Suruhanjaya Sekuriti
Securities Commission
Malaysia

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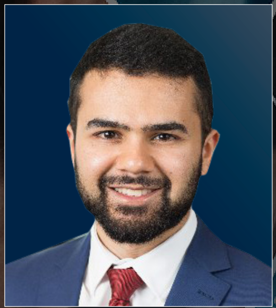
capital markets
MALAYSIA

Islamic Fintech for Social Good

Roundtable Discussion Outcome Featuring High-Level Stakeholders From Malaysia and the UK

PARTICIPANTS



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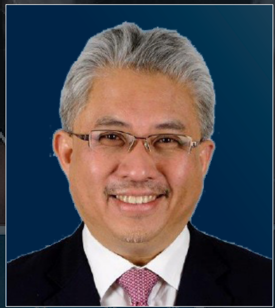

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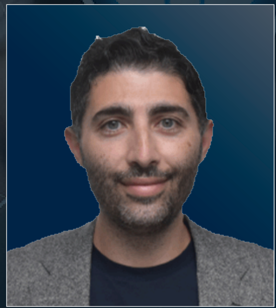

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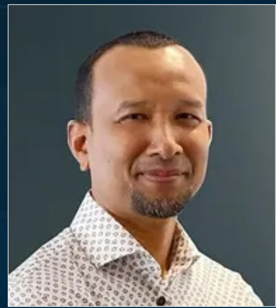

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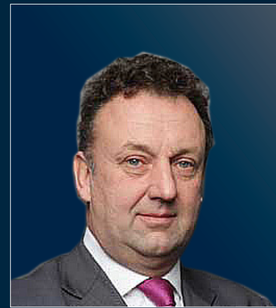

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ROUNDTABLE OBJECTIVES

Islamic Fintech for Social Good

On the 18th September 2023, Securities Commission Malaysia and Capital Markets Malaysia convened a stakeholder roundtable in London between UK and Malaysian ecosystem builders, regulators and Islamic fintech industry players to discuss how Islamic fintech and digital market platforms can be leveraged to scale up and lead innovation in social impact and social finance.

1

Identify the challenges faced by Islamic fintech start-ups in scaling up and expanding their impact while exploring potential solutions to assist them.

2

Explore potential synergy and collaboration opportunities between the two countries to leverage and maximize social finance impact through Islamic fintech.

3

Serve as a platform to share best practices and success stories from both countries on how Islamic fintech platforms are contributing to social impact from the perspectives of start-ups and ecosystem builders.

DISCUSSION POINTS

Islamic Fintech for Social Good

1

What are the pain points faced by Islamic fintech companies in scaling up social impact and social finance solutions?

2

How can regulators and government bodies support the start-ups and innovation?

3

What is the state of the Islamic fintech landscape in both markets and has it been effective in addressing social challenges?

4

What successful initiatives to mobilize digital social finance can we learn from each other?

5

What areas can we collaborate to promote cross-border knowledge, expertise and most importantly, cross-border business and impact?

PRINCIPAL FINDINGS

01

Tech-enabled Islamic finance solutions hold the potential to address various social issues; however, they remain underutilized due to a host of challenges faced by start-ups providing Shariah compliant products and services.

02

Despite the alignment with the fast-growing ESG finance movement which provides an opportunity for greater mileage into mainstream consciousness, Islamic fintech start-ups find themselves having to navigate the challenging landscape of being branded as Islamic due to the lack of understanding of Islamic finance and erred perceptions about Islam.

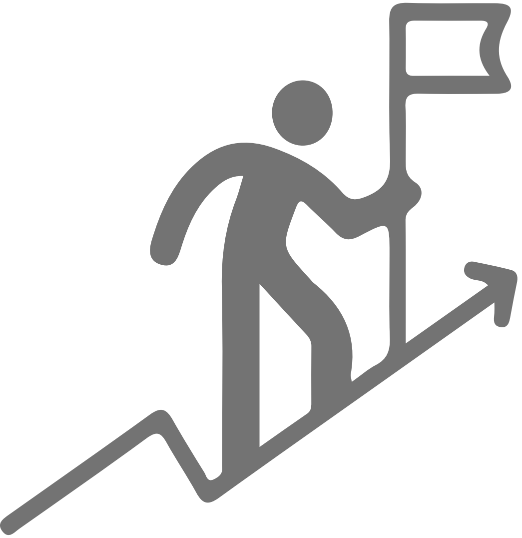
03

Malaysia as a global Islamic finance leader and the UK as an international fintech hub stand to learn from each other's experiences to advance the transformative potential of Islamic fintech particularly in delivering social impact.

