (2022)*

> "*Technology do the heavy lifting – data collection, data processing, data analysis, data recommendation. But the human part will be needed to provide the input. They do the site visit, the interview, evaluating the application form. This is important to ensure the governance of the funds and distribution of funds can be ascertain, at the very first point.*"
>
> **(FinTech Industrial Player Expert)**

Source: *Islamic Finance Case Studies Focus Group Discussion (2022)*

First, the observed impact could be seen now in the improving of the operation efficiency and effectiveness in terms of collection fund and distribution activities. Next observed impact is allowed real-time detection and tracking of the channelling the collected fund from donors to beneficiaries. And creating a tech-friendly culture among the Muslim community in Malaysia. In addition, enhance the friendly environment community by reducing the use of paper and using more automation processes. Likewise, enhancing the transparency and reporting performance using digital technology will be a priority exercise going forward (See Figure 4.6).

Figure 4.6: Current Impact in the Islamic Social Finance's Performance

Source: *Islamic Finance Case Studies Focus Group Discussion (2022)*

The second group is potential impact. By collecting and analysing the whole value chain data in the upstream (i.e., the improvement of policy, the collection, the managing, the distribution process) and downstream (i.e., capturing and recording tangible impacts of the distribution fund has given to each individual family or recipient) components (See Figure 4.7).

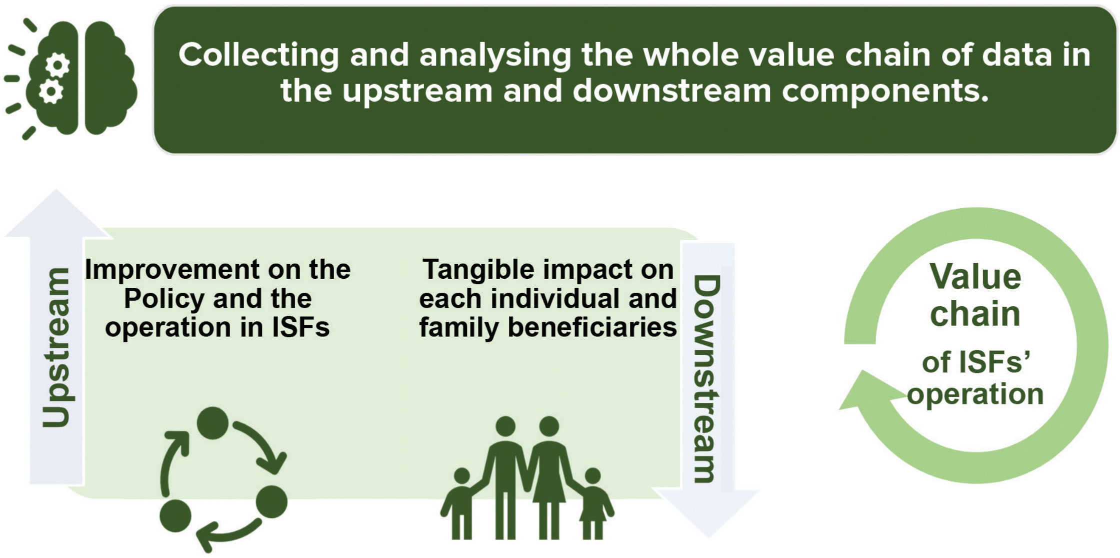


Figure 4.7: Potential Impact in the Islamic Social Finance's Performance

Source: *Islamic Finance Case Studies Focus Group Discussion (2022)*

Fintech has the power to significantly enhance the Islamic social finance institutions' operation efficiency and effectiveness. The ISFs experts strongly believe that fintech is impacting the Malaysian Islamic social finance institutions services in a very momentous way. Thus, fintech is considered as a game changer for Islamic social finance institutions.

4.3.3 Issues, Challenges, and Prospects of Fintech Adoption in Islamic Social Finance

There are a number of problems faced by the ISFs in adopting fintech. Among them are: lack of understanding by the stakeholders, high costs of infrastructure, technological risk and cybersecurity risks, and legal constraints including *Shari'ah* compliance (IFN Financial Innovation Report, 2021). These issues and challenges are common to all ISFs in the world.

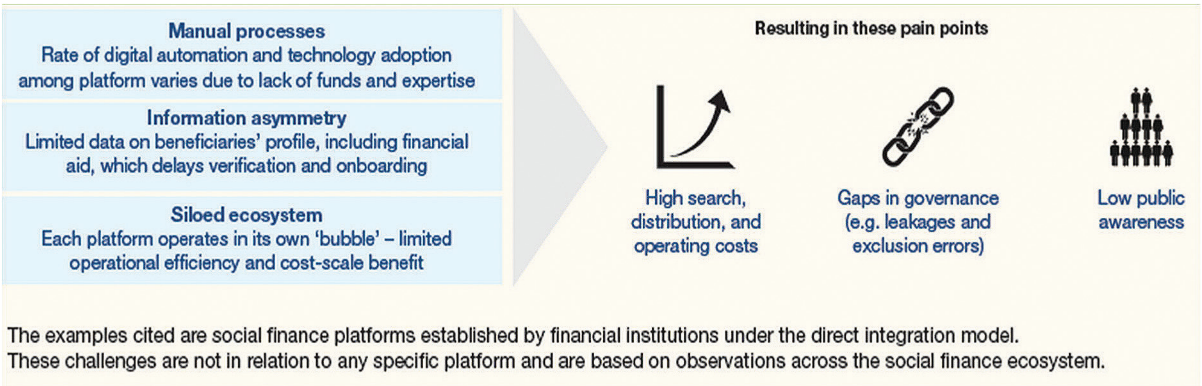


Figure 4.8: Common Challenges in Islamic Social Finance in Malaysia

Source: *Financial Sector Blueprint 2022-2026* (BNM, 2022)

The challenges and issues of fintech adoption in the Islamic finance institutions (*zakat* and *waqf*) in Malaysia could be grouped into five groups. First stakeholders related issues. The first challenges in this group are the digital literacy among the Islamic social finance's employees, and the digital literacy among the *zakat* payers, *waqf*, and donors. The spiritual culture issue, as many donors and *zakat* payers especially the elderly people prefer to physically hand their *zakat* or donation to the imam in a mosque or mutawalli and receive praying (*doa*) and blessing from the imam. Thus, the absence of the spiritual aspect in fintech payment methods considered one of the main issues for fintech acceptance among the stakeholders of Islamic social finance in Malaysia.

"*If there is a good 'ayn with good fintech technology, but there is no policy support from the government, the waqf will not progress. If it is the policy's direction, it is excellent.*"

(Perlis Islamic Religious Council Officer)

Source: *Islamic Finance Case Studies Focus Group Discussion (2022)*

"*When making online payments, the issue of "merchant fees" will arise. According to the total amount of waqf (in RM) or the number of times waqf is made, 'merchant fees' may apply in a variety of circumstances.*"

(MAIWP *Waqf* Centre Officer)

Source: *Islamic Finance Case Studies Focus Group Discussion (2022)*

The second issue is related to the digital aspects. The internet connection and the IT infrastructure within the Islamic social finance institutions. Third group is related to the cost. The cost of developing talent and experts internally within the Islamic social finance institutions (i.e., IT training the existing staff and attracting talent and fintech experts). Another cost is fintech (apps, software, website) vendors either for developing or the maintenance, another considerable cost is the fintech consultation cost.

The fourth group is related to the legal and *Shari'ah* compliance aspects. First challenge is related to the state-based administration of *waqf* and *zakat* which limits cross-state collaboration or activities. There is also the difficulty in charging W*aqf* management fees in case of fintech *waqf* i.e. when and how to charge the *waqf* management fees and the suitable contracts. Tax exemption on fintech waqf is not currently available but should be a good incentive to be established. The last challenge pertains to w*aqf* types, as the fintech focused only on cash *waqf*, but not other *waqf* types (buildings, lands, etc.) (Figure 4.9).

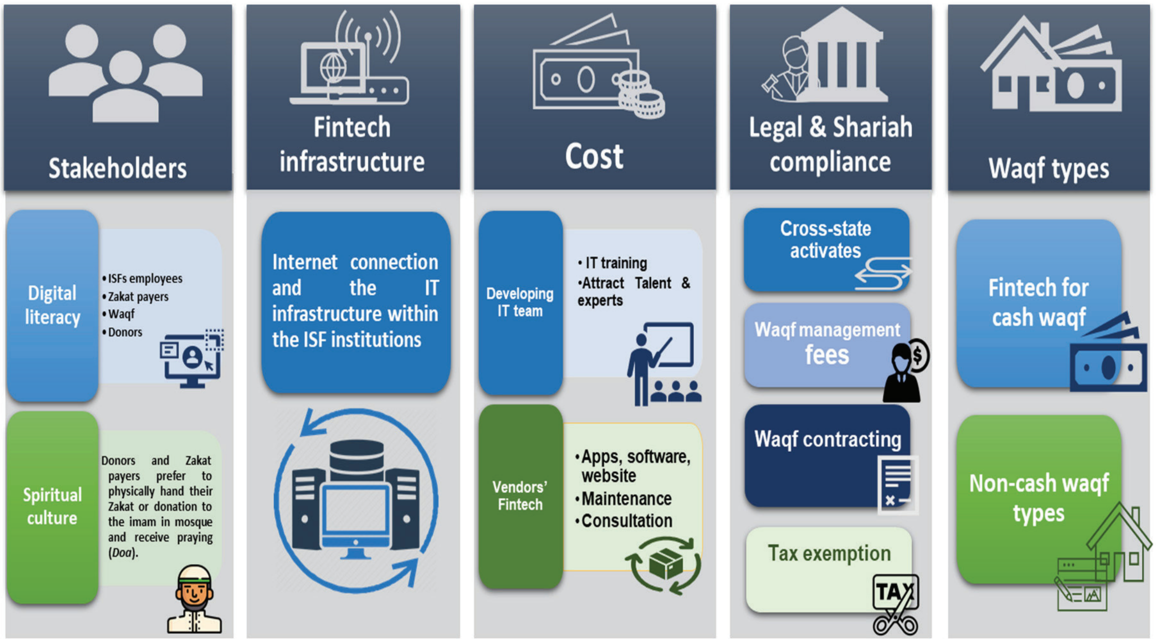


Figure 4.9: Challenges of Fintech in Islamic Social Finance in Malaysia

Source: *Islamic Finance Case Studies Focus Group Discussion (2022)*

Despite the above challenges, the potential of adopting fintech is huge. Fintech can improve the efficiency of the Islamic social finance institutions operations and allow them to be more transparent in reporting their activities and performance. The transparency of Islamic social finance institutions means more real-time data use and the information in their reports is more reliable, relevant, and timeliness. Fintech as a productive tool allows Islamic social finance institutions to gain the trust of the donors by providing useful information which leads to effective decision making and provide beneficiaries with more sustainable and effective services. This eventually increases donors' trust levels.

"*The Islamic capital market have released waqf featured fund framework- an example of when SC wants to integrate the capital market with the benevolent or the Islamic social finance. What it does is it allows fund managers or unit trust management companies to integrate certain waqf feature framework into their offerings to allow investors to have an opportunity to participate in the product that could deliver a sustainable benefit to the society. Having that framework as the foundation, we can always put technologies surrounding it to make it more efficient and seamless. Fintech can come in to make the fund management process more efficient and more transparent.*"

(Securities Commission Malaysia Officer)

Source: *Islamic Finance Case Studies Focus Group Discussion (2022)*

Zakat and *waqf* institutions in Malaysia have yet to embrace a more advanced use of automated analysis and reporting functions allowed by digital technology. For instance, MAIWP has close to 200,000 *zakat* beneficiaries. Currently, to identify, to evaluate their needs, and determine how much funds to distribute, the approach is very much a manual process. Customer relationship management (CRM) technology can be used for managing all their stakeholder relationships and interactions with current or potential contributors and beneficiaries, and reduce issues related to database and manual approach to evaluating beneficiary's eligibility.

More than 90 percent of the *waqf* assets in Malaysia are very much in need of a proper monitoring and assessment on the yield, potential value as well as optimizing value. Therefore, digital transformation in the context of using AI, in particular natural language generation, understanding and processing, so fintech will help these institutions to convert a huge amount of data as scattered as it may be into narrative text to make a proper monitoring and assessments needed. Although this will be quite a complex solution, the ability to gather all the information, put it into the engine and then generate the analysis will greatly help these institutions in the near future.

It would be useful to see the prospects of fintech adoption on the Islamic social finance in Malaysia (Figure 4.10) for example: AI and NLP technologies to collect and analyse the whole value chain data in the upstream (i.e., the improvement of policy, the collection, the managing, the distribution process) and downstream (i.e., the tangible impacts of the distribution fund have given to each individual family or recipient) components applying the CRM based approach.

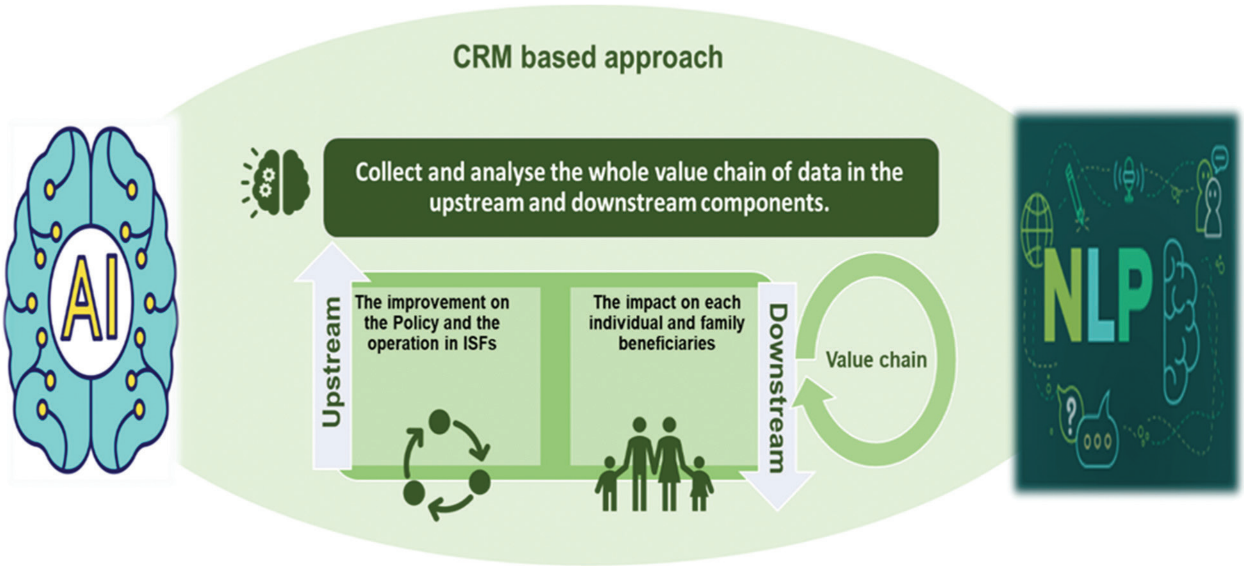


Figure 4.10: Potential Impact in the Islamic Social Finance's Performance

Source: *Islamic Finance Case Studies Focus Group Discussion (2022)*

4.3.4 Recommendations and Lessons from the Fintech Adoption in Islamic Social Finance in Malaysia

Participants in FGDs sessions provided four sets of recommendations. First recommendation is related to enhancing the collaboration between Islamic social finance institutions across the states in the fintech adoption and development. Second recommendation is consultation with fintech experts and collaboration with fintech start-up companies. Third recommendation is to collaborate with Securities Commission Malaysia and benefit from fintech platforms and B2B (business-to-business) ecosystem to enhance the efficiency and the transparency of the Islamic social finance performance. Fourth recommendation is to emphasize on training the Islamic social finance's employees to ensure mastering the fintech tools and options. Final recommendation is to enhance the transparency and real-time reporting practices using fintech (See Figure 4.11).

