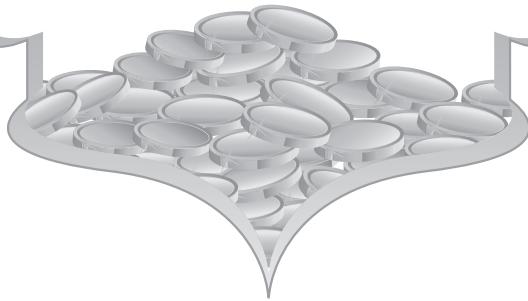


# **ISLAMIC BANKING AND FINANCE IN MALAYSIA: SYSTEM, ISSUES AND CHALLENGES**

**MUHAMMAD RIDHWAN AB. AZIZ**



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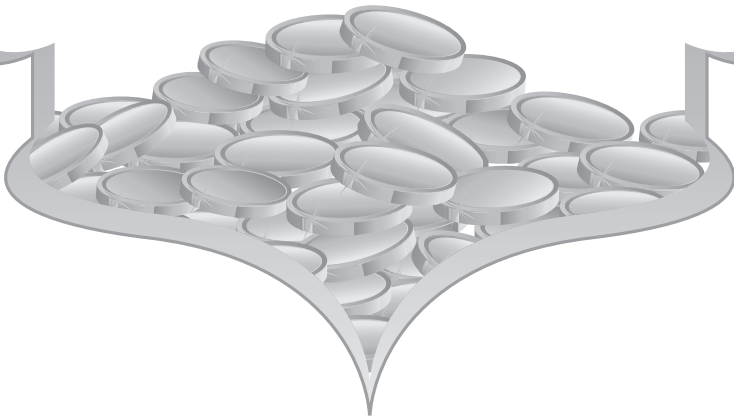






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USIM Publisher  
Universiti Sains Islam Malaysia  
Bandar Baru Nilai  
Negeri Sembilan  
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## PREFACE

Praise and glory be to Allah (SWT), the Most Gracious and Most Merciful. Bless and prayer be upon His Messenger Prophet Muhammad (SAW). I consider this book as my small and humble contribution to the Muslim *ummah*. It is very true that I was only able to complete this book by the blessing of Allah (SWT).

Thus, I would like to express my thorough and sincere gratefulness to Allah Almighty, who has given me the opportunity to write and complete this small book relating to Islamic banking and finance in Malaysia.

I also wish to extend my appreciation to friends and family for their encouragement, patience and moral support. To my wife- Azizah, my daughter- Madihah, and my son- Alif Arshad, who have motivated me in writing this book. Also, to my mother- Fauziah and my father- Prof. Dr. Ab. Aziz, to whom I owe much.

Special thanks to all my ex-students at International Islamic University College Selangor who have contributed many important points for the preparation of this book. They deserve huge credit because they are the ones who have inspired me to write this book. May Allah (SWT) accept this humble effort, honor it with His pleasure and make it beneficial for the readers.

Muhammad Ridhwan Ab. Aziz,  
Faculty of Economics and Muamalat,  
Universiti Sains Islam Malaysia (USIM),  
71800, Bandar Baru Nilai, Nilai,  
Negeri Sembilan.





# INTRODUCTION

Islam is a comprehensive way of life, which strikes the balance between the spiritual and the material needs of human being. One of the very important aspects in human life is the need for a comprehensive system in order to govern their life including the material needs in the financial matters. The emergence of Islamic banking and finance is often related to the revival of Islam and desire of Muslims to live all aspects of their live in accordance with the teachings of Islam.

Indeed, Islamic banking and finance is one of the components in Islamic financial sector that plays very vital role to generate the growth of economic, besides Islamic money market, capital market and *takaful* especially for Malaysian economy. On the other hand, Islamic banks can generate in *halal* activities, promote profit lost sharing, quest for justice, ethical and sanctify contract. Hence, Islamic bank is expected to run according to *Shariah* principles, mobilizing and utilizing the financial resources for the sake of Muslim *ummah*.

In addition, the Islamic banking system in Malaysia seems to prefer a sale-based mode of financing over other modes of financing. This might be due to the fact that the sale-based mode of financing can contractually guarantee a fixed flow of income to the financiers and investors as compared to other modes of financing. The main objective of the offering of these types of products and services in Islamic banking and financial institutions is to eliminate the element of *riba* (interest), which is clearly forbidden in *Shariah*.

A humble effort has been made through the publication of this book in order to explore the system, issues and challenges for Islamic banking and financial institutions as the sole alternative for Muslim society in practicing permissible *muamalat* transactions in the banking and financial sectors.

Although the Islamic banking and financial institutions have been introduced since 1983 in Malaysia, by the formation of Bank Islam Malaysia Berhad, still Islamic banking and financial institutions have been associated with numerous negative conceptions. Also, Muslim community still cannot understand the actual concept of Islamic

banking and financial institutions and some of them regarded these institutions merely an imitation of conventional financial institutions. Badly, some of them considered these two Islamic financial institutions are oppressed and not practicing true Islamic principles.