04

The challenges are complex, and concerted efforts from all stakeholders are key in addressing the regulatory architecture, start-up funding environment, social impact measurement mechanisms and collective branding of the Islamic fintech industry.

KEY CHALLENGES



01 Restrictive regulation and legal frameworks in the UK are restraining Islamic fintech start-ups from coming to market and scaling up.

02 The UK's regulatory approach favors debt over equity, putting equity-based Islamic fintech start-ups at a great disadvantage.

03 Capital, or the lack thereof, is still the biggest obstacle faced by Islamic fintech start-ups.

04 Investors are still largely unwilling to compromise returns for social impact.

05 The lack of proper, effective and cohesive impact measurement methodologies severely hampers product development, investor outreach and strategy design.

06 Adopting a Shariah compliant or Islamic identity may be working against Islamic fintech start-ups.

RECOMMENDATIONS

Regulators to adopt a light-touch approach in regulating alternative asset or finance providers to provide previously unregulated start-ups with proper oversight and flexibility while providing market with confidence in new players.

Need to promote and nurture venture capital-accelerator model of funding, ie accelerator model backed by an industry body to ensure start-ups can remain sustainable post-funding.

Governments to play a stronger role in pushing the industry to collaborate with Islamic fintechs.

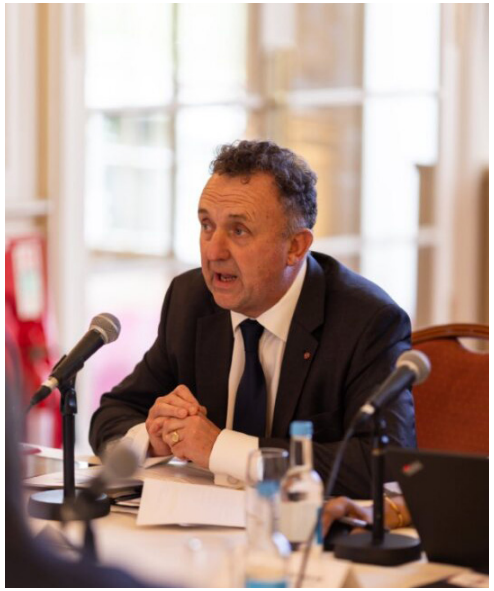
Just as the UN has compelled governments to focus on the environment stream of ESG, the UN is also well placed to push for governments to focus on the social pillar of ESG.

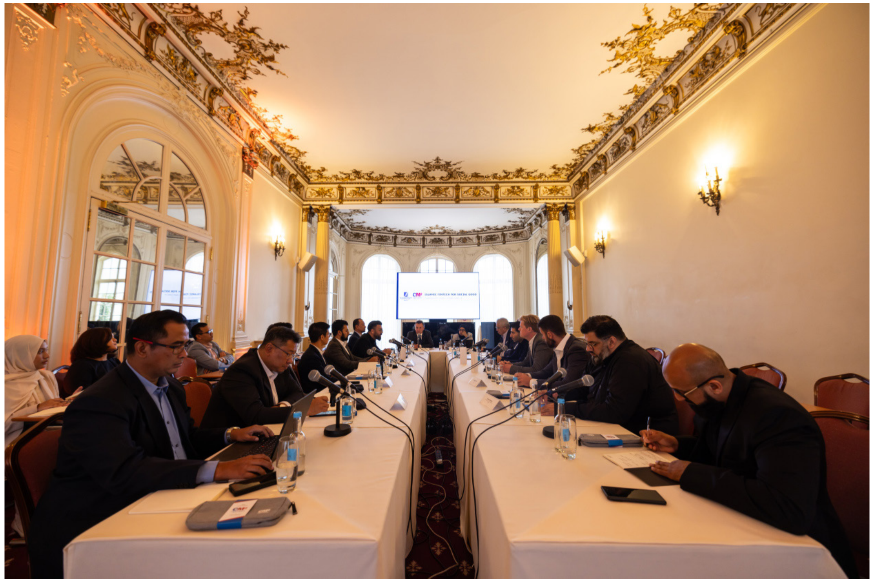
The industry needs more good quality data points on social impacts and effective measurement tools.

