



## Compliant Mi'yar for Islamic Digital Economy



ISLAMIC DIGITAL ECONOMY

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## EXECUTIVE SUMMARY

The financial services industry serves as the backbone of this country's economy due to the source of financing it provides in the private sector as well as the economic growth brought upon the development of new businesses. Part of the financial services is the advancement made by Islamic finance which has grown over the years. This growth is more evident with the industrial revolution 4.0 - where automation and data exchange via technology is the trend. Nowadays businesses are exploring avenues to leverage on digital platforms in all areas – product manufacturing, marketing strategies, operationalizing processes and delivering the final product.

This revolution would result in newer ways to operate businesses and a technology driven value chain. Cloud based application, payments via bitcoins, digital manufacturing processes will be the norm. Malaysia Digital Economy Corporation (MDEC) recognizes the importance of riding the technology wave now; in tandem with its role as an advocate of technology advancements and creator of a conducive environment to nurture the growth of local technology companies. Following this line of thought, MDEC has established a compliant mi'yar to Islamic Digital Economy (IDE) with the targeted outcome to globally position Malaysia as the focal point of reference for this mi'yar.

The development of this mi'yar closely follows MDEC's guiding principles in attracting investors, building critical enablers, encouraging usage of technology and creating a facilitative environment for a digital ecosystem. The IDE is set to change the Islamic financial landscape due to its impressive size and potential to grow further. The capital providers, startup companies and products that are to be offered need a guide to facilitate its development in the digital space. The introduction of MDEC's IDE is timely as it provides clarity that is unique to the Islamic culture in a financial environment.

Malaysia is one of the leading countries in the Islamic finance arena and has successfully established itself as one of the experts in this area. Based on the Global Islamic Economy Indicator (GIEI) by Thomson Reuters, Malaysia continues to lead the indicator, followed by the UAE and Saudi Arabia<sup>1</sup>. The GIEI is a barometer of the state of Islamic economic sectors and is made of composite weighted index that measures the overall development of the Islamic economic sectors. Malaysia's top spot is attributed to its Islamic finance and Halal food ecosystems.

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<sup>1</sup> Source: (<http://www.zawya.com/giei/#>)

Another indicator of global excellence is the Islamic Finance Country Index (IFCI), an index developed by Edbiz Consulting in 2011. It ranks different countries with respect to the state of Islamic banking and finance (IBF) and their leadership role in the industry on a national level and then benchmarks to an international level. Malaysia ranks number one, with a score of 79.25 in 2017 followed by Iran and UEA.<sup>2</sup>

Cross border international relations and knowledge sharing plays a vital role in the development of this industry as each possess their own area of skill and expertise as well, have an array of their own unique products which can be offered to the Malaysian market. In terms of Islamic banking worldwide, though Saudi Arabia takes the top spot, Malaysia comes in second and manages 33% of the US\$71 billion Shariah compliant asset fund. In terms of *sukuk* (Islamic bond) market, Malaysia is the largest in the world.<sup>3</sup>

Following the progressive nature of the Islamic finance locally, Malaysia is also one of the leaders for the *Halal* certification industry. The Department of Islamic Development Malaysia (JAKIM) is the issuer of these certificates. The first Halal standards were adopted by Malaysia in 2000 and marks the first country to have a documented and systematic Halal assurance system. This propelled the Halal certification system to become an economy on its own with an estimated global market value of USD2.3 trillion<sup>4</sup>. The global Halal industry is estimated to be valued at USD 3.7 trillion by year 2020 and Malaysian Halal industry is valued at USD3.1 billion. JAKIM as the recognised Halal certification body in Malaysia, has the most comprehensive and sought-after Halal system recognition program globally with over 50 international registered bodies.

Taking advantage of the momentum provided by the Halal certification system, in 2008 the Halal Industry Development Corporation (HDC) was formed and was tasked to develop the local Halal industry and attract foreign direct investments. One of the latest moves made by JAKIM is to attract global interest by introducing new initiatives within the Halal industry. Among the initiatives are the establishment of International Halal Authority Board (IHAB) and Halal Innovation and Technology Centre (HITEC).

Advancements made in the digital agenda has also made it possible for the development and launch of the SMART HALAL application which assists users to obtain information on the Malaysian Halal Validation status. The Halal Industry

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<sup>2</sup> Source: <http://www.gifr.net/publications/gifr2017/ifci.pdf>

<sup>3</sup> Source: <https://www.nst.com.my/business/2017/10/286454/bank-negara-islamic-finance-will-focus-quality-growth>

<sup>4</sup> Source: (<http://www.itc.gov.my/tourists/discover-the-muslim-friendly-malaysia/malaysia-the-worlds-leading-halal-hub/>)

Masterplan 2.0 (HIMP) 2018-2030 was also organised by HDC and expected to launch in 2018. The plan will focus on addressing existing gaps and strengthening the identified priority areas within the Halal industry.

