63 IPBJ Vol. 5 (2), 63 - 76 (2013)

THE IMPLEMENTATION OF ISLAMIC BANKING SYSTEMS IN MALAYSIA: AWARENESS AMONG BANKING STAFF

AZIZI ABU BAKAR
Universiti Utara Malaysia
FAIZATUL HASLIYANTI GHAZALI
Central Queensland University, Melbourne, Australia

ABSTRACT

In Malaysia, a relatively new but fast developing sub-sect of the financial sector is the Islamic banking and industry. Despite its recent history, Malaysia's Islamic Banking institutions (IBIs) have dramatically increased in number and currently have seventeen (17) full-fledged and emerging Islamic Banking Institutions. It has been observed that despite the current global economic recession, the Islamic finance and banking industry has sustained its growth at extraordinary levels, having now become an essential part of global financial services landscape. The development of IBIs normally has been effected by internal and external environment, but the most important of development is on IBIs' products and services. The aim of this paper is provide a conceptual understanding on history and development of IBIs by exploring the awareness facing by banking staff towards Islamic banking systems in Malaysia.

Keyword: *Islamic Banking Institutions*

INTRODUCTION

The framework of Islamic Banking Institutions (IBIs) is likely to be somewhat different from the traditional financial institutions that operate under a capitalistic economy. In general, the Islamic banking institutions' activities are dependent on the principles of Islamic law *(Shari'ah)*. The IBIs wishing to conduct financial activity in compliance with the Shari'ah is likely to look to a Shari'ah scholar for guidance and supervision. Today, IBIs have developed from just a substitute form of financial intermediation mainly to meet the Shari'ah compliance requirements of the Muslims in the Muslim world to become a complete, competitive and essential component of the global financial system that serves both Muslims and non-Muslims worldwide (Azrul A, 2010). This development, although guided by customary Islamic finance strongholds such as Malaysia, Bahrain and Pakistan, is now increasingly being witnessed in a diverse range of countries around the world (ACCA 2010).

There are more than 600 Islamic Financial Intuitions operating in at least 75 countries although Islamic finance in some form or other institutionalised or otherwise, is probably present in some 90 countries worldwide in the Muslim and the Western world. About a dozen long-established and emerging financial centres worldwide aspire to become international centres for Islamic finance; Bahrain, Brunei, Doha, Dubai, Hong Kong, Jakarta, London, Luxembourg, Malaysia, Paris, Singapore and Tokyo (Bank Islam Malaysia Review, 2010). However, IBIs are one of the largest components of wealth management in Malaysia. To ensure that IBIs contribute towards optimizing wealth distribution in economy, there is an urgent need to re-evaluate its effectiveness and efficiency. To be efficient and effective as a sector, the IBIs must have good trained staff to deal with Islamic banking products. Workshops, training sessions, and seminars are good way to overcome the lack of qualified personnel.

Islamic Banking Systems

Based on Islamic Banking Act 1983, the definition of Islamic bank is banking business whose aims and operations do not involve any element which is not approve by the religion of Islam. It may be noted here that some of the activities made possible by conventional banking will lead to social ills such as gambling, lending or borrowing at the fixed interest. According to Vibhu (2008), Islamic banking refers to a system of banking where its activities are consistent with Islamic law (Sharia) and aided by Islamic economics. One major distinction between conventional banking and Islamic banking is based on the concept that transactions are free of riba. For example, compared with giving loans to buyers to purchase property, Islamic banking would otherwise buy the property and sell them to buyers. And buyer will pay back that amount by progressive payment.

Haque, Osman and Ismail (2009) also defines Islamic banking system as a system of usury-free finance and follow Islamic law in offering services and products to customers. Islamic banking system prohibits any economic activities that lead to speculation and introduced a system based on Islamic tax namely charity and the avoidance of any product and service that are contrary to Islamic values such as wine, pork, and so on. Additionally, gambling, prostitution, pornography and weapons are banned altogether. Among the sectors that are accepted are education, food expenditures and biotechnology.