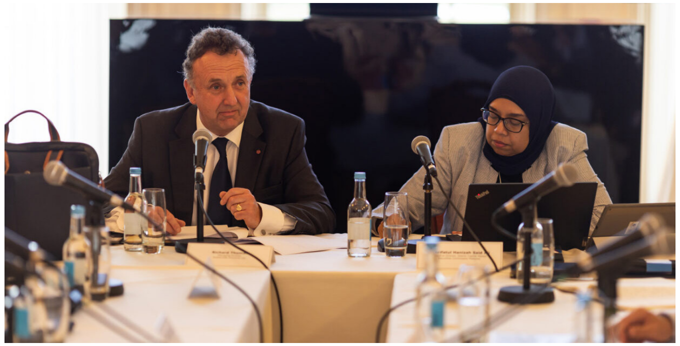
The industry needs to develop guidance on social impact to facilitate cross-border collaboration and provide direction for Islamic fintech start-ups toward delivering maximum social impact returns.

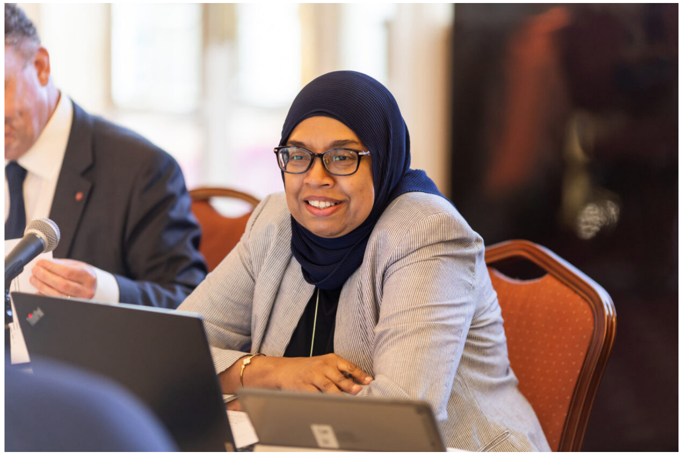
The industry needs to rethink its branding — move away from 'Islamic' and focus on Tayyib or values to appeal to a wider audience.