The significant progress made as shown in these developments and achievements, make Malaysia an ideal hub for Islamic digital economy. Ideally the establishment of compliant mi'yar to IDE by MDEC will expand the Islamic capital market, Halal industry and Islamic finance industry in Malaysia and beyond. Figure 1 below illustrates how the Compliant Mi'yar to IDE can contribute towards bigger economic objective of Malaysia.

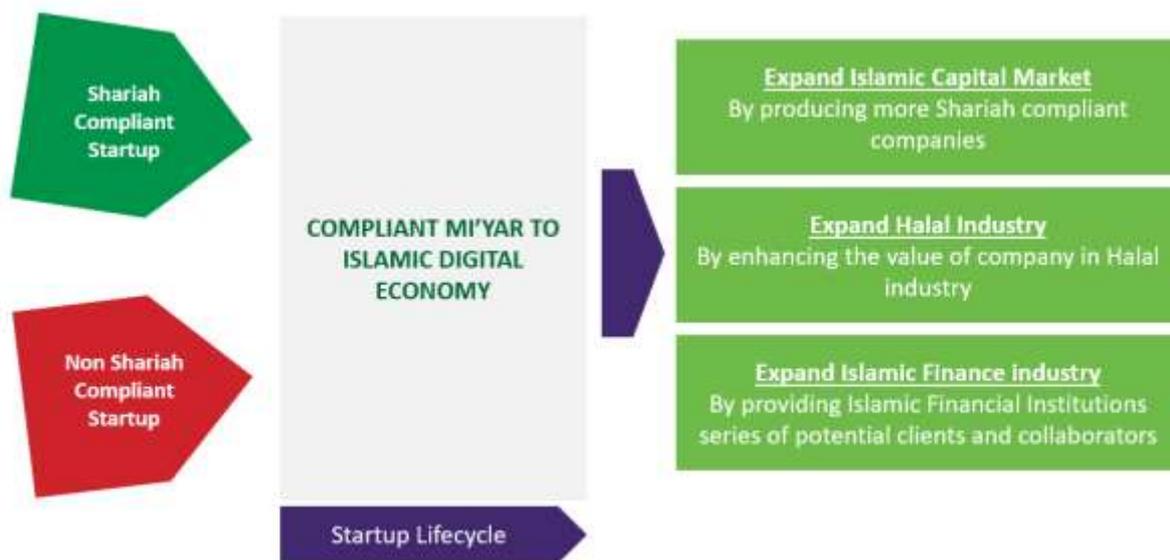


Figure 1 Compliant Mi'yar to IDE Contribution Towards greater economy

## THE COMPLIANT MI'YAR FOR ISLAMIC DIGITAL ECONOMY

MDEC is a proponent of the IDE in line with Malaysia's status as one of the countries leading the evolution of the Islamic industry landscape. The objective of the IDE is to set out a clear guide for startup companies on the processes involved in obtaining a Shariah Compliant and Halal Certified business and product. The JAKIM Halal certification framework is already well known for its coverage in the food and beverage industry, pharmaceuticals, cosmetics and other goods. This Halal certification is now made available to the services industry which is where the IDE comes into play. Regulatory clarity would be provided to ensure sustainability of the Shariah Compliant status. The prerequisite to be recognised as a Shariah compliant startup is to ensure the establishment of the company follows Shariah compliant rules. In short, the mi'yar is for venture capitalists to conduct their transactions and investment in accordance to Shariah laws. MDEC's vision is not only to assist startups but also position Malaysia in a competitive advantage over others. The Mi'yar will hopefully increase the contributions in the digital economy segment to the gross domestic product to 20% by 2020 compared to the current contribution of 18.2%.<sup>5</sup>

IDE refers to any commercial or social activities undertaken within the digital space that is Shariah compliant and Shariah neutral. Activities that fall within the realm of IDE include but is not limited to any activities related to customary Islamic practices as well as practices that are branded Shariah or Halal certified.

The core components of the Compliant Mi'yar to IDE are Capital Provider (source of funding), Startups (investing the funds received accordingly) and Product and Services. Each of these core components are influenced by elements that are People, Process and Oversight.