Shariff (1997) said the Section 2 Islamic Banking Act, Islamic banking may be defined as the ubiquitous running a reputable commercial and Islamic banks have a legitimate licensed. When the Islamic banking system as well as a banking system that aims and operating within the scope defined by the religion of Islam and are not involved in any element which is prohibited by Islam.

According Rosly and Abu Bakar (2003), the Islamic banking system may be defined as a banking system that operates with according to ethical values and based on Islamic Sharia. In other words, he does not have the level of interest and does not practice any form of commerce that is not ethical. Instead he emphasizes the achievement target and objective of Islamic economics. Rosli and Sanusi (2001) also said that the Islamic banking system is the institution that runs the operation finance follows the principles of Sharia. Haron and Wan Azmi (2008) also stated Islamic banking system based banking to Sharia principles in achieving its objectives.

Dusuki and Abdullah (2007) also confirms Islamic banking system is a banking system that is based on the concept of fair and thorough in society as demanded by Islamic economics. With that, there are some restrictions as examples of usury, gambling, prostitution, speculation and so set aims to protect all parties involved in any transaction, and so on to form a harmony society. Islamic banking system is a system in which all police operations and is based on the norms and regulations stipulated by Islamic law (Sharia). Additionally, he has Sharia Institute which will make an assessment on all trade and commerce so activities it goes in line with *Sharia* principles which have been established (Mouawad, 2009).
According to Mouawad (2009), the Islamic banking system is based on two major milestones. Firstly, namely religious framework based to four main principles namely forbids usury; activities circumvent any speculation (*gharar*), prohibit any form of unlawful resurfacing in cases such as gambling (*qimar*), prostitution, and wine and so on and also promote such charitable giving. The second milestone is also based to the achievement of socio-economic, social justice and virtue in Islamic societies by increasing the levels of deposits free of interest.

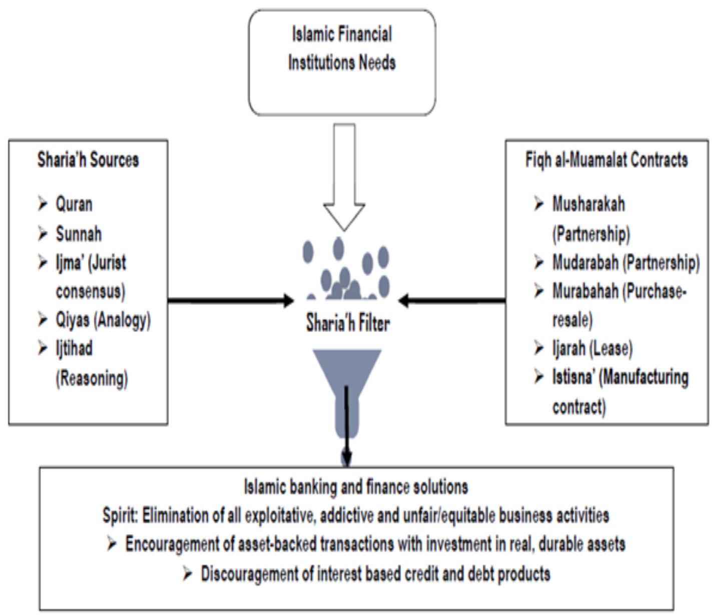
Islamic banking system operates based on the principle of partnership profit or loss, in which he stressed the practice teamed in the profit and loss risk between borrowers and lenders (Wilson, 1991). Islamic banking system is a subset of the overall Islamic economic system in which he championed the concept of fairness, accuracy and balance in society as demanded by the Sharia (Dusuki, 2008). Pervez (1990) also stated the

Islamic banking system is the institution that runs its operations of finances the principles of Sharia.