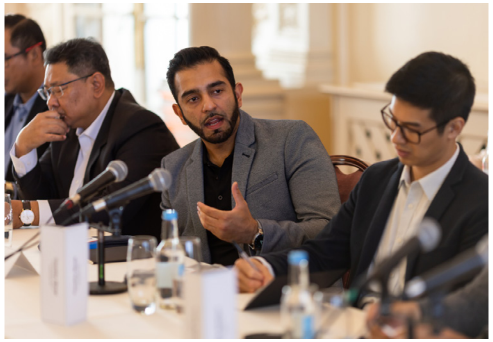
PHOTO HIGHLIGHTS

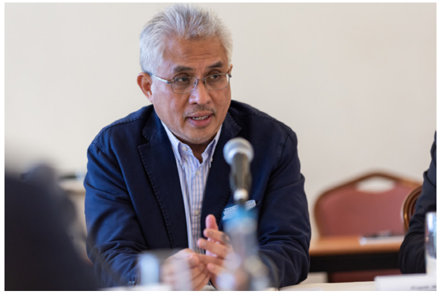


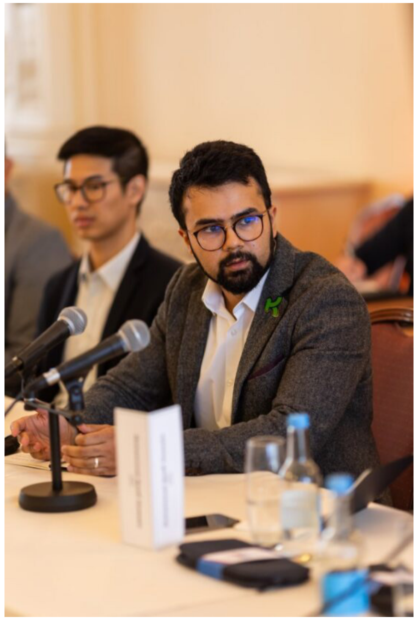


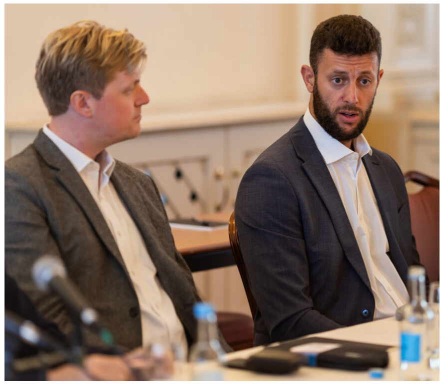


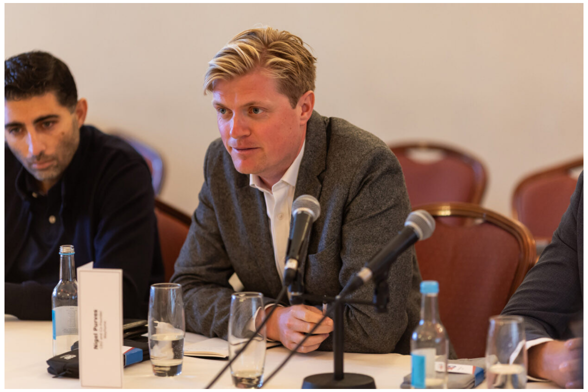


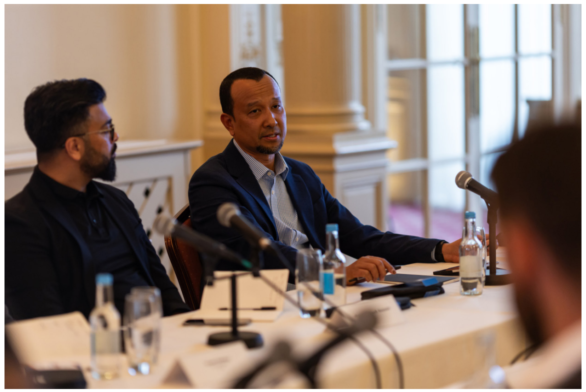












OVERVIEW

Malaysia and the UK are some of the biggest Islamic fintech markets in the world by number of service providers. Together, they account for over a quarter of the 388 Islamic fintech start-ups globally, with Malaysia housing at least 58 start-ups and the UK home to 43 companies providing Halal digital finance services, according to the IFN Islamic Fintech Landscape as at the end of October 2023. The UK is only trumped by Indonesia which has 49 Islamic fintech start-ups registered by the IFN Islamic Fintech Landscape.

With Shariah at their core, these start-ups have built social equity and risk sharing into their operational DNA, making them aligned with the multitrillion-dollar ESG investment industry. While numbers vary, PwC projects ESG-related assets under management to grow at a compound annual growth rate of 12.9% to reach US$33.9 trillion by 2026 while Bloomberg Intelligence anticipates global ESG assets to hit US$50 trillion by 2025; what is clear is that the ESG investment space is growing at a phenomenal pace.

