HISTORY OF ISLAMIC BANKING IN MALAYSIA: A GENERAL REVIEW

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Abstract
This study aims to review in general the historical development of Islamic banking in Malaysia. It examines the development of Islamic banking products and services along with the issues, challenges, and prospects of Islamic banking in Malaysia. The research approach is qualitative, and data were collected from various sources such as government and corporate documents, articles, Islamic banking websites and books related to the history of Islamic banking. The study shows that Malaysia is among the best places in the world to practice Islamic banking along with universities and institutions developing knowledge in Islamic finance. The Islamic banking system in Malaysia has been developed gradually and succeeded in line with countries like Bahrain, UAE, Saudi Arabia, Qatar, the United Kingdom, and Pakistan. The study further revealed that Malaysia is currently the leader in developing financial technology for Islamic banking and finance. It was concluded that Islamic finance has come a long way toward becoming a profitable and globally competitive alternative to the conventional banking system.

K**eywords**: Islamic Banking, History of Islamic banking, Malaysia, Development, Challenge

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INTRODUCTION

The Islamic banking system in Muslim countries as well as other non-Muslim countries such as Dubai, Malaysia, Saudi Arabia, Indonesia, Nigeria, and the United Kingdom is experiencing rapid growth. Historically, Malaysia was among the countries that pioneered Islamic banking in 1983 and made a steady development through government support (Husseini et al., 2019).

After the global financial crisis, Malaysia opened its centre of Islamic finance and Islamic economy for the growth of Islamic industries. The result shows that Malaysia was the best industrial centre for Islamic finance in the world. Besides, the government has given full support to the operating system. Malaysia has recently had a history of education, contribution, and knowledge development in Islamic financial industries (Safiullah & Shamsuddin, 2018).

This study aims to review the historical background of Islamic banking from the beginning of the era of Islam and the establishment of the Malaysian Institution of Islamic banking until the present time. It examines the success of Islamic banking and finance in Malaysia in developing Islamic banking products and services. It also reviews the issues, challenges, and prospects of Islamic banking in Malaysia.

This paper is arranged as follows: it began with reviewing the literature related to the definition of Islamic banking, the beginning of Islamic banking and finance, and then the development of Islamic banking around the world. The study also discussed the Malaysian history of Islamic banking and finance and the development of Islamic banking services throughout Malaysia. Finally, the issues, challenges, and prospects of Islamic banking in Malaysia.

LITERATURE REVIEW

Definition of Islamic banking

According to Nasser and Sharif (2022), Islamic banking is a system based on the principles of Islamic law guided by Islamic jurisprudence. Islamic banking can refer to a procedure practiced based on the concept of Sharia by Muslim scholars. The main idea behind Islamic banking is that parties involved should share their profits and losses and not charge or give interest (Riba), which is against Islamic Sharia.

The root of Islamic banking and finance

Arabs, since the period of Jahiliya (pre-Islamic period), were practising trades and commercial contracts among themselves. After the emergence of Islam, they left the prohibited business entirely and switched to the businesses permitted in the formal Islamic legal system.

During the prophetic period, Islamic banking began to develop. The Qur'an and hadith reveal the permission for business. Allah the Almighty said in the Noble Qur'an: "Allah has allowed trade and forbidden usury" (Quran, 2:225). Historically, the Prophet, peace be upon him, participated in the Mudarabah contract with his wife Khadija as a joint venture. Mudarabah means partnership contract, and the profit as well as the loss (if any) would be shared between both entrepreneurs. However, it allows for the Muslim ummah to use some alternative business principles, such as Mudarabah and *Bay al-Salam* (Ogunbado et al., 2017). The Prophet was the most trusted and blessed person in mankind. He played a vital role in his society; that is why his people called him *al-Amin* (the truthworthy). However, when Allah ordered him for migrating to Medina, he ordered Ali bin Abi Talib to return the funds entrusted to him to their owners (Haron and Wan Azmi, 2009).

The *Bayt al-Mal* was established during the time of the Prophet after the migration from Mecca to Medina. The Bayt al-Mal was led by Umar ibn al-Khattab, operating from the Prophet's Mosque. However, it was the first Islamic public treasury (As-Sallabi, 2007).

