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LEADING TOWARDS IMPACTFUL ISLAMIC SOCIAL FINANCE: MALAYSIAN EXPERIENCE WITH THE VALUE-BASED INTERMEDIATION APPROACH

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Abstract

With the introduction of Sustainable Development Goals or SDGs in 2015, the notion of sustainability and impactful services give an inspiration to the dual financial services industries in Malaysia. The approaches that are taken by both of Islamic financial services industry (IFSI) and its counterpart conventional financial services industry (CFSI) are almost similar. However, a distinguished approach is introduced by the Central Bank of Malaysia towards IFSI. While Sharī'ah provides holistic objectives in comparison to SDGs, the approach of value-based intermediation (VBI) opens a new pragmatic dimension for IFSI in providing impactful and beneficial services to the public at large. The end results of VBI are placed to reach the holistic objectives of Sharī'ah and in achieving complete sustainability of IFSI. This paper investigates the approach of VBI and its proposed implementation from Sharī'ah perspective. Depending on qualitative investigation, this paper also explores the practices of Islamic banks in applying VBI through Islamic social finance and its impacts. It is found that VBI facilitates Islamic banks to provide impactful services to their customers and other innovative strategies based on Islamic social finance.

Keywords: *Maqāṣid al-Sharī'ah*, Value-based Intermediation, Sustainable Development Goals, Financial Intermediary, Islamic Social Finance

1.0 Introduction

The introduction of Sustainable Development Goals or SDGs in 2015 inspire all main stakeholders of the financial market locally and globally to look closely on the notion of sustainability and impactful services to the society. Not limited to the social well-being, such impactful services are also looking into dynamic activities that may improve the environment, economy, and education of the people. In Malaysia, versatile approaches can be traced from the practices from both the Islamic financial services industry (IFSI) and its counterpart, the conventional financial services industry (CFSI). The existence of such a dual financial services system encourages creativity and innovates activities among bankers to contribute back to society. Even though similarities can be traced from impactful activities made by the IFSI and CFSI, *Shari'ah* provides wider and holistic objectives that IFSI needs to achieve. While focusing on reaching the sustainability of IFSI, it is also essential for the IFSI to provide impactful and meaningful financial services to the public at large. Consistently, along the way, it may lead to achieving the holistic objectives of *Shari'ah*.

In order to achieve such holistic objectives of *Shari'ah*, the principles of *Shari'ah* need to be enshrined and strengthened in IFSI in Malaysia. A priority concern is placed among bankers on the practicality of such holistic objectives into the modern financial services and financial market. Contrast to SDGs, such holistic objectives are wider and more rooted deep into the Islamic jurisprudential foundation of *Shari'ah*. Taking the concern pragmatically, the Central Bank of Malaysia introduced the approach of Value-Based Intermediation or VBI in 2017¹. While introducing the VBI, a remark was made by the previous Governor of Central Bank of Malaysia (2016-2018), Muhammad bin Ismail, in relation to the sustainability of IFSI in Malaysia:

“... the rapid changes and dynamism of the industry require Islamic Finance to strive even harder now. True

¹ BNM (2019), “Guidance Documents on VBI,” October 3, 2018, retrieved from http://www.bnm.gov.my/index.php?ch=en_announcement&pg=en_announcement&ac=670

to its name, Islamic Finance needs to continuously carve its own branding and distinctiveness to provide wholesome value propositions. On this premise, the next frontier and the major milestone would be positioning Islamic Finance to become more prominent and leading agent of positive change for the financial system, and operates within a network economy that is built upon shared values of integrity, inclusivity and sustainability. Greater attention will be devoted to value creation and value-based businesses that reflect the true essence of Islamic Finance².

Depending on the qualitative investigation, this research explores the approach of VBI and its proposed implementation from *Shari'ah* perspective. The researchers look closely into analyzing the relationship between VBI, SDGs, and *Shari'ah* holistic objectives or *Maqasid al-Shari'ah*. By looking also into the practices of Islamic banks in applying VBI, an evaluation of the Islamic social finance and its impacts on society is also carried out. The research is organized into several sections. After the introductory section, the next section provides an overview of VBI in relation to IFSI. The third section examines the relationship between VBI, SDGs, and *Maqasid al-Shari'ah*. This section also provides a brief analysis of VBI from Islamic perspective. The fourth section discusses the concept of Islamic social finance and its relationship with VBI. The fifth section is provided to explore the current practice of VBI in IFSI based on the selected Islamic banks. These selected Islamic banks are Bank Islam (M) Berhad, AgroBank (M) Berhad, and AmBank Islamic Berhad. The sixth section discusses on banks are not financial intermediaries and its counterarguments. The conclusion is provided at the end of the discussion.