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<sup>5</sup> <http://www.thesundaily.my/news/2017/12/20/mdec-launch-islamic-digital-framework>

Figure 2 below illustrates Compliant Mi'yar to IDE

<b>Capital Provider</b>	Existing courses from universities and Islamic finance training centre:- • INCIEF • SIDC • IBFIM	• Securities Commission Shariah VC guideline • Shariah VC Mi'yar	• Registered Shariah Advisor
<b>Start-up</b>	Halal Academy to develop Islamic finance for Halal Entrepreneur module	• Shariah compliant Mi'yar for Start-ups	• Registered Shariah Advisor
<b>Product &amp; Services</b>	Module on digital product & services from Halal perspective	• Mi'yar on digital product & services from Halal perspective	• JAKIM
	People – Training	Process – Guideline etc	Oversight – endorsement & audit

Figure 2 Compliant Mi'yar to IDE

**A) Capital Provider:**

**i. People (Training)**

Malaysia's status as the lead in the knowledge component based on Thomson Reuters GIEI suggests its stronghold in this area. Most of the financial education available for professionals is provided by the local regulators – Bank Negara Malaysia (BNM) and Securities Commission Malaysia (SC) with its established subsidiaries namely International Centre for Education in Islamic Finance (INCIEF), Securities Industry Development Corporation (SIDC) and Islamic Banking and Finance Institute Malaysia (IBFIM). Other proponents of Islamic education are the institutions of higher learning with programs tailored toward Islamic centric subjects such as Shariah compliant venture capital (VC) which includes the basic of investing and Shariah screening relevant to Shariah compliant VC.

**ii. Process (Guide, guidelines, regulatory requirements)**

A corporation which seeks to offer capital for a startup within IDE should comply with both SC's Guidelines on the Registration of Venture Capital and Private Equity Corporations and Management Corporations. Under SC's Guideline, the requirement is for the VC Company to appoint a Shariah advisor to provide the relevant expertise, guidance and endorsement.

Shariah VC Mi'yar provides examples on the type of Shariah compliant instruments that can be used by the VC Company for investment purposes

in the Shariah compliant startup. In addition, Shariah VC Mi'yar provides clarity on the specific clause to be included in the term-sheet produced by the VC Company. This is an important aspect to consider as startups need to ensure that the funds they receive, or raise is Shariah compliant.

It is important to note that Shariah VC Mi'yar is not a stand-alone guide and needs to be read with other regulatory requirements. Hence, MDEC is fully aware that the IDE will need to mirror any updates or announcements made by the SC and BNM.

### **iii. Oversight (Endorsement and Audit)**

Information that is transparent and accurate are important to make an informed decision. Regulatory supervision plays a vital role to ensure there are the necessary procedures and safeguards in place to mitigate or lessen any risks in the capital market industry.

Hence the need to have a Shariah advisor becomes vital as part of their role is to not only provide advice and Shariah opinion, but they are also required to ensure the investments are Shariah compliant. More importantly, these advisors provide oversight function by reviewing a VC fund's report and state that it has been operated and managed in accordance with the Shariah principle for the said financial period.

Currently, SC's website lists down 51 individuals registered Shariah advisors, 16 Shariah advisors that are corporations and 4 registered Shariah advisors in relation to foreign currency *sukuk* in Malaysia. These Shariah advisors would also need to maintain certain CPE points or license requirements and are required to carry out their roles with due care, skill and diligence. The level of professionalism and integrity of those elected as Shariah advisors are maintained through constant training and education of the latest trends in this space.

## B) Startups

### i. People (Training)

For startup companies, most of the training programs available on Islamic finance focuses on Islamic finance professionals. The training programs for these group of people are developed by the Halal Academy which is an online learning platform endorsed by JAKIM. Its modules focus on the application of Islamic finance to startup companies and the key salient features that startups shall employ in their operation.

It is very important for those labelled as Shariah compliant startups to be supported by personnel who understand the key parameters on what is considered Shariah compliant to effectively carry out their tasks. As new developments are often made in this field of work, the personnel must keep abreast of the latest developments to manage change and implement new standards as and when required.

