Malaysian Experience in Islamic Banking

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Abstract:
The Islamic banking experience is generally new compared to its western counterpart, which reached the stage of sagging and intellectual and institutional pyramid. It is still at the beginning of life and the stage of growth and violence in the countries where it originated and spread to reach more than 75 countries across the Islamic and Western worlds.
The Malaysian political economy integrates a very singular Islamic dimension, resulting from the State voluntarism, whose social and political springs (nationalism, social cohesion, diplomacy) are noteworthy. An entire segment of the economy "compliant with the Shari'ah" accompanies the rapid growth of capitalism in Malaysia - the first economic power in Southeast Asia after Singapore - on both material and ethical fields. Indeed, its growth has accelerated for over twenty years in concert with Islamic finance, a highly internationalized sector in which Malaysia is the main domestic market and occupies a leading position of expertise worldwide. This article of sociology of development, including a perspective echoing Max Weber inspiration, discusses the political institutionalization of Malaysian Islam to highlight its articulation, in a conservative scheme, with the expansion of capitalistic modernity.
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Introduction:

The spread of Islamic banks within and outside the Islamic world, the demand of Muslim and non-Muslim traders to deal with them, the increasing volume of their investments confirms the credibility of the Islamic economy and the strength of the principles and foundations upon which Islamic legislation is based.

The rapid development witnessed by Islamic banking and its emergence as an alternative to conventional banks, especially in Islamic countries, was not coincidental. It was a necessity to respond to the desire of customers who refuse to deal with usury, as well as their role in achieving economic and social development. Notably the global financial crisis, led to the demand for the adoption of the Islamic banking system by providing a set of requirements, different in different countries and taking into account the prevailing conditions.

The Malaysian experience is one of the pioneering and worthy experiences of the great achievements that could benefit developing countries in general and Arab countries in particular. It has also made tremendous strides in human and economic development and has been able to establish advanced infrastructure as well as diversify its sources of income and mobilize its savings to promote its economy.

Based on the above, the problem of this study crystallizes in the following question:

What factors have helped the development of Islamic banking in Malaysia?

This topic will be addressed through two sections. *The first section* focuses on the emergence of Islamic banks in Malaysia, and *the second section* focuses on Malaysia's experience in the field of Islamic banking.

Section I: Islamic banks in Malaysia

Islamic banking has been very popular over the past 20 years. There are nearly 400 banks offering Islamic banking services with a turnover of approximately 2 trillion $ in 80 countries around the world. Shari'ah financing increased more than 50 % last year to 130 billion $. (*International Shari'ah Research Academy (ISRA*)). No one denies the growth of the assets of Islamic banks and their ability to overcome the financial crisis either because of non-trading in derivatives or due to its keenness to develop fixed assets. (*Muhammad Ridhwan, AB Aziz, 2013*)

1. The concept of Islamic banks

The Islamic Bank is an economic and social financial and banking organization that seeks to attract resources from individuals and institutions. It works to make better use of the performance of various banking services. It works to achieve the right return for the capital owners. It also contributes to social solidarity in the community and is committed to the principles and requirements of Islamic Shari'a. In order to achieve the economic and social development of individuals and institutions, taking into account the conditions of society. (*Wan Sulaiman Bin Wan Yusoff Alfattani, 2008*)

2. The emergence of Islamic banks in Malaysia

Malaysia's Islamic financial system has grown exponentially since its inception in 1963, and with the establishment of the Malaysian Pilgrims Council, the Taobung Haji Fund and the country's first Islamic bank, Bank Islam Malaysia Berhad (BIMB). Since the first Islamic finance legislation in 1983, Islamic industry has continued to this day. In 1963, when Malaysian Muslims began to care about a mechanism to save money for their pilgrimage, they set up an organization called Tabong Hadji. Founded in November 1962, it officially began operation in 1963.

