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FOCUS

ISLAMIC FINTECH: ROUTE TO TECH DISRUPTION

Islamic Finance and Fintech used to be two separate topics until recently. I was having my usual latte at my favourite cafe in Ampang when I overheard two bankers speaking about how Islamic Fintech needs to do a lot of catching up with conventional fintech.

What does Islamic Fintech really mean? Why were the two bankers making that comparison and complaining about how lagging Islamic Financial institutions are when it comes to technology adoption? I was even more tempted to interrupt their interesting conversation as topics like blockchain, analytics, remittance and financing came up.

Does technology need to be Halal or Shariah-compliant to be called Islamic Fintech? How does it really work?

Fintech in the Islamic Finance Landscape

"In essence, fintech/ FinTech refers to the use of financial technology (such as smart phones and devices for online payment, financing, investing and money transfer services, crowdfunding, etc.) to satisfy the needs of those seeking financial services through more efficient and accessible and cheaper means in comparison with those provided by traditional financial institutions.

For example, it involves the financial technology that aims to bridge the gap between financial institutions and those seeking project financing. In this sense, it provides an alternative to traditional financial methods in the delivery of financial services.

That said, fintech is a tool and a general concept which means there is no such a thing as Islamic fintech in as much as there is an "Islamic vehicle", so to speak.

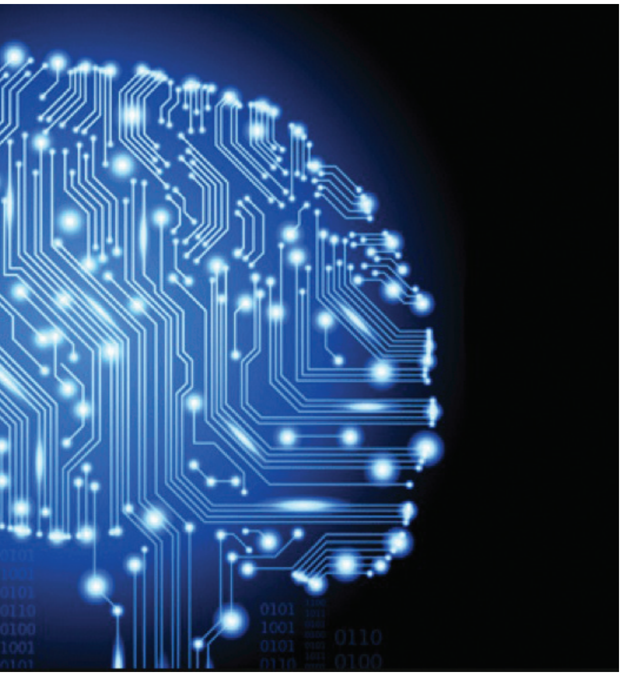
However, the use of fintech in the area of Islamic finance might be dubbed broadly as "Islamic fintech": this involves both consumer-side and investment-side access to Shari'ah compliant products and services."

For many Muslims, their religious practice means they can't use conventional finance products and must instead use Shariah-compliant alternatives. Demand for these products is increasing across the globe.

At the same time, advances in technology have made it cheaper and easier to create Sharia-compliant products. That's creating a huge opportunity for fintech. Some fintech concepts such as P2P lending and robo-advice are well suited to the Islamic market, while the agility of others means they can quickly adapt their services to achieve Sharia compliance.

There is no questioning the fact that the financial world as a whole is experiencing a wave of innovation through Fintech. The latter is taking over all aspects of financial businesses, such as banking, insurance, asset management and the changes that it brings are nothing short of revolutionary.

Lately, the Islamic financial institutions are also experiencing those changes at a fundamental level. While many claimed that the users of such services will benefit largely, the question remains as to whether Islamic Fintech would be able to lessen costs and make services more affordable.



Would the inclusion of financial technologies help Islamic financiers in becoming smarter and better manage risks? Is Islamic Fintech another step towards a more inclusive financial system?

These are the pressing questions we attempt to answer throughout this article.

Global Trends: Opportunities and Threats

The Islamic Financial industry nowadays is faced with a series of advances in technology as users become increasingly tech savvy. As fintech is disrupting the entire finance industry, the Islamic finance landscape is also facing some major opportunities and threats.

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– Datuk Dr. Mohd Daud Bakar, Chairman of EAC

The application and integration of financial technologies in Islamic finance solutions could prove to be a major game changer with unique value propositions.