Development of Islamic Banking around the World

Previous literature indicates that the modern practice of Islamic banking and finance began in the mid-1940s in India and Pakistan. By comparison, it has been highlighted by scholars that the first bank was introduced in Malaysia in the mid-1940s. In addition, another study considered the Mit Ghamr Savings Bank in Egypt, which was launched in 1963. The Savings Bank of Egypt was established as a riba-free bank that generates profit through business, and its founder was Ahmad El-Naggar. This bank was based on Islamic Shariah principles and was under the leadership of the Central Bank of Egypt and the National Bank of Egypt in 1967 (Muslimin, 2019).

Moreover, many Islamic financial institutions were introduced worldwide in the 1970s. In 1971, Egypt introduced the Nasser Social Bank under the Islamic Development Bank, and the bank did not operate to make a profit. The Kingdom of Saudi Arabia was established in 1975 in Jeddah to boost the social development and economy of the country. Dubai also offered an Islamic bank in 1975, but Sudan established Faisal Islamic Bank in 1977, Bahrain in 1979, and Malaysia introduced Bank Islam Berhad in 1983. The Islamic banks introduced the banking system according to Shariah principles because Islam prohibited the association of riba (interest) in a financial transaction. Islam commands justice when distributing wealth among the people of society (Hussain, 2010).

METHODOLOGY

The present study aims to review the history of Islamic banking from the beginning of the Prophet era to the modern period. However, the data has been gathered from the library, government and corporate documents, articles, books and banks’ websites and related pieces of literature on the history of Islamic banking practice. The researcher logically applies this method (Creswell & Poth, 2017).

However, the author structured the paper as follows: the study started with a discussion about the beginning of Islamic banking from the root and then the development of Islamic banking around the world. The study ends with a discussion of the history of Malaysian Islamic banking to the present.

Library research helps a researcher to explore a phenomenon step-by-step to apply the information in the article paper. Library research can be used in primary and secondary data and analysed to determine what has got to express the idea (Creswell & Poth, 2017).

RESULTS AND DISCUSSION

Malaysian history of Islamic banking and finance

The Malaysian history of Islamic banking and finance can be traced back to 1963 when the government established Tabung Haji (the Malaysian hajj pilgrims fund board) to assist Muslims in Malaysia. The government offered the administration to encourage people to participate and store money to perform the Hajj in Mecca. However, the Tabung Hajj brought good opportunities and economic activity. The operation was carried out under Islamic law, as there was no practice of usury or any prohibited commercial activity that violated the provisions of Islamic law (Husseini et al., 2019).

The Tabung Hajj continued to help Muslims wishing to perform the Hajj in Saudi Arabia. Several organizations advised the government to open a fully Islamic banking institution during the period. Lots of meetings and conferences were organized in favour of establishing Islamic banking. In 1981, the government finally agreed to establish a national council and authorized 20 professionals in the field to study the concept of how to develop Islamic financial institutions in Malaysia. Moreover, Malaysia is a country with many Muslims, so it was welcomed by the citizens. Therefore, the Malaysian government provides Islamic banking services because it was supported by the citizens (Mokhtar et al., 2008).

In July 1983, Malaysia established the first Islamic bank, Bank Islam Malaysia Berhad, and the capital was 80 million Ringgit. Likewise, Bank Islam Malaysia undertook a similar process of introducing *Shariah*-compliant products. For example, *Qard al-Hasan* (easy loan), *Murabaha* (cost plus), and *Bay bitman ajil* (home financing), among others (Muhammed, 2013).

Development of Islamic Banking around Malaysia

According to Bank Negara Malaysia (2020, February 3), a Malaysian Islamic bank has been overgrowing since December 2007, and the capital assets of Islamic banking have reached 152.93 billion Ringgit. In 2018, Islamic banking assets rose to RM771.81 billion, also from January to the end of December 2019, they rose to RM835.19, with an addition of 8.2%.

Malaysia is now among the major contributors to the growth of Islamic banking services worldwide (Alwi et al., 2019). In Malaysia, four banks are full-fledged Islamic banks, and the rest are a mixed system of Islamic banking and conventional operations (BNM 2019).