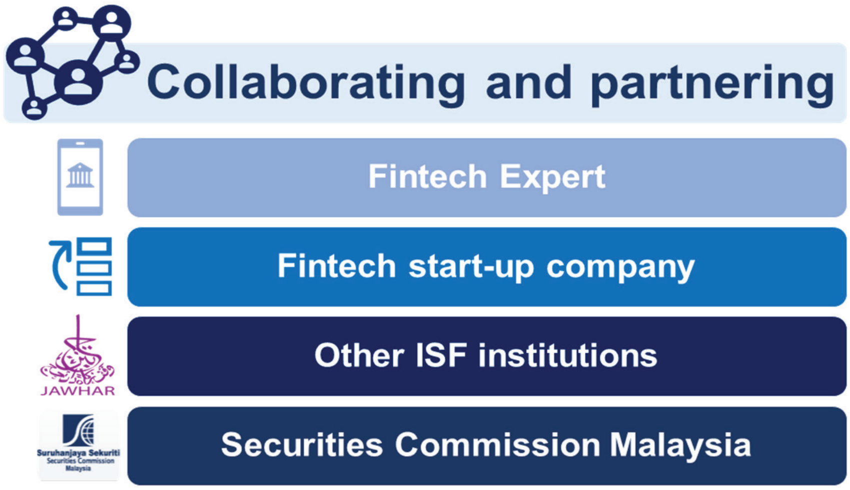


Figure 4.11: Recommendation to Improve Fintech Adoption in Islamic Social Finance in Malaysia

Source: *Islamic Finance Case Studies Focus Group Discussion (2022)*

4.4 Indonesia Fintech and Islamic Social Finance: Background

Indonesia's total population stands at 277.7 million in January 2022. Data show that Indonesia's population increased by 2.8 million (+1.0 percent) between 2021 and 2022. There were 204.7 million internet users in Indonesia in January 2022. Indonesia's internet penetration rate stood at 73.7 percent of the total population at the start of 2022. Data from Global System for Mobile Communications Association (GSMA) Intelligence shows that there were 370.1 million cellular mobile connections in Indonesia at the start of 2022.

Figure 4.12: Overview of the Adoption and Use of Connected Devices and Services

Source: *Datareportal* (2022)

However, since many people around the world make use of more than one mobile connection – for example, they might have one connection for personal use, and another one for work – it's not unusual for mobile connection figures to significantly exceed figures for total population.

GSMA Intelligence's numbers indicate that mobile connections in Indonesia were equivalent to 133.3 percent of the total population in January 2022.The number of mobile connections in Indonesia increased by 13 million (+3.6 percent) between 2021 and 2022. There were 191.4 million social media users in Indonesia in January 2022. The number of social media users in Indonesia at the start of 2022 was equivalent to 68.9 percent of the total population.

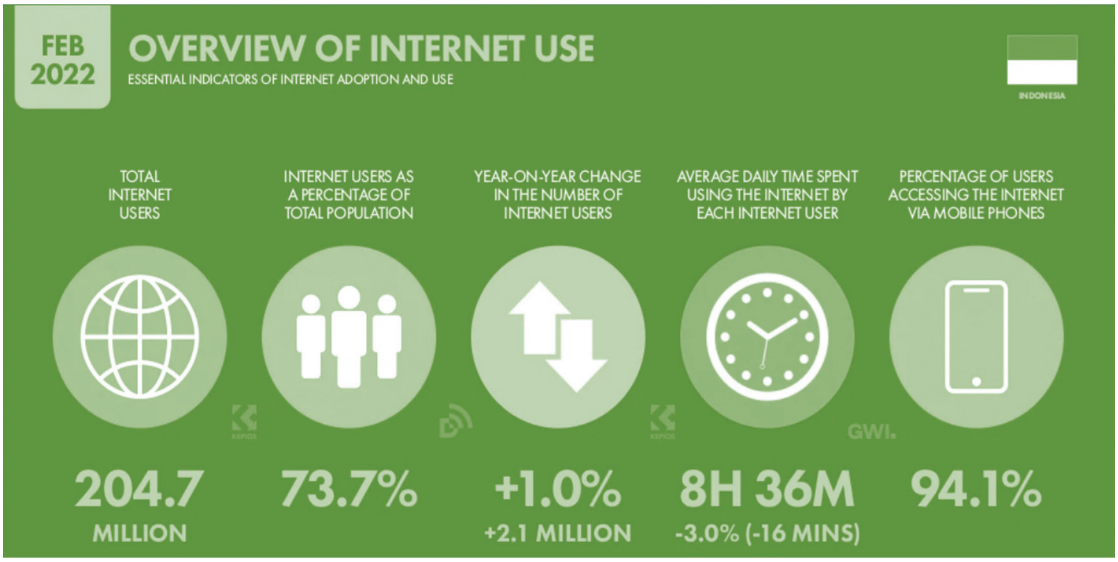


Figure 4.13: Essential Indicators of Internet Adoption and Use

Source: *Datareportal* (2022)

Not only social media, society is also increasingly adaptive to electronic-based payments. This is reflected in the amount of electronic money in circulation growing 49.06 percent to reach IDR305.4 trillion during 2021 according to Bank Indonesia. For 2022, BI estimates that electronic money transactions will increase by 17.13 percent to reach USD241.06 billion (IDR357.7 trillion). Meanwhile, during 2021, the value of digital banking transactions will increase by 45.64 percent to USD268.5 billion (IDR39,841.4 trillion), and it is projected to grow 24.83 percent to reach USD335.17 billion (IDR49,733.8 trillion) for 2022.

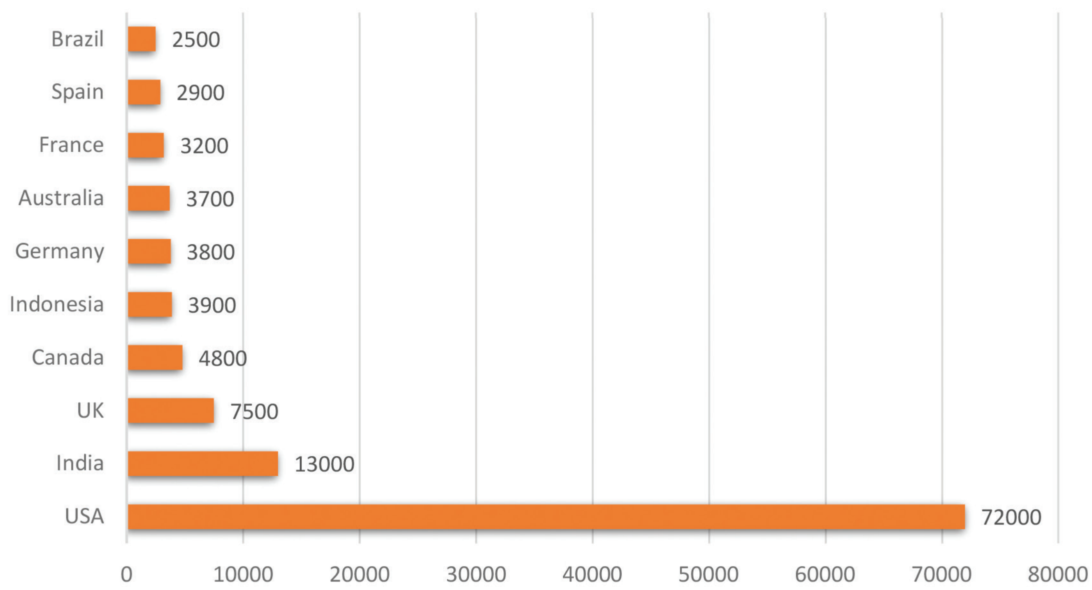


Figure 4.14: Top 10 Countries of the Most Start-Up (2022)

Source: *Start-Up Ranking Report 2022*

The digital market in Indonesia has encouraged start-ups to mushroom in the country. Indonesia has 2,324 start-ups as of December 2021. This number places Indonesia as the country with the fifth largest number of start-ups in the world. Indonesia's position is only behind the United States with 70,468 start-ups, India with 12,283 start-ups, Britain with 6,124 start-ups, and Canada with 3,204 start-ups. Another thing that has the potential to encourage the potential of Indonesia's digital economy is the growing development of financial technology companies (fintech).

The presence of fintech encourages wider adoption of electronic money in society. Based on reports from the United Overseas Bank (UOB), PwC, and the Singapore Fintech Association (SFA), the number of fintech companies was only 440 units in 2017. The number then increased by 32.5 percent to 583 companies a year later. The number of fintech companies again increased to 691 units in 2019 and 758 units in 2020. The figure rose another 3.56% to 785 fintech companies as of September 2021. The number of fintech companies in Indonesia is the second largest in Southeast Asia, right behind Singapore with 1,350 fintech companies. Malaysia is below Indonesia with only 549 fintech companies. Meanwhile, the Philippines and Vietnam both have 268 fintech companies.

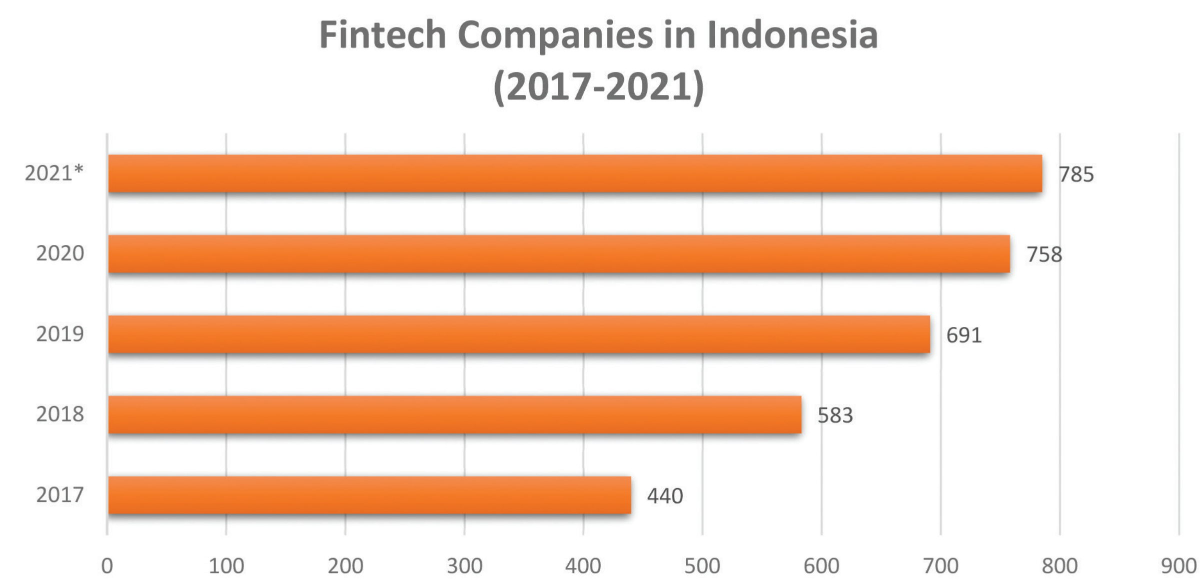


Figure 4.15: Fintech Companies in Indonesia

Source: *UOB, PwC & SFA* (2021)

The adoption of digital financial services and changes in the behaviour of the Indonesian people continue to lead to a digital economy and accelerated by the pandemic, so that the digital financial sector, including fintech, is clearly in a very strong position to play an increasingly important role. The growth of internet users and the significant economic value of digital activities are factors in the emergence of various kinds of fintech players or non-bank payment systems in Indonesia, such as OVO, Dana, BluePay, Midtrans, PayTren and so on.

Several Islamic banks in Indonesia such as Bank Syariah Indonesia, Bank Muamalat Indonesia and BCA Syariah also continue to innovate to create products and services that further facilitate digital transactions, starting from account opening services via smartphones, various types of payments, KTA/KPR application facilities and loans, to adequate security facilities.

The government has also been committed to enlarging the digital economy in Indonesia. One of them is through the preparation of the Indonesian Islamic Economic Masterplan (MEKSI) 2019-2024, which has 3 (three) pillars that are structured to strengthen Islamic economy and finance and realize the Vision of "*Independent, Prosperous and Civilian Indonesia by Becoming the World's Leading Islamic Economic Center*".

In the Indonesian Islamic Economic Master plan framework, strengthening the digital economy as one of the government's main strategies to develop the Islamic economy and finance in Indonesia along with 3 other strategies (shown in Figure 4.16) is the government's priority. The three strategies are: (1) Strengthening Halal Value Chain, which consists of halal food and beverage industry, halal tourism industry, Muslim fashion industry, halal media and recreation industry, halal pharmaceutical and cosmetics industry and renewable energy industry, (2) Strengthening Islamic Finance, (3) Strengthening Micro, Small and Medium Enterprises (MSMEs).

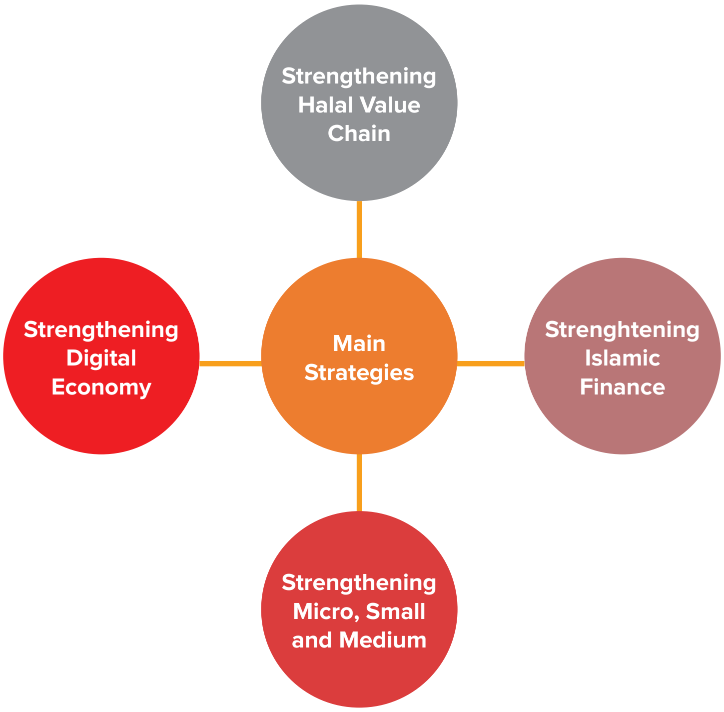


Figure 4.16: Strategies of Islamic Economy and Finance in Indonesia

Source: *Indonesian Islamic Economic Masterplan (MEKSI) 2019-2024*

In addition, five basic strategies have been formulated to support the ecosystems (shown in Figure 4.17), namely: (1) Strengthening regulation and governance, (2) Increasing Public Awareness and Literacy, (3) Report and development capacity building, (4) Quality improvement and quantity of human resources, and (5) Strengthening data, information and technology.

Figure 4.17: Basic Strategies of Supporting Ecosystem of Islamic Economy in Indonesia

Source: *Indonesian Islamic Economic Masterplan* (MEKSI) 2019-2024

In terms of regulation and support for the digital economy, the Indonesian government began to pay attention to its potential and had since issued several regulations to develop this sector. Among the strategic plans that have been issued by the government are the 2015-2019 Strategic Plan of the Ministry of Cooperatives and SMEs to develop the MSME sector through the digital economy, the 2015-2019 Ministry of Communication and Information Strategic Plan, Making Indonesia 4.0 by the Ministry of Industry, and the E-Commerce Roadmap by the Ministry Communication and Information. In Indonesia, three regulators are responsible for financial services and digital-based transactions. These bodies (BI and OJK) also regulate *Shari'ah* digital services.

Table 4.2: Regulators in Digital Financial Services

Bank Indonesia	Financial Services Authority	Ministry of Communication and Informatics
BANK INDONESIA BANK SENTRAL REPUBLIK INDONESIA	OJK OTORITAS JASA KEUANGAN	KEMKOMINFO
• e-Wallet • e-Money • Gate of payment • Principals • Switching companies • Card issuers and acquires • Clearing houses • Settlement agencies • Cryptocurrency and blockchains • National Payment Gate • Support for payment transactions, for example ATM, EDC, and data centers	• Peer-to-peer lending • Crowdfunding • Digital banking • Insurtech • Fintech in the capital market • Venture capital • Online financing • Data security • Consumer protection	• Telecommunication • Information Technology • Aspects of fintech which are included in information technology

Source: *Indonesian Islamic Economic Masterplan (MEKSI) 2019-2024*

For the fintech industry, which requires heavy monitoring, the government through Bank Indonesia and the OJK also issues regulations and guidelines. Bank Indonesia has the Fintech Office, supports innovation through the Sandbox Regulatory, and issued regulations related to fintech through Bank Indonesia Regulation Number 19/12 of 2017 concerning the implementation of financial technology. Meanwhile, the OJK issued POJK Regulation Number 77/POKL.01/2016 concerning Information Technology Lending and Borrowing Services, based on POJK Number 13/POJK.02/2018 concerning digital financial innovation in the financial sector.