2.0 Value-Based Intermediation in IFSI

The value-based intermediation or VBI was first introduced in

² BNM, "Value-based Intermediation: Strengthening the Roles and Impact of Islamic Finance," March 12, 2018, retrieved from <http://www.bnm.gov.my/index.php?ch=57&pg=137&ac=612&bb=file>

Malaysia in July 2017. This was done through the issuance of a strategy paper by the Central Bank of Malaysia titled the “Value-based Intermediation: Strengthening the Roles and Impact of Islamic Finance”³. The introduction of VBI receives positive feedback from the industry players, especially *Shari’ah* scholars. By having VBI as an approach to sustainability, the IFSI is shaped to be more strong especially in resilience towards economic crisis. Furthermore, Malaysia is also attempting to contextualize VBI into a pragmatic practice in the financial services as offered by the IFSI. This is taken with a hope that IFSI can be brought to the next level of growth. Beside of the introduction of the VBI strategy paper, the Central Bank of Malaysia also introduced three important guidance documents, namely (i) the Implementation Guide for VBI; (ii) the VBI Financing and Investment Impact Assessment Framework (VBIAF); and (iii) the VBI Scorecard. According to the announcement made by the Central Bank of Malaysia, these three main documents have certain specific functions:

“The VBI aims to re-orient Islamic Finance business models towards realising the objectives of *Shari’ah* that generate positive and sustainable impact to the economy, community and environment through practices, processes, offerings and conduct:

1. The Implementation Guide for VBI provides guidance on practical value-based banking practices, as reference to Islamic financial institutions that intend to embark on the Value-based Intermediation initiative. It also outlines the phases of implementation and deliberates on key implementation challenges alongside some pragmatic solutions;
2. The VBI Financing and Investment Impact Assessment Framework (VBIAF) facilitates the implementation of an impact-based risk

³ BNM, “Value-based Intermediation: Strengthening the Roles and Impact of Islamic Finance,” March 12, 2018, retrieved from http://www.bnm.gov.my/index.php?ch=57&pg=137&ac=612&bb=file_

management system for assessing the financing and investment activities of Islamic banking institutions in line with their respective VBI commitment...; and,

3. The VBI Scorecard provides an overview that covers purposes, key components of assessment and proposed measurement methodology. (This paper is jointly developed with the Global Alliance for Banking on Values)⁴.

By referring to the abovementioned documents, VBI as an approach for IFSI sustainability is defined as “an intermediation function that aims to deliver the intended outcomes of *Shari’ah* through practices, conduct and offerings that generate positive and sustainable impact to the economy, community and environment, consistent with the shareholders’ sustainable returns and long-term interests”⁵. From this definition, it can be understood that the Islamic financial services institutions especially Islamic banks have the central role of the financial intermediary to deliver Islamic financial products and services that may create sustainable impacts towards the environment, economy, and society. According to Engku Ali, while the profit-making is an important component for VBI, there are two other important components that make VBI works; they consist of sustaining planet (including environment, economy, etc.) and people (i.e. society)⁶. Thus, these three main components must be placed accordingly in making VBI as a successful approach to IFSI. In the practical implementation of VBI, the current Governor of the Central Bank of Malaysia, laid down three main strategies that depend on: (i)

⁴ BNM (2019), “Guidance Documents on VBI,” October 3, 2018, retrieved from http://www.bnm.gov.my/index.php?ch=en_announcement&pg=en_announcement&ac=670

⁵ BNM, “Value-based Intermediation: Strengthening the Roles and Impact of Islamic Finance,” March 12, 2018, retrieved from http://www.bnm.gov.my/index.php?ch=57&pg=137&ac=612&bb=file_

⁶ E.R. A. Engku Ali, “Perantaraan Berasaskan Nilai” (Value-Based Intermediation) Menurut Perspektif Syariah”. In Muzakarah Ahli Majlis Penasihat Syariah Institutusi Kewangan Islam di Malaysia Kali Ke-14, 31st October 2018, Malaysia. (Unpublished).

rethinking value where the real value may be derived from the holistic objectives of *Sharī'ah*; (ii) rethinking risk where the financial market and management's view of risks is reflecting sustainability factors; and (iii) changing the mindset to push the limits for IFSI in reaching holistic objectives of *Sharī'ah* and sustainability.⁷

3.0 VBI, SDGS, and *Maqāṣid al-Sharī'ah*

This section is provided to elaborate the understanding of VBI, SDGs, and holistic objectives of *Sharī'ah* i.e. *Maqāṣid al-Sharī'ah*.

3.1 VBI From an Islamic Perspective

Generally, any approach which is not contradictory to *Sharī'ah* is acceptable to be practiced unless there is a clear prohibition to such an approach. In facing the reality of financial services and market, an innovative approach can be considered as a necessity especially when it is to enhance and strengthen the principles of *Sharī'ah* in IFSI while facing the modern world. This is allowed by following the Islamic legal maxim of *al-aṣlu fī al-ashyā' al-ibāḥah* that means the original of things is permissibility. Although VBI is permissible based on the said Islamic legal maxim, it is not wrong to take careful consideration in analyzing VBI.

