

Pioneering Efforts in Islamic Banking

By Fakhiah Azahari

Rarely has a speaker been so forthright about his opinions on the latest developments in Islamic finance in Malaysia as Dr Abbas Mirakhor, a former International Monetary Fund executive director. At a recent talk on “Strengthening the Islamic Financial System: Lessons From the Crisis” organised by the Securities Commission, he observed that interests in Islamic banking and finance in Malaysia has waned over the last five years or so.

Dr Mirakhor said that this was rather unfortunate considering that Malaysia has been at the forefront of Islamic banking since the establishment of the first Islamic Bank way back in 1983. As a result of this malaise, he said the industry has been suffering from a dearth of good products and innovation; and may consequently diminish in importance.

This situation is being constantly examined in many local Islamic finance conferences, where practitioners are questioning the direction the industry is heading. Also of concern is whether Islamic finance may gradually cease to be relevant in the local and international financial systems. To answer part of this question, we need to understand how Islamic finance first found its way in Malaysia and the progress that were made in the last 30 years or so.

Malaysia was the main driver for drawing up the framework for the setting up of the Islamic Development Bank in the world. Our history spans over a period of over forty five years from a lone bank engaged in mainly retail housing financing into an industry of international repute, dealing in international trade, corporate finances and capital markets.

Although the country’s Islamic bank (Bank Islam Malaysia) in Malaysia was set up in 1983, the roots of Islamic Banking in Malaysia began much earlier, even preceding the Islamic Development Bank in Jeddah. In 1963, the Pilgrims Fund or Lembaga Tabung Haji was established for the purpose of providing savings accounts to pilgrims to cover the costs for haj or pilgrimage to Makkah. These funds were then channelled towards investments in productive sectors which enabled Lembaga Tagung Haji to give good returns to its depositors in line with Shariah principles.

The initiatives for the setting up of the first Islamic Development Bank began at a meeting held in Cairo in 1972 organised by the Conference of Foreign Ministers of Muslim countries. The Islamic Secretariat advised that the Commission should establish what was termed as a “Development Bank” to be headed by the Malaysian team under the late Tunku Abdul Rahman Putra and Malaysian experts were sought to draw the legal framework for the Islamic Development Bank. After a year of preparatory work by the Malaysian team, the first Islamic Development Bank came into being in 1974.

As such, the Malaysian team were responsible for setting the foundations of Islamic banking of which the global Islamic banking industry acknowledges. Their efforts have been documented for perpetuity in the report written for publication by the Islamic Development Bank in 1989 outlining in detail the early progress of the preparatory team. Until today, this framework remains a source of reference and a working model for Islamic banking and financial institutions of international jurisdiction.

Subsequently, a national steering committee headed by Raja Tan Sri Mohar bin Raja Badiozaman wrote a letter to the then Prime Minister dated 1 July 1982 with a conclusive study and recommendation for the set up of the first Islamic Bank in Malaysia.

Bank Islam Malaysia is the first Islamic bank in the world to operate under the purview of its own legislation, the Islamic Banking Act 1983. In other Muslim countries, banking businesses operates under conventional framework with no specific banking laws to govern its operations until recently. The Act further empowers the Shariah Advisory Council of the Central Bank to issue fatwas which are binding and enforceable whilst in other jurisdiction, the laws and regulations including fatwas pertaining to Islamic banking operations and activities are of moral persuasion.

Dr Mirakhor reminds us that it is due to this legal framework and support from the Central Bank and government agencies that the Islamic banking industry in Malaysia saw tremendous progress and was considered an industry leader. However, according to him, dissenting views and heavy criticism from practitioners of Islamic banks within a conventional system of other jurisdictions began to influence the local Islamic banking industry.

In the initial years of Islamic banking, cases heard in the Courts were in support of Islamic banking which provided a high level of confidence within the industry towards Islamic banking and the guarantee of legal redress for parties concerned. This environ prompted the entry of many participants into the market, both domestic and international. The presence of foreign participants brought new ideas, mainly in the form of Shariah opinions from various countries adhering to specific Schools of thoughts. Many of the Scholars in Islamic banking were not in agreement with some issues in Islamic banking in Malaysia and their ideas found their ways into the minds of various sectors in the industry including the judiciary. Another prominent Shariah Scholar in finance, Dr Monzer Khaf once remarked that “*there are as many people claiming to be phd holders as there are people claiming to be Shariah Scholars*”. Dr Monzer Khaf in making this remark, did not at all meant for it to be a derogatory statement towards Shariah Scholars. In fact he was trying to illustrate an important point; some Scholars may be Islamic economic jurists without Shariah background and some Scholars may be Shariah jurists without economic background. Unfortunately, in accepting many of the opinions of these jurists, we have not distinguished between the economic jurists and Shariah jurists. We are then left with incomplete fatwas on many issues on Islamic banking which we have been guilty of accepting without due consideration.

Dr Mirakhor also commented on the role of Shariah advisors in advancing the Islamic banking and finance industry. He appeals for Shariah advisors not to purely concentrate on the rules and regulations of Islamic finance. Rules and regulations as applied by most Shariah advisors in his view, are either black or white, without shades of grey in between. This perspective according to Dr Mirakhor will hinder the growth of Islamic finance unless the Shariah advisors start to delve deeper into the philosophy of the rules and regulations and explain fully in written publications their rationale for their rulings. It is not sufficient that certain rules are pronounced as either halal or haram with no rationale and authorities from Shariah sources to support the ruling.

One impact that the views of Shariah scholars from other schools of thoughts have on the local scene that this author wish to share is with regards to the development of Bai Bithamin Ajil financial product (BBA). Following the criticism by these Scholars against BBA and recent rulings on BBA cases, industry practitioners have been persuaded that BBA is not in line with Shariah principles and have introduced the Musyarakah Mutanaqisah to replace the BBA. Musyarakah Mutanaqisah was first introduced to Malaysian bankers in 1995 by a group of academic researchers who were experts in economics but not necessarily with Shariah qualification. Over the years, Musyarakah was touted as a better alternative to BBA and have been implemented by some banking and financial institutions. The perspective that we should take with regards to Musyarakah that this author wish to proffer, is not whether Musyarakah is a more Shariah compliant instrument in comparison to BBA, but whether Musyarakah is a more suitable product for a long term facility for purchase of real asset.

How do we move forward to the next phase of development and claim back our leadership in this industry? As history proves, we have been responsible for the seeds and growth of Islamic banking worldwide and have shown that a harmonisation of conventional and Islamic banking system is possible. Let us look to the work and compilation done by our pioneering team and share our experiences with the younger industry; instead of being dominated by their ideas, views and perspectives; its time to steer the industry to the right direction.