Table 4.3: Digital Economic Challenges and Opportunities

Aspect	Opportunity	Challenge
Demand and Market	1. Growth in the number of Indonesian and global Muslims 2. Growth of digital transactions, especially transactions via mobile 3. Growth of the Islamic fintech industry 4. Expansion of the sector from e-commerce & e-travel to education, health, and technology	1. Lack of digital economic capabilities 2. Inequality of exposure to digital technology between urban and rural areas (digital divide) 3. Literacy of halal products and halal branding
Production/ Input/ Resource Factors	1. Digital startup investment continue to increase 2. Improving the conditions of telecommunications infrastructure 3. The level of ICT graduates in Indonesia is relatively high 4. Foreign investors' interest in domestics digital startups 5. The creation of new types of work	1. The cost and internet and electricity access are stilll relatively expensive and uneven 2. Curriculum and education for the digital economy have not yet been formed 3. Domestic venture capital has not been able to meet startup capital requirements 4. There is no sharia advisor for the digital startup industry 5. The lack of professionals in the field of digital economics
Regulations	1. Government support for the digital economy industry in general 2. There is a roadmap, strategy, and government policy related to the digital economy industry carried out by relevant Ministries and Institutions (E-Commerce Roadmap)	1. Government regulations cannot accommodate the rapid growth of digital startups 2. Harmonization of regulation and coordination between institutions 3. Rules for consumer protection in the digital sector 4. Issues of cybercrime and cyberattack

Source: *Indonesian Islamic Economic Masterplan (MEKSI) 2019-2024*

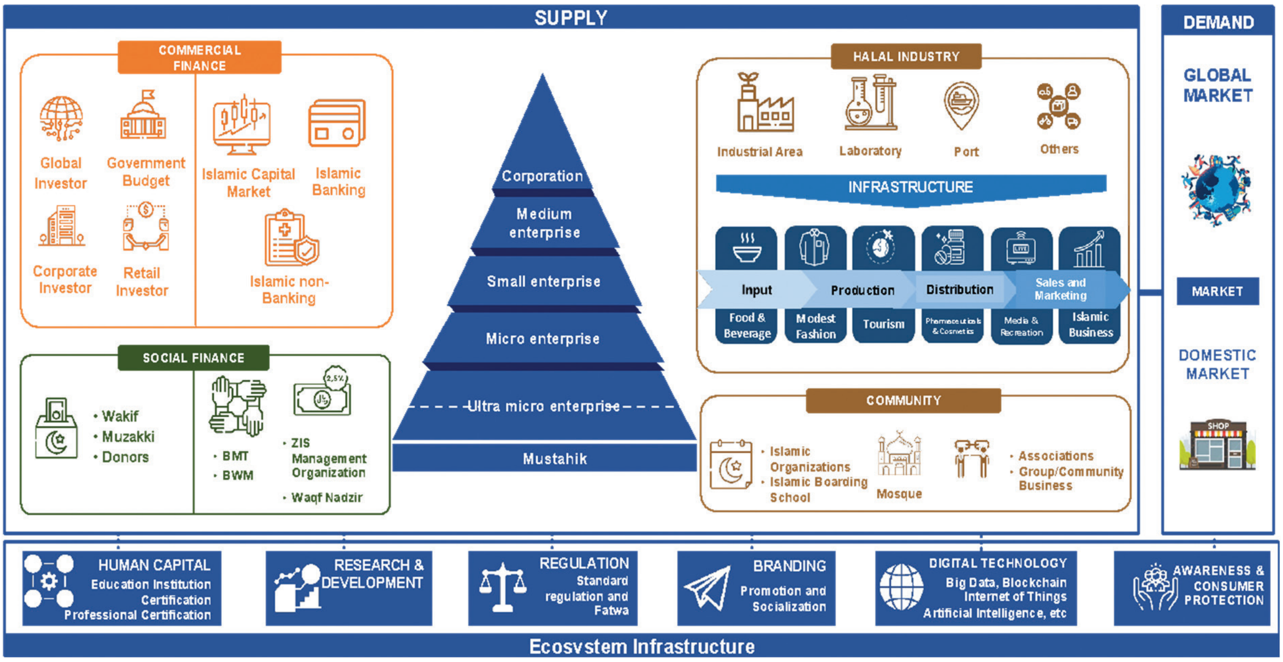


Figure 4.18: Islamic Economic and Financial Ecosystem

Source: *Indonesian Islamic Economic Masterplan (MEKSI) 2019-2024*

In addition to commercial finance, social financial support from *zakat*, infaq, alms and *waqf* (ZISWAF) is also equally important as an industrial cluster. People who are below the poverty line (mustahik) get assistance from *zakat*, infaq and alms funds, so that even though they do not have income, they can still meet their basic needs for life. One of the roles of *zakat* is to eliminate poverty and maintain the level of national consumption. The mobilization of *zakat* funds from *muzakki* to be distributed to mustahik is carried out by amil *zakat* institutions at the regional to national level. Another Islamic social financial instrument is *waqf*, which is an asset/endowment with a wider range of beneficiaries than *zakat* asnaf. The Nadzir institution or *waqf* manager is tasked with collecting *waqf* funds, managing the assets/*waqf* funds and distributing the benefits to beneficiaries according to the mandate of the wakif.

4.5 Key Players and Institutional Enablers

4.5.1 Role of the Financial Service Authority (OJK)

OJK carries out its authority as an institution that provides regulations and oversees fintech-based companies. In general, OJK is tasked with reviewing and studying fintech developments and preparing regulations and development strategies. OJK is also authorized to protect consumer interests regarding the security of funds and data as well as national interests related to preventing money laundering and terrorism financing, as well as financial system stability.

4.5.2 Role of the Central Bank of Indonesia (BI)

Bank Indonesia as a macroprudential institution, in maintaining orderliness in payment traffic related to fintech, has several roles, one of which is Bank Indonesia ensuring protection for consumers, especially regarding guarantees for the confidentiality of consumer data and information through cyber security networks.

4.5.3 Role of the Indonesian Ulama Council (MUI)

The Indonesian Ulama Council through the MUI DSN has a role as fatwa authority or collective ijtihad institution, mufti jama'i, regarding the development of Islamic economy, finance and business including Islamic fintech.

4.5.4 Role of the National Zakat Board (BAZNAS)

The Indonesian National *Zakat* Board (BAZNAS) provides digital *zakat* convenience services through a financial technology (fintech) platform. This service facilitates the community in performing *zakat*, *infaq*, alms (ZIS) worship easily.

4.5.5 Role of the Indonesian *Waqf* Board (BWI)

Similar to BAZNAS, the Indonesian *Waqf* Board (BWI) has begun to utilize a number of digital platforms in Indonesia in the collection and dissemination of *waqf*.

Other than the above key players, Islamic fintech is also linked to Indonesian *Shari'ah* Fintech Association (AFSI) and *Amil Zakat* Institution (LAZ). Asosiasi Fintech *Shari'ah* Indonesia (AFSI) is an umbrella organization bridging the communication between Islamic fintech industry, communities and the Indonesian government & advocating for greater role of Islamic fintech in supporting financial inclusion in Indonesia. Meanwhile, The Amil *Zakat* Institution (LAZ) is an institution that assists BAZNAS, in the implementation of the collection, distribution, and utilization of *zakat, and* is formed by the private sector and operates outside of the government.

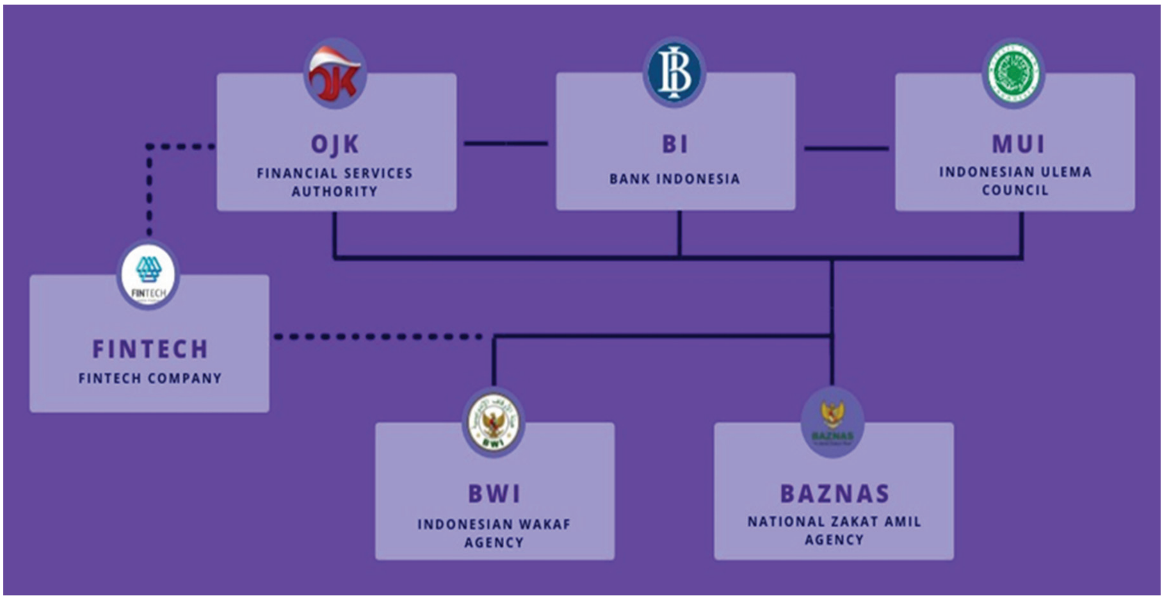


Figure 4.19: Stakeholders in Fintech and Islamic Social Finance in Indonesia

Source: *Islamic Finance Case Studies Focus Group Discussion (2022)*

The potential for *zakat* in Indonesia according to BAZNAS (Indonesian *Zakat* Authority) data for 2021 is USD14.6 million (IDR217 trillion), the potential for *waqf* which is largely in the form of land, around 58,259 hectares managed by the Ministry of Religion Affairs and 21,000 hectares managed by an Islamic organization called as Muhammadiyah – roughly valued around USD12.1 million (IDR180 trillion).

According to OJK, fintech is divided into three clusters; P2P lending fintech (borrowing or financing), SCF (Security Crowd Funding) which used to be Equity Crowd Funding, fintech non-P2P Lending and SCF. There is a digital financial innovation (IKD) in the form of credit scoring, to detect and score the borrower using traditional and non-traditional data. An IKD model (digital finance innovation) can detect the borrower's legitimacy. A SCF fintech intends to provide funds for the MSMEs that need capital. In fact, there is no *Shari'ah* label from the DSN or from the OJK or BI but runs with the *Shari'ah* concept. There are 10 SCF companies, one with a *Shari'ah* concept and 102 P2P lending consisting of seven *Shari'ah* providers.

In terms of contributions in P2P lending, it has not had a large contribution in *Shari'ah* fintech and this poses a challenge. The growth of Islamic banking from 5 percent now to 6 percent and in terms of assets was only 2.1 percent of the Islamic P2P asset portfolio. In terms of disbursement of new financing only 1.7 percent of all disbursements means that it is still very small. From the host lending, the financing is still not 5 percent which is 3.31 percent which is a challenge for P2P *Shari'ah*.

The *Shari'ah* concept was not mentioned in *Shari'ah* fintech by OJK on P2P lending but in practice there are companies using the *Shari'ah* concept. This is supported by the MUI fatwa through the issuance of MUI DSN's fatwa in an article of 117/2018 in February regarding information technology-based financing services based on *Shari'ah* principles. This fatwa was the basis for *Shari'ah* P2P fintech. For SCF, there is no fatwa related to *Shari'ah* but OJK allows the operations. In 2018, MUI has issued a fatwa related to this aspect but needs to update it again.

In P2P Lending OJK only facilitates people who borrow and people who have funds through P2P but there is no (*zakat*, infaq, sadaqah and *waqf* (ZISWAF) element. Meanwhile, when fintech platform companies must cooperate with the ZISWAF institution, the *zakat* can be deducted from any profits.

The fintech payment model may depend on the fintech company. The Fintech development referred to in terms of the Islamic financial process talks about the collection, management, distribution, and aspects related to the non-ZISWAF world. OJK presented that by developing the ecosystem of ZISWAF in Indonesia, it has a fairly good adaptation along with technological developments in Indonesia. Meanwhile, *zakat* institutions have interacted with fintech quite extensively.

Tabel 4.4: List of Islamic Fintech in Indonesia

No	Name of Electronic System	Website	Name of Company	Date of Registration	Type of Business	Operational System
1	Duha SYARIAH	www.duhasyariah.com	PT Duha Madani Syariah	21 Apr 2021	P2P Lending	Android & iOS
2	Ammana.id	https://ammana.id	PT Ammana Fintek Syariah	13 Dec 2019	P2P Lending	Android & iOS
3	investree	https://www.investree.id	PT Investree Radhika Jaya	13 May 2019	P2P Lending	Android & iOS
4	ALAMI	p2p.alami*Shari'ah*.co.id	PT Alami Fintek *Shari'ah*	27 May 2020	P2P Lending	Android & iOS
5	DANA SYARIAH	http://danasyariah.id	PT Dana Syariah Indonesia	23 Feb 2021	P2P Lending	Android
6	LAHAN SIKAM	https://www.lahansikam.co.id/	PT Lampung Berkah Financial Teknologi	24 Aug 2021	P2P Lending	Android & iOS
7	PAPITUPI SYARIAH	www.papitupisyariah.com	PT Piranti Alphabet Perkasa	8 Sep 2021	P2P Lending	Android
8	ETHIS	ethis.co.id	PT Ethis Fintek Indonesia	17 Sep 2021	P2P Lending	Android
9	Kapital Boost	https://kapitalboost.co.id	PT Kapital Boost Indonesia	30 Oct 2019	P2P Lending	Android
10	Qazwa	https://qazwa.id	PT Qazwa Mitra Hasanah	24 Aug 2021	P2P Lending	Android

Source: *Islamic Finance Case Studies Focus Group Discussion (2022)*

In Indonesia, cash *waqf* linked sukuk is managed by Bank Indonesia. However, other forms such as murabaha financing, musyarakah, ijarah financing schemes have not been implemented optimally. *Zakat* and *waqf* have a strictly regulated fiqh concept. In the MUI fatwa, it is only limited to the fatwa in the form of qardhul hasan lent to those in need, including SMEs but there must be limited sets for better control. They provide a free crowdfunding platform for labels. This has been integrated between ZISWAF and fintech, they are basically able to attract many Islamic social institutions to use their payment gateways because they provide a white label crowdfunding platform. The digital transformation carried out, especially at BWI, has encouraged or built a digital *waqf* ecosystem, it must be admitted that it is quite late compared to the adoption in *zakat*.

Based on experience at BAZNAS, fintech has become the backbone for digital collection which is required to be maintained. There are various platforms that are used to strengthen digital services apart from fintech, BAZNAS also looks for other applications to be used as a backbone for collection purposes. BWI (Indonesian *Waqf* Agency) is actually almost the same as what has been experienced in BAZNAS. This Fintech has now been used by the UPZ (*Zakat* Collection Unit) (as already received legal standing) to collect *zakat*. The development of the *zakat* collection is affected by the use of fintech. This initiative from BAZNAS intends to make fintech as the backbone, however it needs to strengthen its legal standing.

These are important stakeholders for ZISWAF who can directly interact or directly support are; universities/ colleges; community organizations; pesantren (boarding school); secondary *Shari'ah* cooperatives.

Figure 4.20: Stakeholders Supporting ZISWAF in Indonesia

Source: *Islamic Finance Case Studies Focus Group Discussion (2022)*

The first is Universities or colleges that have Islamic economics study programs are very supportive of ZISWAF. There are *zakat* courses, management economics as well as *waqf* studies that can be potentially explored.

The second is community organizations, this is an important thing that must be considered. Community organizations such as Nahdlatul Ulama, Muhammadiyah and other mass organizations have very good solidarity, when the head of the organization or the leadership of the mass organization says any instructions, it will be followed by all its members. This is needed to encourage members to have the *waqf*.

The third is pesantren, pesantren has its own impression. The biggest Islamic boarding school in Indonesia is Gontor, which has alumni who have founded Islamic boarding schools, there are 400 alumni and these 400 have graduated many students or Santri throughout the country. These graduates have established more pesantren (boarding schools) with even a larger number which create *zakat* and *waqf* potential.

The fourth is secondary *Shari'ah* cooperatives. In Indonesia, it is permissible to have cash *waqf*. The secondary *waqf* cooperative has many primary cooperatives, sometimes during times like Ramadan or Eid the need for funds is extraordinary. If this can be funded with *waqf*, then used for financing and the risks could be considered. Or choose primary cooperatives that have minimal risk and promising profits to be given funds from *waqf* funds.

Lastly, the initiative of AFSI is to try to encourage collaboration so that every company doesn't play alone. For example, the initiation initiated by KNEKS is KoLaKS, namely the collaboration of Islamic finance institutions.

A good example of *waqf* in practice is the popular Pesantren or Islamic Boarding Schools in Indonesia. Among the most successful Pesantren that has mobilised *waqf* funds from all stakeholders is the Gontor Islamic Boarding (GIS) school in Ponorogo, East Java. It runs fully on *waqf* funds just like Al-Azhar University in Egypt. Many students have successfully completed their studies and are currently employed in Indonesia and other Muslim countries.

GIS has 235,000 hectares of *waqf* land since 1991. This was managed by the Foundation for the Maintenance and Expansion of the Modern Pondok *Waqf* in Gontor. In fact, this institution was established on 12 October 1958, by its founders (Trimurti) represented by 15 people who were appointed as nazirs. The nazirs were then appointed to the *Waqf* Board of the Modern Darussalam Gontor Islamic Boarding School. In order to sustain and grow Gontor as an Islamic endowment institution similar to al-Azhar University *waqf* was pursued by the board to self-sustain its operating expenses. The waqif or the founder of the Gontor gave up their heirloom property rights in exchange for the advancement of Islam, the umma, and its educational system through Islamic endowments.