The economist Inko Aziz called for the establishment of a non-interest-based institution to save money from malaysians wishing to perform Hajj and invest in ways that comply with Islamic law and do not include the benefits obtained from traditional banks. This body has achieved an Islamic service system far away on the problems of riba-based banks.

The government's interest in the work of independent Islamic banks began after the success of this model of Islamic savings. This was translated in 1981 with the establishment of a public authority consisting of twenty banking experts to study the possibility of working Islamic banks in Malaysia. The results were positive. Which was actually embodied in 1983 through the issuance of the Islamic Banking Law, which gave full power to the Bank of Negara to supervise and regulate Islamic banks. The first Islamic bank was established under the name "Bank Islam", which was established in accordance with the principles of Islamic Shari'a, under the Malaysian government's strategy to support the Malay Muslims.

In 1993, the Malaysian Bank of Malaysia introduced a dual banking system called the Islamic Banking Scheme (IBS), the Islamic Banking Scheme (IBS). In order to accelerate the spread of Islamic banking products to local customers in the shortest possible time. As a result, traditional banks were allowed to offer Islamic banking products through their existing facilities. 24 conventional banks responded to Islamic banking products and services. (*Rustam Idris, 1994*).

After 1997, the financial crisis and the changing environment of Islamic banking in Malaysia, the Malaysian government established a second Islamic bank in 1999, known as Malaysia Transaction Bank, to accelerate progress in the Islamic banking industry, followed by the financial sector plan introduced in 2001, The Central Bank of Malaysia to close Islamic branches and encourage them to convert to full Islamic banking entities. *(Angelo M. Venardos, 2005*).

In 2006, a program was created to make Malaysia an international Islamic financial center (MIFC). This program provided Malaysia with a platform to expand the reach of Islamic financial services to international markets and to allow financial institutions to expand Islamic financial activities by benefiting from the existence of a comprehensive Islamic financial system and supporting environment. This was further strengthened in 2001 by the development of a second long-term plan for the financial system called "Financial Sector Blueprint" (2011-2020), in the framework of Vision 2020 which is a strategic plan to shape the future direction of the financial system and its main objective is "Internationalization of Islamic Finance"

On the other hand, in 2013, the regulatory and regulatory framework for the Islamic financial industry in Malaysia was strengthened by the adoption of the Islamic Financial Services Law (IFSA). Among the advantages of this law is the imposition of Islamic Shari'a compliance on Islamic financial institutions to ensure that their objectives and activities comply with the principles of Islamic Shari'a as part of the Shari'a governance of the Islamic financial system in Malaysia.

Islamic banking today was able to integrate with the traditional financial system of the Malaysian economy, which once again proved to the world its success and success in adopting a dual system. Islamic banking has played an important role in Malaysia's overall financial industry, so the government is trying to attract non-Muslim clients to Islamic banking. In 2002, it issued the first Islamic Sukuk in the world to attract many investors. Currently, there are 23 banks in Malaysia Islamic local and 9 Islamic foreign banks, as shown in the following table:

Table (1): List of local and foreign Islamic banks in Malaysia

	Banks	Nbs	Property
1	Local Full-Fledged Islamic Banks	2	Local
2	Local Islamic Subsidiary Banks	8	Local
3	Local Development Financial Institutions	4	Local
4	Foreign Islamic Banks	9	Local
5	Kuwait Finance House (Malaysia) Berhad	1	Foreigner
6	Asian Finance Bank Berhad	1	Foreigner
7	Bank of Tokyo Mitsubishi	1	Foreigner
8	Al-Rajhi Bank Berhad	1	Foreigner
9	HSBC Amanah Malaysia Berhad	1	Foreigner
10	OCBC Al-Amin Bank Berhad	1	Foreigner
11	Standard Chartered Saadiq Berhad	1	Foreigner
12	BNP Paribas	1	Foreigner
13	Citibank	1	Foreigner

Source: Shahrizan Adzham Ahmad: Customer Awareness and Satisfaction of Local Islamic Banks, IJIB Report, vol 2, N: 2, 18 Novembre 2017, pp: 22-23.

