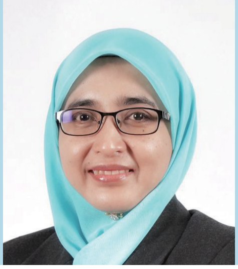

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Islamic Fintech: Accelerating the Financial Inclusion Agenda in Malaysia

Introduction

Financial technology (fintech) refers to the application of technology—software, algorithms and even hardware—to traditional financial services to save time, optimise cost, and enhance efficiency and user experience. Fintech applications, which include digital payment, internet and mobile banking, peer-to-peer (P2P) financing, equity crowdfunding (ECF), robo-advisory, digital asset exchanges, insuretech, and e-services have provided innovative solutions to various stakeholders, either the surplus units (i.e., investors who have excess funds) or deficit units (i.e., parties who need funds). Islamic fintech, on the other hand, refers to the use of technology to deliver financial services and solutions that comply with the Shariah principles and requirements, promote the well-being of mankind, and integrate ethical elements to attain fairness and justice. Figure 1 presents a comprehensive picture of the Islamic fintech framework.

According to the *Global Islamic Fintech Report 2022*, Islamic fintech transactions in the Organisation of Islamic Cooperation's (OIC) member countries stood at about USD79 billion in 2021, representing 0.8% of global fintech transaction volume. The five largest markets in terms of transactions are Saudi Arabia, Iran, the United Arab Emirates, Malaysia, and Indonesia. The Islamic fintech market is forecasted to grow at a cumulative average growth rate (CAGR) of 17.9% to reach USD179 billion by 2026.

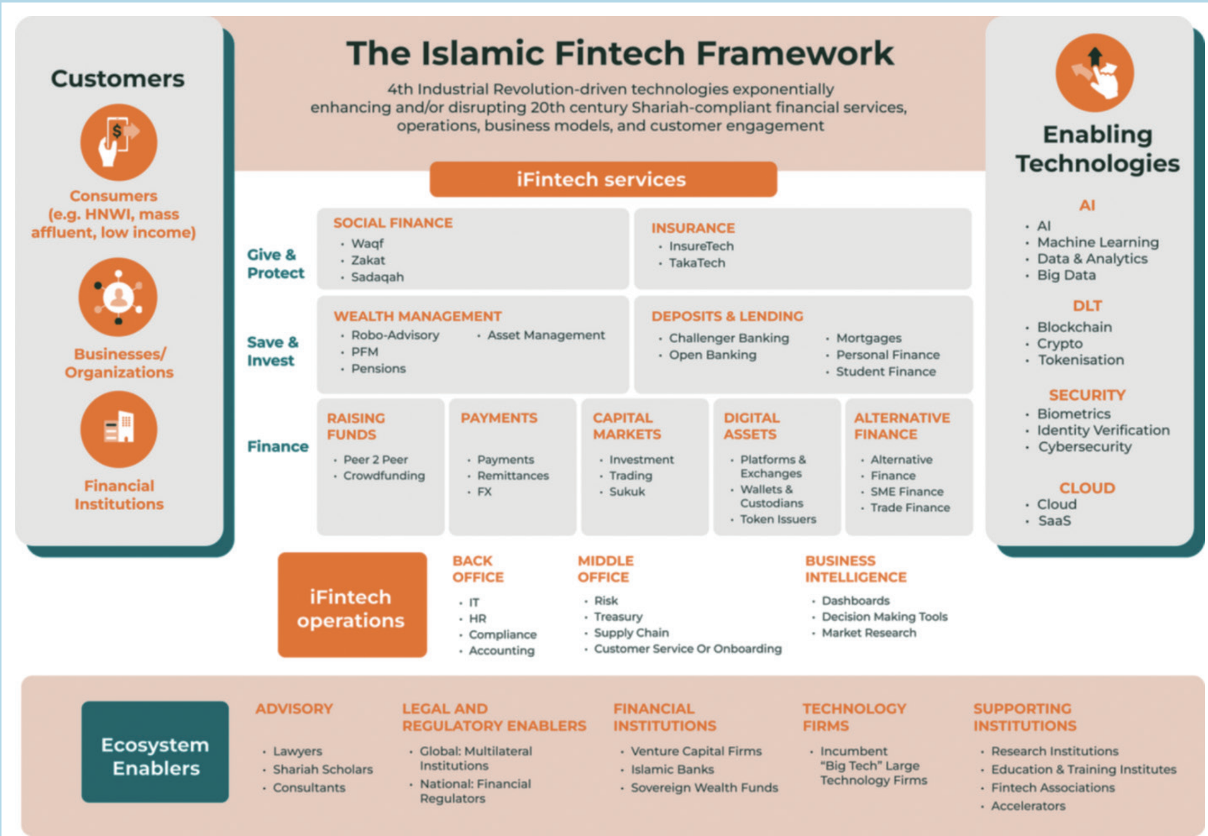
Malaysia is a global hub of Islamic finance with Islamic financing assets of RM974.1 billion (USD216.5 billion) and Islamic deposits and investment accounts of RM1,058.6 billion (USD235.2 billion) that accounted for 44.5% and 41.6%, respectively, of the market share in 2022—as reported by Bank Negara Malaysia (BNM, 2023a). As such, the country capitalises on fintech to accelerate and democratise the accessibility of Islamic financial products and services to less fortunate segments of society. The Global Islamic Fintech (GIFT) Index 2022 ranked Malaysia at the top of the five countries with the most conducive Islamic fintech ecosystems worldwide for two consecutive years (2020 and 2021). Accordingly, this article showcases how the Islamic fintech market in Malaysia has progressed to accelerate the national agenda of financial inclusivity and sustainability.