### ii. Process (Guide, guidelines, regulatory requirements)

The processes that startups need to adhere to is set out in Shariah Compliant Startup Mi'yar. As mentioned, the Mi'yar is established to attract more startups globally to develop Islamic solutions and services in Malaysia. There are two channels whereby the startup is considered as a Shariah compliant startup:

- New startup that is Shariah compliant from the beginning: This is companies that are already Shariah compliant during the initial stage. These companies will comply to SC's Guidelines on the Registration of Venture Capital and Private Equity Corporations and Management Corporations and Shariah Compliant VC Mi'yar, Shariah Compliant Startup Mi'yar and the product will be endorsed by JAKIM Halal Certification Guideline and Standard on Digital Content from the beginning.
- Non Shariah Compliant startup that became Shariah compliant at a later stage: As these companies decide to become Shariah compliant after the initial stage, it needs to take remedial action by appointing a Shariah advisor and prepare a conversion plan to showcase its strategy to transform from a non-compliant Shariah entity to one that is Shariah compliant. Thereafter, the startup is obliged to comply to similar guidelines and guide as per startup that has obtained its Shariah compliant status from the beginning.

iii. **Oversight (Endorsement and Audit)**

The oversight function would broadly emulate the oversight function of the capital providers. Audits must be carried out periodically by qualified individuals/ companies. Reports must be prepared by qualified individuals and verified by independent parties.

C) **Product and services**

i. **People (Training)**

Training modules for products and services is predominantly under the guidelines and standards provided by JAKIM, while the development of specific digital content training module is provided by MDEC and JAKIM. The startups players will need to identify the required skill set employees need to have to perform well in IDE.

Areas that need to be covered are knowledge on the products and services, the relevant Shariah elements that resulted in these products being labelled as Shariah compliant and the code of conduct in distributing these services. The resources involved at this stage is crucial as the marketing element is not only on the in-depth knowledge the distributor has on the product, but also on the conduct during promoting such a product.

Adequate and proper training is important to curtail complaints and minimize issues such as questionable conduct of the distributor, mis-selling or false representation of the product or services, lack of disclosure of pertinent information such as fees involved, as well as usage of language which is too technical (jargon).

ii. **Process (Guide, guidelines, regulatory requirements)**

The process in obtaining product approval often involves a submission to the relevant regulatory body or authority figure. Checklists on compliance to these requirements are fundamental. Often products that are considered plain vanilla has a faster approval process. Products that are more exotic in nature will require buy in from the relevant stakeholders and discussion with the regulatory bodies depending on the complexity of the product/ service. Details that should be addressed are product features, investors profile,

investment strategy, the fees/expenses incurred, distribution/marketing/promotional plan, projected returns and additional disclosure requirements.

Most companies are also recognizing the role fintech plays in the day to day process of their companies. The marketing of these products is revolutionized with the introduction of online platforms, payment gateways and robo-advisory services. While the convenience of these platforms is apparent, measures still need to be undertaken to safeguard the investors. The face to face meetings with an individual is replaced with algorithms and digital forms. Hence, the approval process encompasses safeguards in place and disclosure requirements needed.

iii. ***Oversight (endorsement and audit)***

The supervision of products and services are to promote clarity and investor protection. JAKIM plays an active role in carrying out its duties by conducting yearly audits on the issuer of the capital or the startup company. Regular reporting is required as these reports provide an overview of the performance of the product and indicates the capability of the product issuer.

Audits are carried out to examine there are procedures in place for the pertinent operationalisation of the product and risk mitigation plans are drafted for dire situations. Action taken for failure to meet certain requirements signals the importance of upholding integrity and consequences of failure to do so.

## CONCLUSION

Establishment of the Compliant Mi'yar to IDE is the first step towards many future endeavours that MDEC plans to champion in the Islamic Digital Economy. Continuous alignment to the best international standards and practices is essential for the success of Islamic finance industry. Undoubtedly, Malaysia will continue to serve the Islamic agenda in the financial sphere, nevertheless, collaboration and information sharing remains a pivotal point that requires involvement and commitment from all countries.

Advancements in any industry goes hand in hand with increased regulation and corporate governance. There is a need to achieve regulatory balance so that investor interests are protected while at the same time facilitate the growth of the industry. The interest of shareholders and the responsibility and accountability of the board of directors are also upheld within this strong regulation framework. Synergies from all stakeholders – issuers, regulatory bodies and companies is vital for the success of the industry and IDE.

Protecting the reputation and integrity of this business segment and increasing investor confidence is not an easy task to achieve. Yet, the continuous development in this avenue with establishments of new guide or mi'yar such as the IDE marks the drive and dedication that is needed to boost Malaysia further as a forerunner of fostering change in Islamic finance. In widening the global appeal of Islamic products and garnering economies of scale to arrive at cost efficient products and services, a well-established and well accepted guide shall become the foundation of a strong and robust Islamic Digital Economy.