As instructed by Trimurti, who freely gave their property, including their soul, Gontor *Waqf* Corporate Management is responsible for administering its *waqf* assets (including value, system and property) based on the goal of 'ibadah, praising Allah SWT. Since they must acknowledge that everything will be held accountable to Allah SWT, this is a respectable value that inspired the Pesantren community to carry out their duties in accordance with the Qur'an and al-Hadith. The *waqf* charter, vision, and mission of Gontor *Waqf* Institutions are the foundations upon which management of *Waqf* is built upon. The charter covers a number of aims namely; First, Gontor must continue to be an Islamic-compliant religious social activity ('amal Jâriyah). Second, Gontor must be a source of general information, Arabic and religious knowledge that adheres to pesantren-mind. Third, Gontor is a community service organization with an aim to develop the ummah's character for both internal and external welfare. Fourth, Gontor needs to be promoted and maintained so that it can one day become a reputable Islamic university. Fifth, the *waqf* body must have a notarial deed right away to guarantee that the *waqf* mandate has official legal force.

In order to realize the "Five Principles of Gontor" and produce Islamic instructors and graduates who have three important values. They are faith (imân), deed (amal), and scientific ('ilm). Gontor balances Islamic principles in every action conducted, including distribution of *waqf* outcomes namely developing of *waqf* assets for teaching and education, providing infrastructure and facilities for teaching and learning, financing from its own financial sources, and strengthening the sustainability of family welfare who directly contribute to and are responsible for the sustainability of Gontor.

Waqf assets generated by Gontor are invested to produce income for the institution. Many business units have been set-up on every campus. There are 30 units specifically for productive business units at campus Gontor in a variety of businesses that have been operating since 1970. It showed the corporate management of the Gontor *Waqf*'s commitment to accountability in cooperation with all external partners and members.

Additionally, over the past four years, Gontor *waqf* land has grown to 24 acres and is still growing. The *waqf* land expansion program can function effectively with all the available resources. *Waqf* land is expanded and developed by endowments and purchasing new land. Currently Gontor campus consists of buildings and infrastructure such as mosques, dorms, madrasas, and 14 branch campuses for boys and 7 branch campuses for girls. Gontor's achievement in mobilizing *waqf* cash and properties should be adopted by other Muslim countries to provide quality Islamic and contemporary education to all youths. Youths are the future leaders of the nation. Quality education through *waqf* can be provided as shown by Gontor.

Table 4.5: Gontor *Waqf* Land Expansion 2016-2019 Over 25 Regions in Indonesia

Year	Area of M^2
2016	11,081,968
2017	12,620,269
2018	12,643,712
2019	15,640,612

Source: *YPPWPM* (2019)

Currently, the mandate of wakif has been achieved, namely establishing a university. The university was initiated in 1963 and only became a full-fledged university in 2014. The establishment of a university took longer because of human resource problems.

Moreover, with the launch of the cash *waqf* movement by the Vice President of the Republic of Indonesia, H.E. KH Ma'ruf Amin in 2021, Gontor also has initiated to implement a cash *waqf* platform. The cash *waqf* collection can be successful by adopting fintech. Fintech will make the expansion of *waqf* faster and easily managed.

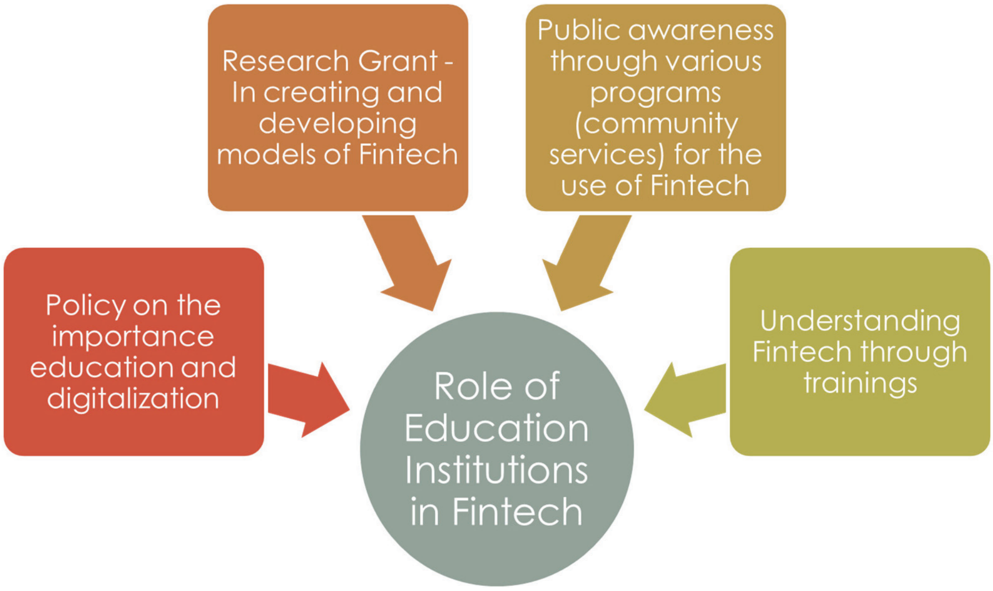


Figure 4.21: Role of Education Institutions in Fintech

Source: *Islamic Finance Case Studies Focus Group Discussion (2022)*

4.6 Success Factors and Challenges

4.6.1 Current Fintech Adoption in Islamic Social Finance Institutions

Adopting fintech in collecting and distributing ZISWAF is one of the effective ways in order to achieve the target optimally. However, there are 2 issues that have emerged, namely: the financing scheme and how to collect these financing as much as possible. These have been incurred in many years. But the institutions in charge like BAZNAS, LAZ, BWI are trying to minimize these issues. Expectedly the solutions could be identified, one of them through the adoption of Fintech (financial technology).

Meanwhile, the *zakat* actualization in Indonesia is about 5% with only USD620 million (Rp9/10 trillion) of the estimated USD15 billion (Rp217 trillion). This goes to *Waqf* development which is still far from expected. Depending on the fintech itself, if the fintech payment model can be introduced, the distribution of *zakat* is done effectively. The technology development of Fintech is needed as suggested by OJK and Bank Indonesia.

Based on the Indonesian Islamic Fintech Association (AFSI) observations regarding the use of technology are still very focused on the fund raising movement, even though the success of ZISWAF is divided into two fund raising and distribution. Meanwhile, the current best practice, although the implementation may not be perfect, there are several platforms which could be enhanced through associations. For example; a platform owned by the PBMT Indonesian (BMT Association) which is designed to be used jointly by a number of BMTs.

Currently some ZISWAF or LAZ in several Islamic banks provide several payment models ranging from transfer transactions, virtual account payments via digital wallet money, transactions via credit or debit cards. According to ALAMI, this can open wider access to users of Islamic financial services, especially in terms of Islamic social finance itself, which currently targets *mustahik*. It needs to build access to financial service access resources and access to opportunities for *mustahik* through the adoption of digital technology that is commonly developed by Fintech actors. Meanwhile, BWI doesn't have a model for productive *waqf*. It is possible if all stakeholders agree between BWI, KNEKS, Fintech associations and existing players to try making a comprehensive piloting from the collection to the distribution aspect.

Several institutions have begun to initiate distribution platforms that can support the digitization of system management. For example, KNEKS received information that the Sumsel Babel Syariah bank had built a companion platform for their *zakat* distribution which is now also being offered to BAZNAS Sumsel Babel. How can *mustahik* be given a barcode, this barcode will contain few rupiahs that can be spent at a neighbouring shop merchant whose merchant has been given a system to capture the barcode scanner label balance only, the balance is transferred from *mustahik* to the merchant. Then, the merchant will be integrated with the Sumsel Babel Syariah bank account.

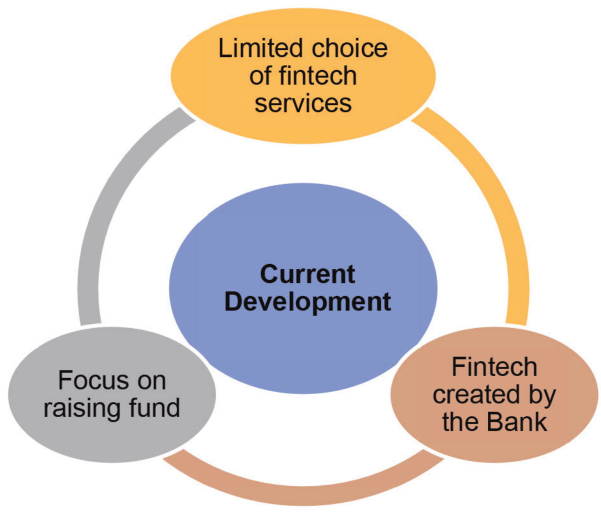


Figure 4.22: Current Development of Indonesian Fintech on ZISWAF

Source: *Islamic Finance Case Studies Focus Group Discussion* (2022)

> *"The fintech development in relations to the Islamic process consists of collection, management, distribution, and aspects related to the non-Ziswaf. But currently, the collection of Zakat and Waqf starts of using various Crowd Funding platforms."*
>
> **(Head of Division on Islamic Social Fund, National Committee for Islamic Economy and Finance, KNEKS)**

Source: *Islamic Finance Case Studies Focus Group Discussion (2022)*

> *"ZISWAF practices themselves do not yet to be adopted. In P2P lending, only facilitates people who borrow and who have funds and there is no ZISWAF element."*
>
> **(Officer from Financial Services Authority or OJK)**

Source: *Islamic Finance Case Studies Focus Group Discussion (2022)*

4.6.2 Impact of Fintech Adoption in Islamic Social Finance

In terms of regulations, adjustments are needed due to the increase in the dynamic of trends on Fintech. There should be an element of flexibility so that speed and convenience can be encouraged, but in today's context with existing regulations it is still not possible to do or adopt Fintech unless to be connected to collaborate with LKS-PWU (Islamic Financial Institutions Recipient of Cash *Waqf*) from the aspect of fundraising, including *waqf* through money and *waqf* through Fintech money. These have great potential when collaborating with *waqf* Nazir institution to expand the access of *Waqf*.

The implementation of Fintech in ZISWAF institutions such as *zakat* institutions is more advanced and some even have virtual system services. But the *waqf* sector needs improvement and standards. In fact, the distribution of *zakat* can also be developed. Fintech can be a platform, for example a means of developing cash *waqf* investments. This investment scheme has not yet been occupied, so it means that the money *waqf* investment needs to be invested. Currently, the investment made is still conservative, namely through *Shari'ah* banking instruments at most.

There are many regulatory aspects of the OJK and the financing side by Bank Indonesia that have not been able to be implemented by stakeholders. As has been stated, the existing regulations or POJK (OJK Regulation) still do not specifically mention the *Shari'ah* requirements. Expectedly, it can be upgraded and highlighted in the future to include the *Shari'ah* specifications.

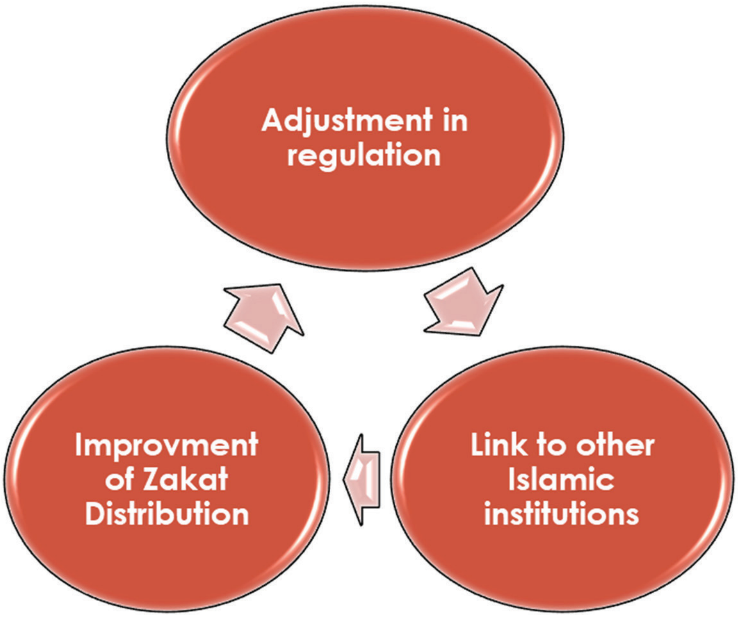


Figure 4.23: The Impact of Fintech to Indonesian Islamic Social Finance

Source: *Islamic Finance Case Studies Focus Group Discussion* (2022)

4.6.3 Issues, Challenges, and Prospects of FinTech Adoption in Islamic Social Finance

The competence and capacity of amil *zakat* is important in improving the knowledge of *zakat*. The *zakat* payers sometimes need to be explained on the requirements of *zakat* or other related matters. Continuous training is required to upgrade and update skills in the amil of *zakat* due to the importance of increasing the *zakat* collection. Programs related to the exchanging information on *zakat* matters are needed to improve the abilities of *zakat* amil in controlling the distribution of *zakat* funds.

Meanwhile, due to the huge geographical area of the country, it is difficult to collaborate or synergize in the collection and distribution aspects. One of them is due to the inadequacy of data on the activities of the *zakat*, data related to poverty maps, the distribution of needs-based *mustahik* in Indonesia, as well as a map of the *zakat* distribution that have been carried out by other *zakat* institutions/agencies. There are people in Indonesia that tend to donate to the mosques rather than to involve in *zakat* or *waqf*.

The accountability of *zakat* management organizations must be improved to build public trust. The accountability reflects a good and professional in reporting, recording, quality standards, communication, human resources management, and others. A number of challenges faced in collecting *zakat* in Indonesia. The authorities could capture all existing initiatives well. There is no specific regulation on ZISWAF and in this case, KNEKS (National Committee for Islamic Economy and Finance) tries to encourage specific regulations related to ZISWAF that are integrated with existing ecosystems.

AFSI mentioned that the use of technology for the distribution and accountability part is still behind compared to the first focus, the use of financial technology focuses on fund raising. This is a challenge in the future how technology can also be used to increase impact in terms of distribution and accountability. Fintech is expectedly able to overcome those issues. It needs to ensure that the financial technology is relevant and brings full impact to ZISWAF.

ZISWAF institutions need to consider adopting Fintech although it is expensive. AFSI has stated that Fintech is generally in the form of a social crowdfunding platform, making the platform not cheap but also not too difficult. It makes the platform known to the public, trusted by the public, and willing to be used by the public.

The hardest part of ZISWAF is implementation in the field which cannot be replaced by platforms or financial technology. This is when they create their own platform, the attention on managing the platform becomes too big, so it is necessary to find a platform method that can be used together so that they can channel more into the implementation of distribution. Hence ZISWAF makes *mustahik* become *muzakki* become more realistic. It is suggested that some Fintech companies continue to be in touch with BAZNAS such as GoPay, OVO etc or with other e-commerce, then social media and online payment channels.

Figure 4.24: The Challenges of Zakat Collection and Distribution in Indonesia

Source: *Islamic Finance Case Studies Focus Group Discussion* (2022)

> "*Waqf system in Indonesia is in very early stages and the challenge is because the intiatives have not been going well, there needs to be a standard mechanism so that anything that appears can be linked to one authority to another.*"
>
> ***(Member of Commmisioner, Indonesia Waqf Agency, BWI)***

Source: *Islamic Finance Case Studies Focus Group Discussion (2022)*

> "*The potential of the Fin Tech development supported by the increase of Islamic finance courses in various higher education institutions in Indonesia. It is also supported by the improvement in ZISWAF institutions and awareness by them on the use of technology to make the Islamic social finance better.*"
>
> **(Rector of Tazkia Institute)**

Source: *Islamic Finance Case Studies Focus Group Discussion (2022)*

Below are the internal and external challenges faced by of Indonesian Fintech companies, users, authorities and society.