In analyzing the VBI from an Islamic perspective, it is important to examine the principles of *Sharī'ah* that relevant to it. In essence, VBI is derived from the principles of *Sharī'ah*. The end outcomes of VBI must be consistent with the holistic objectives of *Sharī'ah* or *Maqāṣid al-Sharī'ah*. This can be traced from the strategy paper of VBI as produced by the Central Bank of Malaysia:

“Value-based intermediation (VBI) aims to deliver the intended outcomes of *Sharī'ah* through practices, conduct, and offerings that generate positive and sustainable impact to the economy, community and environment, consistent with the shareholders' sustainable returns and long-term interests. VBI also

⁷ N.S. Mohd Yunus, “Value based Intermediation: Beyond Profit”. In Keynote Address at the Global Islamic Finance Forum 2018 (GIFF), 3rd October 2018, Kuala Lumpur, retrieved from <https://www.bis.org/review/r181003e.htm>

emphasizes on minimization and prevention of negative impact arising from Islamic banking industry's practices, conduct, and offerings. VBI promotes a more holistic observation of *Sharī'ah*, beyond *Sharī'ah* compliance, i.e. ensuring Islamic banking offerings and practices not only comply with *Sharī'ah* requirements but also achieve the intended outcomes of *Sharī'ah*. Intended outcomes of *Sharī'ah* focus on the enhancement of the well-being of the people through the preservation of wealth, faith, lives, posterity and intellect”⁸.

Since the end outcomes of VBI are elaborated to be in line with *Maqāsid al-Sharī'ah*, it is justified to discuss in brief about *Maqāsid al-Sharī'ah* here. In evaluating the historical emergence of in Islam, Sarkawi et al.⁹ said:

“*Maqāsid al-Sharī'ah* is the ultimate aim of the Islamic law. It can be said as a synthesis made by Muslim jurists on the Quranic verses and Prophetic Reports. The 4th until 7th century after Hijrah, marked the evolution of the theory of *Maqāsid al-Sharī'ah*. The theory of *Maqāsid* can be traced back to the administration of the second caliph, ‘Umar bin al-Khaṭṭāb (d. 644) and the Mālikī School of Islamic jurisprudence, which emphasized public interests or *maṣlahah*. Its conceptual idea was first developed by the twelfth century theologian Abū Ḥamīd al-Ghazālī (d. 1111) in reference to the five fundamental aspects of human life i.e. protection of life, religion, intellect, progeny and property. He also pioneered the categorization of *Maqāsid al-Sharī'ah* into three descending categories of significance: the *darūriyyah* (the essentials), the *ḥājīyyah* (the complementariness) and the *taḥsīniyyah* (the desirables or the embellishments). *Darūriyyah* are

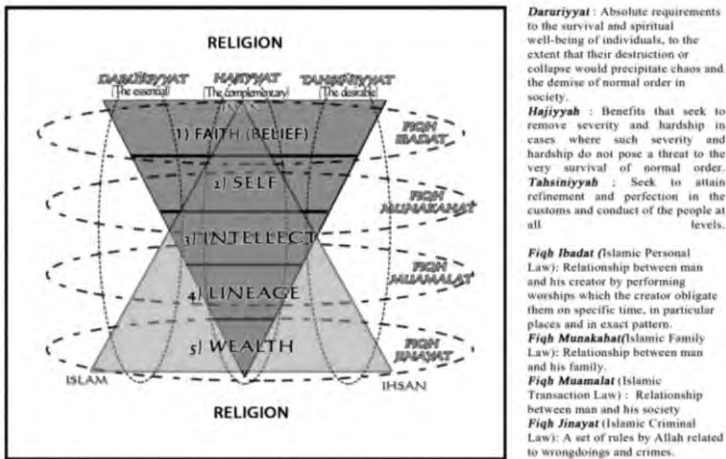
⁸ Ibid.

⁹ A.A. Sarkawi, A. Abdullah, N. Md Dali and N. A. Mohd Khazani, “The Philosophy of Maqāsid Al-Sharī'ah and Its Application in the Built Environment,” *Journal of Built Environment, Technology and Engineering* 2, (2017), 215-222.

seen as absolute requirements for the survival and the spiritual well-being of individuals and communities. These objectives are musts and basic for the establishment of the general human welfare of this world and the world hereafter. If they are ignored then the world’s coherence and order cannot be established and chaos, disorder and loss will prevail”¹⁰.

When *Maqāsid al-Sharī’ah* is referred to, it is important for all stakeholders in IFSI to realize that the said concept stands with its own framework that already been developed by the classical Muslim scholars. Not just merely depends on the existence of *maṣlahah* or the public interest, this concept of *Maqāsid al-Sharī’ah* is safely guarded with the long-standing principles of *Sharī’ah*. In describing the framework of *Maqāsid al-Sharī’ah* as provided by the classical Muslim scholars, Ahmad Sarkawi et. al configured the said concept in a structure as provided in Figure 1.0.

