

# FUNDAMENTALS OF ISLAMIC BANKING

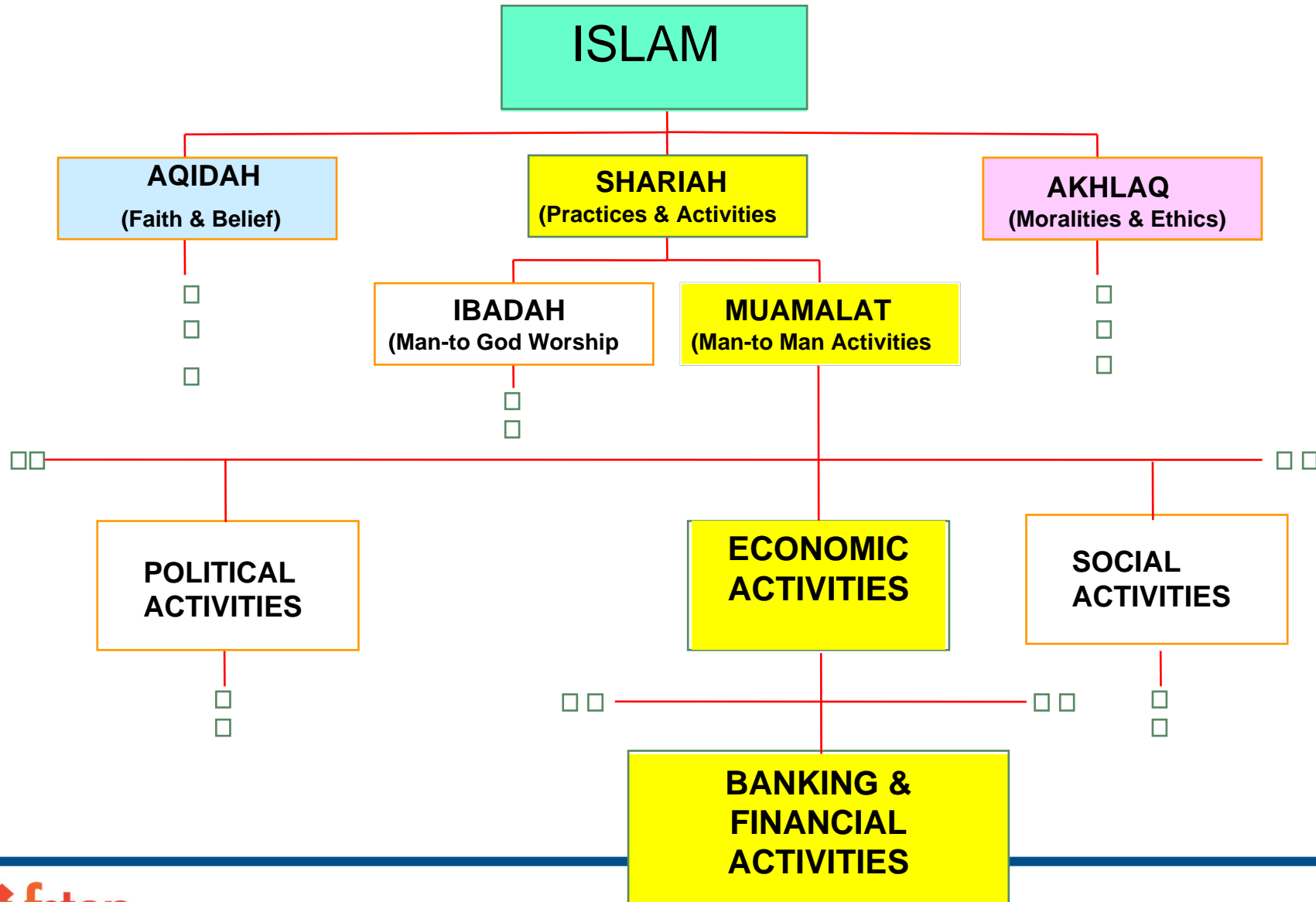
*presented by*

**Ahmad Sanusi Husain, Executive Director, AIBIM**  
**Muhammad Faozie Shahari, AmIslamic Bank Berhad**  
**Jamil Ramly, IBFIM**

1. Introduction to Islamic Financial System
2. Introduction to Legal and Regulatory Framework of Islamic Banking and Finance
3. Sources and Application of Funds

# INTRODUCTION

# ISLAMIC VIEW OF LIFE OF A MUSLIM



# SOURCES OF SHARIAH

- ◆ AL-QUR'AN
- ◆ AL-SUNNAH (THE TRADITIONS OF PROPHET MUHAMMAD-PEACE BE UPON HIM)
- ◆ AL-IJMA' (CONSENSUS OF OPINION AMONG JURISTS OF ISLAMIC LAW)
- ◆ AL-QIYAS (ANALOGICAL DEDUCTION)

