



UNIVERSITI SAINS ISLAM MALAYSIA

جَامِعَةُ الْعُلُومِ الْإِسْلَامِيَّةِ الْمَالِيزِيَّةِ

ISLAMIC SCIENCE UNIVERSITY OF MALAYSIA

# An Overview of Islamic Finance

LAB4112

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# Introduction

- Ibn Khaldun:
- “The strength of the sovereign (al-mulk) does not become consumed except by implementation of the Shari’ ah;
- The Shari’ ah cannot be implemented except by a sovereign (al-mulk);
- The sovereign cannot gain strength except through the people (al-rijal);
- The people cannot be sustained except by wealth (al-mal);
- Wealth cannot be acquired except through development (al-‘imarah);
- Development cannot be attained except through justice (al-‘adl);
- Justice is the criterion (al-mizan) by which God will evaluate mankind; and
- The sovereign is charged with the responsibility of actualising justice”

# Content

- **Islamic Economic and Islamic Finance**
- **Overview of Modern financial management of banking, capital market, insurance, securities.**
- **The development of Islamic finance**
- **Islamic finance in Malaysia**

- Islamic banking sector grew 50% faster than the overall banking sector. In 2011, Islamic banking assets grew to USD1.3 trillion.
- Islamic finance will grow with rapid pace in the year 2014 and its volume will pass through USD2 trillion, with Islamic banking dominating at 78%, sukuk at 16%, takaful at 1%, Islamic funds at 4% and Islamic microfinance with 1%.
- In 2013, global Islamic banking asset with commercial banks reach USD1.8 trillion representing 17% average annual growth.
- It is estimated that Islamic finance will be able to tip USD6.5 trillion by the year 2020 with the current growth rates.



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graph TD; A[Economic System] --- B[Capitalist]; A --- C[Socialist]; A --- D[Islamic Economic]
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**Economic  
System**

**Capitalist**

**Socialist**

**Islamic  
Economic**

# Islamic Economics (1)

- Analyse the ‘cause and effects’ of the problems.
- IE knowledge accumulated over many centuries.
- Effort of Muslim jurists to address the economic problems.
- Abu Yusuf: pricing issue, monetary.
- Al Ghazali: benefit of using money rather than barter trading, prohibition of hoarding and monopoly
- Ibnu Qayyim: Made and natural price.

# Islamic Economic (2)

- Analyse the economy within the historical and social context.
- Ibnu Khaldun: how economic changes in different stages, main reason of output, monetary.
- Al Maqreezi: inflation

# Islamic Economic (3)

- Contemporary IE. Invigorated in 1976 by the First International Conference on IE in Makkah. 3 Categories
- 1. Advocated by fuqaha. The approach was more of a legalistic approach while their emphasis was on issues such as riba and interest, banking and zakat.
- 2. Group that responded to the orthodox view of the above fuqaha. Although they were not Islamic scholars, the advocates of this group of writing attempted to reinterpret (tafsir) the Qur'an and the Sunnah using their 'aql (mental) to promote ijtihad, under the pretext of overcoming the problems faced by modern society.
- 3. Current mainstream IE was the writings by Western-educated Muslim economic scholars. They adopted economic-based approach that reflects the background of their conventional economic thinking using western economic techniques and sophisticated writings

# Concept of IE

- Is the science that studies the best possible use of (i) all available economics resources endowed by Allah (ii) for the production of maximum possible output of (iii) Halal goods and services that are needed for the community now and in the future and (iv) the just distribution of this output (v) within the framework of shariah and its intents' .