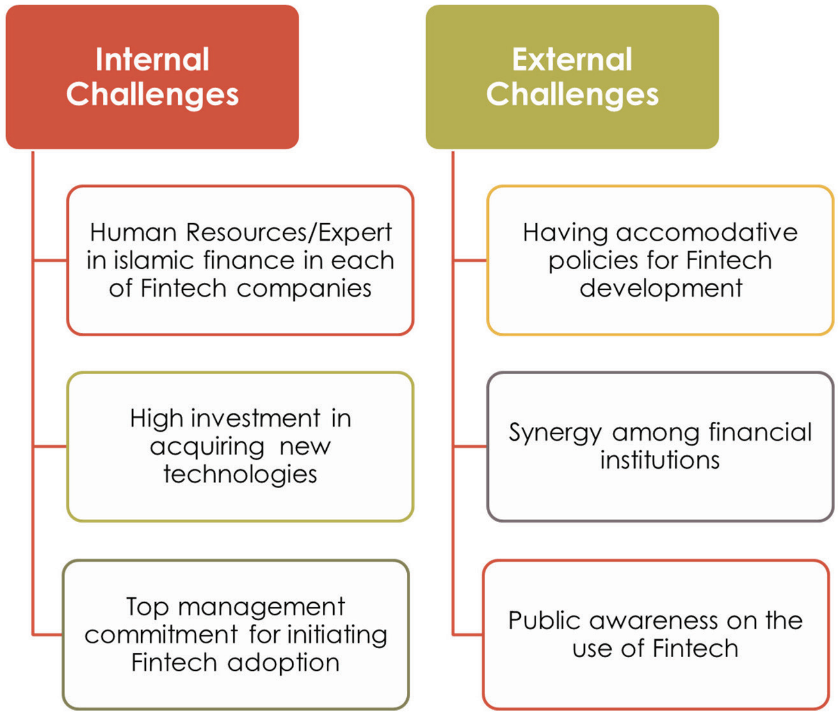


Figure 4.25: Challenges of Islamic Fintech in Indonesia

Source: *Islamic Finance Case Studies Focus Group Discussion (2022)*

4.6.4 Recommendations and Lessons from the Fintech Adoption in Islamic Social Finance in Indonesia

Firstly, every stakeholder has to collaborate which then creates flexible ways of adopting Fintech. The applications of fintech must be user friendly with a simple user guide for the users to learn independently. For example, an agency like Rumah *Zakat* (House of *Zakat*) has initiated to share 'happiness' and teach others the applications which then they can just open it and learn about it. These kinds of synergy among the institutions generate interests to the potential customers.

Secondly, relatively large fintech companies in Indonesia are trying to complement the systems with Gojek's ZISWAF with the go-gift feature. Then the commercial P2P Fintech trusts are also developing *waqf* features in Tokopedia, Shopee, Bukalapak, Lazada as well as approaching many *zakat* institutions such as BAZNAS and LAZ to open ZISWAF channels. There are potential new applications that link to ZISWAF that could focus on the distribution aspect throughout Indonesia.

It's time for us to promote Indonesia and how this ZISWAF can link or open access to other Islamic financial institutions such as the Islamic capital market, stock *waqf* in Islamic banks, *zakat* and *waqf* as LKS-PWU and *zakat* as UPZ or directly they could create a ZISWAF institution. From the side of *Shari'ah* insurance, there is also a *waqf* link. This is a very good initiative from BAZNAS as well as the *zakat* journal which has become one platform and collaboration between ZISWAF institutions and campuses that can later involve students not only in terms of learning from experts who enter/join to the campus but also there are intensive or independent campuses which could narrow down the gaps of the *zakat* knowledge. Many campuses now offer the Islamic social finance courses, at least at the master's level.

Other countries can immediately learn how many Fintech ZISWAF in Indonesia has been adopted. In fact, it is only in Indonesia that Fintech is closer to the ZISWAF with some services in Indonesian banking with a special menu of choices for *zakat*, infaq, alms, *waqf*, qurban on the ATM menu.

Thirdly, Saudi Arabia and Malaysia learn from Indonesia that they can build a system that can accommodate all due to a decentralized system of ZISWAF. There is no conflict that harms the government. Indonesia has dynamic players and each has their own perspective. Other countries can learn how everything can be adjusted to make it easier for people to pay ZISWAF. Indirectly, when everyone is involved, it means that the ZISWAF becomes part of an ecosystem. With the existence of this Fintech, any services should be easier.

There are only 18 countries that have a *zakat* law. 17 OIC countries and one Muslim minority country, namely Singapore. Of the 17 countries, only 6 countries require the paying of *zakat* from a legal perspective. Out of 6 countries, 3 of them are facing a conflict or war near the Middle East such as Libya, Yemen, and then other 3 countries that exist, Saudi Arabia, Pakistan and Malaysia are the most advanced. These Fintech applications make more fundraising, then more familiar to donors, create a good brand image which will attract donors. Everything will be easy if there is one big platform that will shade all of them.

Figure 4.26: Fintech Best Practices in Indonesia

Source: *Islamic Finance Case Studies Focus Group Discussion (2022)*

> *"AFSI's initiative is trying to encourage collaboration among the Islamic financial institutions lead by the KNEKS. AFSI is creating awareness on the potential of Islamic Fintech and educating the people (millennial) especially the students"*
>
> ***(Deputy Chief Executive of Social Development, Indonesian Islamic Fintech Association, AFSI)***

Source: *Islamic Finance Case Studies Focus Group Discussion (2022)*

4.7 Opportunities Ahead

Firstly, the prospect of fintech is quite large and potential but couldn't be used as a reference. In fact, the *zakat* can be linked with mobile banking and internet banking for account opening and other services. This has been done by Islamic financial institutions, namely Islamic banks that have become LKS (Islamic Financial Institutions) for both *zakat* and *waqf*. There are approximately 18 LKS-PWU (Islamic Financial Institutions Recipient of Cash *Waqf*) and this makes the ZISWAF link or social finance better.

Secondly, these accesses are linked to a prospect of having data integration in ZISWAF. There should be a single payment method with payment codes as a door that can direct all players in the *Shari'ah* digital financial service ecosystem to be able to bridge from one point to another.

> *"Based on experience at BAZNAS, Fintech has become the backbone for digital collection which to continue to increase in portion and this is largely due to the use of Fintech. In BAZNAS, there are various platforms that are used to strengthen digital serviecs apart from Fintech."*
>
> **(Director of Centre for Strategic Studies of BAZNAS)**

Source: *Islamic Finance Case Studies Focus Group Discussion (2022)*

Many Fintech companies such as Tokopedia *Shari'ah*, Shopee *Shari'ah*, Bukalapak *Shari'ah*, and e-wallet such as OVO, Dana, etc. have been integrated with Islamic institutions to facilitate payments. However, in the context of *waqf* there are regulatory issues. When *waqf* today launched cash *waqf*, it can connect to or have transactions via Islamic financial institutions. Even today, the payment process can be done through the existing fintech companies, especially marketplaces and e-wallets.

Economies of scale must be taken into account. It is hoped that the technology that quickly reaches potential donors will give people a big opportunity to increase their collection. Example: Kitabisa.com with their creative services which attract potential donors to do charity.

There is further development for creating a national fintech ecosystem. This starts with many events for increasing literacy, outreach, education, and some practices related to the financing scheme. In fact, in every mosque, the *nazir* (mosque admin) were trained and encouraged to manage the *zakat*. Moreover, the BAZNAS has used SIMBA (BAZNAS and LAZNAS Information System to all *Zakat* Institutions) to give more flexibility, faster response for the *muzakki* and to get used to it.

Fintech has become a tool that makes things easier. Almost everyone has a smartphone in hand so it's easy to reach them either through ideas, through literacy, education or directly to their phones quickly. When it comes to the prospect of fintech, it is very possible to collaborate with existing fintech other than crowdfunding. Crowd funding is meant for social purposes, but this one is opted for investment with productive *waqf*. The social financing can be done with various schemes including the financing schemes from ZISWAF that are more productive. Thus, fintech is one form or solution that can accelerate and be carried out with various stakeholders such as OJK, BI, BWI, BAZNAS, as well as other Islamic organizations.

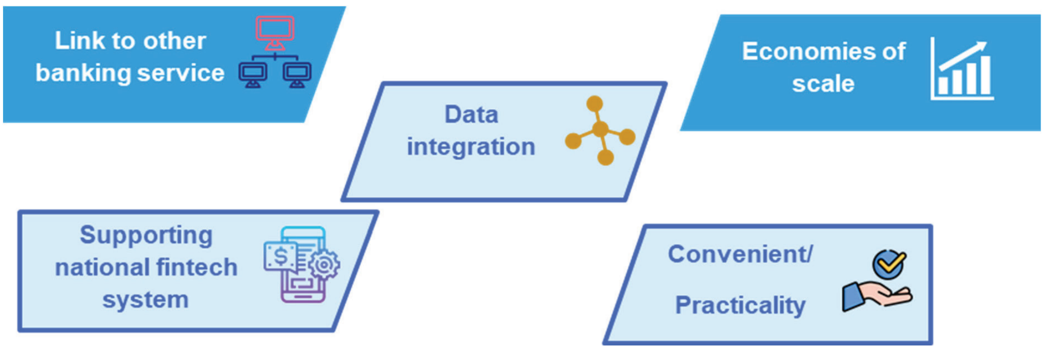


Figure 4.27: Fintech Prospect in Indonesia

Source: *Islamic Finance Case Studies Focus Group Discussion (2022)*

> "It still takes time to have a comprehensive zakat system and the key is in improving the credibility of zakat and waqf data in Indonesia."
>
> **(Head of DIvision on Islamic Social Fund,
> National Committee of Islamic Economy and Finance, KNEKS)**

Source: *Islamic Finance Case Studies Focus Group Discussion (2022)*

5. Case Study 4: Indonesian Islamic Microfinance (BMT)

5.1 Background

According to The Law No. 1/2013 on Microfinance Institutions (MFIs), microfinance institutions are financial institutions that are specifically established to provide business development services and community empowerment, either through credit or financing in micro-scale businesses to members and society, managing deposits, as well as provide business development consulting services that not just merely for profit motive. There are at least seven different types of microfinance organizations operating in Indonesia's market and each are governed and monitored by a separate authority (Table 5.1).

Table 5.1. The Landscape of Islamic Microfinance in Indonesia

Legal Entity	Microfinance Approaches	Regulator or Supervisor	Main Market / Segments
Islamic micro bank (Commercial bank & BPRS)	Financial intermediary	Financial service authority (OJK)	Formal small and micro enterprises
Islamic saving and loan cooperatives (*KSPPS* or *BMTs*)	Financial and social intermediary	The Ministry of Cooperative and MSMEs	Formal and informal micro-enterprises
Limited liability *MFIs (LKM)*	Financial intermediary	Financial service authority & Regional Government	Small and micro enterprises
Islamic fintech (P2P)	Peer-to-peer financing or crowdfunding Financial and social inclusion	Financial service authority (OJK)	Small and micro enterprises
Zakat organizer (BAZ and LAZ)	Financial intermediary	The National *Zakat* Board (BAZNAS)	The poor and the poorest of the poor
Wakaf organizer	Economic and social empowerment	The National Wakaf Board (BWI)	The poor and the poorest of the poor

Source: *Suseno* (2020)

As can be seen from the table above, different microfinance institutions may use distinct financing techniques, even though they serve similar market segments. *Baitul* Mal wat *Tamwil* which is also known as Islamic saving and loan cooperatives (Koperasi Simpan Pinjam Pembiayaan Syariah/KSPPS) is one of the largest MFI in the current landscape of Islamic financial inclusion, offering relatively wider set of products and services compared to other Islamic microfinances compared to its competitors.

Baitul Mal wat *Tamwil* (BMT) is a form of microfinance institution that operates based on Islamic principles to provide capital for micro and small business communities excluded from the formal financial system. BMT is considered as a unique and holistic form of Islamic microfinance. It is highlighted as well that in contrast to Islamic microbanks that exclusively utilize financial intermediation, BMTs use a combination of financial and social intermediation in delivering services to MSMEs and the poor.

Basically, there are two terms that constitute BMT, that is *Baitul mal* which implies the non-profit motive through managing *zakat*, *infaq, sadaqah* and *waqf* funds, and *Baitul tamwil* which represents profit motive in saving and financing activities. While *Baitul mal* reflects social intermediary/ empowerment, *Baitul tamwil* is a form of financial intermediary. Beside these two main roles, BMT also plays another role, that is dakwah through educating the community to conduct any economic activities according to the *Shari'ah* rules. Thus, the holistic nature of BMT can be seen from its three main roles, i.e., as financial intermediary, social intermediary and da'wah.

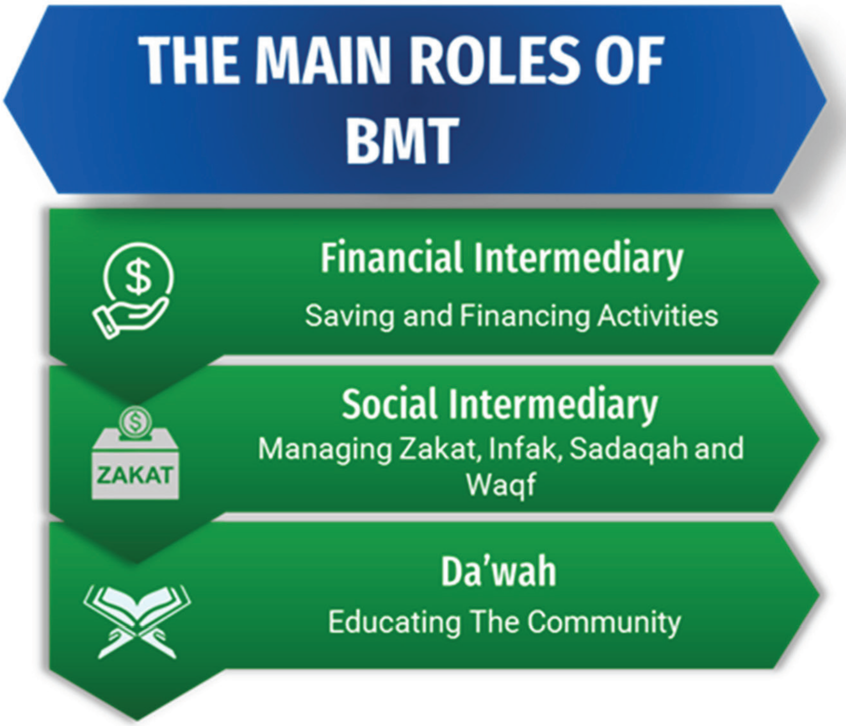


Figure 5.1. The Main Roles of BMT

Source: *Islamic Finance Case Studies Focus Group Discussion (2022)*

BMT has grown since the 1990s and flourished continuously throughout the years. However, so far there is no valid data regarding the number of BMTs in Indonesia. Basically, there are two main players for Islamic microfinance in Indonesia, that is Bank Pembiayaan Rakyat Syariah/BPRS (Islamic village banks) and BMT. Data shows that BPRS and BMT/KSPPS contribute the biggest amount to the total financing provided by the microfinance institutions (Suseno, 2020) as shown in Figure 5.2. Meanwhile, compared to the total national microfinance providers, the number of BMTs serving the Indonesian market can seen in Table 5.2.

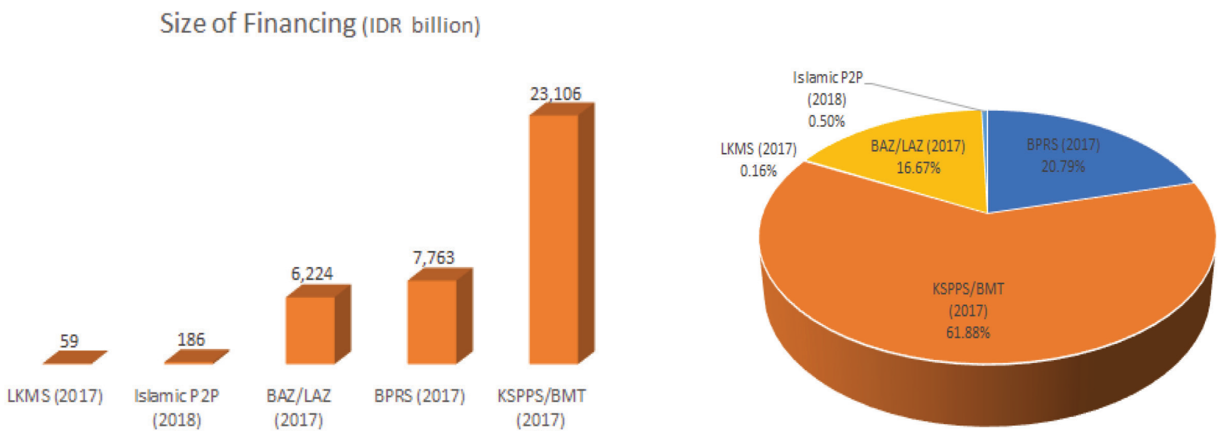


Figure 5.2. Distribution of Financing for Islamic MFIs in Indonesia

Source: *Suseno* (2020)

Table 5.2: Range of Microfinance Market Players in Indonesia

Financial Institutions	Number of Players	
	The 2000s	2017/2018
Bank		
• Rural Bank		
○ Village Credit Bank (BKD)	5,345	n.a.
○ Conventional Rural Bank (BPR)	2,148	1,430
○ Islamic Rural Bank (BPRS)	-	167
• Micro unit of Commercial Bank (BRI)	4,049	5,382
Cooperatives		
• Saving and loan cooperative (KSP)	1.097	23,551
• Saving and loan unit/office (USP)	35,218	55,992
Other microfinance institutions (LKM)		
• Cooperative supervised by OJK	-	160
• Limited liabilities MFIs supervised by OJK	-	23
• BMTs (Islamic microfinance institutions)	3,038	4,500
• Credit Union and NGO	1,146	832
• Pawnshop	774	4,311
• Fintech (Peer to peer lending)	-	113
Micro Credit and poverty alleviation programs	21,088	1,770
Informal Providers		
• Money lenders	n.a.	404
• ROSCAs	n.a.	n.a.