# PROHIBITION OF INTEREST

Allah has permitted trade and forbidden usury

**AI-BAQARAH:275**

# OBLIGATION TO REPAY DEBT

## HADITH :

PROPHET (PEACE BE UPON HIM) SAID :

IF A MAN BORROWS FROM PEOPLE WITH THE INTENTION OF REPAYING THEM, ALLAH WILL HELP HIM TO REPAY,

WHILE IF HE BORROWS WITHOUT INTENDING TO REPAY THEM, ALLAH WILL BRING HIM TO RUIN.

(REPORTED BY AL- BUKHARI)

# OBLIGATION TO REPAY DEBT

## HADITH :

PROPHET (PEACE BE UPON HIM) SAID :

EVERYTHING WILL BE FORGIVEN TO THE SHAHEED  
(MARTYR IN THE CAUSE OF ALLAH) EXCEPT DEBT.

(REPORTED BY MUSLIM)



# RIBA (INTEREST)

THERE ARE TWO TYPES OF RIBA :

1. **RIBA DUYUN** (ARISING FROM DEBTS)
  - 1.1 **RIBA QARDH** (ARISING FROM LOAN)
  - 1.2 **RIBA JAHILLIYAH** (ARISING FROM LOAN)

# RIBA (INTEREST)

THERE ARE TWO TYPES OF RIBA :

2. **RIBA BUYU'** (ARISING FROM COMMERCIAL TRANSACTIONS)

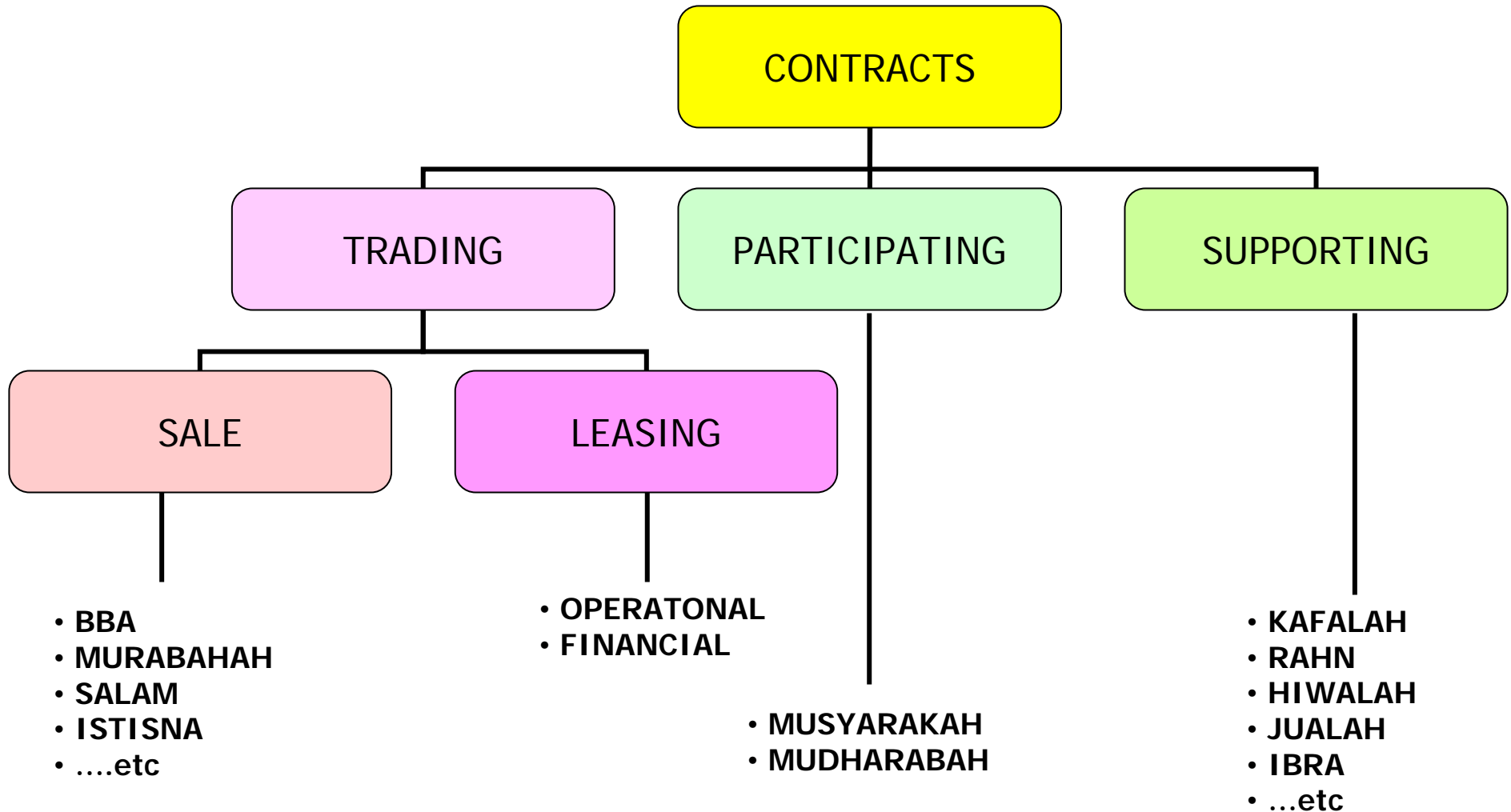
2.1 **RIBA FADHL** (EXTRA)

