Chapter 9
Conclusion

Islamic banking is broadly defined as a banking system whose operations are not only governed by the Shariah that prohibits interest but which are conducted in accordance with the value system of Islam. Islamic banks in present times are considered as the end product of the Islamic resurgence which took place in many Islamic countries during the late 1960s and in 1970s. Nevertheless, the existence of Islamic banking products can be traced back to the early days of Islam. While conventional banking products started to emerge with the revival of commercial activities during the 13th century, Islamic banking products were not reinvigorated and as a result of colonialisation the banking system in Muslim countries was based on conventional banking rules.

The establishment of the Mit Ghamr Local Savings Bank of Egypt in the 1960s marked a new milestone in the modern world of Islamic banking. Currently there are more than 150 interest-free institutions all over the world, especially in Muslim countries, providing services which are compatible to those services offered by interest-based institutions. The range of services includes commercial banking services, merchant banking services, fund management activities, investment activities, and insurance businesses. Islamic financial institutions have now extended their activities to the Western world and serve the banking requirements of both Muslim and non-Muslim customers.

As in the case with conventional banks, profitability is considered as one of the important objectives of Islamic banks. Contrary to conventional banks, Islamic banks are expected to include social and moral aims as well as profit in their objectives. This is in line with the main purpose of their existence that is to promote, foster and develop banking services and products based on Islamic principles.
As institutions whose foundations are based on Islamic religious doctrines, Islamic banks are expected to conform to Islamic business principles. Eliminating the element of interest in their operations is only one part of the total Islamic business ethos. Other principles include (i) to engage in legitimate and lawful businesses; (ii) to fulfill all obligations and responsibilities; (iii) business must be based on the concepts of honesty, justice and equity; (iv) overspending and wastage are prohibited; (v) wealth must be used in a proper and orderly manner; (vi) to help and assist the needy; and (vii) transactions must be properly executed.

The main source of funds for Islamic banks is from deposits made by customers. Basically there are two main categories of deposit facilities provided by Islamic banks, namely non-investment deposits in the form of current accounts and savings deposit and investment account facilities. While current account facilities are provided for customer convenience, savings accounts are designated for those who wish to save money and at the same time earn income. Investment accounts are for those who keep money for investment motives.

In the case of current accounts, no returns will be given to depositors and they are allowed to withdraw their funds at any time without notice. The current account facilities are usually governed by the principle of wadiah (trust) or qard hassan (benevolent loan). Returns to savings and investment account holders are not pre-determined and usually these returns are based on profit-sharing concepts or mudharabah. Depositors only know their rewards at the end of the deposit period.

Funds collected from the depositors are used for financing activities based on allowable Shariah principles. There are three categories of principles, namely: (i) principles that are based on profit-sharing; (ii) principles that are based on mark-up; and (iii) principles that are based on free of charge transactions. Other banking services such as letters of credit, letters of guarantee, remittance
services, travellers' cheques, buying and selling currencies, and safe-deposit boxes are also available at Islamic banks. These services are considered fee-based activities.

Islamic banks have to conform to two types of laws, Shariah law (Islamic law) and positive law. With regard to the Islamic banking system, Shariah does not provide any single decree in which it gives all the rules and guidelines to be followed by Islamic banks. The most important matter directly related to the banking system is the prohibition of interest. There are a lot of verses in Al-Qur'an which prohibit Muslims from associating themselves with interest. Similarly, there are many Hadiths describing the Prophet (pbuh) being totally against those who give and take interest.

Positive law is given by a person of authority or the government of the country. With the exception of countries such as Malaysia, Turkey, and Iran where a special law was decreed prior to the establishment of interest-free institutions to govern the operations of these Islamic banks, no special law was promulgated in other countries. There are, however, special laws decreed by countries such as Jordan, Sudan and Egypt, but these laws only apply to a specific Islamic bank. Besides observing the special laws, Islamic banks must also conform to other laws which directly regulate the entire country's financial system and laws for those activities which an Islamic bank is involved in.