Here is a sample of Islamic banks operating in Malaysia:

Figure 1: List of Banking Institutions with Islamic Business as at August 2017

Source: Bank Negara Malaysia, August 2017

Section II: Malaysia's experience in the field of Islamic banking

In the last decade, the Islamic finance industry has grown fastest in the global financial system, outpacing traditional banks' growth rates. The transformation of traditional banks into Islamic banking has been transferred to several Arab and Islamic countries and even to Western countries. Malaysia's leading Islamic banking industry, with Islamic banking operating alongside the traditional banking system, making the Malaysian model now one of the most sophisticated Islamic banking systems in the world. (*Shahrul Azman bin Abd Razak, 2014*).

I. How to use Islamic finance in the development of the Malaysian economy:

Islamic finance in Malaysia has gained broad acceptance among the population, regardless of race or religion. Industry estimates that non-Muslims make up more than 50% of the Islamic bank's customer base. Funding from Islamic banks is mainly used to buy cars and real estate, Investment in securities, and during 2015, 18% of the funds obtained from banks were purchased for the purchase of transport vehicles (personal cars mainly, while the share of financing residential property and working capital amounted to 25%.

II. Expand Islamic banking services and tools and establish an Islamic banking market in Malaysia:

This component will be addressed through:

II.1. Expansion of Islamic banking services and tools:

At the beginning of 1992, the Central Bank of Malaysia successfully developed 21 Islamic banking products and services, after successfully introducing two new Islamic banking instruments, Islamic Acceptable Bills and Islamic Credit Reimbursement Facilities. Thus, one of the three elements required to establish an integrated Islamic monetary system is the availability of a wide variety of Islamic financial services and instruments to meet the different needs of both financial institutions and customers. (*Malaysia International Islamic Financial Centre (MIFC*)). The following is a list of those services or products:

Table 2: The most innovative Islamic financial instruments in Malaysia

Service or Product	Islamic Concept
Deposit or guarantee	**1.** For current account
Deposit or guarantee	**2.** Calculation of savings or savings
Speculation	**3.** Public investment account
Speculation	**4.** Calculate your investment
Good loan	**5.** Investment in government investment certificates
Agency or speculation or selling at a future price	**6.** Investment in shares / equity financing
Selling at a forward price	**7.** Housing finance
Sale at a later price or leave and then sell	**8.** Financing the purchase of vehicles
Murabaha	**9.** Working Capital Financing
Speculation or participation	**10.** Financing the project
Selling at a forward price	**11.** Financing the acquisition of assets
Murabaha / sale of debt	**12.** Refinance Islamic Export Credit:
Sell debt	**A)** Before shipment
Murabaha / sale of debt	**B)** After shipment
Sell debt	13. Acceptable Islamic bills of exchange
Agency or Murabaha or participation	**A** / imports / purchases
Guaranty	**B.** For exports / sales
Guaranty	**14.** Letter of credit facilities
Good loan	**15.** Shipping guarantee
Holiday	**16.** Letters of guarantee
Pay	**17.** overdraft facilities
Pay / agency	**18.** Leasing
Good loan	**19.** Guarantee of Islamic bonds
Speculation: The sale of debt	**20.** Commercial paper operations
	21. Charity loans
	22. "Kajamas" bonds for speculation (Starting March 1994)

Source: Malaysia International Islamic Financial Centre (MIFC), Report on: Insights Global Financial Inclusion Islamic Finance Meets the Challenge**,** Malaysia, 2014, pp: 8-9.

A. GIC Investment Certificates:

Bank Islam Malaysia BIM, when it was established and started operations in 1983, was unable to purchase Malaysian government securities (MGS) or Treasury Treasuries (MTB). The bank had to maintain liquid paper so that it could meet the liquidity requirements of the Central Bank of Malaysia. (*Malaysia International Islamic Financial Centre (MIFC*)).

