

# ISLAMIC BANKING IN MALAYSIA: UNCHARTERED WATERS

Source: Abdul Kareem, M. A. & Rosly, S. A. (2011). Islamic banking in Malaysia: uncharted waters. *Asian Economic Policy Review*, 6 (2), pp. 301-319.

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## INTRODUCTION

Islamic banking is not confined to full-blown Islamic banks only, as conventional banks also offer Islamic financial products through Islamic windows.

The history of Islamic banking began with the establishment of Bank Islam Malaysia Berhad (BIMB) in July 1983.

The government of Malaysia has given strong support to the Islamic banking industry.

Islam prohibits interest (*riba*) but permits trade (*al-bay*). The basic principle of *al-bay* is business risk taking.

This paper examines the cost of operating Islamic banks within an environment immersed in interest.

## ISLAMIC BANKING IN MALAYSIA

Islamic banks in Malaysia comprise:

- 1 Five full-fledged local and foreign Islamic banks
- 2 Eight Islamic subsidiary banks
- 3 Islamic windows in foreign conventional banks
- 4 International Islamic banks

## THE SHARI'AH FRAMEWORK



Islamic banking operations are largely driven by the Shari'ah (Islamic jurisprudence) which defines the nature and character of the deposits and financing system.



In the financial system of Islam, rules are set by God as revealed in the Holy Qur'an and the Prophetic Traditions (Ariff, 1988b).

## DIFFERENCES BETWEEN ISLAMIC BANKS AND CONVENTIONAL BANKS

### Conventional BANK



- 1 Customer deposits represent "**loans**" to the bank.
- 2 Earn **interests** from borrowers and pay interests to depositors.

### Islamic BANK



- 1 Customer deposits are treated as "**investments**".
- 2 Earn **profits** from asset-based financing activities and share these profits with depositors in the form of dividends.

## RISKS FACED BY ISLAMIC BANKS



CREDIT RISK



MARKET RISK



LIQUIDITY RISK



SHARI'AH COMPLIANCE RISK

## THE WAY FORWARD

There is certainly a need to devise modern financial instruments that will conform fully to the Shari'ah.

Care must be taken to ensure that *riba* (interest) is not admitted unwittingly through the backdoor in the name of financial innovation.

Islamic finance is not just about sharing of profits and risks. The spirit of Islamic finance demands that it reach out to the masses in a caring manner.