General Framework for Islamic Banking

Iqbal (2007) draws the general framework on IBIs as in Figure 3. Islamic finance activities are dependent on the principles of Islamic law *(Shari'ah). Shari'ah* is sourced from the holy Quran, *Sunnah (Hadith), Ijma'* (jurist consensus), *Qiyas* (analogy) and *Ijtihad* (reasoning). An Islamic financial institution wishing to conduct financial activity in compliance with the *Shari'ah* is likely to look to a *Shari'ah* scholar for guidance and supervision. Figure 3 also shows that, the establishment of Islamic financial institutions will be expected to resolve some issues regarding a prohibition on interest, speculation and gambling. Second issue to resolve is a prohibition of certain investments; for example in alcohol, weapons, pork, pornography and tobacco activities and a prohibition in certain investment instruments like forward transactions, limited option use or short selling followed by replacing the use of asset-backed transactions with investments in real and durable assets. Lastly, credit and debt products are not encouraged in

Figure 1 : General Framework for Islamic Banking



Islamic banking and finance activities (Iqbal 2007).

Business activities can be viewed as contracts between business agents (Iqbal & Abbas 2007). But in Islam, this business contracts are called as *"Fiqh al-Muamalat"* contracts.) Islamic financial institutions cover a range of financial products and services similar to conventional finance such as banking, capital market, insurance and asset management (Syed 2007). Iqbal (2007) classifies the key contract of *Fiqh al-Muamalat* contracts are as follows:

a. Contract of profit-sharing *(Uqud al-ishtirak*)(MASB-Tr*i*-4 2010):

- *Musharakah* (Partnership); Syed (2007) defines *Musharakah* is a contract between partners who combine their funds to undertake commercial business venture. Abdul Rahman (2010) elaborates *Musharakah* is where the IFIs enter into a partnership with entrepreneurs to invest in a feasible business project. Prior studies (see Abdul Rahman 2010; Syed 2010; Iqbal & Abbas 2007) have identified the concept of *Musharakah* as if there is profit, it will be shared based on pre-agreed ratio and if there is loss, it will then be shared according to capital contribution ratio.
- *Mudarabah* (Partnership); is a contract between one party who provides the full capital outlay of the business venture (Syed 2007). Abdul Rahman (2010); AAIOFI Standards 2010) have identified M*udarabah* contract is a concept where the capital provider (*rab al-mal)* or the IFIs and the small entrepreneur *(mudharib)* become a partner. They also distinguished that, the profits from the project are shared between capital provider and entrepreneur, but the financial loss will be borne entirely by the capital provider.

b. Contract of exchange *(Uqud al-mu'awadat)* (MASB-Tr*i*-4 2010):

- *Murabahah* (Purchase-resale); Syed (2007) defines *Murabahah* contract is a sale contract executed between a purchaser and a seller. Similar with Abdul. Rahman (2010) defines that, *Murabahah* is an asset based financing widely used for house and motor vehicle financing by IFIs. The concept of *Murabahah* is basically an arrangement where the customers, who wish to purchase certain goods or assets, he requests the bank to purchase the items and sell them to him at cost plus a declared profit (see Abdul Rahman 2010; Syed 2010; Iqbal & Abbas 2007). In a simple word, *Murabahah* is sales of goods at cost plus mark up.
- *Ijarah* (Lease); Refer to Syed (2007), *Ijarah* is a contract of exchanging the benefits of an asset for a consideration. In other words, it is a contract of leasing. Abdul Rahman (2010) confirmed that *Ijarah* is a well-recognized concept used in IFIs especially

for motor vehicle and equipment financing. According to Abdul Rahman (2010); Syed (2010); Iqbal & Abbas (2007) stated that the concept of *Ijarah* has some similarities with Western leasing but it possesses a number of unique characteristics founded by *Shari'ah*. Refer to AAIOFI 2010, *Ijarah* can be defined as a process by which the "*usufruct* (benefit) of a particular property is transferred to another person in exchange for a rent claimed from him/her'.