Figure 1.0: The Framework of *Maqāsid al-Sharī’ah*



Source: Ahmad Sarkawi et. al (2017).

¹⁰ A.A. Sarkawi, A. Abdullah, N. Md Dali and N. A. Mohd Khazani, “The Philosophy of *Maqāsid Al-Sharī’ah* and Its Application in the Built Environment,” *Journal of Built Environment, Technology and Engineering* 2, (2017), 215-222.

3.2 The Relationship Between VBI, SDGs, and Maqāṣid Al-Sharī'ah

When VBI is mentioned, it gives a focus on the financial intermediary role of Islamic financial institutions in delivering positive and sustainable impacts on the society, SDGs specifically focus on the set goals and their achievements. It is important to remember that SDGs are man-made goals which not related to divine revelations. Thus, SDGs are secular in nature and subjected to criticisms. SDGs are suited to be applied within a capitalist system and less consistent with *Sharī'ah*. There are collectively 17 goals that are set based on the needs of humans. Whilst, holistic objectives of *Sharī'ah* or *Maqāṣid al-Sharī'ah* are the higher objectives of Lawgiver i.e. Allah the Exalted which bestowed down through the intermediary of Prophet Muḥammad (ﷺ). In comparison to *Maqāṣid al-Sharī'ah*, the set goals are limited to 17 goals and can be changed according to the needs. The foundation of *Maqāṣid al-Sharī'ah* is general and universal in nature, while they must be consistent with *Sharī'ah*, these holistic objectives are well-encompassing and perpetuity in their characteristics.

Figure 2.0: Underpinning Thrusts of VBI



Sources: Engku Ali (2018); The Central Bank of Malaysia (2018).

The real value of Islamic financial intermediation is more towards bringing benefits (*maṣlahah*) to their customers in a mutually beneficial manner, ward off any form of harm (*ḍarar*), and

firmly rooted in the *Maqāṣid al-Sharī'ah*. By referring to VBI, the role of financial intermediary of Islamic financial institutions must always consistent and meet with the *Maqāṣid al-Sharī'ah*. While SDGs may become a part of VBI, careful consideration should be taken since SDGs may also include elements which are contrary to *Sharī'ah*. Therefore, in achieving sustainability of IFSI, VBI may take SDGs as a set of goals. However, such SDGs must be consistent with *Maqāṣid al-Sharī'ah* and in compliance with *Sharī'ah*.

4.0 VBI and Islamic Social Finance

While SDGs can be used as a set of goals in relation to VBI as long as such goals are consistent with *Sharī'ah*, the existence of Islamic social finance and its instruments are beneficial as tools in carrying out VBI-based activities. According to Mohd. Zain and Engku Ali, Islamic social finance consist of “the Islamic traditional instruments based on philanthropy (such as *zakāt*, *ṣadaqah*, and *waqf*) and cooperation (such as *qard* and *kafālah*) (Islamic Social Finance Report, 2015:8). Not limited only to the traditional instruments, it also covers the modern form of Islamic financial services such as Islamic microfinance, *ṣukūk* and *takāful* which stand with the objectives of solving societal challenges”.¹¹ They also identify that Islamic social finance has its own categories, such as:

“As identified earlier, the Islamic social finance which currently applied nowadays can be divided into three main categories which consist of: (a) Islamic traditional instruments based on philanthropy. Examples: *zakāt*, *ṣadaqāh* and *waqf*. (b) cooperative-based foundations. Examples: *qard* and *kafālah* (Islamic Social Finance Report, 2015:8). (c) Other modern forms of Islamic financial services. Examples: Islamic microfinance, *ṣukūk* and *takāful*”¹².

¹¹ N.R. Mohd. Zain and E.R.A. Engku Ali, “Implementing Islamic social finance: challenges and proposed solutions”, ISFIRE Magazine (2018), 72-81.

¹² N.R. Mohd. Zain and E.R.A. Engku Ali, “An Analysis on Islamic Social Finance for Protection and Preservation of *Maqāṣid al-Sharī'ah*”, *Journal of Islamic Finance (Special Issue)*, (2017), 133-141.

It is interesting to note here that even though the instruments of Islamic social finance are majorly developed classically from the divine revelations and practices of Sunnah, such instruments of Islamic social finance remain relevant and can be utilized by IFSI towards reaching holistic principles of *Shari'ah*. They are also consistent with the modern concept such as SDGs. The instruments of Islamic social finance are also encouraged for the stakeholders regardless of bankers or customers to be responsible in their investment and wealth.