The Islamic Banking Law, with the establishment of Bank Islam Malaysia, coincided with the promulgation of the Government Investment Law of 1983, allowing the government to issue non-interest-bearing certificates, known as Government Investment Certificates (GICs). These certificates were not exclusive to Bank Islam Malaysia but were available to all other institutions in Malaysia's financial and banking system, as well as individuals. The purpose of issuing these certificates is to obtain the government funds to finance their expenditure on development projects. Of course, the return on these certificates is not determined in advance.

In order to determine the yield, the Central Bank of Malaysia considered that it would not be possible to apply the principle of profit and loss sharing directly, as it is difficult to determine the income resulting from the investment of the proceeds from certificates issued and sold. Thus, the central bank attempted to use an indirect formula for sharing profit and loss, which is to link the rate of return on these certificates to the rate of GDP growth. However, the central bank found that this rate does not accurately reflect the return of the invested government capital, as there are many other elements that affect the rate of GDP growth other than government spending. Finally, in response to practical considerations, the Central Bank of Malaysia considered reliance on the principle of good loan. According to this principle, the purchase of an individual or institution as a GIC is considered a good loan to the government, so that it can finance development projects for development projects for the benefit of the nation.

If, in accordance with this principle, individuals are not expected to pay any return on their loans, with the exception of the obligation of the borrowing Government to repay the original value of the loans at the maturity date, the borrowers (the borrowing Government of Malaysia) can give the borrowers a return of gratitude. To give this yield or not, but subject to the absolute desire of the borrowers without any obligation on their part.

In accordance with this principle, a committee was formed comprising representatives of the Prime Minister's Department (Economic Planning Unit), the Religious Affairs Section and representatives of the Ministry of Finance and the Central Bank to indicate to the Government any rate of return that can be determined on these certificates. The yield is declared at the time of maturity in the case of a certificate issued by one year, but if the period exceeds one year, the yield is announced annually after one year from the issuance of such certificates. The government usually issues certificates for one, two or five years. There are certificates issued by the government to deepen and develop the market dealing in these certificates, and to meet the needs of Islamic financial institutions. There are also three and four-year certificates entered in 1992 and 1994, respectively.

If the principle of good loan does not require the borrower to give any return, the malaysian government has announced, over the past years, a satisfactory return of

these certificates ranged between 5.5% and 7.92% on average annually for certificates with maturities of one to five years, Period from 1989-1992.
When the Islamic Bank of Malaysia started its business, the ceiling of the issuance of these certificates was set at about 390 million $. Due to the introduction of the non-interest-bearing banking system (SPTF).
In January 1994, the ceiling was raised to 2 million $ due to increased demand. As of June 30, 1994, the outstanding balance of these certificates was 1.8 million $, of which 63% was held by Bank Islam Malaysia BIM and 37% held by institutions involved in the banking system without interest.

B) Islamic Accepted Bills (IAB):

Islamic accepted bills (IBA) or Islamic Bankers Acceptances (IBA) were introduced in 1991 on the basis of the principles of "speculation" and "sale of debt". These IABs are used for two types of financing. The first is the financing of local imports and purchases according to the principle of speculation. The first method is to create a debt, which is then represented in a securitized instrument that takes the form of a bank draft drawn from the customer. If the bank decides to sell the bill to a third person, it is based on the principle of "selling the debt" where the bill can be sold for less than the price, ie with a discount on the value of At-marked-down price. The second type of financing is financing transactions for exports and local sales.
These exchanges are traded in the Islamic interbank market (IIM) based on the principle of "sale of debt". In this regard, the Central Bank of Malaysia issued special improvements to these "acceptances", including the status of goods prohibited from circulation.

