

ANALYSIS OF THE TWENTY YEARS OF CREATING ALTERNATIVE BANKING SYSTEM IN MALAYSIA

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Abstract:

Malayan Pilgrims Savings Corporation was introduced in 1963. Six years later, Malaysian Pilgrims Fund Board (Tabung Haji) was formed. The board used to collect funds from pilgrims who expected to perform pilgrimage in the future dates. Moneys were collected and kept as per given rules and procedures emanated from Islamic sources of law. Twenty years later, the country was ready to run a fully fledged Islamic bank where the Bank Islam Malaysia Berhad (BIMB) came into existence in the year 1983. This paper investigates stages of development of Islamic banking system in Malaysia from 1983 to date. This study discovered that Malaysia had enough time to make Islamic banking system works alongside conventional banking system and for sure, has successfully managed to come up with the comprehensive and workable financial system which accommodates both the conventional and Islamic banking. As a result, Malaysia stands to be the hub of Islamic banking products and services in the world today.

Keywords: Tabung Haji, Islamic Banks, Conventional law

INTRODUCTION

There is an ongoing debate on establishment of Islamic banking system in various countries. The debate is on how this system can work within the conventional system without causing any financial problems in the country. However, the debate is mostly on the introduction of this system in secular states where common law is dominant. Religious and customary laws are being used when they do not contradict with the laws of the nation. Study reveals that

Malaysia is an international hub for Islamic banking activities where a quite good number of countries work with Malaysia in as far as Islamic banking activities is concerned. However, the journey of accommodating Islamic financial system within the conventional financial system in Malaysia did not start overnight. It has taken twenty years for this idea to be officially recognized by the government prior to its establishment as a local board governing accumulation of funds for future pilgrimage trips. Collecting and managing funds was done in accordance with Islamic ways where no interest was given or taken to any party involved in the process. The trips were also made smoothly without any problems the situation which indicated that the system was pure, self sufficient and beneficial to members of the community. Today, Malaysia stands as a champion of Islamic banking activities in Asia in particular and the world in general.

The rest of the paper is organized as follows: Section II provides the analysis of the twenty years of operation of *Tabung Haji* in Malaysia while section III discusses legal recognition of Islamic banks in Malaysia. Section IV dwells on the state of affairs of Islamic banking system in Malaysia to be followed by findings and discussion in Section V while Section VI concludes this paper.

Methodology

The author reviewed various journal articles, research papers, books, legislations and other reputable online sources in gathering information on the subject in question. That said, this paper turns to be a purely library research article, the methodology of which most legal and social-legal research are conducted. Reviewed materials have indeed demonstrated to what extent Malaysia has set the bar very high in terms of standards and how Islamic banking activities can be carried out in secular states.

Literature Review

Twenty Years of Operation of the *Tabung Haji*

Study reveals that the first Islamic financial institution in Malaysia is the Malayan Pilgrims Savings Corporation in the year 1963. This institution was established specifically to assist Muslims who would want to go for pilgrimage in Makkah, Saudi Arabia. Money from individuals was collected and saved until they satisfied to finance the said trip. Six years later, Pilgrims Management and Fund Board (*Tabung Haji*) was introduced. This board was investing the deposits made by the prospective pilgrims. The investment was done in accordance with Islamic *Shariah* and that only non banking activities were carried out by the board (El-Karnashawy, 2015).

Oseni reports that the resilience of some Muslims in various countries resulted into an official provision of Islamic banking activities in the world (Oseni, 2009). Making his argument, Oseni presented the Mit Ghamr Savings Bank based in Egypt which aimed at mobilizing funds from ordinary citizens for them to be used in economic development of the respective area. In fact, this was not a purely functional bank but rather a collection point of funds for

the purpose of developing the area economically. Oseni further reveals that the collected money and credits issuance was performed by following the principles of profit and loss sharing (PLS). The same turned to a full bank in the year 1981. Again, Oseni has mentioned about the *Tabung Haji* which started as an experiment in 1969 in Malaysia. These two experiments resulted into full fledged Islamic banks in the later years and being improved from time to time. Others are considering that *Tabung Haji* is the organization of its kind in the world due to its formation, how it works and the nature of activity the society engages with (Mokhtar, Abdullah, & Al-Habshi, 2006).