Government Policy and Blueprint on Digitalisation and Financial Inclusion

Malaysia has launched several policies, strategic plans, and frameworks to enhance financial inclusion and digitalisation efforts in the country, at both the government and regulatory levels, as captured in Figure 2.

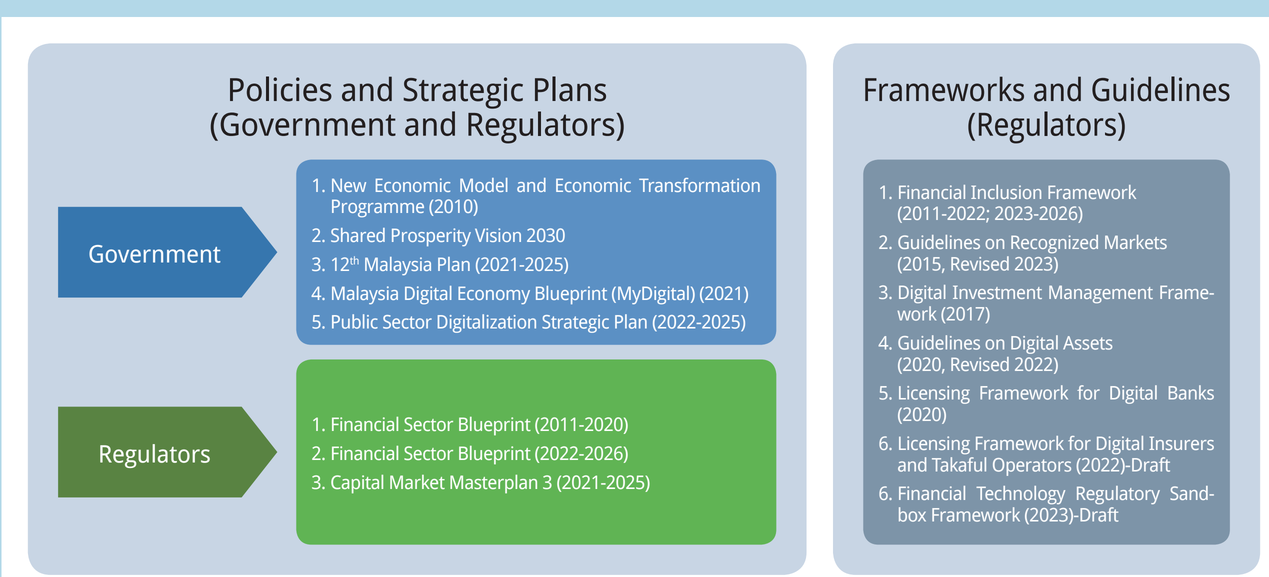
In line with the Financial Sector Blueprint (2011–2020), Bank Negara Malaysia (BNM) formulated the first Financial Inclusion Framework (2011–2020), which outlined four broad strategies (i.e., innovative channels, innovative products and services, effective financial institutions and infrastructure, and well informed and responsible consumers) along with four corresponding desired outcomes (i.e., convenient accessibility, high take-up, responsible usage, and high satisfaction), to achieve an inclusive financial system that serves all members of society including the underserved. In 2017, BNM revisited the strategies of the framework and hence introduced six game changers, focusing on establishing greater collaboration and consumer empowerment to accelerate the progress of financial inclusion.