On a global scale, Fintech start-ups are making large inroads and openly challenging the conventional financial institutions. Surveys conducted by various entities have shown that there are at least 103 fintech companies across 24 countries that are Shariah compliant or are offering shariah compliant solutions. Fintech is significantly reshaping the Islamic Finance industries around the world and yet, it does offer major opportunities for those companies that know how to take full advantage of it.

In his speech at the Islamic Fintech Dialogue 2017, the Assistant Governor of Bank Negara Malaysia pointed out that digital-banking consumers stand at approximately 670 million in Asia alone and are expected to reach a staggering 1.7 billion by the year 2020. By leveraging on financial technologies, Islamic Fintech start-ups would be able to create more value for their customers.

M Nazri, CEO of Expert Analytics Centre (EAC) goes on to add: "Value creation can be achieved through the delivery of customised solutions by using big data and analytics. The use of such technologies would bring enormous benefits to customers in terms of making banking transactions simpler, faster and more convenient."

Furthermore, the integration of Fintech could allow Islamic Finance companies to create a niche for themselves in market segments that would not otherwise be cost-effective.

This presents such companies with the opportunity to serve untapped markets. Fintech solutions benefits companies' internal processes as well by improving the efficiency of back-end systems and operations. For instance, the use of predictive analytics would significantly ameliorate real time risk management techniques.

Datuk Dr. Mohd Daud Bakar, Chairman of EAC comments on the opportunities provided by fintech in the Islamic finance landscape: "The matching of funds that Fintech solution allows has great impact within the social funding space. More specifically, there is the potential for digitising the collection and utilisation of zakat, waqaf and sadaqah."

Such digitisation would not only provide greater confidence to customers but would go a long way in building public trust and confidence. As a result, there will be increased participation and greater contributions towards social impact initiatives.

While there have been an increasing number of Islamic Finance Fintech start-ups both domestically and internationally, the industry is still in its infancy and thus has a few challenges to overcome in order to be more visible and omnipresent.

The most pressing challenge would be the regulatory environment. Currently, the Islamic finance industry is already facing challenges in terms of standardisation and changing regulations.

Regulatory limitations could obstruct the ability of Islamic Finance companies in integrating certain Fintech solutions such as P2P, crowdfunding or big data into their business models.

In some areas of the world such as the Middle East and Africa, regulators are pushing fintech as a necessity for Islamic finance. Nevertheless, the industry seems to be struggling to keep pace with the rapidly changing regulations. Moreover, time and lack of history could a huge stumbling block for the adoption of Fintech with the Islamic Finance space.

Finally, Fintech has its own cost and integration requirements. Therefore, it is critical for the industry to identify which aspects of Fintech are suitable and necessary to be adopted in Islamic Finance solutions.

Malaysian Perspective

From a more domestic perspective, the case is compelling for Islamic Finance companies to adopt and integrate fintech solutions in its business models. Bank Negara estimates that with a growing tech-savvy population, Malaysia is the ideal test bed for developing and commercialising Fintech solutions in the Islamic Finance industry.

Traditional Fintech start-ups on their own, have significantly helped to improve and simplify financial transactions, which a decade ago seemed impossible.

Fintech provides the technological grounding to realise the goal of Islamic finance in creating a risk sharing economy. For instance, the Investment Account Platform is the first multi-bank online platform in Malaysia that provides a combination of credit evaluation expertise of Islamic banks and the power of technology to transfer funds from investors to economic ventures.

This has benefitted entrepreneurs who are now able to gain a wider access to bank-intermediated credit.

According to Nazri, "The time is ripe now for Malaysian Islamic Financial institutions to embrace A.I. technology to achieve financial inclusivity and higher productivity."

In Malaysia, the Islamic financial institutions are in a good position to benefit from the growth that Fintech offers. The key to making this endeavour a success is for the industry leaders to embrace digital transformation to re-engineer the entire organisation.

Customised financial solutions can be achieved through fintech, with Shariah contracts as building blocks for innovation.

Listed below are a few companies to look out for in Islamic Fintech:

MyFinB (M) – MyFinB Malaysia is a virtual CFO and risk analytics platform that uses Artificial Intelligence and Natural Language Generator to conduct financial assessments and provide recommendations to enterprises on a web-to-mobile platform.

It has a Shariah component that evaluates balance sheets and management of the business in accordance to Shariah principles and guidelines. Recently, MyFinB(M) was awarded as the winner in the Big Data Analytics and A.I. category as part of a programme organised by Islamic Development Bank.