The word Shariah originally meant the path leading to the water and in religious usage it means the way which directs a person's life along the right path. The Shariah governs all aspects of human life. Its principles include not only faith or spiritual aspects of human life but also personal behaviour, legal and social transactions. The Islamic banking system is linked with Shariah through one of the aspects of Shariah called muamalat or the man-to-man relationship.
There are some discrepancies among Muslim scholars on the number of sources of Shariah. Nevertheless, the majority of past and present scholars believe that Shariah is derived mainly from four sources, Al-Qur'an, Hadith, Ijma' and Qiyas. Both Al-Qur'an and Hadith are called "al-adilat-al-qatiyyah" or absolutely sure arguments or infallible proof. Al-Qur'an constitutes messages that Allah inspired the Prophet (pbuh) to deliver for the guidance of mankind. Hadith in many cases confirmed, extended, elaborated, explained, and complemented the revelation. Al-Qur'an comprises the words of Allah, whereas Hadith is a piece of information, account, narrative, story and record which designate the Prophet's (pbuh) behaviour, mode of action, or his saying and declaration under a variety of circumstances in life.

In the case of Ijma' and Qiyas, these two sources of Shariah are known as "al-adilat-al-ijthadiyyah" or arguments obtained by exertion. The role of Ijma' and Qiyas is to decide in juridical questions of theory or practise concerning one way or another, the behaviour of the believer, as he is subject to the rules of conduct laid down by Allah and His Prophet (pbuh). That is to say that Ijma' and Qiyas have a part to play in the field of muamalat but not in the areas of ibadat and i'ktikad. Other sources of Shariah are not widely accepted and may be applicable for a particular school of law. Among the principle within this category are ijtihad, ma'ruf, maslahat, istihsan and istishhab.

The prohibition of riba in Al-Quran developed gradually and appeared in four revelations. The first revelation was in Mecca (30:39) and three others were in Medina (4:160-161; 3:130; and 2:278-279). These revelations clearly indicated that riba is prohibited and condemned severely those who take riba. In line with its function as the original and eternal source of Shariah, Al-Qur'an neither defines nor provides any detailed explanation about riba. Hadith on the other hand serves as a source of reference in order for Muslims to confirm or to get further explanation on the rules stipulated in Al-Qur'an. The Hadith reports
prohibition of riba in numerous accounts, although sometimes the content of a particular Hadith is slightly different from one narrator to another.

It is said that the journey of a thousand mile begins with a first step. An issue that often arises in discussion on the implementation of Islamic financial system is whether a step-by-step approach is desirable or a one-go approach is better. The Islamic financial system in Malaysia has been developed with a step-by-step approach is desirable or a one-go approach is better. The Islamic financial system in Malaysia has been developed with a step-by-step approach on a well-planned and well thought out basis.

Islamic principles in the Malaysian financial system were first introduced in 1969 with the setting up of the Pilgrims Management and Fund Board (now changed to Pilgrims Fund Board). The Board manages a fund, derived from the accumulation of savings of intended pilgrims, based on the principles of Shariah. The total resources of the Pilgrims Fund Board have grown tremendously since its inception. At the end of 2000, total resources mobilised by the Board amounted to RM 10.2 billion, representing an increase of RM 1.6 billion or 19 per cent from 1939. The expansion in resources arose from the increase in deposits placed by an increase number of depositors.

The government has covered a reasonable distance since then. We realised, of course, that we have many more miles to go to reach our destination. Be assured, that the authorities have every intention of continuing the journey. In so doing, however, the government will ensure that every step is taken after testing the grounds for firmness, so that we do not have to turn back half way.

The second major financial institution established in Malaysia was an Islamic bank. The first Islamic bank established in the country was Bank Islam Malaysia Berhad (BIMB) which commence operations on 1 July 1983. In line with its objectives, the banking activities of the bank are based on Shariah principles.
After more than a decade in operations, BIMB has proved to be a viable banking institution with its activity expanding rapidly throughout the country with a network of 82 branches and 1,200 employees. The bank was listed on the Main Board of the Kuala Lumpur Stock Exchange on 17 January 1992. On 1 October 1999, a second Islamic bank, namely Bank Muamalat Malaysia Berhad (BMMB) commenced operations. The establishment of BMMB was the effect of the spin-off following the merger between Bank Bumiputra Malaysia Berhad and Bank of Commerce (Malaysia) Berhad.