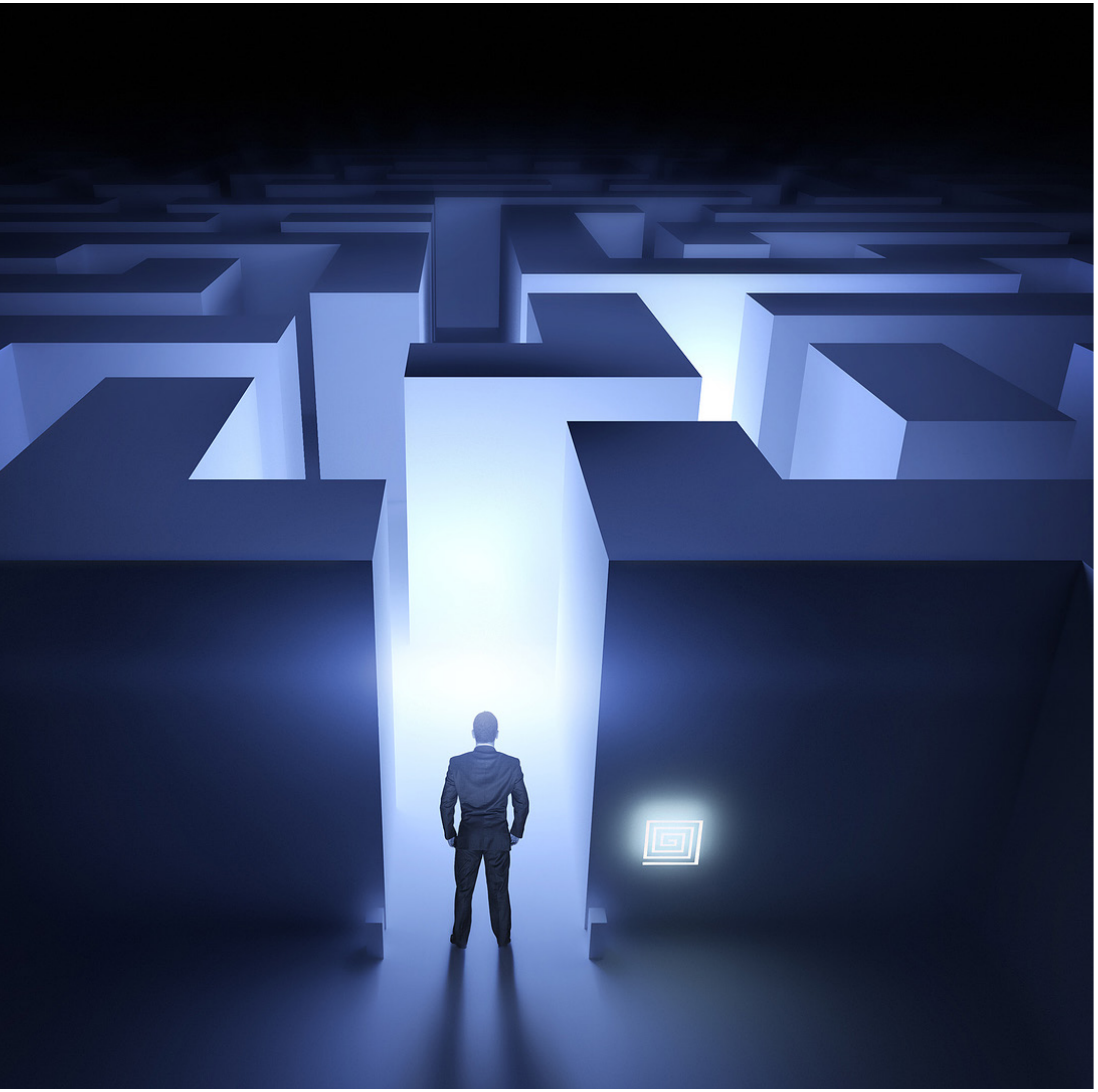
Malaysia has benefited from its forward-looking proactive regulators. The Securities Commission Malaysia (SC) in 2015 introduced alternative digital financing channels, namely equity crowdfunding and P2P financing and has since released multiple supportive frameworks including for robo-advisors, and digital asset exchange and initial exchange offerings.

A common theme weaved into the regulator's policies is integrating fintech and social finance. In the case of Islamic fintech, it is leveraging on the intrinsic emphasis on ethical and socially responsible investment to build constructive collaboration with the broader fintech ecosystem.

The UK, on the other hand, has attracted a significant number of Islamic fintech start-ups to its shores despite being a non-Muslim majority nation where Islamic banking and finance accounts for a minor share of its total financial system. This is attributed to the country's robust regulatory financial system, vibrant fintech start-up ecosystem and pent-up demand for Muslim-friendly financial services.

Yet, despite their respective credentials and achievements, market practitioners from both markets still face persistent challenges hindering them from scaling up further.

CHALLENGE



Challenge: Restrictive and unaccommodating regulatory environment

This is particularly true in the context of Islamic fintech start-ups in the UK. While it is widely acknowledged that the UK's Financial Conduct Authority (FCA) is one of the most robust regulators globally, its strong and strict regulations, according to practitioners, also mean restrictive.