Source: *Suseno* (2020)

Regarding the contribution of BMTs to the national share of Islamic microfinance can be seen from the following Table 5.3.

Table 5.3: The Share of Islamic Microfinance to the Total Microfinance in Indonesia

Institutions	Number of Institutions	Loan Extended (USD)	Saving (USD)
Islamic Rural Bank (BPRS)	2012: 158	2012: 23.94 billion	2012: 197.93 million
	2018: 167	2018: 61.1 billion	2018: 547.9 million
Saving and Loan Cooperatives (KSPPS/ BMTs)	2013: 1,522	2013: 50.02 billion	2013: 251.1 million
	2017: 5,648	2017: 155.72 billion	2017: 1.03 billion
Islamic Limited Liabilities MFIs (LKMS)	2015: 7	2015: 1.41 million	2015: 400,309
	2018: 61	2018: 6.79 million	2018: 9.67 million
Zakat Operators (LAZ and BAZ)	2018: 40	2012: collected ZIS fund = 142.89 million	
		2017: collected ZIS fund = 419.52 million	
Islamic Fintech (P2P)	2017: n.a of 85	2017: total lending = 202.3 million	
	2018: 7 of 113	2018: total lending = 1.53 billion	

Source: *Suseno* (2020)

The history of BMT in Indonesia dates back to 1984 when Teknosa Cooperative was established at the Salman Mosque of Bandung Institute of Technology (ITB). Teknosa Coop gave financing for small businesses in accordance to *Shari'ah* principles. In 1988, another *Shari'ah* cooperative was established in Jakarta, namely the Ridho Gusti Cooperative. The year 1992 also marked two important events in BMT's history. First, the enactment of Law No. 25 on cooperatives under which BMT's legal standing is established. Second, the introduction of the first BMT, BMT Bina Insan Kamil. Later, in 1995 Ikatan Cedikiawan Muslim se-Indonesia (ICMI) (All-Indonesia Muslim Scholars Association) then initiated the establishment of the Center of Micro Enterprise Incubation (PINBUK) to support the development of small and micro businesses. In the following years, the development of BMT was marked by promulgation of laws and regulations that has bearing on its operations, such as Law No. 21/2011 on the Financial Services Authority, Law No. 23 of 2011 on *Zakat* Management, Law No. 1/2013 on Microfinance Institutions (MFIs), and Ministry of Cooperative and MSME regulation No. 11 of 2017 on the implementation of Islamic Savings and Financing Cooperatives (KSPPS) by Cooperatives. The milestone of BMT is in Figure 5.3.

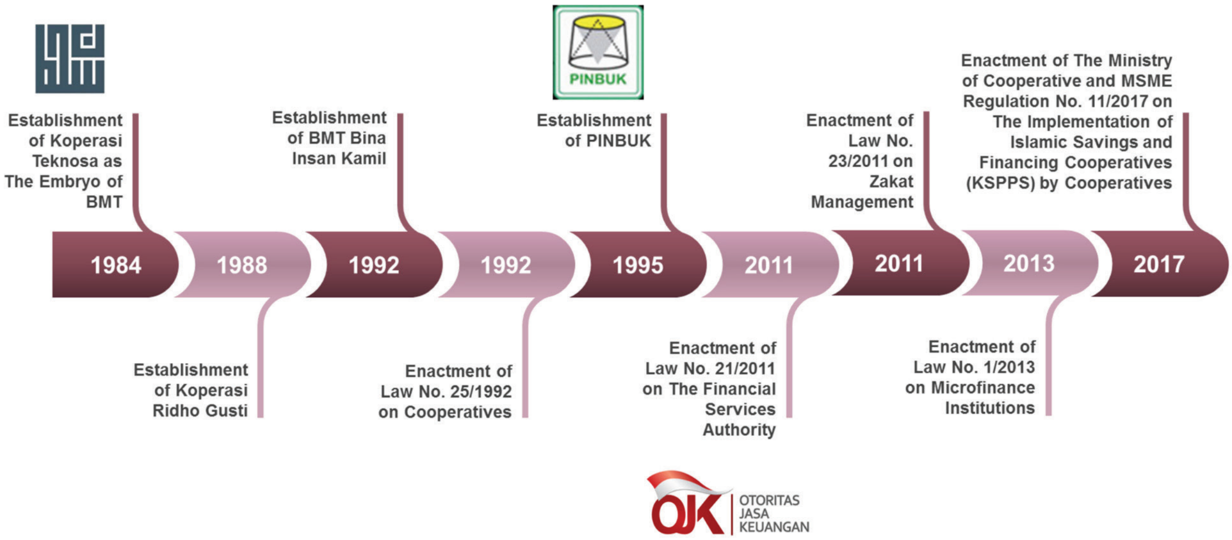


Figure 5.3: Milestone of BMTs

Source: *Ajija et al.* (2018) and *Sakti* (2019)

5.2 Key Players and Institutional Enablers

Key players that play role in the development of BMTs in Indonesia, as follows:

5.2.1 Role of the Ministry of Cooperatives and SME

The Ministry of Cooperatives and SME can be said as the main key player in the development of BMTs in Indonesia. This is because most BMTs choose cooperative form, hence they should seek license from the Ministry of Cooperatives and SME.

5.2.2 Role of the Financial Service Authority

According to Law Number 1 of 2013 concerning Microfinance Institutions, all microfinance institutions, including BMTs, should obtain a business licence from the Financial Service Authority (OJK).

5.2.3 Role of the Ministry of Home Affairs

Although the role of the ministry of home affairs seems not very visible in the development of BMTs, Law Number 1 of 2013 concerning Microfinance Institutions states that in educating, regulating and supervising Microfinance Institutions, the Financial Service Authority should work together with the Ministry of Cooperatives and the ministry of home affairs.

5.2.4 Role of the National *Zakat* Board (BAZNAS)

Given the social intermediary function of BMTs that enable them to collect *zakat*, *infaq*, sadaqah, BMT can act as the *Zakat* Collection Unit (UPZ) of the National Amil *Zakat* Agency (BAZNAS)

Besides the above key players, BMTs are linked to institutions that provide organisational support, consultation, and supporting programs for the development of BMTs. These institutions include Centre of Micro Enterprise Incubation (PINBUK), Association of *Shari'ah* Cooperatives (INKOPSYAH), BMT Venture Capital (PBMTI), Microfin Indonesia, Association of Indonesian BMTs (ABSINDO) and Regional Centre for *Shari'ah* Cooperatives (PUSKOPSYAH).

Figure 5.4: Other Key Players of BMT

5.3 Success Factors and Challenges

5.3.1 Legal status and Function of BMTs

Being an institution based and operating in Indonesia, BMT needs a legal status (legal entity) in order to perform its obligations and activities and have its existence guaranteed and protected by applicable laws. Prior to the enactment of Law Number 1 of 2013 concerning Microfinance Institutions, there was an about which government agency will BMT be regulated by – either the Ministry of Cooperatives and SMEs or the Financial Services Authority (Otoritas Jasa Keuangan/ OJK).

If it is the Ministry of Cooperatives, BMT must request for a cooperative license from them and also change their legal name to *Koperasi Simpan Pinjam Pembiayaan Syariah* (KSPPS). The Ministry of Cooperatives would be responsible for supervising, inspecting, and monitoring Islamic Cooperatives/BMTs (primary cooperatives) and BMT Associations at the national, provincial, and district levels (secondary cooperatives). However, the Ministry does not act as a supervisory agency and deposit insurance agency for cooperatives. On the other hand, if regulated by the Financial Services Authority then BMT must seek a finance institution license from them and change its legal name to Lembaga Keuangan Mikro Syariah (LKMS). It would be governed by Law No.21/2011 on the Financial Services Authority, which stipulates terms of its existence and scope of financial services.

The key distinction between the two options is; BMT under the Ministry of Cooperatives and MSMEs would be wholly owned by the members, whereas BMT under the Financial Services Authority required local government districts/ cities or village-owned enterprises/ wards to own at least 60% of the shares. On the basis of this ownership conditions, the majority of BMTs chose to be supervised and regulated by the Ministry of Cooperatives in order to preserve the spirit and concept of BMT, which is catering to, by, and for its members. Hence, today BMTs in Indonesia is regulated by Law No. 25/1992 on Cooperatives, as well as Ministry of Cooperative and

MSME regulation No. 11 of 2017 on the implementation of Islamic Savings and Financing Cooperatives (KSPPS) by Cooperatives.

Due to the fact that BMTs is subjected to multiple regulatory frameworks, Sakti (2019) suggested having a sole authority for BMTs and Islamic microfinance institutions. This will create opportunities for the institutions in terms of their services or offers and provide more flexibility in their development.

In terms of function, BMT is a social organization that is permitted to distribute Islamic social funds received from *zakat*, contributions, and alms payments. In accordance with Article 16 paragraph (1) of Law No. 23 of 2011 on *Zakat* Management, it is stated that in carrying out their duties and functions BAZNAS, Provincial BAZNAS, District / City BAZNAS can form *Zakat* Distribution Units (UPZ) in government agencies, state-owned enterprises, state, private companies, and representatives of the Republic of Indonesia abroad, and can form UPZ at the level of sub-districts, sub-districts or other names, and other places. BMT through its *baitul* mal, can act as the *Zakat* Collection Unit (UPZ) of the National Amil *Zakat* Agency (BAZNAS), which engages in *zakat* management and assists BAZNAS in general.

Figure 5.5: Regulations Related to BMTs

Source: *Ali* (2019)

5.3.2 Impact of Islamic Microfinance

In terms of BMTs contribution to the community, as presented in Figure 5.1, BMTs and KSPPS contributed the biggest share to the total amount of financing provided by the microfinance in Indonesia. This is understandable because basically the target market of BMTs is small communities and micro-enterprises, which so far have not had access to the banking system. In countries where the size of its informal economy is very large, community groups and micro and small business will need to be served by a specialised type of finance services.

BMTs' mission is to bring economic empowerment to the people, or in other words to turn people who used to be *zakat* recipients (*mustahik*) into *zakat* payers (*muzakki).*

> *"Mal is the main mission that be carried on by BMTs. One of the advantages of BMTs is that its ability to do social innovations hence transform mustahik into muzakki"*
>
> **(BMTs Expert)**

Source: *Islamic Finance Case Studies Focus Group Discussion (2022)*

BMTs also play an important role in spreading dakwah. Changing the lifestyle of the community to stay away from riba is the main spirit of BMTs. In addition to this, as part of dakwah, some BMTs carry out Quranic classes for their members.

> *"There is a strong slogan of a BMT: Whenever riba exists, we will come"*
>
> **(BMTs Expert)**

Source: *Islamic Finance Case Studies Focus Group Discussion (2022)*

5.3.3 Regulatory and Governance Challenges

BMT suffers from structural deficiencies which are yet to be resolved. Although currently there are several regulations related to BMTs, BMT is weak in terms of supervision. The supervisory function that should be carried out by the Ministry of Cooperatives and SME as well as the OJK has not run effectively as mandated by law.

From the *Tamwil* side, BMT is a micro banking system that has the same system as bank financial institutions, that is savings and financing, collecting public deposits and then distributing them in the form of financing. However, since it is a micro institution targeting the poor, BMT faces constraints in attracting sufficient amount of savings relative to the amount demanded as financing. Being a cooperative-based MFI, BMT's capital adequacy and other financial ratios are not monitored by the Central Bank authorities, and neither does the Central Bank play the role of the lender of last resort for BMTs. Another important limitation is that while Banks have access to inter-bank money market, BMTs are not allowed to borrow from other entities to maintain its cash reserve ratios.

Another big challenge for BMTs is governance. The regulation is not as strict as in the banking sector hence the practice of good governance among BMTs varies. Since BMT plays many roles, there are various governance standards expected of BMTs. According to Suseno (2020) at the very least, BMTs must ensure strict compliance to principles of cooperative governance, *Shari'ah* governance, *zakat* governance and *waqf* governance. Therefore, a standard code of governance is needed to regulate the existence and practices of all BMTs. The governance problem is exacerbated by the poor standard of professionalism and qualified human resources in the BMTs.

Figure 5.6: Issues and Challenges of BMTs

Source: *Islamic Finance Case Studies Focus Group Discussion (2022)*

However, the future of BMT remains highly promising. Its unique characteristics that combine financial, social and dakwah roles at the same time reflect the holistic nature of Islamic finance, which cannot be found at other Islamic commercial banks.

5.3.4 Recommendations and Lessons from the Islamic Microfinance in Indonesia

The main recommendation for the improvement of BMT is related to its supervisory function. There are more than one agency involved in regulating the existence of BMT namely; the Ministry of Cooperatives and SME, the Financial Services Authority, the Ministry of Home Affairs, the National *Zakat* Board, and the Fiscal Policy Agency. However, there is a lack of supervisory control on its operations on the ground. Although the Ministry of Cooperatives and SME holds the key supervision function, they have not been active in monitoring BMTs operations, other to grant licenses to increase number of BMTs. Thus, to achieve effective regulation of BMT, the sole authority of BMT should be considered. However, it should be noted that any changes that occur in terms of BMT regulations should not eliminate the ease in terms of establishment that has been enjoyed by BMT operators.

In addition, BMT should maintain its characteristics that are close to the community. Although there is an idea that BMT should adopt advances in information technology and based on digitalization, the achievement of BMT's mission to serve the community is far more important. BMT's adoption of fintech has to be done carefully and in only selected aspects. Lack of personalised services and support will cause the spirit of BMT's establishment to severely undermined.

Several lessons can be learnt from BMTs evolution until today. Firstly, BMT is a financial institution that combines financial, social and da'wah functions. BMT was born from a society that reflects the independence of the community. Its closeness to the small business communities in providing access for those who are not bankable provides opportunities for a microfinance institution like BMT to continuously grow and develop. Therefore, the model of Islamic microfinance institutions such as BMT can be adopted by other countries, in alleviating poverty, especially for those countries where the poverty line is high and informality dominates the economy.

5.4 Opportunities Ahead

BMT has social capital that is not owned by other Islamic financial institutions, that is close to the community. Considering the large number of lower middle class and small and micro businesses that exist in Indonesia, the opportunity for the sustainability of BMTs is there, as long as they maintain their identity and fundamental objectives. Therefore, proper regulation for BMT is needed hence it can represent the true model of Islamic microfinance.

> "The existence of BMT provides opportunities for those Muslim community who have a strong spirit to implement a genuine Islamic financial system"
>
> **(BMTs Expert)**

Source: *Islamic Finance Case Studies Focus Group Discussion (2022)*

BMT should also consider adoption of Information technology to become a full-fledged financial institution. It is undeniable that advances in information technology are a challenge for BMT. Staff training in Fintech is a must. More investments in IT are necessary for BMT to provide financial services to MSMEs in an efficient manner. Nevertheless, the adoption of information technology is not expected to change the initial goal of establishing a BMT which focuses on empowering small communities.

6. Moving Forward

The above case studies of Malaysia and Indonesia are descriptions of the growth and development of innovative Islamic finance in these two countries. Malaysia's experience in issuing digital sukuk during COVID-19 pandemic to overcome economic uncertainties and help the poor and needy can be a valuable lesson for others. Likewise, the implementation of VBI by IFIs in Malaysia and the adoption of fintech by *zakat* and *waqf* institutions in Malaysia and Indonesia to improve the collections and distributions systems to make it more efficient for the poor and needy (asnaf) can be used by other member countries.

Malaysia and Indonesia can share their valuable experiences and best practices with member countries in a number of innovative products such as Sukuk Prihatin that Malaysia issued during COVID-19 pandemic. Another Malaysian initiative in the form of VBI to improve IFIs financing targeted at areas that are of concern to stakeholders and society can be valuable to member countries.

Lately, Islamic social finance has become an important tool to many governments to overcome many problems associated with poverty and providing quality education to the people. ISF if used properly can alleviate poverty which is prevalent in many Muslim countries. But Malaysian and Indonesian experience in adopting fintech to improve collections and distribution of *zakat* funds is not without its weaknesses. A number of challenges and issues have been identified that can be a guide for others if they decide to adopt fintech in ISFs. Fintech is a game changer and an innovation in Islamic social finance, but the cost involved must be studied properly. Nevertheless, the Malaysian and Indonesian experiences show that the benefit of using fintech in Islamic social finance is more than the cost, especially in the long term.

As part of the data collection process employed to produce this report, a survey of Islamic finance case studies was carried out among practitioners and IF stakeholders in various countries. They were surveyed on three themes (i.e., Sukuk Prihatin, Value-Based intermediation, Islamic social finance adoption of fintech). Main focus of the survey was on the level of adoption and acceptance of the finance tools as well the challenges and prospects associated with fintech.