The third type of Islamic financial institution introduced in Malaysia was an Islamic insurance company, namely, Syarikat Takaful Malaysia Sendirian Berhad, which commenced operations in August 1985. The foundation for the development of Takaful or Islamic insurance was set by the wish of Muslims to realign more to Islamic practices in the economic activities coupled with the strong support from the government for Islamic financial services. In 1994, MNI Takaful Sdn. Bhd. was established, to become the second Islamic insurance company in Malaysia. The company changes its name to Takaful Nasional Sdn. Bhd. on November 1998. The company is a subsidiary of a conventional insurer licensed in the country.

Insurance, especially life insurance is an essential part of the social protection needed for any society. It has its rightful place in Islam but years of misunderstanding and misconception have created mental blocks against insurance in the Muslim culture. We believe Takaful or Co-operative Insurance is the right way forward towards the breakdown and removal of such mental blocks. This type of insurance has great deal to offer in Muslim countries where the spread of insurance per person and percent of GDP can increase manifold if the system of takaful is projected correctly and understood properly. It can genuinely enlarge the insurance market in areas where traditional insurance has not been able to grow, as it should have done. This is true of personal lines, especially of life insurance or family takaful.
In order to create the essential trust and confidence, which is needed to remove the mental blocks just mentioned, the efforts to develop and manage takaful business must be genuine. Investors, entrepreneurs and insurers have good opportunity to take up the challenge of developing insurance business on Islamic principles. After all takaful is intrinsically in accordance with indigenous consumer needs.

What has been attained so far is comparatively small, but as shown from the performance of takaful operators generally, is growing rapid. Considering only a tiny percentage of the ummah have some form of life insurance cover, the potential for takaful to penetrate deeper into the market is tremendous. In this context family takaful products would have strong chance to grow and expand. Therefore takaful is here to stay.

However, the future of takaful would depend on the ummah. Whether takaful would develop into an industry and eventually become the real insurance alternative for the ummah would depend on the commitment and political willingness of the muslim at the individual, community, national and international levels. What is urgently needed is the practical translation of these commitment and political willingness by all.

As we mentioned earlier, Islamic banks in its current form were first established in Dubai and Saudi Arabia 26 years ago. But the basic practices and principles went back to the seventh century, its philosophy and principles enshrined in the Holy Qur'an and observed by the Prophet (pbuh). It prospered in the early years of Islam, boosting commerce, confidence and prosperity. Muslim merchants straddled the civilised world, in Spain, the Mediterranean and Balkans. European financiers and businessmen later embraced some of its principles.

By the mid-80s, Islamic banking in the OIC member countries could be divided into three categories. Many of them had no Islamic banking, few had Islamic
banking on the fringe-of the financial system such as Saudi Arabia and Egypt and there were countries who were thinking of going into full-scale Islamic banking by doing away with conventional banking. These countries are Pakistan, Iran and Sudan. Malaysia is different from both groups in the sense that we have a dual system. Here we have a parallel system that would be equally sophisticated and comprehensive, and have equally good infrastructure to function side-by-side with the conventional system. Today, Malaysia is the only country with a dual system.

The long-term objective of the government has always been to create an Islamic banking system to run parallel to the conventional banking system. However, a single Islamic bank does not fit the definition of a system. An Islamic and finance system requires a large number of dynamic and pro-active players, a wide range of products and innovative instruments, and a vibrant Islamic money market.

On 4 March 1993, Malaysia introduced the world's first dual banking system through the introduction Islamic Banking Scheme (IBS) which allows conventional banking institutions to offer Islamic banking products and services within their existing infrastructure. Recognising that a successful Islamic banking and financial system required a large number of players, Malaysia sought to build critical mass and national reach within a short period.