C) Cagamas bonds for speculation:

The Cagamas Mudarabah Bonds CMB, which began in March 1994, converts Islamic housingdbs into Securitised securities or securities on an Islamic basis. According to this idea, Cagamas or the Nationa Mortage Corporation is buying Islamic housing debt, and is in the process of issuing a bond known as the CAGAM, to finance the debt purchase. The purchase is based on the principle of selling debt, while the bonds are issued in accordance with the principle of speculation or profit sharing, where Cagamas shares with the bondholders the profits achieved according to a specific percentage. These profits are generated from Cagamas' purchases of Islamic housing debt and reinvestment of its funds. The bonds will enable Islamic banking institutions offering Islamic finance facilities for housing to obtain a continued refinancing facility from Cagamas, enabling them to offer Islamic finance services to households as affordable and affordable.

II.2. Establishing an Islamic banking market in Malaysia:

An integrated Islamic (or conventional) monetary system requires three basic elements:
- Availability of a large number of banking institutions, ensuring a minimum depth and breadth of the operation of the system efficiently. Which is virtually nonexistent in all the countries where Islamic banking institutions were established, to the extent that it is limited to the mere existence of a single institution operating in accordance with Islamic law?
- The availability of a wide range of Islamic banking services and products, which can be carried out and traded by Islamic banking institutions among them at home

or abroad, or between them and between conventional banks, and between them and the central banks. The availability of these services and products is essential to enable these institutions to experience the remarkable development of banking products globally and to respond to the needs of their committed clients who are committed to dealing with Islamic banking institutions and to stand on par with traditional banking institutions.

- The existence of an Islamic market for transactions between banks, in the sense of an efficient and efficient market linking Islamic banking institutions on the one hand, and the circulation of Islamic banking tools and products to cover the needs of these institutions, in case of deficit or in the case of surplus, on the other hand.

An Islamic cash market was established in the Malaysian financial and banking system as of January 3, 1994. This market covers the following areas:

• Trading among Islamic banks in Islamic financial instruments.
• Inter-bank Islamic investments.
• Islamic system for clearing checks between banks.

It should be noted that this Malaysian Islamic Monetary Market, which began its activities on 3 January 1994, is considered the first Islamic cash market of its kind in our modern world.

Table 3: Islamic Banking Statistics

	2005	**06**	**07**	**08**	**09**	**2010**	**11**	**12**	**13**	**14**	**15**	**2016**
Number of Institutions	43	42	47	54	54	55	56	56	55	54	54	54
Commercial Bank	27	22	22	22	22	23	25	27	27	27	27	27
Merchant/Investment Bank	10	10	14	15	15	15	15	13	12	11	11	11
Islamic Bank	6	10	11	17	17	17	16	16	16	16	16	16

Source: Bank Negara Malaysia, 2017 (http://www.bnm.gov.my/index.php?ch=statistic)

1. Trading Islamic Financial Instruments

BIM Malaysia and BIM's financial institutions are allowed to trade Islamic financial instruments (such as government investment certificates, Islamic banking acceptances, etc.) among themselves.

2. Islamic investments among banks

Islamic inter-bank Islamic investment means that any bank of the interest-free banking system can invest surplus funds in another bank of the system that has a deficit on the basis of speculation (participation in profit). The characteristics of this mechanism are as follows:

a- The investment period ranges from one to twelve months.

b- The minimum investment amount is 50000 Malaysian Ringgit (MR) (19.5 thousand US $).

c - The rate of participation in profit depends on the period of investment, as follows:

For periods of less than or equal to one month, the participation rate in profit shall be 70: 30 (70% for the owner of the capital).

For periods of more than one to three months, the participation rate in the profit shall be 80: 20.

For periods of more than three months, the profit participation rate is 90: 10.