Figure 1: The Islamic Fintech Framework



Source: DinarStandard & Elipses (2021, p. 8)

Figure 2: Malaysia's Key Policies, Strategic Plans, and Frameworks on Financial Inclusion and Digitalisation



Source: Compiled by the author based on various sources

After the release of the Financial Sector Blueprint (2022–2026), BNM issued the second Financial Inclusion Framework (2023–2026) which provided a more holistic approach to transition from focusing on accessibility and usage to attaining broader development outcomes, financial resilience, and well-being. The revised framework considers the new reality of economic conditions, financial capabilities, and lives of vulnerable, unserved, and underserved groups—households from the bottom 40% (B40) of income earners as well as micro-, small and medium-sized enterprises (MSMEs)—after the devastating impact of the COVID-19 pandemic. Figure 3 provides a snapshot of the revised framework.

It is apparent from the seven policy objectives and strategies envisaged in the revised framework that fintech and digitalisation are the key enablers in achieving an inclusive financial system. Nonetheless, more efforts are required to elevate digital financial literacy, especially among the unserved and the underserved segments, so that they can use digital financial services effectively, responsibly, and confidently.

This revised framework perfectly aligns with the Malaysia Digital Economy Blueprint 2021 (MyDigital), launched by the government of Malaysia in its continuous efforts 'to successfully transform Malaysia into a digitally driven, high income nation, and a regional leader in digital economy' (Economic Planning Unit, 2021, p. 10). The blueprint is intended to accelerate Malaysia's vision to achieve sustainable growth along with fair and equitable distribution across income groups, regions, ethnicities, and supply chains, aspired by the 12th Malaysia Plan (2021–2025) and Shared Prosperity Vision (SPV) 2030.

To proliferate the country's Islamic digital economy as part of the Key Economic Growth Activities underscored by the SPV 2030, the government has mandated the Malaysia Digital Economy Corporation (MDEC), a digital investment promotion industry under the Ministry of Communications and Digital, to spearhead the agenda. MDEC's focus areas for driving the Islamic digital economy include three main sectors:

- Islamic finance: Islamic fintech, social finance, and value-based intermediation
- Halal economy: food, pharmaceutical, and healthcare
- Lifestyle: travel, fashion, media and recreation, and cosmetics