2.2 **RIBA NASIAH** (DIFFERENCE OF TIME)

# ***PHILOSOPHY OF ISLAMIC BANKING***



# TYPES OF CONTRACTS



## TRADING CONTRACTS

- (i) Bai Murabahah (cost plus)
- (ii) Bai Tawliyah (novation)
- (iii) Bai Bithaman Ajil (deferred payment sale)
- (iv) Bai Salam (advance payment sale)
- (v) Bai Istisna'a (sale by order)
- (vi) Bai Istijrar (supply, wholesale financing)
- (vii) Bai Inah
- (viii) Ijarah (leasing)
- (ix) Ijarah Thumma Bai (Islamic hire purchase, AITAB)

## PARTICIPATING CONTRACTS

There are three types of participating contracts which are possible in practice. Two are subdivisions of Musharakah as follows:

- (i) Musharakah
  - Shirkah A'amal
  - Shirkah 'Inan and
  
- (iii) Mudharabah

## SUPPORTING CONTRACTS

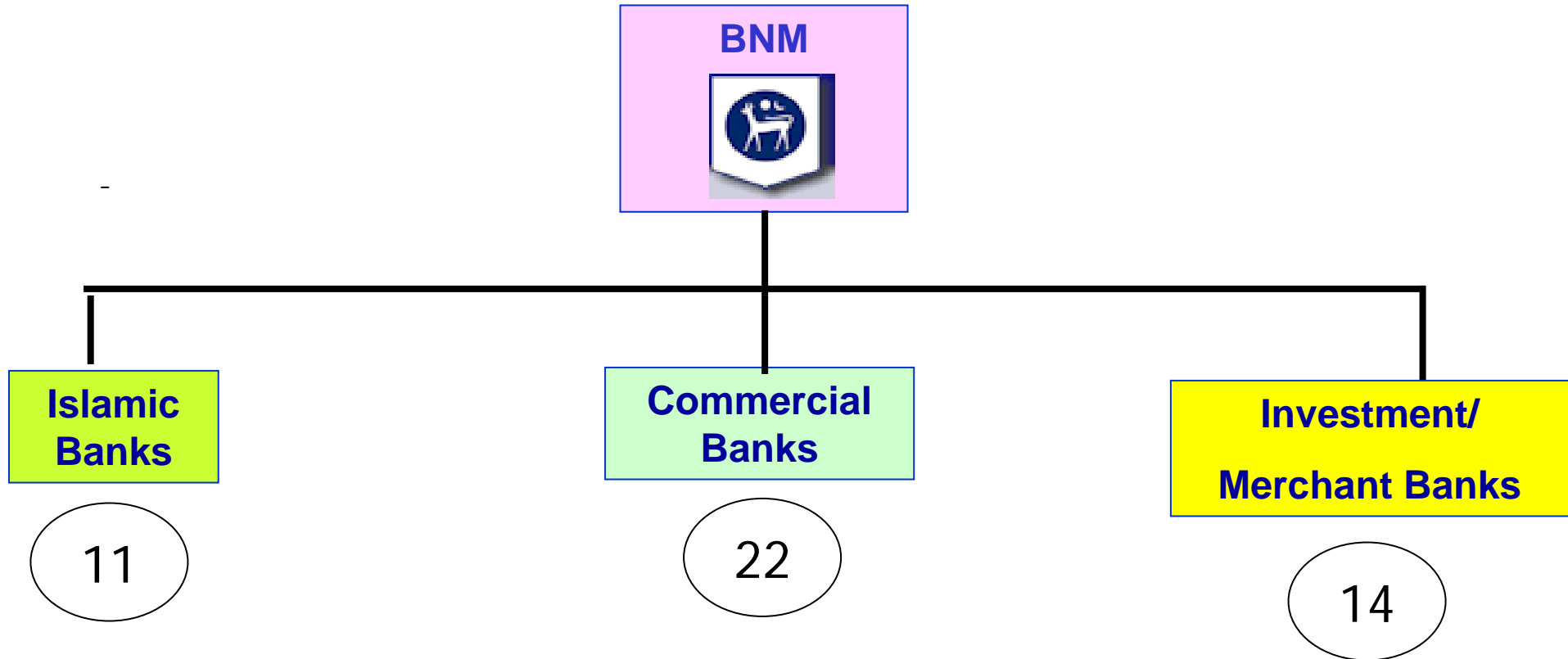
- (i) Rahnu (mortgage)
- (ii) Kafalah (guarantee)
- (iii) Wakalah (agency)
- (iv) Wadiah (safe custody)
- (v) Qardh (loan)
- (vi) Hiwalah (transfer of debt)
- (vii) Tabarru' (donation)
- (viii) Hibah (gift)
- (ix) Wakaf (endowment)
- (x) Ibraa' (rebate)
- (xi) Muqasah (set-off)