III. Islamic system of clearing checks between banks:

The Central Bank of Malaysia introduced a new clearing system for Bank Islam Malaysia (BIM) and commercial banking units in the Interest-Free Banking System, known as the Day1 Islamic Interbank Cheque Clearing System (IICCS) The checks for these institutions have been separated from conventional checks for clearing purposes, based on the principles of "deposit", "agency" and "mudaraba." Joint institutions are obliged to open clearing accounts in the Central Bank in accordance with the deposit principle, Where the Central Bank guarantees the balances of this sense and shall have full freedom to invest in the investments that he sees, provided that they comply with the provisions of the Islamic Shari'a. This is followed by the obligation of the joint institutions to agree that the Central Bank shall act as agent for the distribution and settlement of the financial centers of the surplus banks and joint deficit banks In the middle of the night, during the process of clearing checks automatically at the Central Bank of Malaysia, the system banks (including Bank Islam Malaysia Berhad) are financed by surplus funds from other banks in the system on the basis of the principle Speculation. If the deficit continues after this financing process, the Malaysian Central Bank will finance it on a principle basis, speculation. The profit rate for this mechanism is 30:70 (70% for the investor), and the payment is made the following morning. (*Thomson Reuters Islamic Finance report, 2015*).

IV. Evaluation of Islamic banking experience in Malaysia:

Although it is too early to assess Malaysia's new system of interest-free banking and the establishment of the first inter-bank Islamic money market, it is necessary to address some of the aspects reflected in this pioneering development in Islamic banking.

In principle, only nine months after the introduction of the new system on March 4, 1993, the total deposits and deposits with Bank Islam Malaysia in Berhad and the institutions of the system at the end of December 1993 amounted to about 2.5 million Malaysian ringgit (698 million $) (701 million $) at Bank Islam Malaysia in Berhad and 249 million $ (97 million) for the rest of the system. As of December 31, 1993, the number of account holders reached 522087, including 476,630 account holders at Bank Islam Malaysia Berhad and 4,487 account holders at the rest of the system. The number of branches of financial institutions offering Islamic banking services reached 630 branches by 31 December 1993, of which 52 were branches of Bank Islam Malaysia in Berhad while the total number of other financial institutions of the system was 578 branches. (*Bank Negara Malaysia (center bank), 1994*)

Malaysia's experience in the field of Islamic banking can be assessed through the following points:

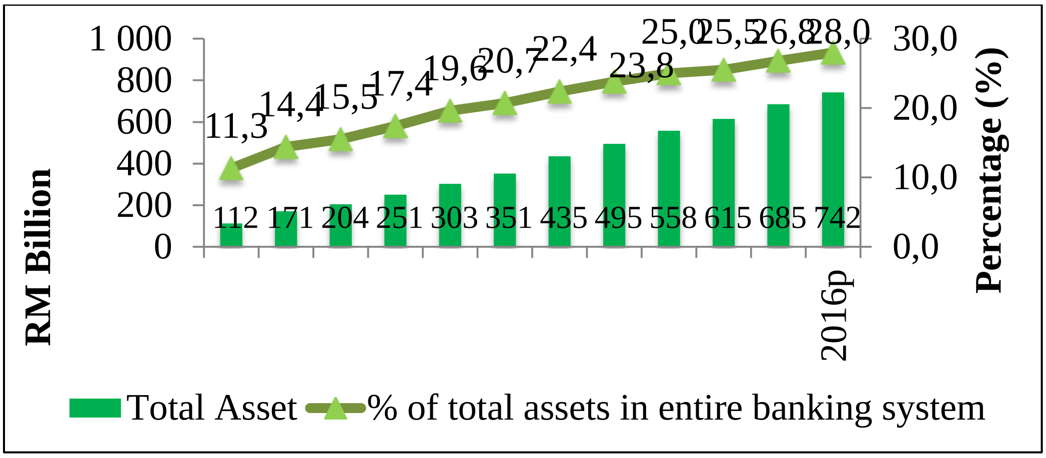
- **Leading the establishment of the first Islamic cash market:**

Malaysia is credited with leading the establishment of the first Islamic cash market and the establishment of the first Islamic system of transactions between banks after the implementation of the planned gradual completion of the necessary elements.