This book entitled “*Islamic Banking and Finance in Malaysia: System, Issues and Challenges*” gives a new dimension for Muslim *ummah* in Malaysia to be involved intensively in Islamic banking and financial institutions without worrying about the misconception accused by certain parties, so that they are able to transact with peace and according to the approved *Shariah* rules.

Through this book, the author has tried to answer many questions regarding Islamic banking and financial institutions: Are Islamic banking and financial institutions similar to conventional financial institutions? How can the Muslim society participate extensively for the success of Islamic banking and financial institutions in Malaysia? Do Islamic banking and financial institutions provide better alternative for Muslims to manage their financial needs? Do these Islamic banking and financial institutions operate comprehensively according to the *Shariah* principles and philosophies?

Furthermore, this book tries to provide fundamental knowledge and understanding on Islamic banking and financial institutions in order to remove any misunderstanding and explore current and future issues and challenges to the industry. In this book, eight most important topics related to Islamic banking and finance in Malaysia have been introduced to the reader. Hopefully, the publication of this book may provide a true picture of the Islamic banking and finance in Malaysia, allowing its practical application by all.



## CHAPTER ONE

# ISLAMIC BANKING SYSTEM

### **Introduction**

Islamic banking system refers to a system of banking or banking activity that is consistent with the principles of Islamic law (*Shariah*) and it is governed by the law of God. In this current global economic environment of extraordinary challenges and uncertainties, Islamic banking and finance is becoming very much a part of the journey to bring the world towards a new level of stability, prosperity and international integration.

Since the 1970s, Islamic banking has emerged as a new reality in the international financial scene. Its philosophies and principles are however, not new, having been outlined in the Holy Qur'an and the *Sunnah* of Prophet Muhammad (SAW) more than 1,400 years ago. The emergence of Islamic banking is often related to the revival of Islam and the desire of Muslims to live all aspects of their life in accordance with the teachings of Islam.

In Malaysia, separate Islamic legislation and banking regulations exist side-by-side with those of the conventional banking system. The legal basis and act for the establishment of Islamic banks was the Islamic Banking Act (IBA) which came into effect on 7<sup>th</sup> April 1983. The IBA provides Bank Negara Malaysia (BNM) with powers to supervise and regulate Islamic banks, similar to the case of other licensed banks. The Government Investment Act 1983 was also enacted at the same time to empower the Government of Malaysia to issue Government Investment Issue (GII), which are government securities based on *Shariah* principles.

Thus, this chapter will explain the norms of Islamic banking system as one of the integral part of Islamic finance in the light of the *Quran*, *Sunnah* and *Muamalah* (Islamic Commercial law), and how these principles are regarded as the best alternative for Muslim society in particular and all mankind in general. This chapter will be divided into three topics namely overview of Islamic banking, Islamic banking system as well as Islamic banking and economic development.

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## ISLAMIC BANKING AND FINANCE IN MALAYSIA: SYSTEM, ISSUES AND CHALLENGES

*Islamic Banking and Finance in Malaysia: System, Issues and Challenges* provides a foundation on topics of Islamic banking and finance in Malaysia. The book includes a range of topics such as Islamic banking system, *Shariah* law and *Shariah* review, Islamic legal maxims and *Maqasid al-Shariah*, *riba* and time value of money, *takaful*, *muamalat* contracts in Islamic banking and finance, products of Islamic banking and finance as well as current issues and future challenges for Islamic banking and finance. This book tries to introduce the basic concepts and understanding with respect of Islamic banking and finance in Malaysia that able to solve many unresolved issues for Muslim *ummah* such as the misconception of Muslim society in this country towards the aim and operations of this Islamic institution. This book is suitable for college and university students, academician, practitioner and the general public who are interested in obtaining basic concepts pertaining to Islamic banking and finance in Malaysia.



**DR. MUHAMMAD RIDHWAN AB. AZIZ**

He is a Senior Lecturer and also Head of Program, Bachelor of Muamalat Administration (Hons) at Faculty of Economics and Muamalat, Universiti Sains Islam Malaysia (USIM). He received his first degree in Bachelor of Business Administration (Hons.) from University of Malaya in 2001 and possessed Master in Islamic Studies specialization in Islamic Banking in 2008. In 2011, he has been awarded doctoral degree in Islamic Banking, also from University of Malaya. His area of expertise is in the field of Islamic banking and finance, Islamic commercial law as well as in Islamic financial institutions. Until now, he

has published several books namely *Agriculture in Islam: From the Perspective of Economics, Banking & Finance* (UTM Press Publisher) and *Introduction to Islamic Institutions in Economics and Finance* (USIM Publisher). He has also presented and published papers in various national and international conferences and journals.



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