# Fundamental of Islamic Economic

- Two dimensional utility
- Allah is the absolute ownership
- Sources-Quran and Sunnah, Qiyas and Ijma'
- Vicegerent and Trusteeship
- Islam esteems wealth and wealthy
- Social Mutual Solidarity- Brotherhood
- The Prohibition of usury
- Ummatic(broad) ownership of natural resources

**Financial  
System**

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graph TD; A[Financial System] --- B[Banking System]; A --- C[Non Bank Financial Intermdaiaries]; A --- D[Financial Markets];
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**Banking System**

**Non Bank  
Financial  
Intermdaiaries**

**Financial  
Markets**

# Banking System

- **Monetary Institutions- BNM, Commercial Banks.**
- **Non-monetary Institutions- Finance Co, Merchant Banks and Discount Houses.**



# Non Bank Financial Intermediaries

- Development Financial Institutions- Bank Pembangunan, BKR
- Saving Institution- National Saving Banks and Credit Cooperative
- Provident and Pension Fund-EPF, Pension Trust Funds, LTAT.
- Insurance Companies- Conventional and Islamic
- Other Financial Intermediaries- MBSB, Leasing Co. LTH.

# Financial Markets

- Money and Foreign Exchange- Market for securities less than 12 months to maturity. Eg- banker's acceptance, negotiable instruments.
- Capital Market- Primary and secondary securities market. SC.
- Commodity Futures market and financial futures market and options market

**Financial System**

**Banking**

**Capital Market**

**Insurance**

**Conventional**

Private/Public  
Debt Securities

**Money  
Market**

**Conventional**

**Islamic**

**Stock Exchange**

**Derivative**

**Islamic**

# Bank

- The term bank originates from the Italian word *banco*, which means 'table' as in the past moneychangers from Lombardy used to place money on a table.
- The first modern bank was started in Venice in 979H or 1584CE and was known as *Banco di Rialto*
- 1640 Bank of England

# Islamic Banking in the World

- Africa
- Europe
- GCC
- Asia
- South East Asia
- North America
- Australia

# GCC

- IDB-1975 Saudi Arabia.
- Dubai Islamic Bank- 1975 UAE
- KFH: 1977
- 1978 Jordan Islamic Bank
- Bahrain Islamic Investment Company 1981
- Qatar Islamic Bank 1983
- Bank Melli: Iran-Law of Usury Free Banking 1983-  
It takes about 6 years from 1979 Islamic Revolution to Islamise the whole banking system of Iran.
- Al Rajhi: 1985- Largest Islamic bank in the world
- Bank al Nizwa, Oman 2011

# Asia

- Pakistan- 1977-Report on elimination of interest- 1979-House Building Finance Corporation, National Inv. Corp of Pakistan. Until 1985- Whole system was riba-free. 1991- COA declared Islamic banking operation was not Islamic and confirmed by the Supreme Court 1999. Then, Pakistan followed Malaysia' s model.
- Al Hilal Bank, Kazakhstan Bank 2010
- Ningxia Islamic International Trust and Investment
- Al Ameen Islamic and Financial Inv Corp India Ltd. 1985
- Korea, Japan, Hong Kong.



# Africa

- Mit Ghamr Local Saving Bank: 1963
- Faisal Islamic Bank of Egypt- 1975
- Faisal Islamic Bank of Sudan 1977
- Bait Ettamouli Saudi Tounsi Tunisia 1984
- Albaraka Bank Ltd, Durban (Dallah Al Baraka Group) (1982)
- Al wataniya, Mauritania 2010
- Jaiz Bank, Nigeria 2012
- Tunisia, Algeria, Morocco.



# Europe

- Dar al-Mal al-Islami- Switzerland 1981.
- 1978- Islamic Banking System International Holdings, Luxemburg.
- Union Bank of Switzerland 1990- Offer Islamic Investment fund.
- Islamic Bank of Britain 2004.
- BADR Bank Russia.
- Al-Baraka Turkish Finance House 1985- 99% Muslim- 1928 Secularism by Atartuk.- About 7 IFIs.
- Islamic Bank International Denmark 1983
- Kurveyt Turk Bank, Germany 2012
- Italy, France, Spain.