6.1 Sukuk Prihatin

Malaysia's experience in issuing Sukuk Prihatin in supporting government initiatives in facing COVID-19 pandemic can be emulated by other countries. A survey was conducted to gauge potential of introducing similar sukuk in respondents' countries as a fund-raising tool when confronting economic challenges.

In terms of the demand for fund raising, all the countries agree that their governments need to raise funds to finance public development projects. Most of the countries surveyed already had issued Sukuk for such purposes. These countries have financial infrastructure and regulatory framework in place for Sukuk issuance. The findings are in Figure 6.1.

Among the countries that responded to the survey, UAE has the largest issuance of sukuk (500) with USD5 billion.

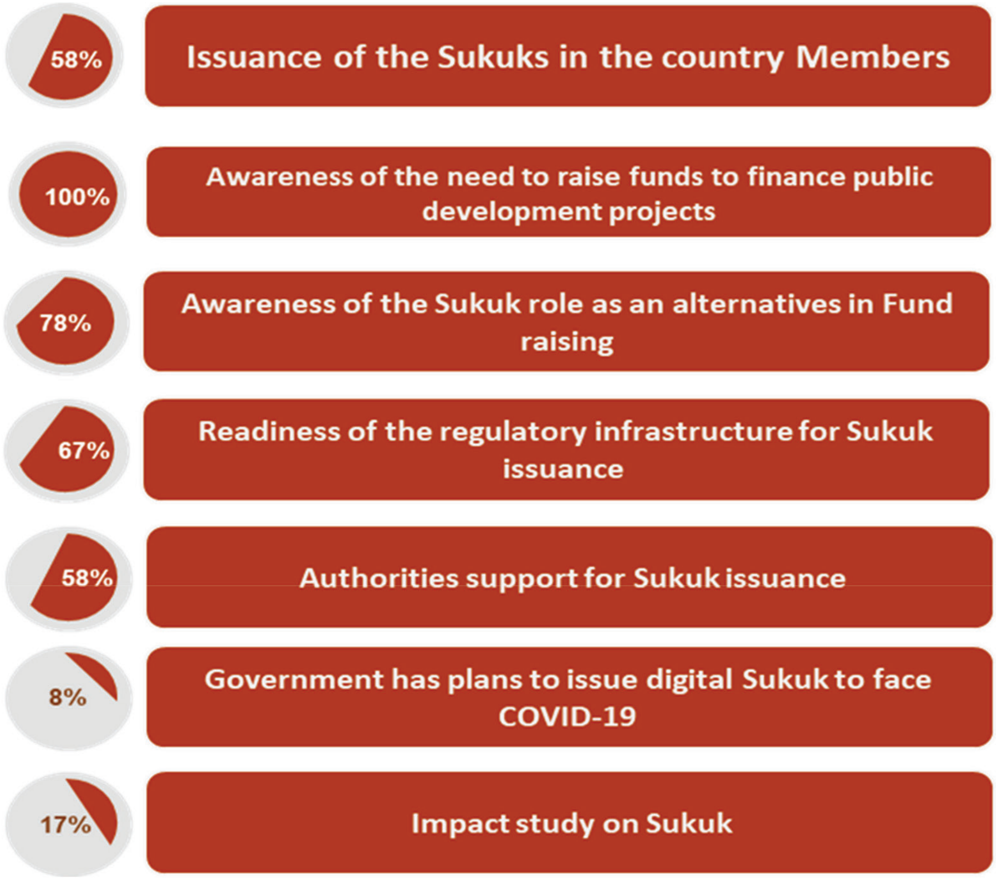


Figure 6.1: Sukuk Practice in Member Countries

Source: *Islamic Finance Case Studies Survey (2022)*

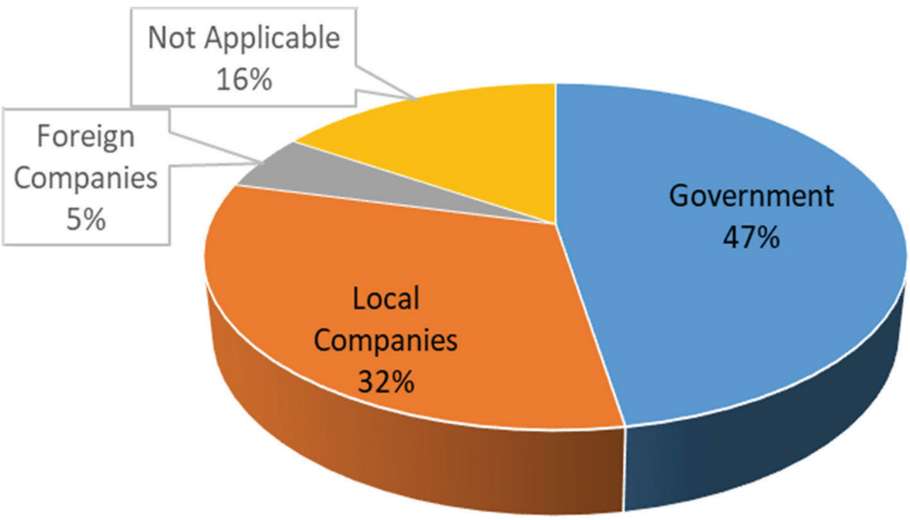


Figure 6.2: Sukuk Issuers

Source: *Islamic Finance Case Studies Survey (2022)*

Sukuk global issuance set another new record in 2020 with short term issuance exceeding long term issuance. The total global sukuk issuance amounted to USD174.641 billion in 2020. The steady issuance mainly contributed by sovereign sukuk issuance in Asia, GCC and Africa. Malaysia continues to dominate the sukuk market with 45.1 percent market share followed by Saudi Arabia with 24.6 percent.

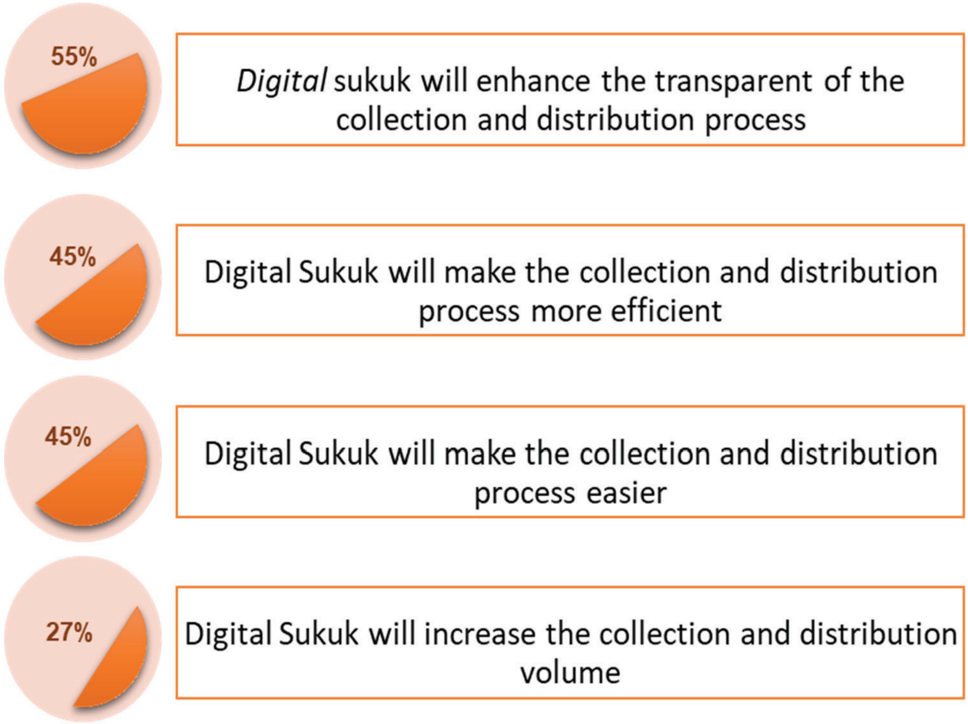


Figure 6.3: Potential Issuance of Digital Sukuk

Source: *Islamic Finance Case Studies Survey (2022)*

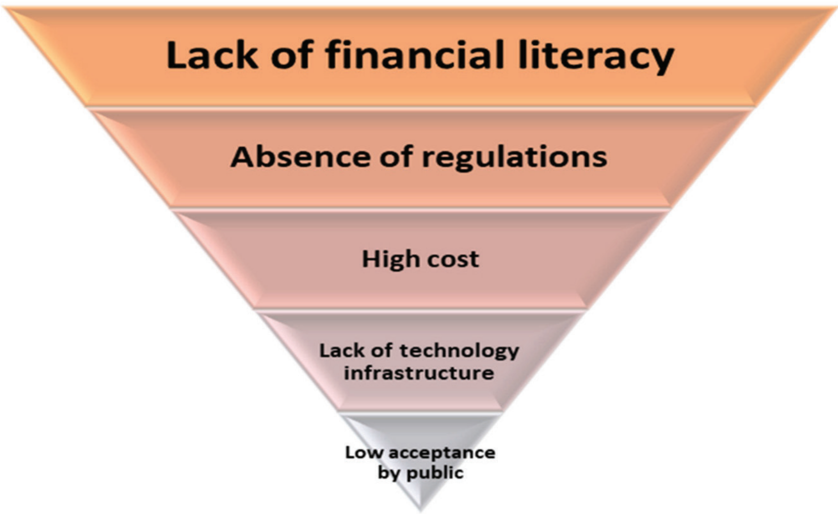


Figure 6.4: Challenges of Digital Sukuk Implementation

Source: *Islamic Finance Case Studies Survey (2022)*

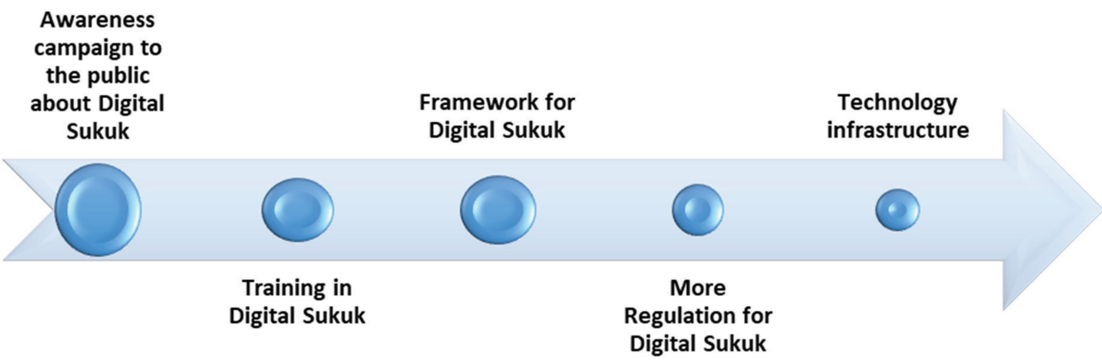


Figure 6.5: Sukuk Enablers

Source: *Islamic Finance Case Studies Survey (2022)*

The survey also explored the potential of issuing digital Sukuk similar to Sukuk Prihatin in the respondents' countries. Most of the respondents surveyed have mixed responses especially towards the readiness of each respective country to facilitate a digital Sukuk issuance. Although the majority agreed that digital platforms will enhance transparency, efficiency and effectiveness aspects, only a few are confident that it will increase the subscription among investors. The potential to emulate Malaysia's success depends on availability of technology infrastructure, level of financial literacy and strong support from the authorities.

6.2 Value-Based Intermediation (VBI)

The survey on the feasibility of implementing VBI in member countries revealed the following:

a. Majority (5.62%) agreed that an initiative like VBI is being considered in their countries.

b. VBI will have an impact on foreign investments (4.50%).

c. VBI activities are reported and disclosed by IFIs in their countries (4.57%).

d. About 5.63% of the respondents said that VBI results are mandatory and must be reported and disclosed by IFIs.

e. On a positive note, about 4.5% said that their government plans to implement VBI in the near future.

f. Another 4.5% agreed that VBI results must be made mandatory and disclosed by IFIs.

Figure 6.6 reports the findings.

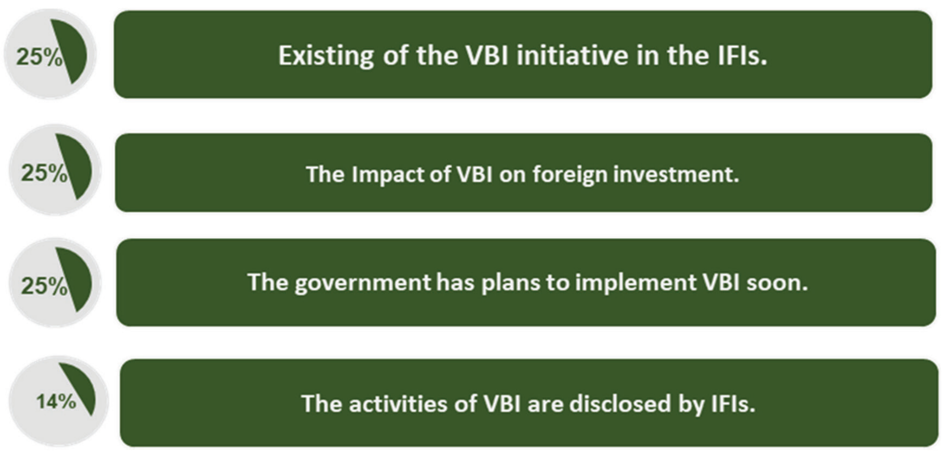


Figure 6.6: VBI Practice in Member Countries

Source: *Islamic Finance Case Studies Survey (2022)*

Member countries also agreed that VBI can be implemented in their countries. Many agree that VBI will improve the performance of the IFIs, and objectives of SDGs can be achieved. Stakeholders of IFIs can also benefit from VBI, and more importantly VBI will help materialise and manifest *Shari'ah* principles and values in Islamic Financial Institutions operations.

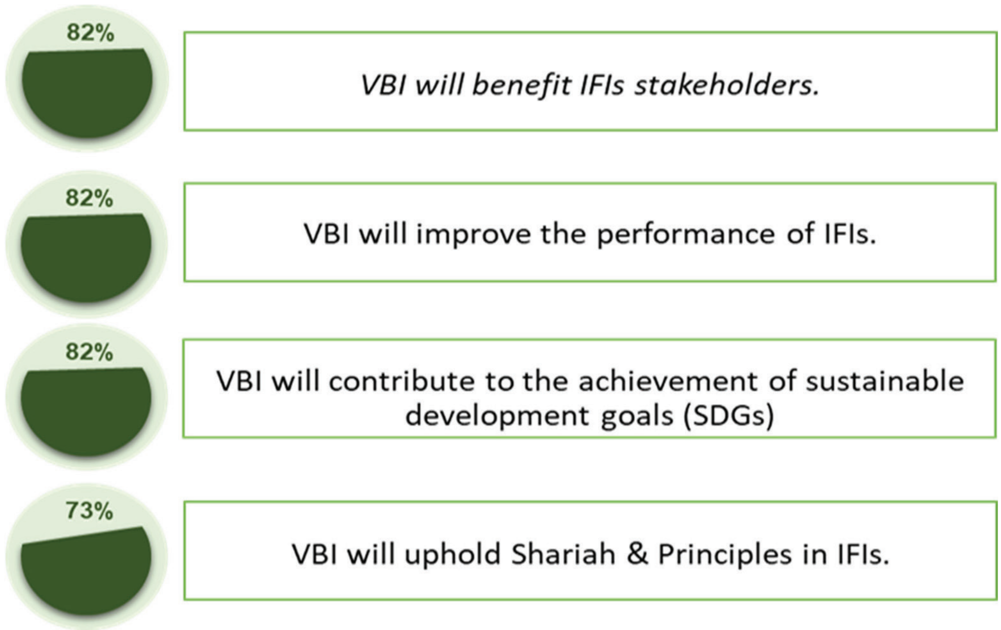


Figure 6.7: VBI Prospects

Source: *Islamic Finance Case Studies Survey (2022)*

Member countries were also asked about the challenges that they will face if VBI is implemented in their countries. Findings show that:

a. Majority agree that VBI must be accepted by the industry players first.

b. Implementation in their country is expected to be costly.

c. It will be a challenge to measure and manage Impact

d. Other challenges include regulatory framework, laws and regulations.