- *Istisna'* (Manufacturing contracts); Syed (2007) states that *Istisna'* is another form of sale contract; it is a contract of manufacturing a specified item before delivering the item to the purchaser. *Istisna*' is normally used by IFIs in project financing an example to finance assets under construction such as real estate, plant and machinery within the sectors of telecommunication, transport, infrastructure, industry, etc.
- *Salam* (Forward sale); According to Syed (2007); Abdul Rahman (2010) *Salam* is a sale of a well-defined commodity to be delivered but the seller in the future but for an immediate payment.
- *Sukuk* (Bonds); *Sukuk* is the other contract in the contemporary Islamic banking and finance. (AAOIFI 2010) classified Sukuk into four categories which are:

i. *Mudarabah Sukuk*; these are investment in *Sukuk* that represent ownership of units of equal value in the *Mudarabah* equity and are registered in the names of holders on the basis of undivided ownership of shares and its returns according to percentage of ownership of share.

ii. *Musharakah Sukuk;* these are investment in *Sukuk* that represent ownership of *Musharakah* equity. It is not differ from the *Mudarabah Sukuk* except in the organization of the relationship between the parties issuing *Sukuk* forms a committee from the holders of the *Sukuk* who can be referred to in investment decisions.

iii. *Ijarah Sukuk*; these are *Sukuk* that represent ownership of equal shares in a rented real estate. These *Sukuk* give their owners the right to own the real estate, receive the rent ad dispose of their *Sukuk* in a manner that does not affect the right of the lessees.

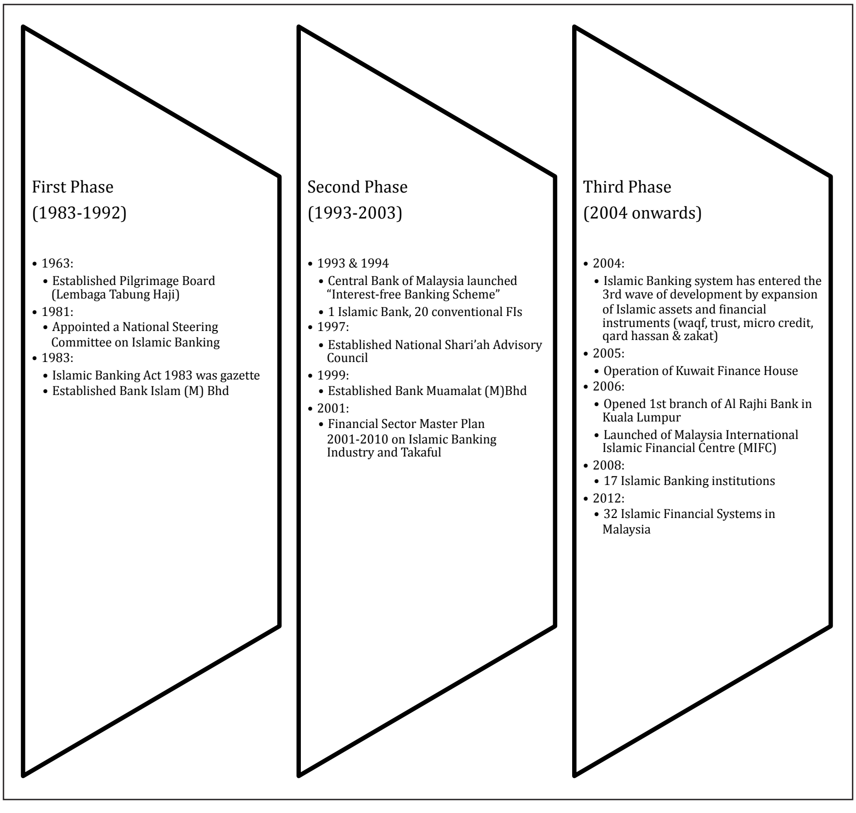
iv. *Salam/ Istisna' Sukuk;* these are *Sukuk* that represent a sale of a commodity on the basis of deferred delivery against immediate payment. *Salam* and *Istisna' Sukuk* are same, both instruments can neither be sold nor traded before their maturity date if either the buyer or seller issues them.