# North America

- American Finance House-Lariba- 1987  
California.
- Islamic Co-operative Housing Corporation  
Ltd, Toronto
- Ameen Housing Co-operative, San  
Francisco
- HSBC, USA

# South East Asia

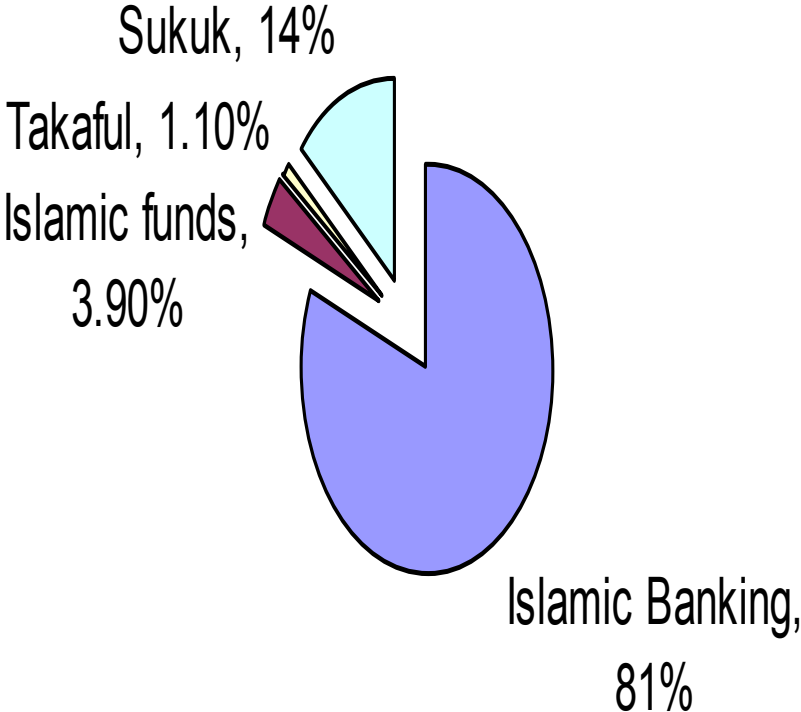
- **Philippine Amanah Bank. 1973.**
- **Bank Muamalat Indonesia 1992.**
- **Alirajni Commercial Establishment for Exchange, Bangkok 1985.**
- **Islamic Bank of Thailand-2002**
- **DBS Bank Ltd Singapore- 2007 First IB in Singapore.**
- **Islamic bank of Brunei: 1993**

# Australia

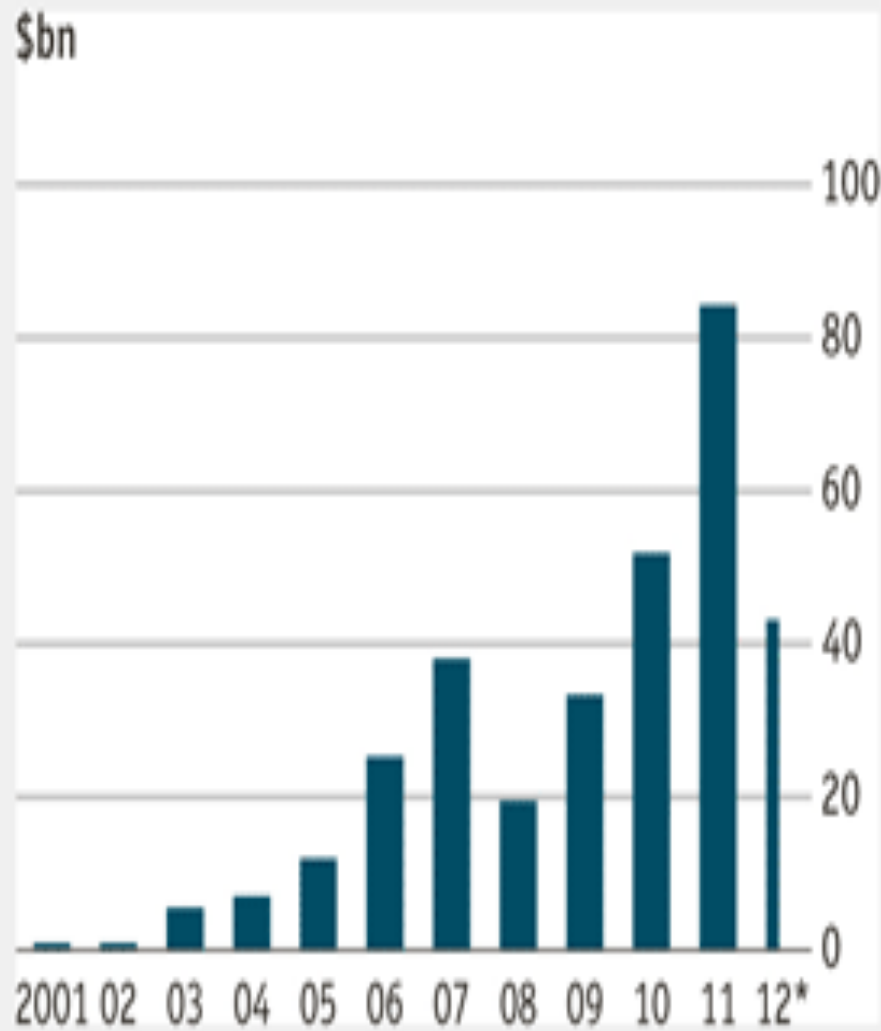
- Muslim Community Cooperative Australia 1989.
- Muslim Community Credit Union 2000. Insolvent in 2002.
- Iskan Finance-2001