Additionally, Islamic social finance and its instruments are important tools for the success of VBI. They are also essential for the sustainability of IFSI because they are naturally emphasized on the social well-being of society, economy, environment, and etc. In evaluating the notion of sustainability relating to Islamic social finance and its instruments, Engku Ali stipulates that “the inherent philosophy & principles underlying Islamic Finance strongly support three pillars of sustainable development, i.e., environment, social equity, and economic growth. Islamic social finance, in particular is well positioned to positively contribute towards achieving the SDGs”¹³. While leading towards having impactful Islamic social finance in IFSI, VBI is important in ensuring the role of IFSI continues to grow. In her evaluation, Engku Ali is in the opinion that Islamic social finance is the sustainability voice of Islamic Finance. The Islamic social finance and its instruments have high potentials to give impactful changes to the society especially with the growth of current technology¹⁴. During KLIF 2019, Engku Ali lists down opportunities that exist with the combination of Islamic social finance and technological innovations in providing impacts to the society. Such opportunities are: (i) transform the lives of people globally with better outreach and financial inclusion; (ii) making IFSI in Malaysia as the main channel for the 4th Industrial Revolution that focuses on Islamic social fintech which equipped with ethical, sustainable, and socially responsible underpinnings; and (iii) accelerate growth and impacts of Islamic social finance with

¹³ E.R.A. Engku Ali, “Achieving Sustainable Development Goals through Islamic Social Finance”. In the Special Presentation KLIF 2019, 10th April 2019, Malaysia.

¹⁴ Ibid.

characteristics of fast, efficient, cost-effective, and data-driven. Therefore, while VBI is focusing on the role of Islamic financial institutions as the value-based intermediaries, the Islamic social finance and its instrument may be utilized in achieving *Maqāṣid al-Sharī'ah* and SDGs.

5.0 VBI in the Practice of IFSI

After the lengthy discussion as provided above, this section provides the findings of investigation relating to VBI in the real practice of IFSI. Even though VBI is emphasized towards IFSI, the center focus of such VBI practices are derived mainly from the Islamic banks in Malaysia. Since VBI's introduction in 2017, many Islamic banks are actively participated and make efforts to reach the recommendations as provided by the Central Bank of Malaysia.

Bank Islam Malaysia Berhad (BIMB) is among the first Islamic banks that make such efforts towards VBI. They produced their own report titled Sustainability Report since 2016. Their approach towards sustainability is by aligning themselves with their goal of becoming a responsible financial entity in doing their financial services operations. As guarded under the principles of *Sharī'ah*, BIMB utilized the Islamic social finance instrument of *ṣadaqah* in achieving VBI. It is stipulated in their Sustainability Report¹⁵ that:

“Bank Islam Malaysia Berhad (“Bank Islam”) has created the e-Donation facility that enables donations to be made at a number of terminals via a Debit or Credit card using PayWave feature. These terminals were installed at various mosques throughout the country, which supports our commitment to moving the society towards cashless transactions. While the facility eliminates the need to carry cash to the mosque thus reducing the need for cash management at the mosque, as well as theft and robbery in the mosque, e-Donation helps foster more acts of good deeds by expanding on

¹⁵ BIMB, “Sustainability Report 2016”, retrieved from <http://bimb.irplc.com/investor-relations/sustainability/pdf/BIMB%20-%20SR%202016.pdf>

selection of platforms that can be utilized for public benefits. To date, 13 terminals have been installed in nine states across Malaysia. A total number of 3,850 transactions have been processed through these e-Donation terminals. Bank Islam is looking to increase the utilization of such facility nationwide, by expanding the service to all other remaining states in the near future. This will ensure that more people are able to perform donation easily and that the much-needed donations are able to reach a greater number of the people within the underserved community”¹⁶.

Another practice of VBI can also be traced from the initiative taken by Agrobank (M) Berhad. Recently, the said bank in collaboration with BERNAS launched an initiative to improve the productivity of paddy and farmers' standards of living. They provided at least a working capital that worth RM50 million to farmers. BERNAS provided free technical advice and consultation to those farmers.¹⁷ They also introduced *tawāruq* based financing facility as financial assistance to farmers with their Paddy-i Tawaruq product¹⁸. In another initiative, AgroBank (M) Berhad signed an agreement for financial facilities amounting to RM112 million to Sarawak Land Consolidation and Rehabilitation Authority (SALCRA)¹⁹. This financial facility is provided to facilitate SALCRA to start off their new palm oil mill and other working capital requirements which is important for Lubok Antu, Sri Aman Sarawak. They believe such an initiative is important to boost the agriculture sector especially the palm oil plantation and improve the economy of the locals.