Tabung Haji a small entity? Gelbard is of the opinion that in 1963, management of small individual funds was managed by *Tabung Haji*. In the contrary, the author noticed great contribution of this organisation and noted that it played “a critical role in consolidating the activities of the small funds” to the extent that it created a huge demand of a total *Shariah* compliance banking products and services (Enrique Gelbard, 2015).

However, in appreciating the contribution of *Tabung Haji* in Malaysia, Siddique views that with all the early Islamic banking activities, only *Tabung Haji* has survived much longer and resulted into a fully fledged bank. The author noted that *Tabung Haji* had a strong root in the community and the narrow nature of its focus assisted in achieving higher performance. The performance was also contributed by the clear structure of the business the board had in time (Siddique, 2006).

Moreover, study reveals that most Muslims religious leaders in Malaysia graduated their religious studies between 1950 and 1960's at Al-Zahra University where they were taught on the prohibition of interest and how business should be carried out as per Islamic *Shariah*. When they returned to Malaysia, they started practicing interest free transactions and that the *Tabung Haji* came into existence (Abdul-Rahman, 2010). The author reports that the collected funds was huge because pilgrimage was an important trip for many devoted Muslims in Malaysia and therefore families worked very hard and invest for this trip. To make the business sustainable, *Tabung Haji* invested the funds in Agriculture and in other real estate projects.

Giving an overview on Islamic financial sector in Malaysia, Hassan reveals that the sector is not new at all as the same was practiced way back in the year 1963 under the *Tabung Haji* which then “forced” the government to come up with the national strategy of introducing Islamic financial system within the conventional banking system in the country (Hassan, 2013).

In fact, the above discussion reveals that *Tabung Haji* paved a way for the introduction of Islamic banking system in Malaysia. It is further reported that before the introduction of *Tabung Haji* project, Malaysians used to accumulate funds and keep them by using traditional means like keeping them in Pillows, under the Mattresses and even in Jars. Others were buying Gold and other Jewelleries, pieces of land and livestock which were then sold later and the money was used to cover their needs (Amin, 2010).

Legal Recognition of Islamic Banks in Malaysia

There are number of provisions which were enacted in order to allow Islamic banking activities to take place in Malaysia. If you examine the dates carefully, you will find out that Malaysia took enough time to evaluate the situation before coming up with the plan. For instance, it took six years to come up with the *Tabung Haji* in 1969. It should be remembered that this board emanated from the Malayan Pilgrims Savings Corporation established in 1963 which dealt with collection of funds from local Malaysian Muslims to cover pilgrimage trips. The *Tabung Haji* was brought in for the purpose of investing the funds in different economic projects.

Islamic Banking Act 1983

Record shows that the first dedicated legislation on the provision of Islamic banking in Malaysia is Islamic Banking Act, 1983. This Act came into force twenty years after the establishment of Malayan Pilgrims Savings Corporation and fourteen years after the establishment of the *Tabung Haji*. Either, this Act is reported to have been amended for more than five times in a bid to fit for the financial environment existed in Malaysia. The amendments were made in the following years; 1985, 1986, 2002, 2004 and 2007.

In this Act, there are number of issues which have been put forward in order to have a satisfactory provision of Islamic banking activities in Malaysia. The Act lays down fundamental requirements for licensing an Islamic bank and Islamic financial institutions. The Act also empowers minister responsible for financial affairs to vary or revoke conditions of licenses as deemed appropriate. It also allows local Malaysian banks to work with other banks outside Malaysia in order to strengthen local banks to provide better services. Again, it provides for the reasons leading to the revocation of a license and how Islamic banks are bound to follow the advice given by *Shariah* Advisors Council (Act, 1983).

Other issues covered in this Act are such as financial requirements to be fulfilled by Islamic banks and Islamic financial institutions as well as the vital aspects of ownership, control and management of Islamic banks and Islamic financial institutions. Again, the Act provides for restrictions in providing Islamic banking activities, how to conduct international Islamic business and powers, supervision and control of Islamic banks, Islamic financial institutions and the entire industry in general.

Takaful Act 1984

The Takaful Act number 312 secured a Royal assent on 24th December, 1984 and published in the government gazette on 31st December, 1984 of the same year. Among other things, the Act was enacted to regulate Islamic insurance business in Malaysia and other related or connected with it. This Act came into force in 1st January, 1985.