While designed to cater to the specific Islamic obligations for Muslim customers, Islamic banking and finance is not limited to Muslims but the transactions can be undertaken between Muslims and non-Muslims. An Islamic finance product can be attractive to non-Muslim stakeholders for its industrial features as well as its underlying ethical and socially responsible quality.

IMPLEMENTATION OF BANKING SYSTEM IN MALAYSIA

Malaysia has a long history of developing and structuring its economy and financial institutions under Islamic financial principles. As a multi-racial country but Muslim majority nation, Malaysia was affected by the Islamic resurgence movement among the intellectuals around 1960's. Figure 1 shows three phases of the present movement on Islamic Banking institutions in Malaysia.

Figure 2: Implementation of Islamic Banking System in Malaysia



The first phase (1983-1992) is an introduction period of Islamic Banking operation. In 1963, the Malaysian government had established the Pilgrimage Board for the purpose of collecting and investing money owned by Muslims (Haque, Osman and Ismail, 2009).

In 1981, the government appointed a National Steering Committee on Islamic Banking. The Islamic Banking Act 1983 was promulgated and the first Islamic Bank commenced operation under the name of Bank Islam Malaysia Berhad (BIMB) and in 1992, BIMB was listed on the Kuala Lumpur Stock Exchange (KLSE) (Sudin and Nursofiza, 2009).

The second phase (1993-2003) was more to encouraging and developed new Islamic banking institutions. In 1993-1994, Central Bank of Malaysia launched "Interest-free Banking Scheme" among twenty conventional banks in Malaysia. In 1997, concurrent with the development of the Islamic banking industry, the Malaysian government had established National Shari'ah Advisory Council. Two years later, Bank Muamalat (M) Berhad was established and it became the second Islamic bank in Malaysia.

In 2001, the Malaysian government came out with the Financial Sector Plan 2001-2010 on Islamic Banking Industry and Takaful. After the Malaysia government introduced interest-free scheme, the conventional banks also designed their products and services to cater to the specific obligations of Muslim customers, but at the same time, the products and services were also attractive to non-Muslim customers for its industrial features as well as its underlying ethical and socially responsible quality. Islamic banking has entered the 3rd wave of development by expansion of Islamic assets and financial instruments vis a vis waqf, trust, micro credit, qard hassan and zakat. In 2005-2006, Kuwait Finance House and Al-Rajhi Bank were operated in Malaysia. In the same year, Malaysia International Islamic Financial Centre was launched. Islamic financial institutions in Malaysia have shown an extraordinary growth up to 32 including full-fledge and semi-fledge of Islamic financial institutions were established in year 2012 (Sudin & Nursofiza, 2009; Zaid et.al 2011). Malaysia has becomes the first country that implement dual banking system which are Islamic banking system and conventional banking systems. Currently, Malaysia is a model representing a modern Islamic country that has introduced Islamic values in banking systems.

ISLAMIC BANKING INSTITUTIONS IN MALAYSIA

An Islamic banking system in Malaysia has shown an extraordinary development. Figure2 shows the list of Islamic Banking operated in

Malaysia. There are seventeen (17) licensed Islamic Banking in Malaysia which consist of three (3) full-fledge local bank, eight (8) Islamic window conventional local bank, two (2) full-fledge foreign bank and four (4) open window conventional foreign bank.