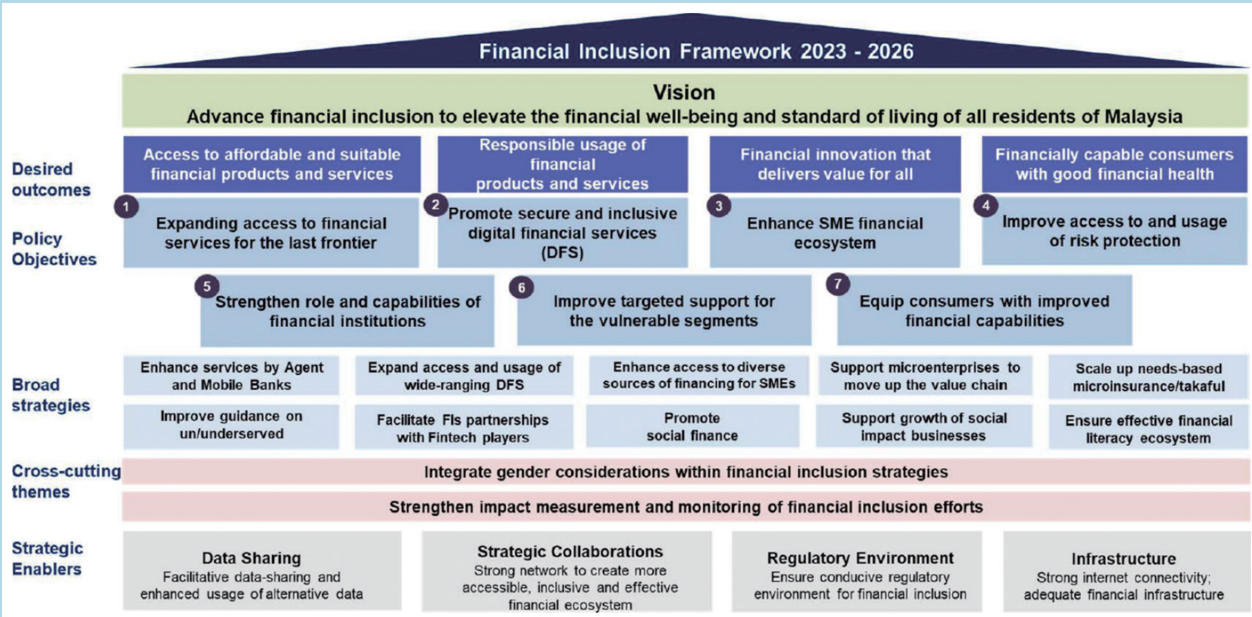
MDEC has facilitated proactive engagements among fintech incubators and accelerators, investors, innovation enablers, Islamic finance practitioners, Shariah advisers, and legal firms to uplift the Islamic fintech sector to the next level. This effort is discussed further next.

Islamic Fintech Landscape in Malaysia

Of the many disruptive fintech innovations introduced since the 1990s, digital payment gateways have had a significant imprint on the economic development of countries. In the case of Malaysia, e-payment transaction volume per capita stood at 291 units in 2022 (BNM, n.d.), having more than doubled within 5 years (2018: 124.6 units). Despite the COVID-19 pandemic's devastating impact to the socio-economic conditions, it has further accelerated digitalisation in Malaysia. E-payment transaction value per capita expanded by 28% from RM668,785.3 during the pre-pandemic year 2019 to RM928,146.9 in 2022. There was a significant jump of internet banking and mobile banking usage compared to the traditional ATM cash withdrawals post-pandemic. While the volume of internet banking increased 44% between the pre- and post-pandemic periods (2019: 1,173.5 and 2022: 2,089.8), the volume of mobile banking grew exponentially by 71% between the same periods (2019: 489.8 and 2022: 1,666.6) (BNM, n.d.).

The Malaysian Revised Budget 2023 comprises several initiatives that can enhance Malaysian fintech businesses and

Figure 3: BNM's Renewed Financial Inclusion Framework (2023–2026)



Source: BNM (2023b, p. 9)

sustainability efforts, including boosting digital adoption among MSMEs across industries, supporting fintech startups, providing oversight for Buy Now Pay Later business with the Consumer Credit Act, cracking down on fraud, and promoting sustainable finance.

The Malaysian Islamic fintech landscape is fairly distributed among most of the categories as shown in Figure 4. Nonetheless, there are more opportunities to be explored and developed, particularly in the deposits and lending and Islamic markets categories.

Figure 4: Malaysia's Islamic Fintech Industry Map (as at 2021)

Source: 1337 Ventures & Masryef (2022, p.15)

Islamic Fintech Initiatives for Financial Inclusion

Both regulators and industry players have leveraged Islamic fintech to accelerate financial inclusion to unserved and underserved segments. Notable initiatives at the regulatory level, by both BNM and Securities Commission Malaysia (SC), as well as the industry level are summarised in Table 1.