- **Banking Practice in Islamic Banking:**

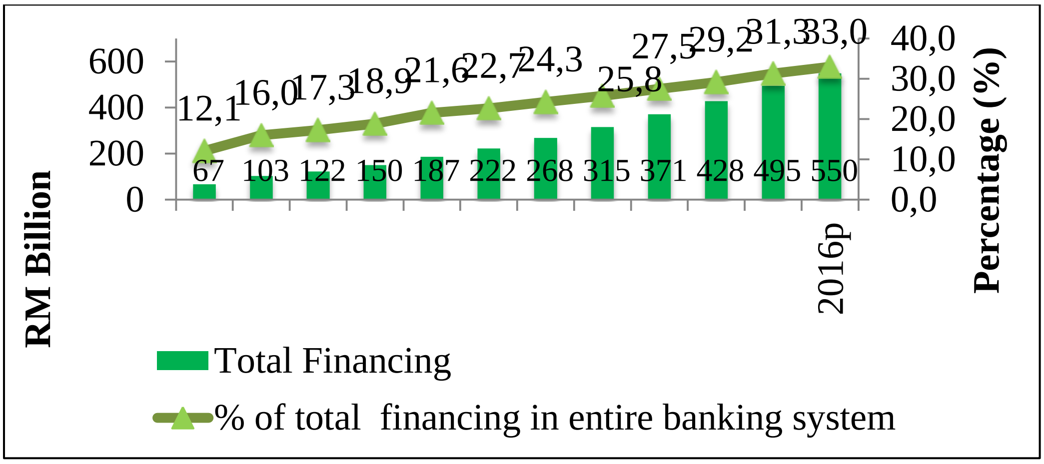
The Malaysian experience also demonstrates the need to deal with the issue of Islamic banking as a matter of legitimacy and banking at the same time, not as a political issue similar to what happened in Pakistan, Iran and Sudan. In addition to the legal aspect, we find that the banking thought was the ruler of all the steps of the regulatory process of Islamic banking in Malaysia.

Figure 2: Islamic Banking Statistics – Asset



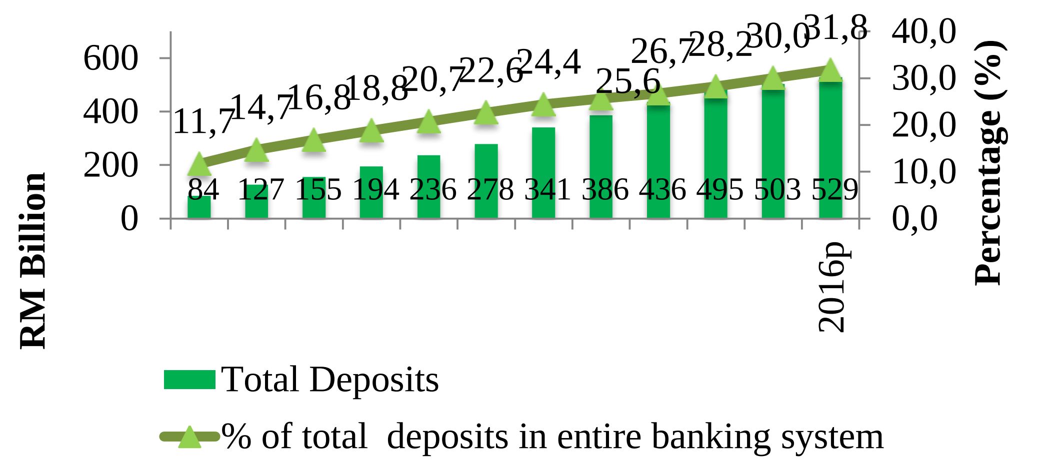
Source: Bank Negara Malaysia

Figure 3: Islamic Banking Statistics – Financing



Source: Bank Negara Malaysia

Figure 4: Islamic Banking Statistics – Deposits



Source: Bank Negara Malaysia

- **The role of the State in supporting Islamic banking:**

The experience of Islamic banking in Malaysia demonstrates the remarkable role played by countries. Malaysia is a country that relies on market forces and mechanisms to guide its economy. The private sector is the main driver of the development process, with more than two thirds of investments, attracting large and growing amounts of foreign investment. However, as the experience of Islamic banking has shown, the state also plays a major role in economic direction in general and in governance without interference.