"Our formative years were spent trying to create a solution that was accessible and shoehorning that through the regulatory framework with the FCA, who was quite difficult in trying to reach an agreement that, to some extent, had already existed as we were not trying to create anything new, other than the fact that we wanted to make it more accessible to all," shared one UK start-up.

Under its Innovation Hub initiative, the FCA has introduced a regulatory sandbox and Innovative Pathways, a program designed to remove barriers to entry for technology providers, to facilitate fintech start-ups.

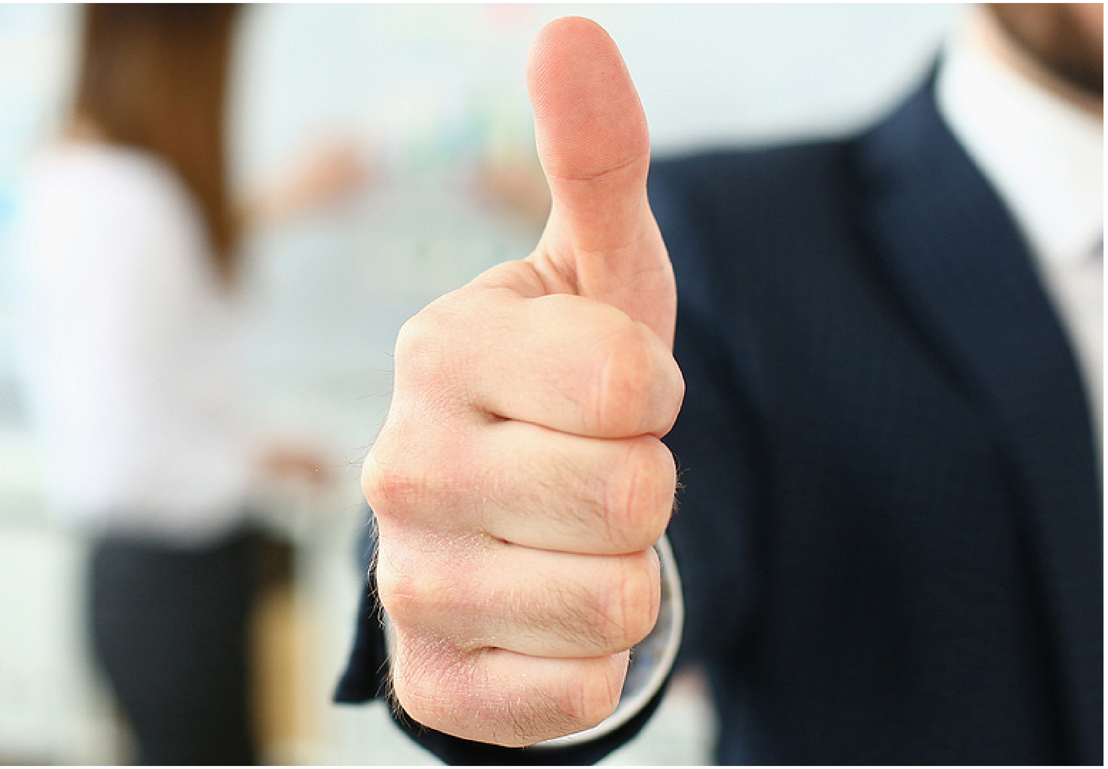
While this initiative is most welcomed, market service providers still require clearer targeted guidance. "We had endless conversations with the regulator about our structure and details only to be told to get legal advice from an expensive law firm to decide whether or not we need to be regulated and whether we need to apply to the FCA," according to one practitioner.

Another real challenge faced by UK fintech start-ups is the pro-debt flavor of the regulations, which is at odds with the pro-equity nature of Islamic finance.

This hamstrings Islamic fintech start-ups, particularly those who are propagating a debt-free equity-based model such as a shared homeownership solution.

"Unless a real estate investment product is formed in a specific structure that it is a security, it is not recognized or treated in the same way by the regulators; instead, it will be treated as a high-risk investment, which completely skews in a balanced portfolio. This is unfair because you could say, the safest investment is bricks and mortar," commented one start-up.

RECOMMENDATIONS



Light-touch approach

While the UK is stringent in its approach, Malaysia on the other hand, has taken a light-touch approach while remaining agnostic.

Fintech companies intending to issue any Islamic financial instruments are responsible to appoint Shariah advisors (who are in turn registered with the SC) to ensure the range of products and services comply with Shariah rules and principles.