# Global Islamic Finance Asset 2012

Total Asset USD 1.6 trillion

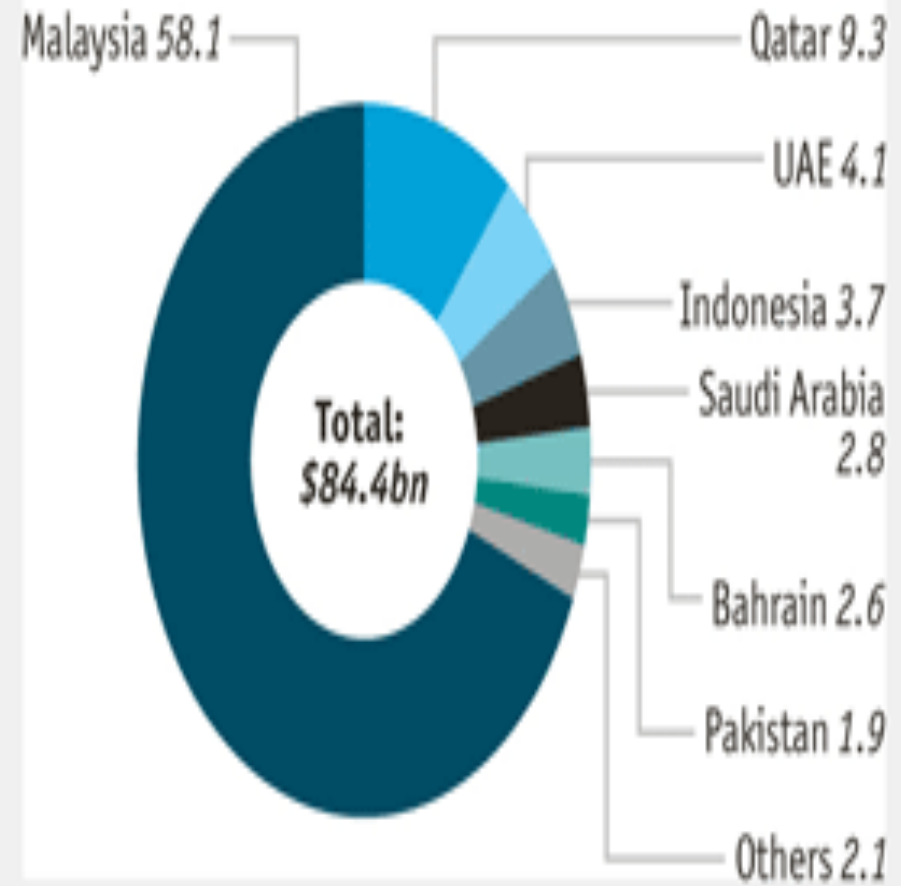


## Global *sukuk* issuance



Sources: Zawya Sukuk Monitor; Islamic Financial Information Service

By country, 2011, \$bn



\*January-March

	Category	Country
1.	Islamic Banking System	Iran and Sudan
2.	<i>Dual system</i>	Malaysia, Pakistan, Indonesia, Singapore, Thailand, Saudi Arabia, Bahrain, Bangladesh, Brunei, Egypt, Guinea, Jordan, Kuwait, Niger, Qatar, Senegal, Tunisia, Turki, UAE, Oman, Lubnan, Palestin, Maldives, Algeria
3	Conventional System only	Afghanistan, Albania, Azerbaijan, Benin, Burkina Faso, Chad, Cameroon, Comoros, Djibouti, Gabon, Gambia, Guinea Bissau, Kyrgyztan, Mali, Maghribi, Sierra Leone, Somalia, Uganda, Turkmenistan, Yemen, Tajikistan and Mozambique.

# Standard Setting Agencies

- Accounting and Auditing Organisation for Islamic Financial Institutions AAOIFI- 1990. Bahrain.
- Islamic Financial Services Board IFSB 2002- KL.



# Industry Architecture

- IDB-1975
- OIC Fiqh Academy: 1988
- CIBAFI-Gen council for IB and FI-2001
- IIFM- 2002-financial market
- IIRA-2005- Rating
- IIRAC-2005-arbitration
- ISRA-2008
- IILMC-2010.

# Evolution

- Rasulullah SAW received deposit from public.
- Az Zubair Awam- received deposit as loan.
- Concept wadiah, loan and mudharabah.
- Umayyah, Abasiyah and Uthmaniah
- Zuhr al-islam- Cheque (Suftajah). Safarnama by Naser Khasro 427m- Active transaction using cheque.

# Sarraḥ

- *Sarraḥ* and jahbadh provided financing facilities primarily on the basis of *mudharabah* and *musharakah*, negotiable instruments and trade facilities by cashing cheques, and issued promissory notes and letter of credits. They also provided banking facilities to the public as well as the private sector,