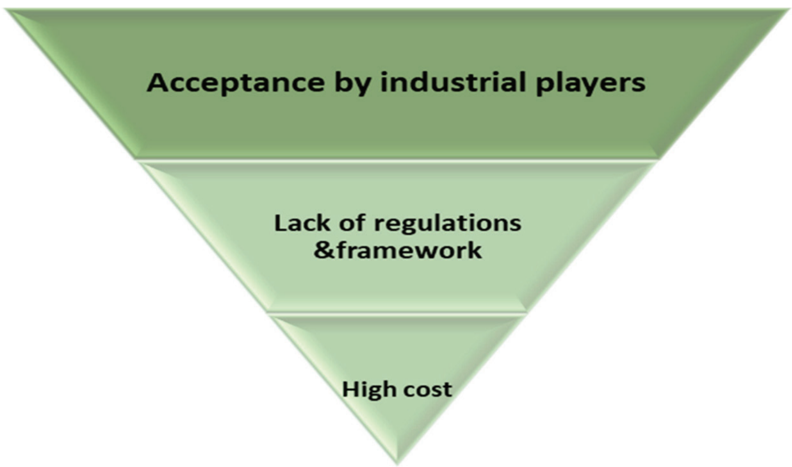


Figure 6.8: Challenges of VBI Implementation

Source: *Islamic Finance Case Studies Survey (2022)*

When asked about the necessary enablers for the success of VBI in their own countries, they mentioned the following:

a. Awareness and commitment by the industry players – majority agree that the key enabler for the success of VBI implementation in their countries depends on the awareness and commitment by the Islamic financial institutions.

b. Staff training – staff training is vital for the success of VBI. Staff must understand the mechanics and requirements of VBI. Islamic financial institutions must commit to train their staff in VBI.

c. Rules and regulations – rules and regulations must be in place before implementing VBI. See Figure 6.9.

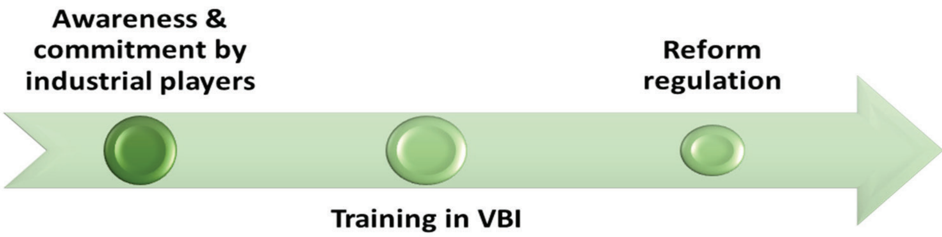


Figure 6.9: Enablers for VBI

Source: *Islamic Finance Case Studies Survey (2022)*

6.3 Fintech and Islamic Social Finance

This segment of the survey attempts to uncover the acceptance and level of adoption of fintech in Islamic social finance institutions. The findings show a very basic and low adoption of fintech among the countries involved in the survey (Figure 6.10). Figure 6.11 illustrated the impact of fintech adoption on Islamic social finance institutions. Which shows that survey respondents put empowering of Islamic social finance compliance and reporting requirements as high impact, followed by minimizing the (cost, effort, risk) of Islamic social finance operations. And then maximising the benefits of the Islamic social finance's beneficiaries. Fintech's contribution or impact to collection and distribution of social finance funds were rated relatively low.

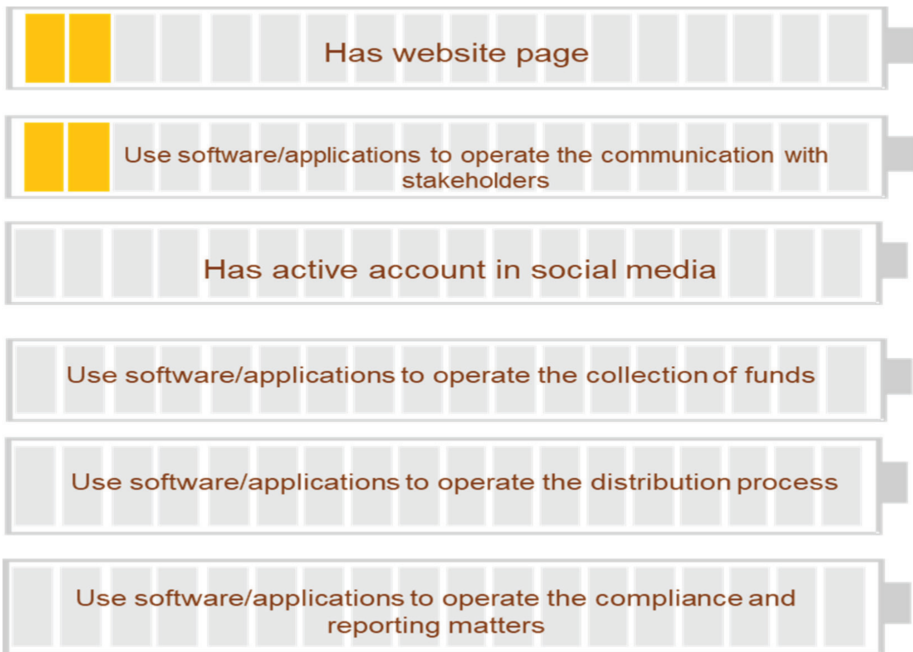


Figure 6.10: Fintech and Islamic Social Finance's Products, Services and Facilities

Source: *Islamic Finance Case Studies Survey (2022)*

Figure 6.11: Impact of Fintech Adoption in Islamic Social Finance

Source: *Islamic Finance Case Studies Survey (2022)*

Figure 6.12 illustrates the challenges of fintech adoption on Islamic social finance institutions in the respondents' countries. The high cost was considered as the biggest obstacle and challenge, followed by financial literacy, and then acceptance by stakeholders of the fintech implementation. Next challenge is the weak top management of the Islamic social finance institutions. The law, regulation, and framework issues as well the poor technology infrastructure were placed as less significant type of challenges. Which indicates that the challenges of fintech adoption are more internal rather than external.

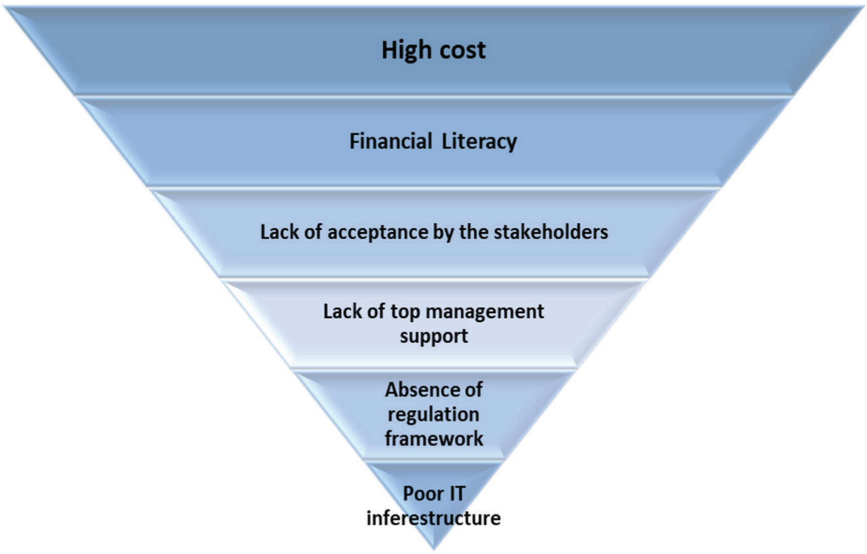


Figure 6.12: Challenges of Fintech Implementation

Source: *Islamic Finance Case Studies Survey (2022)*

Figure 6.13 illustrates the enablers of fintech adoption on Islamic social finance institutions from the point view of respondents. The Islamic social finance institutions employees training and gaining knowledge is the most important enabling factor to enhance the process of fintech adoption in the Islamic social finance institutions among the respondents' countries, followed by the availability of technology infrastructure. The last enabler factor is reforming the regulations to enhance fintech adoption.

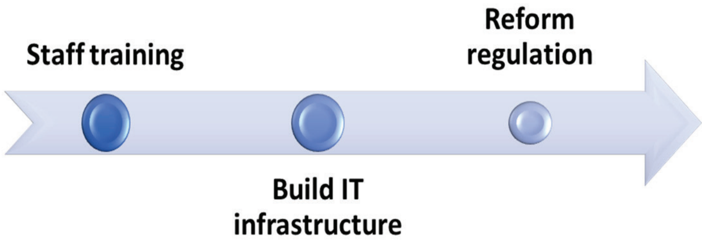


Figure 6.13: Enablers for Fintech Implementation

Source: *Islamic Finance Case Studies Survey (2022)*

Annexes

I. Methodology of Case Study

The scope of this project work is to cover four different cases namely: Sukuk Prihatin, value- based intermediation (VBI), fintech and Islamic social finance and Islamic microfinance. The methodology approach is developed based on the Terms of Reference (TOR). To achieve the aims of the three case studies, a case study method is adopted. The report adopts both qualitative and quantitative report methods due to the need for the report findings to be both robust and practical. Qualitative and quantitative report methodology could complement each other to deliver results that are robust, which quantitative analysis provides and practical, driven by qualitative data obtained from the ground which is actual and relevant for decision making. The use of multiple data collection tools, desk review (annual reports and website) and focus group discussions allow the consultant team to triangulate and validate findings. The review is sharing and consultative in nature to ensure close engagement with relevant stakeholders.

The following Figure A presents the report design proposed covering all four Islamic finance case studies.

LITERATURE REVIEW
- Identification of variables and items used in analysis and survey
- Development of focus group discussion questions - CASE STUDY

↓

DATA COLLECTION PROCESS
- Annual report and website analysis
- Series of focus group discussions and interviews

↓

OUTCOMES
- Case Study I - Sukuk Prihatin
- Case Study II - Value-based Intermediation
- Case Study III - Fintech and Islamic Social Finance
- Case Study IV - Islamic Microfinance

Figure A: Report Design of the Study

Meanwhile, for reporting purposes, this study employs a single-case study approach. This approach was used by combining all selected individual information into a single writing for each case study. The above targeted outcomes will be used as themes in analysing and reporting the findings. To ensure that every statement is documented, all series of roundtable discussions are recorded.

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III. List of Focus Group Discussion Participants

Focus Group Discussion Participants: Sukuk Prihatin

No.	Expert	Institution
1	Imri Dolhadi Ab Wahab *(Deputy Director, Financing Management Section, Fiscal and Economics Division)*	Ministry of Finance
2	Noraizat Shik Ahmad *(Deputy Director, ICM Product Development)*	Securities Commission Malaysia
3	Irene Chua *(Deputy General Manager, Corporate Bonds)*	
4	Ridzham Zaidi RizIzuwan *(Assistant General Manager, ICM Product Development)*	

Focus Group Discussion Participants: Value-Based Intermediation (VBI)

No.	Expert	Institution
1	Ratna Sha'erah Kamaludin *(Executive Director)*	AIBIM
2	Mazura Mohamed Jamil *(Director)*	
3	Norhisham Mohamed *(Senior Manager)*	

Focus Group Discussion Participants: Fintech and Islamic Social Finance

No.	Expert	Institution
1	Assoc. Prof. Dr. Kinan Salim *(Senior Lecturer)*	INCEIF
2	M Nazri *(Founder/Chief Executive Officer)*	My FinB Group
3	Azrina Azmel *(Deputy General Manager, Digital, Digital Strategy & Innovation)*	Securities Commission Malaysia
4	Mohd Azrul Shane Ariffin *(Assistant Manager, Digital Strategy & Innovation)*	
5	Kautsar Abd Rahman *(Senior Manager, Digital Strategy & Innovation)*	

Focus Group Discussion Participants: Fintech and Islamic Social Finance (SIRCs)

No.	Expert	Institution
1	Dato Hj Halidan Md Daud *(Ketua Pegawai Eksekutif)*	Pusat *Zakat* Majlis Ugama Islam & Adat Resam Melayu Pahang (MUIP)
2	Tuan Hj. Zainuddin Mohd Salleh *(Ketua Pegawai Eksekutif)*	Pusat Wakaf MAIWP
3	Tuan Hj. Rosidi Hussain *(Pengurus Besar)*	Wakaf Pulau Pinang
4	Tuan Hj. Mohd Nazim Mohd Noor *(Ketua Pegawai Eksekutif)*	Majlis Agama Islam Perlis
5	Encik Zulkefli Abu Bakar *(Ketua Jabatan Teknologi Maklumat)*	Lembaga *Zakat* Negeri Kedah
6	Encik Mohd Zaidi Azizan *(Ketua Jabatan Kewangan)*	Lembaga *Zakat* Negeri Kedah
7	Mohd Nazri Mat Rejab *(Ketua Bhg Pembangunan Wakaf, Hartanah & Mal)*	Majlis Agama Islam Perlis
8	Norhayati Ramli *(Ketua Unit Hartanah)*	Majlis Agama Islam Perlis

IV. Other Annexes

List of *Zakat* Institutions Under SIRCs

State	*Zakat* Institution	Structure	Function
Johor	Majlis Agama Islam Johor (MAIJ)	Non-Corporate	Collection & Distribution
Kedah	Lembaga *Zakat* Negeri Kedah (LZNK)	Non-Corporate	Collection & Distribution
Kelantan	Majlis Agama Islam Kelantan (MAIK)	Non-Corporate	Collection & Distribution
Perak	Majlis Agama Islam dan Adat Istiadat Melayu Perak (MAIPk)	Non-Corporate	Collection & Distribution
Perlis	Majlis Agama Islam dan Istiadat Melayu Perlis (MAIPs)	Non-Corporate	Collection & Distribution
Terengganu	Majlis Agama Islam dan Adat Istiadat Melayu Terengganu (MAIDAM)	Non-Corporate	Collection & Distribution
Melaka	Majlis Agama Islam Melaka (MAIM)	Non-Corporate	Distribution
Pahang	Majlis Ugama Islam dan Adat Resam Melayu Pahang (MUIP)	Non-Corporate	Distribution
Wilayah Persekutuan	Majlis Agama Islam Wilayah Persekutuan (MAIWP)	Non-Corporate	Distribution
Negeri Sembilan	Perbadanan *Baitul*mal Negeri Sembilan (PBMaINS)	Corporate	Collection & Distribution
Pulau Pinang	*Zakat* Pulau Pinang	Corporate	Collection & Distribution
Sabah	Pusat *Zakat* Sabah MUIS (PZS-MUIS)	Corporate	Collection & Distribution
Sarawak	Tabung *Baitul*mal Sarawak (TBS)	Corporate	Collection & Distribution
Selangor	Lembaga *Zakat* Selangor (LZS)	Corporate	Collection & Distribution
Melaka	Pusat *Zakat* Melaka (PZM)	Corporate	Collection
Pahang	Pusat Kutipan *Zakat* Pahang (PKZP)	Corporate	Collection
Wilayah Persekutuan	Pusat Pungutan *Zakat* MAIWP (PPZ-MAIWP)	Corporate	Collection

List of *Waqf* Institutions under SIRCs

State	*Waqf* Institution	SIRC	Structure
Wilayah Persekutuan	Pusat Wakaf MAIWP Sdn. Bhd (PWMSB)	Majlis Agama Islam Wilayah Persekutuan (MAIWP)	Corporation
Selangor	Perbadanan Wakaf Selangor (PWS)	Majlis Agama Islam Selangor (MAIS)	Corporation
Negeri Sembilan	Perbadanan *Baitul*mal Negeri Sembilan (PBMALNS)	Majlis Agama Islam Negeri Sembilan (MAINS)	Corporation
Johor	*Waqf* An-Nur Corporation Berhad (WANCorp)	Majlis Agama Islam Negeri Johor (MAIJ)	Corporation
Pulau Pinang	Wakaf Pulau Pinang Sdn Bhd (WPPSB)	Majlis Agama Islam Negeri Pulau Pinang (MAINPP)	Corporation
Sarawak	Tabung *Baitul*mal Sarawak (TBS)	Majlis Islam Sarawak (MIS)	Corporation
Kedah	Bahagian Wakaf MAINK	Majlis Agama Islam Negeri Kedah Darul Aman (MAINK)	Department
Perak	Bahagian Pengurusan dan Pembangunan Mal dan Wakaf MAIPk	Majlis Agama Islam & Adat Melayu Perak (MAIPk)	Department
Perlis	Bahagian Pembangunan Wakaf, Hartanah & Mal MAIPs	Majlis Agama Islam & Adat Istiadat Melayu Perlis (MAIPs)	Department
Pulau Pinang	Bahagian Pengurusan Hartanah & Wakaf MAINPP	Majlis Agama Islam Negeri Pulau Pinang (MAINPP)	Department
Kelantan	Unit Wakaf MAIK	Majlis Agama Islam & Adat Istiadat Melayu Kelantan (MAIK)	Department
Terengganu	Seksyen Wakaf MAIDAM	Majlis Agama Islam & Adat Melayu Terengganu (MAIDAM)	Department
Pahang	Pusat Kutipan *Zakat* & Wakaf Pahang	Majlis Ugama Islam & Adat Resam Melayu Pahang (MUIP)	Department
Melaka	Seksyen Wakaf MAIM	Majlis Agama Islam Melaka (MAIM)	Department
Sabah	Bahagian Wakaf & *Baitul*mal MUIS	Majlis Ugama Islam Negeri Sabah (MUIS)	Department