Table 1: Islamic Fintech Initiatives to Promote Financial Inclusion in Malaysia

Year	Initiative	Objective	Outcome
2015	SC released the Guidelines on Regulation of Markets in February, specifying the requirements for the registration of ECF platforms and obligations of their operators, followed by the approval of first six licences in June.	To facilitate the growth of Malaysia's crowdfunding industry that caters mainly to the needs of MSMEs	• Ethis Ventures was approved as the first Shariah-compliant ECF in 2019. • Other Shariah-compliant ECF is pitchIN.
2016	SC introduced the regulatory framework for P2P platforms via the Revised Guidelines on Recognized Markets in May.		• Nusa Kapital was approved as the first Shariah-compliant P2P in 2016. • As of June 2023, there are seven Shariah-compliant P2P firms (apart from Nusa Kapital), namely, Funding Societies, MicroLEAP, CapBay, MoneySave, CapSphere and CoFunds.
2017	SC launched Digital Investment Management (DIM) Framework.	To enhance investors' digital experience, to provide a more affordable and accessible channel to grow wealth, and to improve the industry's operational efficiency	Wahid Invest was licenced as the first Shariah-compliant DIM in 2019. DIM attracts and serves the digitally savvy younger generation. Over 70% of DIM investors in Malaysia younger than 35.
2018	BNM, in collaboration with United Nations Capital Development Fund (UNCDF) and MDEC, launched the Digital Finance Innovation Hub and Inclusive Fintech Accelerator Programme.	To enable service providers (i.e., financial institutions and fintech startups) using technology in their product offerings that meet the needs of unserved and underserved, hence promoting inclusive finance	• Malaysian Takaful Association signed an Memorandum of Understanding (MOU) with the IT service provider Infomina to enhance its capacity and strengthen its role as a commissioning body over the existing 18 takaful companies. • Takaful Malaysia teamed up with the tech giant Fusionex to develop its operational system and explore online marketing to tap into consumers who are not eligible for a takaful coverage. This has resulted in garnering over 40 million new subscribers within just three months from its launch.
2020	• SC issued Guidelines on Digital Assets in January. • The Shariah Advisory Council of SC issued a resolution allowing trading and investment of digital assets in May.	To provide alternative fundraising avenues for early-stage entrepreneurs	As of June 2023, there are four Digital Assets Exchange (DAX) operators and two Initial Exchange Offering (IEO) operators. Meanwhile, there are 11 digital assets that are traded on the regulated exchanges in Malaysia including Bitcoin, Ethereum, Avalanche, Polygon, Bitcoin Cash, Ripple, Litecoin, Solana, Chainlink, Uniswap, and Cardano.
2020	SC approved e-services platforms.	To provide additional investment channels for retail investors via the partnership formed between e-payment, e-wallet, e-commerce providers and Capital Markets Services License holders to distribute capital market products	As of June 2023, there are two registered e-services providers: • TNG Digital: launched GO+ Fund in partnership with Principal Asset Management, and AIA's insurance and takaful products via the Touch 'n Go e-wallet platform. • Versa Asia: introduced Versa Gold, a Shariah-compliant fund that tracks the performance of gold prices using Affin Hwang Shariah Gold tracker fund as the underlying.
2020	BNM issued the Licencing Framework for Digital Banks in December.	To enable digital banks offering banking products and services to unserved and underserved markets primarily via digital channels	• In April 2022, BNM announced five successful applicants, of which two were Islamic digital banks: (i) a consortium of AEON Financial Service, AEON Credit Service and MoneyLion; and (ii) a consortium led by KAF Investment Bank. • Traditional Islamic banks started offering Islamic digital banking services using their existing license: Bank Islam launched 'Be U' and Al Rajhi Bank introduced 'Rize'.
2021	SC, together with the UNCDF, initiated an Islamic Fintech Accelerator Programme (FIKRA) in May.	To identify and scale up innovative fintech solutions for Malaysia's Islamic capital market	7 participants from various background received structured support, regulatory guidance, and engagement opportunity with potential investors.
2022	BNM issued the Exposure Draft of Licencing Framework for Digital Insurers and Takaful Operators (DITO) in November.	To facilitate the entry of DITO to offer insurance and takaful services to the unserved and underserved market via digital means	BNM is expected to issue five DITO licences by end-2023.
2023	BNM released the Exposure Draft on Financial Technology Regulatory Sandbox Framework in March.	To simplify the eligibility criteria and provide a fast track for applicants with strong risk management, governance and compliance capabilities	More applicants from Islamic fintech startups to be onboard.