Table 1: Islamic Banking Institutions in Malaysia

No	List	Year	Ownership	Status
1	Bank Islam Malaysia Bhd	1983	Local	Full-fledge Islamic Banking
2	Alliance Islamic Bank Bhd	1994	Local	Islamic Window
3	HSBC Amanah Malaysia Bhd	1994	Foreign	Islamic Window
4	OCBC Al-Amin Bank Bhd	1995	Foreign	Islamic Window
5	Bank Muamalat Malaysia Bhd	1999	Local	Full-fledge Islamic Banking
6	Bank Rakyat	2003	Local	Full-fledge Islamic Banking
7	CIMB Islamic Bank Bhd	2003	Local	Islamic Window
8	Hong Leong Islamic Bank Bhd	2005	Local	Islamic Window
9	Kuwait Finance House (Malaysia) Bhd	2005	Foreign	Full-fledge Islamic Banking
10	RHB Islamic Bank Bhd	2005	Local	Islamic Window
11	Affin Islamic Bank Berhad	2006	Local	Islamic Window
12	Al Rajhi Banking & Investment Corporation (Malaysia) Bhd	2006	Foreign	Full-fledge Islamic Banking
13	AmIslamic Bank Bhd	2006	Local	Islamic Window
14	Asian Finance Bank Bhd	2008	Foreign	Islamic Window
15	Maybank Islamic Bhd	2008	Local	Islamic Window
16	Public Islamic Bank Bhd	2008	Local	Islamic Window
17	Standard Chartered Saadiq Bhd	2008	Foreign	Islamic Window

Source: Central Bank of Malaysia (2012)

The first Islamic bank established was Bank Islam Malaysia Berhad, which commenced operations on 1 July 1983. On 1 October 1999, a second Islamic bank, namely Bank Muamalat Malaysia Berhad was established. Apart from Islamic banks, other financial institutions also offer Islamic banking services through the "Islamic Banking Scheme". In terms of products, all Islamic banking entities are offering banking products based on the Islamic principles.

The major role of a financial institution is to generate incentives for a resourceful distribution of financial and real resources for competing aims and objectives across time and space (Zamir.I, & Abbas.M (2007). Azrul (2010) states that, IFIs can perform all functions aligned to finance and consist of five (5) major segments which are Islamic banking, Islamic money market, Islamic capital market, Islamic insurance/re-Takaful and Islamic fund management but the IBIs are one of the largest components of wealth management financial industry in Malaysia.