- *Ṣarraḥ* were moneylenders, brokers and pawnbrokers; many *Ṣarraḥ* became large financiers with well-recognized international connections and played a significant role in the economy and politics of the Ottoman Empire.
- *Sarraḥ* also functioned as moneychangers to provide facilities of currency exchange and played a role in determining the relative value of coins.

# Jahbadh

- As an administrator of deposits and as a remitter of funds from place to place through the medium of the *ṣakk* and especially of the *suftadja*.
- Islamic bank of today is a transformation of *Jahbadh* in a modern form where it has some characteristics of a full-fledged banker as well as merchant banker.

# Baitul Mal

- *Bayt al-mal* could be considered as a state-owned bank; it played the role of an agricultural credit bank, commercial bank and clearing house for merchants to facilitate commercial activities from the time of Umayyad

# Modern Islamic Banking

- **Mit Ghamr Local Saving Bank- Saving account, loan, equity financing and welfare services.**
- **Its operation has been taken by National Bank of Egypt in 1967 and riba-free transaction was neglected. 1971- National Social Bank.**
- **OIC- King Faisal. 1975 Dubai Islamic Bank and IDB.**
- **1977 Faisal Islamic Bank of Egypt, Faisal Islamic Bank of Sudan and KFH.**



# Modern Islamic Banking

- 1<sup>st</sup> Phase- 1950s. Concept and Idea
- 2<sup>nd</sup> Phase- 1960s- Early Islamic Bank
- 3<sup>rd</sup> Phase- 1970s- Establishment of academic institution and banking institution. Publication of text materials on IB.
- 4<sup>th</sup> Phase- 1980s- Development of Islamic Bank- Window and Full-fledge
- 5<sup>th</sup> Phase-1990s- Development of Islamic Bank in USA market- Dow Jones Islamic Index was launched.
- 6<sup>th</sup> Phase- 2000s- Maturity , comprehensive architecture, IFSB and etc.