From only three banks in March 1993, the number of conventional banking institutions participating in the IBS (IBS banking institutions) has increased to 47 comprising of 21 commercial banks, 14 finance companies, five merchant banks and seven discount houses. On 1 October 1999, the second Islamic bank, namely Bank Muamalat Malaysia Berhad, was established. As at end of December 2000, the Islamic banking system had 49 players, comprising two Islamic banks and 47 IBS banking institutions. Upon completion of the merger exercise among domestic banking institutions, the number of players will be 35 consisting of two Islamic banks and 33 IBS banking institutions. These
institutions have more than 2,200 branches providing a comprehensive and comparable range of Islamic financial services. The retail and corporate products offered range from investment accounts and house financing to project financing and long-term bond investment.

We believe a dual system is better than a pure Islamic system. In a conventional banking system, changes are made everyday and new products are developed as more research and development is done. Products get more sophisticated by the day. And if we don't have a conventional banking system, we don't know what is happening in the outside world. Because we have it in Malaysia, Islamic banks will have to learn and find products to keep Islamic banking system on its toes when compared with the conventional system.

Today, Malaysia has succeeded in implementing a dual banking system and has emerged as the first nation to have a full-fledged Islamic system operating side-by-side with conventional banking system. The aspiration to establish a comprehensive Islamic banking and finance system has create a spill-over effect to the non-bank Islamic financial intermediaries which started to offer Islamic financial products and services. Such institutions include the takaful companies, the savings institutions (i.e. Bank Simpanan Nasional and Bank Rakyat) an the developmental financial institutions (i.e. Bank Pembangunan dan Infrastruktur, Bank Industri dan Teknologi and Bank Pertanian). Despite these developments, significant potential still remain untapped. Efforts therefore will be intensified to support the expansion of Islamic banking and takaful in Malaysia to operate effectively in parallel with conventional banking.

By any standard, 26 years of Islamic banking is an extremely short period of time if we were to compare it with conventional banking, which has a history of more than 200 years. Islamic banking developed in earnest beginning in 1975 followed by the establishment of the Islamic Development Bank in the same year. In Malaysia, the first Islamic bank was established in 1983. Alhamdulilah, we
have made great strides when Islamic financial institutions began to be set up in all parts of the world, and is continuously being established until this day. It is heartening that we have made remarkable progress, if not momentous, over the years. We have created the genesis of an alternative financial system that has begun to gain worldwide recognition.

Indeed the initial reaction of the West towards Islamic banking was great skepticism. However, the attitude of international financial community towards the system has since improved. Today it is received with significant interest. With about US$170 billion of fund managed by more than 150 Islamic institutions, in more than 50 countries including the US, the UK and the Far East Islamic banking has proven itself and survived. Islamic banking continues to grow because of its value-oriented ethos that enables it to draw finances from both Muslims and non-Muslims alike. Islamic bankers, keeping pace with sophisticated techniques and latest developments have evolved investment instruments that are not only profitable but also ethically motivated.

Islamic banking and takaful has over the past 26 years made impressive progress. However, there is still much planning and strategising ahead – no Islamic banks are in the world’s top 100 banks. The young Islamic banking faces obvious limitations. Although Islamic countries are home to one-fifth of the World population, the total amount of funds accounts for only about 10 percent global funds. Large amount of prove assets belonging to Muslims are still nesting with the traditional bankers:

We have not kept pace with developments in banking. While we have progressed, others have achieved more. We must not live in isolation, or grow independently of each other. Islamic countries must foster greater cooperation. And, the noble form globalisation will spur growth and trade. Aspects of globalisation were evident during the great Islamic Empire. There were no boundaries to deter and stifle the spread of Islam and with it the movement of
trade and knowledge. Resources were utilized and shared for the common good of the Ummah.