¹⁶ BIMB, “Sustainability Report 2016”, retrieved from <http://bimb.irplc.com/investor-relations/sustainability/pdf/BIMB%20-%20SR%202016.pdf>

¹⁷ Cambridge Analytica IF, “Case Study: AgroBank”, retrieved from <https://www.agrobank.com.my/wp-content/uploads/2014/12/Cambridge-Cas-Studies.pdf>

¹⁸ AgroBank, “Paddy-i Tawaruq”, retrieved from <https://www.agrobank.com.my/product/paddy-i-tawarruq/>

¹⁹ AgroBank, “Press Release”, retrieved from <https://www.agrobank.com.my/press-releases/agrobank-signed-agreement-of-rm-12-million-banking-facilities-with-salcra/>

AmBank Islamic Berhad is another active Islamic financial institution that gives a focus to VBI. The said bank places their VBI initiative towards two main pillars of VBI, namely (i) the financial inclusion, and (ii) environmentally and socially responsible financing.²⁰ According to the Chief Executive Officer of AmBank Islamic Bhd., Mr. Eqhwan Mokhzanee Muhammad, the main focus of the said bank is to have active engagements with small and medium enterprises (SMEs) in Malaysia. On this nature, he said:

“Under financial inclusion, the focus on small and medium enterprises (SMEs) comes into play. We have set up a new division called business banking. There are a number of programmes such as enterprise lending, industrial hire and purchase and business property financing. We decided to focus on the SMEs because these businesses are a big part of the domestic economy, accounting for more than 95% of businesses established in the country. More so, SMEs are creators of jobs and, in turn, economic drivers. But it is still a very significant segment that cannot easily obtain financing. So, we are looking at ways to penetrate and improve the provision of funding for this segment”²¹.

In doing so, AmBank Islamic Berhad has taken an innovative step in providing automating service that improves its back-end systems while reducing the processing time in dealing with the applications made by SMEs (that stand with below RM50 million annual revenues under a week)²². The said bank also gives a focus on higher learning institutions where they make one product of credit card with collaboration from International Islamic University Malaysia. Under their revised credit policy, they measure the impact on the environment as a process policy of the credit evaluation²³.

²⁰ The Edge, “Personal Wealth”, retrieved from https://www.theedgemarkets.com/article/wall-islamic-finance-valuebased-intermediation-reinvigorate-industry_

²¹ The Edge, “Personal Wealth”, <https://www.theedgemarkets.com/article/wall-islamic-finance-valuebased-intermediation-reinvigorate-industry>

²² Ibid.

²³ Ibid.

These practices of VBI from the selected Islamic banks indicate the positive acceptance of VBI as introduced by the Central Bank of Malaysia. For certain Islamic banks, their initiatives towards sustainability and achieving *Maqāṣid al-Sharī'ah* are already carried out even before the introduction of VBI to IFSI in Malaysia. Nevertheless, the formal introduction of VBI by the Central Bank of Malaysia is accepted as a wake-up call for the IFSI to give more serious efforts in using Islamic social finance and its instruments in the financial market.

6.0 Banks Are Not Financial Intermediaries

According to Abdullah, banks are not intermediaries even though this is claimed by BNM, given empirical analysis and also admission by practitioners. Various central banks, including the Bank of England have all confirmed that all banks are not financial intermediaries but create money from lending. From an Islamic perspective, lending for profit and creating fictitious purchasing power (in terms of deposits on the liability side of the balance sheet), runs contrary to *Sharī'ah* compliance and the *Maqāṣid al-Sharī'ah*²⁴.

Furthermore, Werner empirically established that individual banks create money out of nothing, thereby affirming the credit creation theory of banking, and also disproving both the fractional reserve and financial intermediation theories of banking²⁵. The findings of Werner's empirical research, was confirmed by the Bank of England (BoE), as the pioneer model for all fractional reserve banks, in two papers entitled *Money Creation in The Modern Economy* in 2014 and *Banks are not intermediaries of loanable funds — facts, theory and evidence*.²⁶

“Money creation in practice differs from some popular misconceptions - banks do not act simply as

²⁴ A. Abdullah, *Money and the Real Economy from an Islamic Perspective*, (Kuala Lumpur: IIUM Institute of Islamic Banking and Finance (IiBF), 2018, pp.33-41.

²⁵ R. Werner, “Can Banks Individually Create Money Out of Nothing? The Theories and Empirical Evidence”, *International Review of Financial Analysis*, 36(2014), 1-19.

²⁶ A. Abdullah, *Money and the Real Economy from an Islamic Perspective*, (Kuala Lumpur: IIUM Institute of Islamic Banking and Finance (IiBF), 2018, pp.37-38.

intermediaries, lending out deposits that savers place with them, and nor do they ‘multiply up’ central bank money to create new loans and deposits...In the modern economy, most money takes the form of bank deposits. But how those bank deposits are created is often misunderstood: the principal way is through commercial banks making loans. Whenever a bank makes a loan, it simultaneously creates a matching deposit in the borrower’s bank account, thereby creating new money. The reality of how money is created today differs from the description found in some economics textbooks: Rather than banks receiving deposits when households save and then lending them out, bank lending creates deposits. In normal times, the central bank does not fix the amount of money in circulation, nor is central bank money ‘multiplied up’ into more loans and deposits”²⁷.