Briefly, the Act explains how Islamic insurance business can be conducted. Sections 4 to 40 cover issues of requirements of carrying out a Takaful business, registration of Takaful

operators, how to maintain Takaful funds, qualifications of agents, brokers, and adjusters, to mention a few. Moreover, the Act provides for the requirements to provide International Takaful business and put forward how a Malaysian company can be registered as an international Takaful operators. The act also provides for the required capital funds as well as the powers of the minister to modify issues related to international Takaful operation.

Additionally, the Act put forward how returns, investigation, winding up and transfer of business can be made. Other issues covered by the Act are such as exemption, secrecy, penalty, application of laws, regulations and powers to issue guidelines on Takaful operations.

Banking and Financial Institutions Act 1989

This Act secured a Royal Assent on 23rd of August, 1989 and published in the government gazette on 24th of August, 1989 and came into force on 1st of October of the same year. The Act among other things provides for new provisions on licensing and regulations of banking sector and other related activities. Either, this Act was not providing new regulations on Islamic banking activities but rather recognizing the existence of Islamic banks, Islamic financial institutions and the general conduct of Islamic banking business as put forward by the Islamic Banking Act, 1983. The same recognition of Islamic banks, Islamic financial institutions and Islamic banking business in general has also been made by the Development Financial Institutions Act, 2002 of Malaysia.

Central Bank of Malaysia Act, 2009

In 2009, the Malaysian government enacted another law which enlarged further activities of Islamic banking industry by providing additional sections in order to better the then financial environment. The Act among other things came up with the following provisions;

Section 27 of the Act specifies that Malaysia is a country which runs a Dual Financial System where Islamic banking system and Conventional Banking system run simultaneously. Again, Section 51 of the same Act establishes the National *Shariah* Advisory Council on Islamic Finance which is dully bound to provide expert opinion on Islamic finance issues in the country. This council is considered to be the highest board in terms of giving advice on all matters related to Islamic finance in Malaysia.

Either, Section 55 of this Act requires all banks and Islamic financial institutions to consult *Shariah* Advisory Council for any matter related to Islamic finance while section 56 of the Act requires courts of laws to consult this council for advice when dealing with Islamic finance cases. Again, section 58 clearly declares that the advice given by the council shall always prevail.

Islamic Financial Services Act 2013

This Act came into force on 30th June, 2013 and among other things repealed the Takaful Act of 1984 as well as Islamic banking Act of 1983. The Act laid down proper and effective ways of running Islamic banking activities in the country by creating efficient regulatory framework and imposing duties to Islamic financial institutions in total compliance of *Shariah*. The Act has wider parameters of regulation as it regulates all Islamic banks, financial institutions and Islamic insurance operators. Again, it also regulates operators of payment systems, issuers of Islamic payment instruments and Islamic insurance brokers. It also regulates Islamic financial advisors as well as all conventional institutions offering Islamic banking activities.

State of Affairs of Islamic Banks in Malaysia

Malaysia has experienced more than four stages of developments towards its great achievements in Islamic banking sector. The first stage is that of the operation of *Tabung Haji* as described above from 1963, 1969 up to 1983. The second stage is when the government enacted Islamic Banking Act, 1983 specifically covering Islamic banking activities. In this period (1983-1992), only one full fledged Islamic bank; Bank Islam Malaysia Berhad was allowed to operate and no conventional bank was licensed to offer Islamic banking products and services. From 1993 to 2003, Malaysia entered its third stage of operation of Islamic banking industry by allowing other conventional banks to offer Islamic banking products and services and the fourth stage is when the government allowed other international players to invest in Islamic banking industry in Malaysia from the year 2004 (Mokhtar, Abdullah, & Al-Habshi, 2006).

Study reveals that up to June, 2006, Islamic banking industry in Malaysia has accumulated RM 143 Billion as an asset which is equivalent to 12% of the total asset of the whole banking sector while it received the total deposits of RM 107.5 Billion in the same period which is equivalent to 12.8% of the total deposit of the whole deposits of the whole industry. Again, the share of financing of Islamic banks amounts to RM 81.53% of the total banking industry financing (Razak, Mohammed, & Taib, 2008). It has also been discovered that fully fledged Islamic banks work efficiently in Malaysia comparing with Islamic windows operated by conventional banks in the same country. Again, Islamic windows operated by foreign conventional banks found to work more efficiently than Malaysian local Islamic banks and Islamic windows as well (Mokhtar, Abdullah, & Al-Habshi, 2006).