This means, the SC focuses on the provider's value proposition. For any new entities as in the alternative finance space, or non-regulated entities, the SC gives them six months to establish their viability.

"I think the UK regulator has something to learn from the Malaysian regulator because that level of handholding is exactly what's required for a young start-up. The light-touch approach would go a long way in the UK for Islamic fintechs who are doing a pure risk, equitable product that's partnership based and not debt-structured; this would do wonders for stakeholder confidence," opined a practitioner.

Establish an industry body

There is also the suggestion to set up an industry body for market players that do not fall under the purview of regulations, to establish credibility.

"Realistically, an industry body would be beneficial but there is no substitute for having a regulatory body," remarked a panelist.

Leaning in and leaning into successful companies doing good things, and leaning in early

In the Islamic finance industry, there are not many natural incentives for (larger) players to innovate and that has trickle-down effects on Islamic fintech start-ups, believes one expert.

Take Wall Street banks for example: the likes of JPMorgan and Goldman Sachs have a strong interest from a commercial survivability and market leader standpoint to work with start-ups to be ahead of the game.

"Something we used to push very aggressively in the UAE in terms of regulations is that we force the big boys to work with start-ups to innovate their own businesses and to create symbiotic relationships," one participant shared. "Unfortunately, the reality is that there are not enough government-mandated pushes on the Islamic finance industry to work with companies like Kestrl and Wahed."

"I think the UK regulator has something to learn from the Malaysian regulator because that level of handholding is exactly what's required for a young start-up"

Just like how the UAE government had played instrumental roles in the acquisition of Careem by Uber, and souq.com by Amazon, governments can do the same for the Islamic fintech sector. These types of signals are very powerful in attracting capital as well as talent into the country and to the industry at large.

CHALLENGE

Challenge: Access to capital

It comes as no surprise that Islamic fintech start-ups — in the UK and Malaysia — struggle to raise funds; and the challenge is bigger when you are unregulated.

Islamic fintech start-ups may have been able to attract non-Muslim investors and conventional/agnostic institutional money, but this has left many with backers who may not share the same values as the start-ups.

> "Islamic fintechs require capital that has flexibility — investors that are willing to accept that part of the return is going to be a social impact return and not all about driving your internal rate of returns to the highest possible figure"

"I've been disappointed to find that among strategic investors, the impact piece is often more of a box-ticking exercise — it is helpful to get you in the door, but ultimately, if you are competing against some random equity strategy that is highly leveraged and is delivering 12–15%, then ultimately, when it comes to investment decisions, we will struggle against some of those alternatives," shared one panelist.

Another noted: "Islamic fintechs require capital that has flexibility — investors that are willing to accept that part of the return is going to be a social impact return and not all about driving your internal rate of returns to the highest possible figure."

In Malaysia, there is a lack of participation or contribution from asset owners, ie mutual funds, into fintech platforms.

According to one practitioner, there is still hesitance within the investment community in accepting fintech as an investment asset class.

The reticence is understandable considering that at the forefront of introducing any new asset class must be investor protection. And also, exit opportunities for investors: in the case of Malaysia, the SC has introduced over-the-counter markets for institutional investors as well as a secondary market. The regulator is also understood to be working on revising the definition of 'sophisticated' investors.

RECOMMENDATIONS

Promote and nurture VC–accelerators backed by industry bodies

Industry bodies should back accelerators to create a venture capital (VC)–accelerator hybrid model to support Islamic fintech start-ups.

> **"We have seen partners of ours unfortunately fall flat. They have not been able to take off, because while they had a good team, good tech and had some investment, they did not really know where to go from there"**

"We have seen partners of ours unfortunately fall flat. They have not been able to take off, because while they had a good team, good tech and had some investment, they did not really know where to go from there."

The VC–accelerator program will see the VC arm injecting capital into the start-up, while the accelerator engine will hold the hands of the start-ups to ensure they move toward a viable business model.

Participants noted the SC's FIKRA accelerator program as a successful platform that has aided start-ups go to market in a meaningful and productive manner.

Launched in May 2021 by the SC and the UN Capital Development Fund, FIKRA is Malaysia's first fintech accelerator program designed specifically for the Islamic capital market. The three-month program provided start-ups with regulatory guidance, mentorship and pilot testing of solutions, as well as connected start-ups with potential investors and partners.