“In the intermediation of loanable funds model of banking, banks accept deposits of pre-existing real resources from savers and then lend them to borrowers. In the real world, banks provide financing through money creation. That is, they create deposits of new money through lending, and in doing so are mainly constrained by profitability and solvency considerations... [As compared to financial] intermediation models, financing [through money creation] models predict changes in bank lending that are far larger, happened much faster, and have greater effects on the real economy”²⁸.

²⁷ M. McLeay, A. Radia and R. Thomas, “Money Creation in The Modern Economy,” Quarterly Bulletin, Bank of England’s Monetary Analysis Directorate, p.14, retrieved from <https://www.bankofengland.co.uk/-/media/boe/files/quarterly-bulletin/2014/money-creation-in-the-modern-economy>

²⁸ Z. Jakab and A. Kumhof, “Banks are Not Intermediaries of Loanable Funds — Facts, Theory And Evidence” Bank of England, Working Paper No.529, pp. i-ii, retrieved from <https://www.bankofengland.co.uk/working-paper/2015/banks-are-not-intermediaries-of-loanable-funds-and-why- this-matters>

Empirical analysis by Werner²⁹ on banks, by Abdul Manap Abdul Wahab³⁰, former CEO of Bank Muamalat (M) Berhad, on Islamic banks, by Abdullah³¹ on the impact of Malaysian banks in terms of exponential prices and the confiscation of wealth, all serve to confirm that banks are the cause of inflation and confiscate wealth, thus do not conform to the *Maqāṣid al-Sharī'ah*, neither the SGDs, and are clearly not intermediaries.

There have been a number of recent studies that discuss BNM's VBI, but according to Abdullah, none have analyzed it in terms of substance over form. When Islamic banks act the same way as conventional banks, then they will contribute to price and financial instability in the same way as their conventional counterparts. By providing impactful regulatory insights for BNM, the regulator will better understand why it is unable to prevent financial crises and why it is unable to stop monetary inflation. At the very least, BNM could provide a credit guidance regime, in terms of monetary policy tools at its disposal, so that Islamic banks provide productive finance to contribute to GDP (whereas according to BNM and IFSB data they are extending speculative credit to mostly second-hand real estate transactions)³².

Furthermore, by re-structuring as genuine intermediaries, Islamic banks would adopt equity products on both sides of the balance sheet, and thus adopt investment (rather than debt), as a more appropriate framework, in the same manner as *i*-NBFIs. Banks and non-banks would then contribute more to Islamic social finance with SME investment (not micro-finance debt), thereby genuinely providing financial inclusion, adhering to the SGDs and the *Maqāṣid al-Sharī'ah*, with better price and financial stability³³.

²⁹ R. Werner, *op. cit.*

³⁰ A.M. Abdul Wahab, "Money Creation in the Modern Economy: Issues and Challenges", IiBF Academic Discourse, Friday, 14th December 2018.

³¹ A. Abdullah, "Economic Security Requires Monetary and Price Stability: Analysis of Malaysian Macroeconomic and Credit Data", *Al-Shajarah*, Special Issue on Islamic Banking & Finance (2018), 205-247.

³² A. Abdullah, *Money and the Real Economy from an Islamic Perspective*, (Kuala Lumpur: IIUM Institute of Islamic Banking and Finance (IiBF), 2018, pp.33-41.

³³ *Ibid.*

6.1 Counter-Argument

There are several reasons why bank is a financial intermediary, the distinguishing feature of which is that they perform liquidity transformation and creating liabilities that act as means of payment.

Figure 3.0: 10 years financial highlights

	2007	2008	Jan 2009 - Mar 2010	2011 Revisited	2012 Revisited	2013	2014	2015	2016	2017
Total Shareholders Fund (RM'000)	737,331	702,236	1,319,131	1,348,286	1,401,004	1,598,476	1,745,576	1,854,694	1,995,937	2,138,571
Profit/(Loss) Before Tax (RM'000)	64,238	44,068	142,061	186,785	103,006	235,963	208,284	121,966	167,233	170,536
Profit/(Loss) After Tax (RM'000)	48,138	31,951	98,834	120,433	69,244	167,936	151,564	89,280	131,909	149,907
Total Assets (RM'000)	13,808,090	14,398,645	16,733,420	18,659,940	20,504,037	21,071,590	20,061,690	22,438,036	22,636,889	23,526,342
Total Deposits (RM'000)	12,172,868	12,447,970	14,920,856	16,216,173	18,151,087	18,744,179	17,629,228	19,544,549	19,643,428	19,917,482
Total Financing (RM'000)	5,870,585	6,427,747	7,037,126	7,495,007	8,064,271	10,352,626	11,899,691	13,414,670	14,512,877	14,918,272
No of Branches	48	48	49	51	58	59	59	59	61	62
No of Service Centres/Kiosk	3	5	6	4	2	7	7	7	1	1
No of Offshore Branches/Labuan	1	1	1	1	1	1	1	1	1	1
No of Staff	1,454	1,419	1,584	1,763	1,929	2,099	2,135	1,987	1,703	1,733
Return on Asset (%) - Pretax	0.47	0.31	0.73	1.06	0.53	1.14	1.01	0.57	0.74	0.74
Return on Equity (%) - Pretax	8.86	6.12	11.24	15.24	7.49	15.73	12.46	6.78	8.69	8.25

