

**6TH MFPC INTERNATIONAL
CONFERENCE ON
*Islamic Wealth Management & Financial
Planning***

**Financial Consumer Protection and Value Based
Intermediation**

**8th April 2019, Berjaya Times Square Hotel, Kuala
Lumpur**

GUIDING PRINCIPLES FOR VBI IMPLEMENTATION

By

SYED OTHMAN ALHABSHI

Member, MFPC

AGENDA

- Introduction
- VBI objectives
- BNM Guiding Principles for BVI
- The Implementation Guide
- Example: LBBW
- Some Progress
- Conclusion

INTRODUCTION

- In July 2017, BNM announced its strategy for VBI as an “Intermediate function that aims to deliver the intended outcomes of Shariah through practices, conduct and offerings that generate positive and sustainable impact to the economy, community and environment, without compromising the financial returns to the shareholders”
- The VBI initiative comes at a point when Malaysia’s Islamic finance industry’s growth is on the decline; asset growth has dropped from around 26 percent in 2011 to around 8 percent in 2016. Although it is still higher than that of conventional banks, it is of grave concern.

INTRODUCTION

- Malaysia's intention to transition its Islamic finance industry from being Shariah-compliant to Shariah-based was articulated in the Capital Market Masterplan 2 for 2011 to 2020 that was released in 2011 by the Securities Commission.
- The Shariah-based approach requires alignment of products and services to MAQASID SHARIAH, or the objectives of Shariah which seek to preserve and promote benefits and prevent harm to society.
- The strategy paper admits that VBI shares similarities with several well-established concepts such as Environmental, Social and Corporate Governance (ESG), Ethical Finance and Sustainable, Responsible, Impact Investing (SRI)

VBI OBJECTIVES

- From the various documents that have been in the public domain, it can be clearly discerned that

“VBI is an approach to Finance and investment that meets the usual financial goals of financial institutions and at the same time gives equal emphasis on achieving goals of the Almighty in creating this universe”

In other words, apart from the business (profit) goals, the financial institution must consider if the activity will bring about any impact to the stakeholders which are in line with the objectives of Shariah, such as environmental friendly, more employment, greater sustainability, better efficiency, useful and healthy yet cheaper products as outputs, etc.

BNM GUIDING PRINCIPLES FOR BVI

- On October 3, 2018, BNM issued 3 guidance documents to facilitate the practical adoption of VBI which requires Islamic finance business models to re-orientate themselves towards achieving the Shariah objectives which include generating positive and sustainable impact to the economy, community and environment through practices, processes, offerings and conduct.
- The 3 guidance documents are:
 - The Implementation guide for VBI
 - The VBI Financing and Investment Impact Assessment Framework (VBIAF)
 - The VBI Scorecard

THE IMPLEMENTATION GUIDE

Sharing of practical banking practices that are driven by impact creation to wider stakeholders	<ul style="list-style-type: none">• How to translate the key underpinning thrust of VBI into banking operations
Outlining 4 phases of implementation that reflect gradual progression towards envisioned financial landscape	<ul style="list-style-type: none">• What are the priorities?• How to know we are on right track?• What is the end-outcome?
Deliberating key implementation challenges & issues as well as pragmatic solutions	<ul style="list-style-type: none">• How to manage/address challenges or issues arising from implementation of VBI?

THE IMPLEMENTATION GUIDE

- The Bank facilitates the VBI implementation by establishing key enablers. They are:
 - Community of Practitioners (CoP)
 - VBI Network
 - VBI Scorecard
 - Series of Guidance
 - In addition, the Bank promotes proactive transparency on optimal information that aims to trigger intended reaction from relevant stakeholders towards existing banking practices and offerings

THE IMPLEMENTATION GUIDE

- Two-pronged approach in facilitating VBI adoption by industry players
 - 1) Creating an enabling environment through regulatory guidance which are:
 - VBI Implementation Guide – provides practical examples of banking practices that illustrates the underpinning thrusts of VBI and deliberates broader implementation issue
 - Corporate Value-Intent (CVI) – provides structured mechanism to formulate the strategic intent in delivering Shariah propositions and monitor execution of implementation strategies that aim to deliver the commitments
 - VBI Investment and Financing Assessment Framework (VBIAF) – provides guidance on establishment of robust risk management system
 - VBI Scorecard – provides structured management tool to assess effectiveness and achievement

THE IMPLEMENTATION GUIDE

- The Second prong

2) Enhancing transparency to trigger intended stakeholder activism

- It is necessary to promote disclosure of optimal set of information to key stakeholders such as financial consumer, investor, government, NGOs, with the intention to generate the market discipline to encourage the IBIs to sharpen their focus in delivering Shariah propositions.
- At this juncture, VBI transparency expectations focus on intent commitment, implementation strategies and comprehensive performance reporting. Eventually this will cover impact of financial intermediation