Unmistakably, globalisation has the potential to produce greater wealth for all. If properly managed, the poor nations will benefit. It presents exciting new opportunities for the creation of wealth and economic growth. At the same time, the idea of bank consolidation is only catching on for the Islamic banks and financial institutions in the last few years. We must understand that to be even acknowledged in the global financial market, a bank must be of significant size and has substantial capital strength. As we mentioned earlier, up to now, no one Islamic bank has made the list of top 100 largest banks in the world by asset size or capital strength. Islamic banks should strive to be in the top 100. Merger is another alternative for we must not be marginalized.

Uniformity and standardization will increasingly shape the Islamic banking and takaful industry and leads it to a lucrative global customer base. This calls for harmonization of Shariah decisions, for which, the concerted efforts within the Islamic banking industry towards uniformity in Shariah interpretations is a right step. This uniformity is emerging partly as a result of the participation of several leading Islamic scholars on Shariah boards of various Islamic financial institutions. Central Banks from Islamic countries should work closely towards evolving a consensus on a uniform set of Shariah standards of least for the more universal products, if not all, to inject greater vitality in the Islamic financial sector.

We need to standardize the supervisory and prudential standards for the Islamic financial institutions. Recently, an international supervisory body known as the Islamic Financial Services Board, or the IFSB, was proposed. It will design and issue these standards. Malaysia looks forward to playing a key role in this initiative and gladly offers to be the host nation. Guided by the IFSB, managing the unique risk characteristics of Islamic financial institutions will become more
structures, prudent and transparent. This will spur the growth of Islamic financial services industry throughout the World.

Malaysia has proposed the idea of an international money ad capital market that adopts the Shariah rules. Malaysia with a group of central banks of Islamic countries and the Islamic Development Bank are developing the International Islamic Financial Market, or IIFM. It will address the liquidity needs of international Islamic banks, broaden the market of Islamic finance and investment internationally and expand the range of new Islamic financial products. For a start, Labuan has been designated as a focal center for IIFM for this region, and Bahrain, for the Middle East region. Both centers can complement each other in achieving and ensuring the smooth implementation and operation of the IIFM.

Islamic financial institutions also have to be active in the international financial market and take advantage of the networking opportunities that it offers. There has been some progress concerning Islamic bonds. It is inevitable that the creation of the secondary market arising from such issues would present active trading opportunities.

On 1 March 2001, BNM has launched the Financial Sector Master Plan which charts the financial sector landscape for the next 10 years. An integral part of the plan is the strategic plan for the development of Islamic banking and takaful in Malaysia. The Master Plan outlines the strategies to be implemented to develop the financial infrastructure for Islamic banking and takaful. More specifically, the Plan outlines strategies to strengthen the institutional and operational capabilities of the institutions in Islamic banking and takaful to operate in a more competitive environment. Research and development efforts in Islamic financial products and innovation will be intensified. Attention will also be focussed on financial infrastructure development, in particular, to support the effectiveness of the Islamic financial markets.
To ensure the stable and sound development of Islamic banking and takaful, the legal, regulatory and Shariah framework will be strengthened. As a regulator, BNM will also continue efforts on product and market development to create more sophisticated instruments, specifically customised to meet the unique requirements needed to facilitate efficient management of the Islamic banking system. In these endeavours, the role of the government will continue to be important. The unrelenting support and unwavering commitment of the government has been an important force that has place Islamic banking and takaful in Malaysia where it is today.

The development of Islamic banking and takaful is now at the threshold of entering its next stage of development, to expand on a global basis, to gain greater acceptance as an effective and efficient means of intermediation and to contribute to overall wealth creation.

The last time the world ushered in a new millennium, the Islamic civilisation was at its peak. When it ended the Islamic civilisation had floundered, and is now on the verge of a revival. We have come a long way and we still have a long way to go. The key is unity, stability and modernisation. The road ahead is fraught with challenges and risks of steep falls, but if we stick together we will, Insya-Allah, succeed. Let us be reminded of the Qur'an verse from Chapter 3, (Surah Ali-'Imran), verse 103, which says:

"And hold fast, all together, by the rope which God (stretches out for you), and be not divided among yourselves and remember with gratitude God's favour on you."