Note: Takaful (Islamic insurance) is an arrangement in which members or participants jointly contribute a sum of money into a common pool to assist each other against loss or damage.
Source: Compiled by the author based on various sources

Table 1 indicates that the concerted efforts undertaken by different stakeholders have one common goal, i.e., extending seamless access of financial products and services beyond the traditional market to include the unserved and underserved segment. This can be achieved by offering differentiated solutions via digital platforms including e-wallet, e-payment, e-commerce, internet banking, and mobile banking. Islamic fintech also seeks to provide alternative sources of funding to startups and MSMEs from diversified investors including retail. These developments demonstrate how Malaysia has capitalised on Islamic finance and Islamic fintech to mobilise capital more efficiently to different segments of the economy. Figure 5 illustrates the key statistics of the ECF and P2P industry, the main fintech-based fundraising platforms in Malaysia as of end-2022.

Apart from commercial propositions, Islamic fintech has also empowered the mushrooming of charitable digital-based fundraising platforms. Examples include charity crowdfunding platforms established by Islamic banks such as Bank Islam's Sadaqah House, Bank Muamalat's Jariah Fund and Alliance Islamic's Socio-Biz as well as zakat authorities like Lembaga Zakat Negeri Kedah's Asnaf Care. These platforms successfully provided financial assistance for community empowerment during the pandemic.

Issues and Challenges in Islamic Fintech Adoption

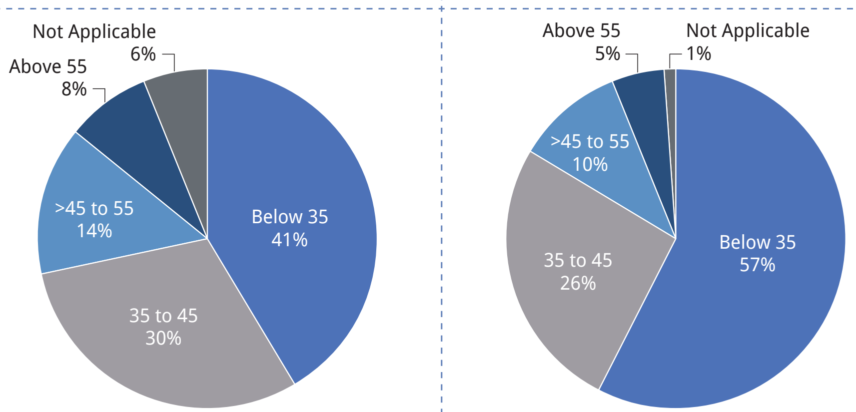
While the financial inclusion agenda in Malaysia is progressing on the right track with the help of digitalisation, it is not free from road bumps. In fact, the COVID-19 pandemic exposed major regulatory and cybersecurity inadequacies within the country's fintech operations. Mardhiah (2023) highlights that fraud, malware and intrusion were the top three cyber issues in Malaysia in the first half of 2022. Data misuse by agents is considered another pertinent obstacle impeding the penetration rate of digital financial services, particularly amongst the underserved. It is worth noting that the prevalence of cybercrimes in Malaysia is not due to the lack of adoption of fintech solutions; rather, it is a consequence of the relatively low levels of financial literacy, particularly amongst members of marginalised groups.

According to Dawood *et al.* (2022), inadequate funding to meet the needs of Islamic fintech startups has forced entrepreneurs to relocate to other jurisdictions where capital is abundant, hence exiting from Malaysia. This is mainly due to the immature venture capital industry in Malaysia coupled with economic and political uncertainties facing the country in recent years. In addition, competition from conventional counterparts poses some challenges to Islamic fintech players. They have to exert more efforts to persuade consumers to switch to digital solutions

Figure 5: ECF and P2P Financing Performance Indicators (2022)

	ECF	P2P
Campaigns launched	330	54,791
Capital raised	RM560.3 mil	RM3.873 bil*
Successful issuers	141	6,188
Retail investors	55%	87%
Malaysian investors	95%	98%

Investors by age group



Note: The 'RM3.873 bil*' is based on September 2022 data, the rests are based on end-2022 data.
Source: Compiled by the author based on data from SC (n.d.)

that offer value creation and Shariah compliance.

The Way Forward

Moving forward, key stakeholders of the Islamic fintech industry in Malaysia need to collaborate to promote inclusive finance. Greater synergies between Islamic fintech players and government entities and regulators are pivotal in establishing the necessary infrastructure, developing the much-needed regulatory framework, innovating new business models, and increasing consumer literacy. Capacity building is also key in molding a better future of the Islamic fintech industry in this country.

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