Dr Daud says, "With the use of A.I., financial players in OIC countries will find it easier to finance profitably to underserved segments of the population, which in other words enhances the financial inclusion. The adoption of A.I. is not an option anymore."

Several companies, apart from MyFinB are making breakthroughs in the field of Islamic Finance Fintech around the world. All of them contribute in some way or the other to the field to come up with Islamic financial solutions that are revolutionising the finance industry.

Yielders – Yielders, a London-based Islamic Finance Fintech start-up, has become the first company to obtaining regulatory approval in the UK. Yielders is a property-based Equity Crowdfunding platform. It uses the latest online technologies, with automated workflows to allow retail investors to get exposure in the property market.

Their first innovation was to bring a fully integrated proposition with investment selection, acquisition, value creation and placement on to the platform to crowd investors. The company complies with Shariah laws by following the principle of no debt, no interest, full voting rights and full financial rights.

Hada DBank – Established in 2017,

Time will tell if Islamic Fintech will indeed be able to provide a sweeping change in the financial industry, but with technological innovations transforming the way people carry out financial transactions, Shariah-compliant fintech is increasingly likely to become a visible part of the global financial landscape.

Hada DBank is among the first digital banks to fuse Islamic banking principles with blockchain technology in Malaysia. The company believes that Islamic banking are not just for Muslims but represents a way of doing finance that caters for everybody.

Their banking principles is based on the concepts of transparency, profit sharing concept that will minimise market manipulation and avoid another domino crash similar to the financial crisis of 2009.

The company uses chatbots to manage its customers' day-to-day expenses and assist them in planning long term and short financial goals. At the same time, the company makes use of A.I. technology to collect real time data across various platforms and market trends to calculate and produce financial advice for customers' investments.

Outlook

We expect Islamic banks likely to focus their FinTech investment in four major areas in 2018:

- Artificial intelligence and machine learning
- Open banking
- Cybersecurity and biometrics
- Commercial banking innovation

Machine learning and AI will help banks not only automate processes, but also learn more about customer patterns and behaviours to create more individual experiences for individual customers.

For example, chatbots will not only answer basic questions, but be able to provide tailored product recommendations and financial health of companies.

With regulatory developments having to tackle new phenomenon like cryptocurrencies and ICOs -coupled with the rapid rise of FinTech companies, many banks are planning to seek out partnerships to help them get ahead in innovation.

Some predict this will result in connected ecosystems of shared data and services, resulting in increasingly sophisticated offerings to customers.

FinTech investment is increasingly moving away from back-end compliance to developments focusing on customer experience. For example, big data can assist to smooth out customer interactions with banks and improve the whole customer experience.

Finally, cybersecurity is always going to be a priority for Islamic banks. Biometrics will play a larger role in customer-side security with the development of high-powered smartphones.

At the same time, Islamic banks are expected to increasingly pay attention to their supply chains. We expect that Islamic banks will become increasingly interested in their vendors' security profiles, and integrating that into their purchasing decisions.

The year 2018 looks promising for Islamic FinTech for both start-ups and banks alike. There should be more open innovation and collaboration to create long term partnerships in the Islamic ecosystem.

Conclusion

The reason why Islamic Fintech has been lagging behind conventional Fintech is largely due to the fact that investment in the former has been very low so far. Even in markets such as Malaysia, which is considered as a market leader in Islamic Finance, progress has been slow.

Entrepreneurs are aware of the potential of Islamic Fintech but many are apprehensive and are trying to understand how Fintech is applicable to Islamic Finance in the current landscape. The biggest issue that needs resolving is the gap between people who know about Islamic Finance and those who know about financial technology.

At this point, the innovation agenda must a top priority for Islamic Financial institutions. They must be willing to allocate capital and resources to make the integration of Fintech solutions a success. Islamic Financial Institutions should further be able to rethink their traditional business models.

In doing so, they will be indeed be able to synthesise the needs of customers and to develop products and solutions which respond to those needs. Fintech has the potential to play a major role in improving risk management processes and cost effectiveness while maintaining Shariah compliance.

Time will tell if Islamic Fintech will indeed be able to provide a sweeping change in the financial industry, but with technological innovations transforming the way people carry out financial transactions, Shariah-compliant fintech is increasingly likely to become a visible part of the global financial landscape. mb