EXAMPLE: LBBW

- The guide provides an interesting example which is LBBW, one of the largest banks in Germany and a universal commercial bank operating worldwide based in Stuttgart.
- Its mission: Commitment to Sustainability
- As a company with regional roots, it is committed to fulfilling its responsibilities. Business is done in environmental friendly manner and advocates for social issues.
- Transparency in mission statement instils a sense of self-discipline and accountability throughout the organisation

EXAMPLE: LBBW

- LBBW has adopted a comprehensive sustainability policy. It provides a framework for all business activities which is set out in the “Principles & Guidelines for Implementation of LBBW’s Sustainability Policy and Goals”.
- They provide guidance on the operational implementation (business area-specific guidelines and goals for investment, financing, business operations and human resource management). For example, its Guidelines for Business Operations set standards for its resource use (setting standard for usage of recycled paper)

EXAMPLE: LBBW

- LBBW has also formulated a **climate strategy** where it intends to reduce carbon dioxide emissions
- Established cross-functional committee driving sustainability agenda with clear roles and KPIs in overseeing and driving implementation of sustainability initiatives

OTHER EXAMPLES

- **The guide also gives many other examples such as**
- HSBC Sustainability Risk Management
- Yoma Bank Agribusiness Finance Programme
- Program Keusahawanan by Taylor's and CIMB Islamic
- Agrobank's Integrated Value-Chain Financing Approach
- Westpac Energy Efficient Financing
- Agrobank Knowledge Management Roadmap
- Bank Islam Integrated Reporting
- Triodos “Know Where Your Money Goes”
- TeamBank – Finding Profit in Fairness and Transparency
- Maybank – Structured engagement framework addressing interests of multi-stakeholders
- Shorebank – Too Good To Fail

SOME PROGRESS

- Enhanced assessments of customers' application for financing where the traditional credit assessment methodology is supplemented with an assessment of the positive impact of the financing to the community and economy. For business financing, for example, the consideration is also given to whether the financing will generate sustainable employment and entrepreneurship.
- Being more customer focus, IBs will have to also look into the unique circumstances of individual customers, provide solutions that address the differentiated needs, such as complementing financing with finance capability advice.

SOME PROGRESS

- By collaborating with other relevant industry experts, IBs are expected to offer business and technical skills training to help young and new entrepreneurs better commercialise their ideas.
- Another approach being considered is to directly link the incentive structures not just in terms of volume and value of financing disbursed, but also with the ability of customers to service the financing over a long horizon. This will enable the bank and its employees to take a longer view of the financial well-being and commercial success of their customers.

SOME PROGRESS

- The VBI is industry driven. To support changes by the industry, a Community of Practitioners (CoP) comprising nine IBs was established. It serves as an effective platform to share knowledge and pursue collective efforts to develop and execute VBI strategies in collaboration with strategic partners beyond the financial fraternity
- The CoP also leverages its connections with established VB Institutions such as The Global Alliance for Banking on Values and Triodos Bank to advance the understanding and practice of VBI among Islamic Banks in Malaysia

SOME PROGRESS

- Specific progress – Funds raised through investment accounts (IA) are being channelled to a variety of purposes, including risk capital for entrepreneurs such as SMEs.
- The IA are being used more frequently as ‘risk capital’ instruments. For this the BNM issued regulatory guidance on the accounting treatment for restricted IA to ensure that cash flows are managed in a way that allows such accounts to be treated off-balance sheet

SOME PROGRESS

- Another concrete example, 6 Islamic Banks collaborated to develop cash waqf with the State Islamic Religious Councils of 10 States to modernise the collection of cash waqf through their access points. Funds collected will be invested in Shariah-compliant instruments. Returns from these investments will be channelled to projects that promote economic empowerment, education and health.
- In conjunction with this activity, the Islamic Banks have also committed to the development of knowledge and expertise in managing the investment and distribution of waqf funds. The Association of Islamic Banking Institutions Malaysia will also come up with Code of Governance and Transparency for the management of waqf funds.

CONCLUSION

- Whilst the initiative of VBI is making good progress, we should anticipate more activities to be developed in due course especially those that would generate more benefits to the community. One of the stark problems facing our youth in pursuing higher education is the increasing cost of education everywhere. Before they could start earning some income after graduation, they are already slapped with a huge debt to repay the education cost. This is very true with those belonging to B40.
- The second issue is that we have not progressed much in terms of transforming this country into a high income nation. Wages and salary have been stagnant for more than two decades whilst prices have risen beyond their means, particularly in terms of transport and housing.

CONCLUSION

- The third issue is that those interested to own houses do not seem to get the financing from banks. In one property development company I know, at least 70% of applicants for house financing by banks are rejected. This situation used to be the reverse say a decade ago. Two reasons may explain this problem – price of houses have increased manifold and income of house buyers have not increased enough. Shouldn't banks look at the situation differently?
- Finally, looking at the many examples given, it would seem to me that the Islamic Banks could actually collaborate with non-financial organisations to get wonderful ideas for implementation. This will also bring the banks much closer to the community at large.

THANK YOU VERY MUCH