Table 1. The list of banks in Malaysia offer Islamic products, full-fledged and mixed system

No.	Name	System
1	Affin Islamic Bank Berhad	Mix
2	Agrobank	Mix
3	Al Rajhi Banking & Investment Corporation (Malaysia) Berhad	Mix
4	Alliance Islamic Bank Berhad	Mix
5	AmBank Islamic Berhad	Mix
6	Bank Islam Malaysia Berhad	Full
7	Bank Muamalat Malaysia Berhad	Full
8	Bank Rakyat	Full
9	CIMB Islamic Bank Berhad	Mix
10	Citibank Malaysia	Mix
11	Co-op Bank Pertama	Mix
12	Hong Leong Islamic Bank Berhad	Mix
13	HSBC Amanah Malaysia Berhad	Mix
14	Kuwait Finance House (Malaysia) Berhad	Mix
15	Maybank Islamic Berhad	Mix
16	MBSB Bank Berhad	Full
17	OCBC Al-Amin Bank Berhad	Mix
18	Public Islamic Bank Berhad	Mix
19	RHB Islamic Bank Berhad	Mix
20	Standard Chartered Bank Malaysia	Mix
21	UOB Malaysia Bank	Mix

Today, non-Islamic banks in Malaysia have started to develop Islamic financial institutions, including the Islamic stock exchange, Islamic index, and Islamic financial market. The concept of *Shariah* is applied in Islamic banking in Malaysia as the product variants offered are: *ujrah*, *bay al-inah*, *tawarruq*, *ibra*, *qard Hasan*, *mudarabah*, *musharakah*, *istisnah*, *ijarah*, and others. These products are used to strengthen Islamic financial institutions (Asni & Sulong, 2019).

Malaysia has been progressing and developing in the field of Islamic banking education, which has established a university known as the International Centre for Education in Islamic Finance (INCEIF) to study Islamic banking from different parts of the world. Many students are being accepted for a full scholarship for learning and future benefits. The government also established the International *Shariah* Research Academy for Islamic Finance (ISRA) (Kitamura, 2020).

The success of Islamic banking and finance in Malaysia

Ali Allawala Saadiq Berhad's Acting Chief Executive Officer discussed the development of Islamic finance in Malaysia. In 2008, the Islamic bank accounted for 7.1 per cent of Malaysia's financial sector. In 2016, that figure rose to 28 per cent, and the Malaysian government estimated it to reach

40 per cent by 2020. Almost every Islamic banker has been following the growth of Islamic banking in Malaysia over the past few years. Malaysia's Islamic financial sector continues to grow steadily, especially with the following five factors:

1. *Products are offered to types of customers*

In the Islamic banking system in Malaysia, the products are developed for the market, regardless of the religious beliefs of the buyers. When we look at a restaurant with a halal logo on its door, it does not mean that the restaurant's food is only for Muslims. Islamic banking is less competitive than conventional. In fact, the principle of discount is suitable for everyone, and the benefit of *hibah* (gift) in *takaful* products (insurance).

2. *Standardization brings consistency*

In Malaysia, the central bank, Bank Negara Malaysia, has standardized the *Shariah* contract in the past few years. Almost all retail, commercial banking, and corporate products are standardized. This includes a full gap analysis, updated documentation, system improvements, and other things, the result should be a stable governance environment with products that comply with Shariah.

3. *Regulatory support has transformed the industry*

Many countries intend to be on the move to support the regulatory framework in organizing banks. Malaysia is not the only country that has included Islamic banking development strategies. In the 1980s, the Islamic Banking Act of 1983 was enacted, and the first Islamic bank was established. On the other hand, *Shariah*-compliance requirements ensure that conventional banks comply with *Shariah* regulations while conducting Islamic banking. The central bank regularly meets with industry experts, holding open discussions critical to innovation.

4. *Industrial integration strengthens the sector*

The Association of Islamic Banks of Malaysia has proven to be a successful policy for developing Islamic banking. Its members include heads of Islamic banks, and it aims to support the industry in collaboration with the central bank and other law enforcement actions. The group came together to discuss new strategies and issues facing the industry. It is good to see that senior executives use the sessions to think about the industry, not just their own teams.