Source: Bank Muamalat, Abridged Report 2017

One might refute the argument on credit creation theory of banking, i.e. banks create money out of nothing, if we look at the financial highlights of Bank Muamalat in Figure 3.0³⁴ and ask why financing has always been lower than deposits? However, without a full interpretation of the balance-sheet this would not fully take into account total assets including reserves and how in any case money is created from lending through the accounting treatments as empirically established by Werner and Abdul Wahab and also admitted to by other Central Banks.

However, Robert Vivian, a Professor of Finance and Insurance, University of the Witwatersrand vehemently defended the view that banks are financial intermediaries and that the belief that banks create money is misguided otherwise it will continue to influence models of the financial sector and monetary policy

³⁴ Bank Muamalat Berhad, "10 years financial highlights", Abridged Report 2017, retrieved from https://www.muamalat.com.my/downloads/corporate-overview/annual/2017_Abrideg.pdf

interventions, which influence the scope of policies aimed at regulating banks such as Basel III and other regulations being formulated in the wake of the recent financial crisis.³⁵ Hence, such opinions continue to deem banks as financial intermediaries.

7.0 Conclusion

Leading towards impactful Islamic social finance, it is found that Islamic financial services institutions in Malaysia have ample of opportunities to use them as tools through VBI approach. Instead of depending only on SDGs, the concept of *Maqāṣid al-Sharī'ah* provides a wider scope for IFSI to utilize while giving impacts to the society, environment, economy, and etc. Relating to the sustainability of IFSI, serious efforts should be made by Islamic financial services institutions by taking up the role of VBI. Furthermore, with a strong regulatory framework, consistent support from their customers, constant monitoring by the Central Bank of Malaysia, the motivation to provide a better financial service, and the full utilization of technological innovations, the sustainability of IFSI can be ensured while simulating their growth locally and globally.

³⁵ R. Vivian, “Do banks really create money out of thin air?” Bank of England, Working Paper No.529, pp. i-ii, retrieved from <https://www.weforum.org/agenda/2015/06/do-banks-really-create-money-out-of-thin-air/>

TRANSLITERATION TABLE

CONSONANTS

Ar=Arabic, Pr=Persian, OT=Ottoman Turkish, Ur=Urdu

Ar	Pr	OT	UR	Ar	Pr	OT	UR	Ar	Pr	OT	UR	
ء	ء	ء	ء	ز	z	z	z	گ	—	g	g	g
ب	b	b	b	ژ	—	—	ʀ	ل	l	l	l	l
پ	—	p	p	ژ	—	zh	j	م	m	m	m	m
ت	t	t	t	س	s	s	s	ن	n	n	n	n
ث	—	—	ṭ	ش	sh	sh	ş	ه	h	h	h ¹	h ¹
ث	th	th	th	ص	ş	ş	ş	و	w	v/u	v	v/u
ج	j	j	c	ض	ḍ	ḍ	ḍ	ی	y	y	y	y
چ	—	ch	çh	ط	ṭ	ṭ	ṭ	ة	-ah	—	—	-a ²
ح	ḥ	ḥ	ḥ	ظ	ẓ	ẓ	ẓ	ال	al ³	—	—	—
خ	kh	kh	kh	ع	‘	‘	‘	—	—	—	—	—
د	d	d	d	غ	gh	gh	ğh	—	—	—	—	—
ڈ	—	—	d	ف	f	f	f	—	—	—	—	—
ذ	dh	dh	dh	ق	q	q	q	—	—	—	—	—
ر	r	r	r	ك	k	k/g	k/ñ	—	—	—	—	—

¹ – when not final
² – at in construct state
³ – (article) al - or l-

VOWELS

	Arabic and Persian	Urdu	Ottoman Turkish
Long	ا	ā	ā
	آ	Ā	—
	و	ū	ū
	ي	ī	ī
Doubled	ي	iy (final form ī)	iy (final form ī)
	و	uww (final form ū)	uvv
	و	uvv (for Persian)	uvv
Diphthongs	و	au or aw	ev
	ی	ai or ay	ey
Short	ا	a	a or e
	ا	u	u or ū
	ا	i	o or ö
	ا	i	i

URDU ASPIRATED SOUNDS

For aspirated sounds not used in Arabic, Persian, and Turkish add h after the letter and underline both the letters e.g. چ jh گ gh

For Ottoman Turkish, modern Turkish orthography may be used.

AL-SHAJARAH

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