The SC built upon the FIKRA model and in June 2023 launched FIKRA ACE, a three-year initiative to enhance the Islamic capital market ecosystem.

Evolving from a single accelerator approach, FIKRA ACE now consists of three components: Accelerator, Circle and Excel. Accelerator is the Islamic-focused accelerator program; Circle is a networking platform to connect stakeholders of the Islamic capital market and the fintech community; and Excel is a platform for collaborations with higher learning institutions for capacity-building.

CHALLENGE

Challenge: Poor social good measurement

One panelist succinctly summed the essence of the state of social impact: "There always seems to be moving goalposts around social impact and on what is social good."

> **"There always seems to be moving goalposts around social impact and on what is social good"**

At present, there is no regulated framework for measuring impact and the quality of data available leaves much to be desired. The lack of a standardized industry framework has seen institutions establishing proprietary frameworks.

"Harvard Business School published the Impact-Weighted Accounts Initiative which maps revenues of companies against the UN SDGs; but the problem is that the UN SDGs were developed for measuring sovereigns and not for corporates. So, people are trying to shoehorn impact into frameworks that were not built to do that in the first place," observed one expert.

Without effective and accurate methods to measure impact, can entrepreneurs truly steer their company toward an 'impactful' proposition while remaining commercially viable? Without being able to gauge the impact of their investments, investors will also not be able to make better informed decisions regarding future ones.

The lack of proper, effective and cohesive impact measurement methodologies severely hampers product development, investor outreach and strategy design.

RECOMMENDATIONS

Stakeholder collaboration to introduce framework

Regulators, innovators and companies need to collaborate and work in tandem to help define, monitor and measure social impact.

“We can draw parallels with the ESG movement — in Asia alone, in the last year alone, we have seen about nine frameworks across the region; if we don’t have more collaborations and more engagements, we are going to have a situation where there is going to be 10–20 impact frameworks and it is going to be hard to develop a global investment product and try to cross these jurisdictions,” cautioned one panelist.

Proportionate regulation

An industry expert emphasized that regulations should not be overly prescriptive; rather it should be proportionate regulation.

Malaysia is already working on initiatives that could lay the groundwork for impact investment standards.

The Malaysia International Islamic Financial Centre Leadership Council, for example, is working on introducing a Tayyib framework. Tayyib, which essentially means being pure, ethical and wholesome, is seen as being closer to the ideals of Maqasid Shariah and is foundational to Islamic traditions. In comparison, Halal simply means to be permissible and lawful.

Simply put, it is no longer sufficient that products are permissible, but they must also be beneficial to society and sustainable.

The SC, on the other hand, in November launched the Maqasid Al Shariah Guidance Islamic Capital Market Malaysia, a set of universal guiding principles to sharpen the Islamic capital market’s competitive advantage while enhancing the impact and contribution of Shariah compliant instruments to society and the real economy.

The new principles-based document is in line with the SC’s Capital Market Masterplan 3 seeking to anchor the country as a regional center for Shariah compliant SRI.

At the end of the day, fintechs on the ground level know what can be quantified.

CHALLENGE

Challenge: The Islamic identity backlash

In the past, Shariah compliance may be a unique selling proposition for Islamic finance/fintech service providers, but times are changing.

"We have got to move away from the terminology of Shariah compliant because having spoken to so many people at the grassroots, they are very disillusioned with this wording. In fact, subliminally, it puts them off straight away," remarked one participant.

This was echoed by another panelist: "It is probably a failure to focus ourselves so narrowly to a population."

"We have got to move away from the terminology of Shariah compliant because having spoken to so many people at the grassroots, they are very disillusioned with this wording"

Recommendation

Rethink our identity

The industry needs to rethink its branding — move away from 'Islamic' and focus on Tayyib or values to appeal to a wider audience. Turkiye, for example, uses participation finance instead of Islamic finance to describe Shariah compliant financial activities in the Republic.

"There is a distinction between Muslim markets and tech enabled by Maqasid, which can be sold to all markets including Muslim markets which are highly underserved. We need to start thinking about tech enabled by Maqasid values instead of Islamic fintech," one market practitioner opined.

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