In a study conducted between the year 2007 and 2010 reveals that Malaysia is one among eight countries where 80% of the banking industry was under Islamic banking activities. Other countries under the said study were Bahrain, Jordan, Kuwait, Qatar, Saudi Arabia, Turkey and the UAE. The report further reveals that in the year 2008, Islamic banks in these countries generated higher profit than their counterpart; conventional banks although the profit came down in the following year due to world economic crisis. But again, it was discovered that although the banking sector experienced a heavy hit due to crisis, Islamic

banks “showed stronger resilience” comparing with conventional banks (Hasan & Dridi, 2010).

Findings and Discussion

Based on the above review, it can be concluded that Malaysia had an ample time to prepare herself for the proper operation of Islamic banking products and services. This can be witnessed when it spent the period of twenty years to come up with the specific law on Islamic banking in the year 1983 which followed by the introduction of the first ever Islamic bank in Malaysia. For the situation which can be termed as “safe playing technique”, Malaysia prohibited any other institution to offer Islamic banking activities for the period of ten years from 1983 to 2003. This has been done deliberately in order to have a straight focus in regulating, monitoring and supervising only one institution taking into consideration that the system was new and therefore it needed a careful and close monitoring.

Financial sector being a very important sector in any given country, it was prudent for Malaysia to have a twenty plus years delay in introducing Islamic banking in its existing system (conventional system). Failure to have a close and careful monitoring of a new system would have disrupted the older one. So, one would conclude that the delay was made for the purpose of satisfying that the newly introduced system is viable, successful, effective and efficient. That satisfaction cannot be reached overnight and that is why Islamic banking system was introduced twenty years later since the first non banking institution was established in 1963.

Twenty years period enabled Malaysia to come up with the law on Islamic banking an act which created more rooms for further amendments which allowed other features of Islamic banking products to take pace. Again, the enactment of Islamic Banking Act of 1983 resulted into enactments of other laws which boosted the Islamic financial industry in general. Enactments like Central Bank of Malaysia Act which established the National *Shariah* Advisory Board to deal with all queries on Islamic banking activities and provide an expert opinion on them. This aspect was not covered in Islamic Banking Act but due to its importance, the same was included in the aforesaid enactment in order to curb the situation.

Introduction of Islamic banks in 1983 also resulted into the introduction of Islamic insurance operations in the country. This was made possible because the operation of Islamic banking set an example that it was also possible to run any Islamic financial aspect within the conventional financial system without any difficulties.

Again, following the successful operation of Islamic banking activities which was run by one institution only, the business was extended to other local players who wanted to provide Islamic banking activities. Later on, the business was also extended to international key players who were ready to invest in Islamic banking activities in Malaysia. All these processes needed enough time to allow authorities to make their house in order before inviting other outsiders to step in.

It is also vital to note that in order to make the system operate smoothly, Islamic Financial Services Act (IFSA) 2013, repealed both the Islamic Banking Act and Takaful Act. IFSA came into force forty years after the first enactment of Islamic banking in 1983 after gaining

enough experience, maturity and trust of the system following its effectiveness and efficiency demonstrated for forty years of service. IFSA accommodated banking and insurance matters in one legislation.

Conclusion

Following the above discussion, it can be concluded that twenty years of operation of the *Tabung Haji* in Malaysia resulted into new ways of handling Islamic banking activities. This study suggests that it is possible for any country to introduce Islamic banking system which can work alongside conventional banking system. Changes can be made gradually in order to avoid challenges of a new system. Again, Islamic bank can be used as a means of accommodating and winning the untapped market (in any given society; if any) by introducing a system which is likely to be trusted by the people due to various reasons like religious ideology, trying to experience a new introduced system or any other reason one would have. Again, policy makers can play a very big role in making Islamic banking helpful to society by enacting laws which will suit the operation of Islamic banking business. As we have seen above, for the period of forty years, policy makers were trying to enact new provisions for the purpose of enabling Islamic banking move as smooth as possible. As a result, Malaysia is considered as the Islamic banking hub in the world today.

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