5. *Sustainability of the bank brings benefits*

Malaysia's critical guideline for Islamic banking is that Islamic banking transactions should be *Shariah*-compliant and make a positive and sustainable contribution to the economy, society, and the environment without neglecting the return of money for shareholders. In general, it follows environmental, social, and corporate governance rules. This is a good way to make sure that Islamic products and services follow Shariah law and achieve Shariah goals.

Islamic Banking products and services in Malaysia

The services provided by Islamic banks and banking institutions are diverse and expand beyond the conventional system under the Islamic Banking system. Islamic banking practices are like those of conventional banks. Of course, there are many known changes. For instance, current and savings accounts fall under the categories of *Wadiah Yad Dhamanah* (deposit with guarantee), *Mudharabah* (interest-bearing interest), and *Qard* (non-profit loan).

Money in the general investment account under *Mudharabah* (dividend interest) and *Qard* (interest-free loan). Islamic banks are not investing in the projects without the depositor's order. Depositors with a particular or specific investment account under *Mudharabah* (dividend profit) may instruct the bank in which the project will be invested (Islamicmarkets.com).

Table 2. Islamic Banking products and services in Malaysia

Name of Product	Islamic Banking Products	The Concept of Shariah Used
Deposit	current account-I	Wadiah Yad Dhamanah, Mudharabah, Qard
	savings account-I	Wadiah Yad Dhamanah, Mudharabah, Qard
	commodity Murabahah-I	Murabahah / Tawarruq
Investment	general investment account-I	Mudharabah, Qard
	special investment account-I	Mudharabah
Trade Finance	accepted bills-I	Murabahah, Bai al-Dayn
	bank guarantee-I	Kafalah
	bills of exchange-I	Wakalah
	export credit refinancing-I	Murabahah, Bai Dayn
	letter of credit-I	Wakalah, Murabahah, Ijarah, Bai‟ Bithaman Ajil
	shipping guarantee-I	Kafalah
	trust receipt-I	Wakalah, Murabahah
Card Services	charge card-I	Qard
	credit card-I	Bai‟ Inah, Bai‟ Bithaman Ajil
	debit card-I	Ujrah
	home/house financing-I	Bai‟ Bithaman Ajil, Istisna‟s
Financing	asset financing-I	Tawarruq / Murabahah, Mudharabah Musharakah, Ijarah
	asset-backed financing-I	

benevolent loan-I	Ijarah
block discounting-I	Qard
bridging finance-I	Bai‟ Dayn
bungalow lots financing-I	Istisna‟, Bai‟ Bithaman Ajil
cash line facility-I	
club membership financing-	Bai‟ Bithaman Ajil
I	Bai‟ Inah, Bai‟ Bithaman Ajil, Murabahah
Commodity Murabahah	Bai‟ Bithaman Ajil
Financing-I	Murabahah, Tawarruq
computer financing-I	Bai‟ Bithaman Ajil
contract financing-I	Murabahah, Bai‟ Bithaman Ajil, Istisna
education financing-I	Musharakah, Mudharabah, Ijarah
	Murabahah, Bai‟ Bithaman Ajil, Bai‟ Inah
	Bai‟ Bithaman Ajil
equipment financing-I Bai"	Bai‟ Dayn
Bithaman Ajil	Bai‟ Bithaman Ajil
factoring facility-I	Murabahah, Bai‟ Bithaman Ajil
fixed asset financing-I	hire purchase agency-i
floor stocking financing-I	Bai‟ Bithaman Ajil, Istisna‟
	Variable Rate Bai‟ Bithaman Ajil Ijarah
hire purchase agency-I	Bai‟ Bithaman Ajil
home/house financing-I	Ijarah
	Rahnu (Qard and Wadiah Yad Dhamanah)
industrial hire purchase-I	Rahnu (Qard) Bai‟ Bithaman Ajil, Murabahah,
	Bai‟ Inah
land financing-I	Bai‟ Bithaman Ajil, Istisna, Ijarah
leasing-I	Bai‟ Bithaman Ajil, Istisna, Ijarah Musharakah,
pawn broking-I	Mudharabah Tawarruq / Murabahah
	Bai‟ Bithaman Ajil, Istisna Variable Rate Bai‟
personal financing-I	Bithaman Ajil
plant & machinery	Bai‟ Bithaman Ajil, Murabahah, Hiwalah, Bai‟
financing-I	Inah
	Bai‟ Bithaman Ajil, Bai‟ Inah
project financing-I	Bai‟ Bithaman Ajil, Istisna‟
	Variable Rate Bai‟ Bithaman Ajil Bai‟
property financing-I	Bithaman Ajil
revolving credit facility-I	Istisna‟, Bai‟ Bithaman Ajil, Ijarah
Share financing-I	Bai‟ Bithaman Ajil, Variable Rate Bai‟
shop house financing-I	Bithaman Ajil Bai‟ Bithaman Ajil
sundry financing-I	Bai‟ Bithaman Ajil