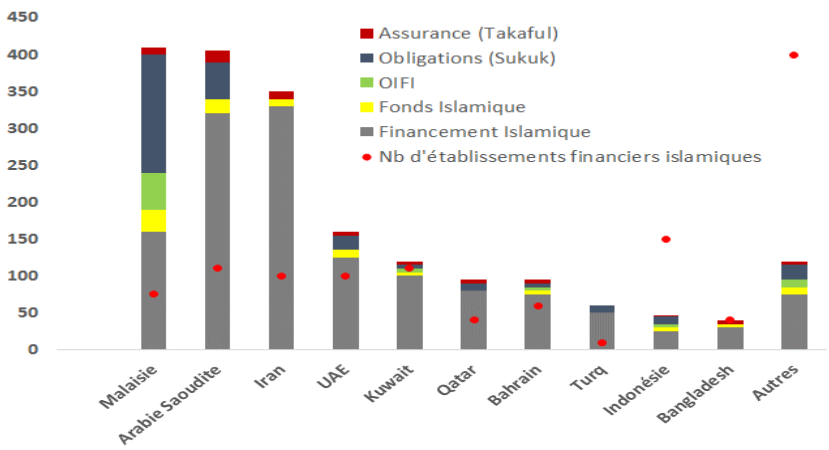
- **Compatibility with the social nature and demographics of Malaysia:**

The Malaysian experience is also consistent with the special nature of the country of Malaysia, where multiple religions, cultures and nationalities. Although Malaysia was the first country to establish an Islamic banking institution (a non-profit savings fund in 1940), it was relatively late in establishing the first Islamic bank in 1983, and continues to be the only Islamic bank to decide to adopt a system that allows all banking institutions Which offers Islamic banking services and products through its Islamic branches and branches throughout the country. Each branch can meet the needs of all customers in its region.

- More than 20% of global Islamic financial assets are managed in Malaysia:

Kuala Lumpur (capital of Malaysia) is the world's leading exporter of Islamic bonds (sukuk) and a major player in Islamic finance and insurance (Takaful). (*Department of Statistics Malaysia*). (415 billion $, 23%) ahead of Saudi Arabia (412 billion $, 22.9%) and Iran (345 billion $) in a global Islamic financial market of $ 1.800 billion at the end of 2015. 19.1%), owns more than 55% of the Islamic bond market ($ 167 billion) and a large share (13%) of Islamic finance (174 billion $) and Islamic insurance (25%, 8%, 2 billion $). (*Shahrizan Adzham Ahmad, 2017*). The following figure is a diagram showing Islamic financial assets in the world (top 10 countries):

Figure 5: Islamic financial assets in the world (top 10 countries)



Source: Thomson Reuters Islamic Finance report 2015, p: 56.

Conclusion:

As one of the seven tigers who made up with Japan, the so-called Asian miracle, with its high growth rates, has succeeded in low inflation rates, increased justice in income distribution, and the recording of all social indicators with high positive rates in transforming the world's eyes from a region Gulf to Southeast Asia. With regard to Islamic banking, Malaysia has achieved a significant transitional step by allowing all financial and banking institutions to offer Islamic banking services and products in accordance with the system of "interest free banking" with the development of a large number of Islamic banking tools and products, as well as completing the necessary elements for the establishment of a monetary system In parallel with the traditional interest-based banking system. Despite the recent experience, but it has registered many positive elements in terms of its leadership in the establishment of the first Islamic money market, whose absence is a major obstacle to the start of Islamic banking in the vast majority of countries that have Islamic banking and financial institutions. However, the question remains about the possibility of generalizing the Malaysian experience to other countries despite the existence of doctrinal differences on the foundations of the Islamic banking business there, a question that can be highlighted in future studies.

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