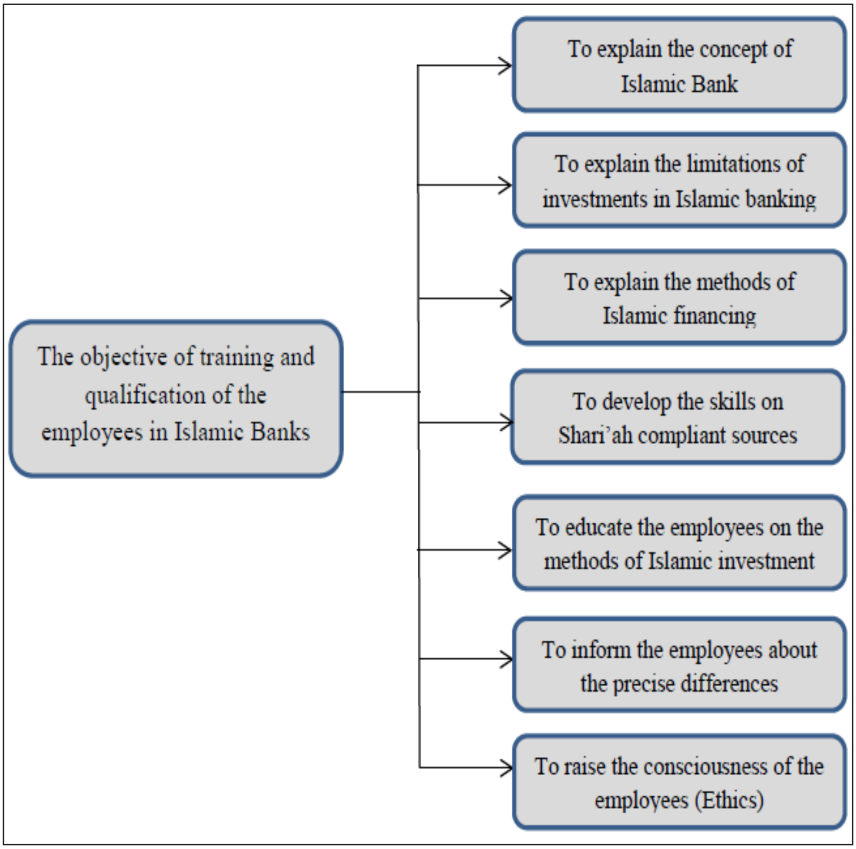
STAFF AWARENESS ON IMPLEMENTATION OF ISLAMIC BANKING SYSTEMS

Iqbal (2007) stated that, there are few challenges in development of IBIs; theoretical, operational and implementation. He mention that, on the theoretical side, further work needs to be done on developing core principles of Islamic finance and banking, understanding the functioning of IBIs that operating on a profit-and-loss-sharing basis. Whereas there are some operational issues relating to innovation, intermediation and risk management are commendable of attention. Finally, special attention should be given to efforts required on a system-wide implementation.

This paper is focused on the challenges of internal operational side in IBIs. On concerning with operations of Islamic banks, the most important is providing the employees of IBIs with comprehensive knowledge of Islamic banking systems. The staff awareness on implementation of Islamic banking systems is important because most of staff in Islamic banks have backgrounds in conventional banking systems. There are so deficient in the understanding of the jurisprudence of Islamic financial transactions.

Dahlawi (2004) lists down the objectives of training and qualification of the employees in Islamic banks as stated in Figure 4 above. He also stated that, the employees may look at the practices of Islamic banks but they not are able to distinguish between Islamic banking system and conventional banking systems. In fact, many of them inform their customer that two systems are the same.

Figure 3: The objectives of training and qualification of the employees in Islamic Banks



Source: Dahlawi (2005)

Abbas et al. (2003) states that, the interfaith understanding and efficiency of staff in Islamic banking system is very important for customers. By the way, the staffs are a great asset to the organization and become one of the important factors why customers choose service Islamic banking. Islamic banking institution shall train and awaken them to the development of staff to ensure more active and service products offered by Islamic banking is much better and has unique characteristics compared with other banking systems.

Due to the importance of Islamic banking system, banking staff must have good knowledge and professional qualifications suitable to their duties in Islamic banking. Deep knowledge of Islamic banking is very important for the staff. In addition, other related aspects such as ethics, professional attitude, their duties and responsibilities to the customer and the organization, is also very important as it can increase efficiency (Dusuki & Abdullah, 2008).

Adequate training for staff can also increase the effectiveness and efficiency of staff in the Islamic banking system and indirectly attract customers to choose Islamic banking systems. Staffs that are qualified and have high proficiency in Islamic banking can ensure smoother banking operations. The bank needs to ensure their staffs have adequate training to handle any customer inquiries and to provide detailed explanations of the convenience offered by Islamic banks. It is important the staff can circumvent any confusion among customers especially in ensuring the unique features offered by the Islamic banking system is really unique and good compared with other banking systems (Ahmad & Haron, 2002).

CONCLUSION

Islamic banking system has become a primary financial service having been around for more than three decades currently. It has expanded to all corners of the world and well received by the Muslims community as well as non-Muslims. Islamic banking has the same function with conventional banks, except transactions executed follow the principles of Islam (Dusuki & Abdullah, 2007). Malaysia is a unique country that runs two banking system where Islamic banking system operates together with the conventional banking system. Islamic banking system in Malaysia began in 1983 with the first embodiment of Islamic bank namely Bank Islam Malaysia Berhad (BIMB). The government has introduced a scheme called the Interest-Free Banking Scheme or also recognized as Islamic Windows in 1993, in an effort to attract more customers. This scheme allows other conventional banks to introduce Islamic banking products to customers in addition to services conventional banking offers (Haron and Wan Azmi, 2008). At the end of 2004, the State Bank has introduced more than 44 products and services for Islamic banking in Malaysia (my www.bnm.gov).

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