syndicated financing-I	
term financing-I	Ijarah, Bai‛‛ Bithaman Ajil, Murabahah
tour financing-I	
umrah & visitation financing-I	
vehicle/automobile financing-I	Murabahah, Bai‛‛ Bithaman Ajil, Tawarruq / Murabahah, Musharakah, Mudharabah
working capital financing-I	

Source: Characteristics of GCC Islamic Banks Investment in Malaysia, Ali Abusalah Elmabrok Mohammed

Discussion of the issues, challenges, and prospects of Islamic banking in Malaysia

According to (2021), during the COVID-19 epidemic, Malaysia's Islamic banking sector has continued to expand. Recent reports from the Big Three international rating agencies, Fitch Ratings, Moody's Investors Services, and Standard & Poor's (S&P) Global say that the Islamic financial industry will grow in 2021, especially in Malaysia and Saudi Arabia, which are both major markets around the world.

In a statement issued in February 2021, Fitch highlighted that Malaysia's Islamic banking sector continued to grow in 2020, facing economic challenges from the outbreak of COVID-19 in ASEAN. However, the country continues to have major Islamic banking markets, including *Sukuk* and *takaful* markets.

Furthermore, Bashar Al Natoor, Head of Global Islamic Finance, mentioned it in 2021 at Fitch. We expect the Islamic Bank of Malaysia sectors to remain stable, with the potential for loss, despite close pressure on asset quality and profit. Consequently, Islamic finance is expected to expand in the medium term. The strength of the economic recovery, the support environment, and the banks that continue improving Islamic products in all trade areas may result in a GDP growth forecast of 6.7% in 2021, higher than the forecast of 5.6% in 2020.

Also, we expect Malaysian banks to continue to be encouraged by the rapid growth of debt once they completely understand unsustainable loan practices. We do not expect this to happen until mid-2022 when lending programs will be reduced to appropriate levels. Similarly, Moody's emphasizes in its report that Saudi Arabia will continue to be the world's most prominent Islamic banking market. In contrast, the sector will continue to expand in Malaysia. Oman and Turkey will also continue to grow rapidly in Islamic banking.

S&P Global mentions that we expect the Islamic bank to be a positive asset or a small number one at best. This follows a 6.6% growth in 2019 because of positive work done in the Gulf Cooperation Council (GCC) countries, Malaysia, as well as in Turkey and Indonesia.

CONCLUSION

The paper demonstrates that Malaysia took a gradual approach to develop Islamic banks and their various types of products and services. For the development of Islamic banking in Malaysia, universities and institutes have been established, including INCEIF and ISRA. The scale of the Islamic banking and financial instruments market will continue to rule the industry. Additionally, the future of Islamic banking appears more promising than traditional banking because it operates interest-free financing and uses Islamic investments, bonds, funds, and asset and wealth management. Also, the global financial crisis has not had as much of an effect on Islamic banking as it has on traditional banking.

In many regions of the world today, Islamic banking is spreading. Suppose Islamic banking is introduced in other parts of the world. In that case, it will benefit the general public since the money currently held in banks, if deposited in an Islamic bank, will improve those nations' economic conditions, especially those in developing and underdeveloped countries. This will pave the way for the continued global expansion of Islamic banking. Also, more courses about Islamic banking should be taught so that more people know about it.

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