# Products Evolution

## Future Prospects

2000s- Advanced treasury services/ Cross border liquidity/ money market instrument

1990s-Project finance and takaful/Sukuk

1980s-Commercial

Pre-1970s-Retail/ Micro finance



# Malaysia

- Phase 1: 1840-1900: 7 Western banks were established.
  - The Oriental Bank was set up in Singapore in 1846
  - The Mercantile Bank of India, London and China in 1855,
  - The Chartered Bank of India,, Australia and China in 1859
  - The Asiatic Banking Corporation and the Commercial Bank of India both in the 1960's,
  - Rhe Nederlandse Handel Matschappij (N. H. M. ) in 1883.
  - The Hong Kong and Shanghai Banking Corporation in 1884.

# The Development of BFI

- Post 1900: Gradual emergence of local Chinese banks.
- The first local Chinese bank,, Kwong Yik Bank, was founded in Singapore in 1903.
- Kwong Yik (Selangor) Banking Corporation in 1913. The first bank incorporated in KL.
- Sze Hai Tong in 1906.
- Chinese Commercial Bank in 1912
- Ho Hong Bank in 1917
- Overseas-Chinese Bank in 1919.
- Lee Wah Bank, Bank of Malaya and Batu Pahat Bank in 1920
- Ban Hin Lee Bank in 1935
- United Overseas Bank in 1935.
- Malay bank was established in 1947 but it failed in 1952.
- Bank of Canton in 1953,
- Bank of America in 1955,
- Bank of Indonesia in 1955,
- Bank of Tokyo and Bangkok Bank in 1957

# Islamic Finance in Malaysia

- 1980- Bumiputra Economic Congress- To establish IB.
- 1981- National Steering Committee.1982 table the report.
- 1 March 1983- BIMB through IBA 1983. 1992- Listed in Bursar Malaysia.
- 1993- Islamic Banking Scheme- 1 IB and 20 windows, BBMB, UMBC and Maybank
- 1994- International Islamic Money Market.
- 1997- NSAC at BNM
- 1999- BMMB
- 2004 - Foreign Islamic full-fledged banking license to Kuwait Finance House (KFH), Al-Rajhi Investment Bank, Saudi Arabia and Qatar Investment Group.
- 2007- 12 IB 9 local and 3 foreign players.
- 2001-2010- Islamic Financial Sector Master Plan- 20%
- 2011: 24 CB and 17 IB

# BNM

- 2 Objectives:
  - 1) To promote monetary stability and a sound financial structure
  - 2) To influence the credit situation to the advantage of the federation
- The BNM is therefore charge with the task of implementing all the regulations concerned with these matters as laid by the law, as well as issuing policies and directives to further the implementation of these regulations.
- Where and when certain of the regulations have become inadequate or new or additional regulations become necessary, it is also the Central Bank's responsibility to initiate the formulation of such changes.

# BNM

- (a) to issue currency in the Federation and to keep reserves safeguarding the value of the currency
- (b) to act as banker and financial adviser to the government
- (c) to promote monetary stability and a sound financial structure
- (d) to influence the credit situation to the advantage of the Federation

# Bank and bank

- “Bank” means the Central Bank of Malaysia established by the Central Bank of Malaysia Act 2009;
- “bank” means a person which carries on banking business;
- Restriction on the use of the term “bank”  
section 4

# Commercial Banks

- 24 Commercial Banks in Malaysia
- Largest and most important
- Provides current account facilities where payments can be effected readily through the issue of cheques.

# IFIs

- “IFIs” means a financial institution carrying on Islamic financial business;
- S 2 IFSA: Islamic banking business” means the business of
  - (a) accepting Islamic deposits on current account, deposit account, savings account or other similar accounts, with or without the business of paying or collecting cheques drawn by or paid in by customers; or (b) accepting money under an investment account; and (c) provision of finance; and
  - (d) such other business as prescribed under section 3



# Development Finance Companies

- the business of providing capital or other credit facility on terms which would require the same to be utilised for industrial, agricultural, commercial or other economic development; and for the purposes of this definition, “development” includes the commencement of any new industrial, agricultural, commercial or other economic venture or the expansion or improvement of any such existing venture; or