# FINANCIAL SYSTEM IN MALAYSIA

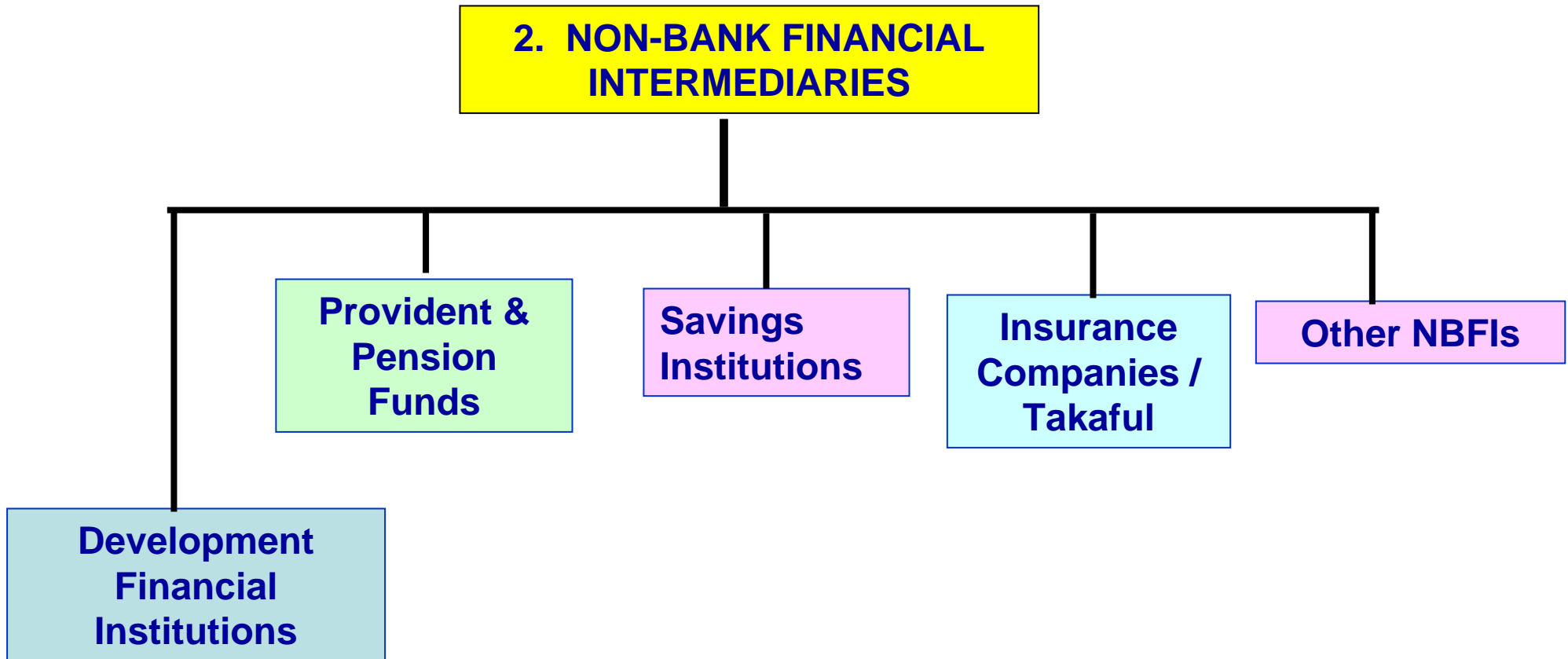


# FINANCIAL SYSTEM IN MALAYSIA

## 1. BANKING SYSTEM



# FINANCIAL SYSTEM IN MALAYSIA

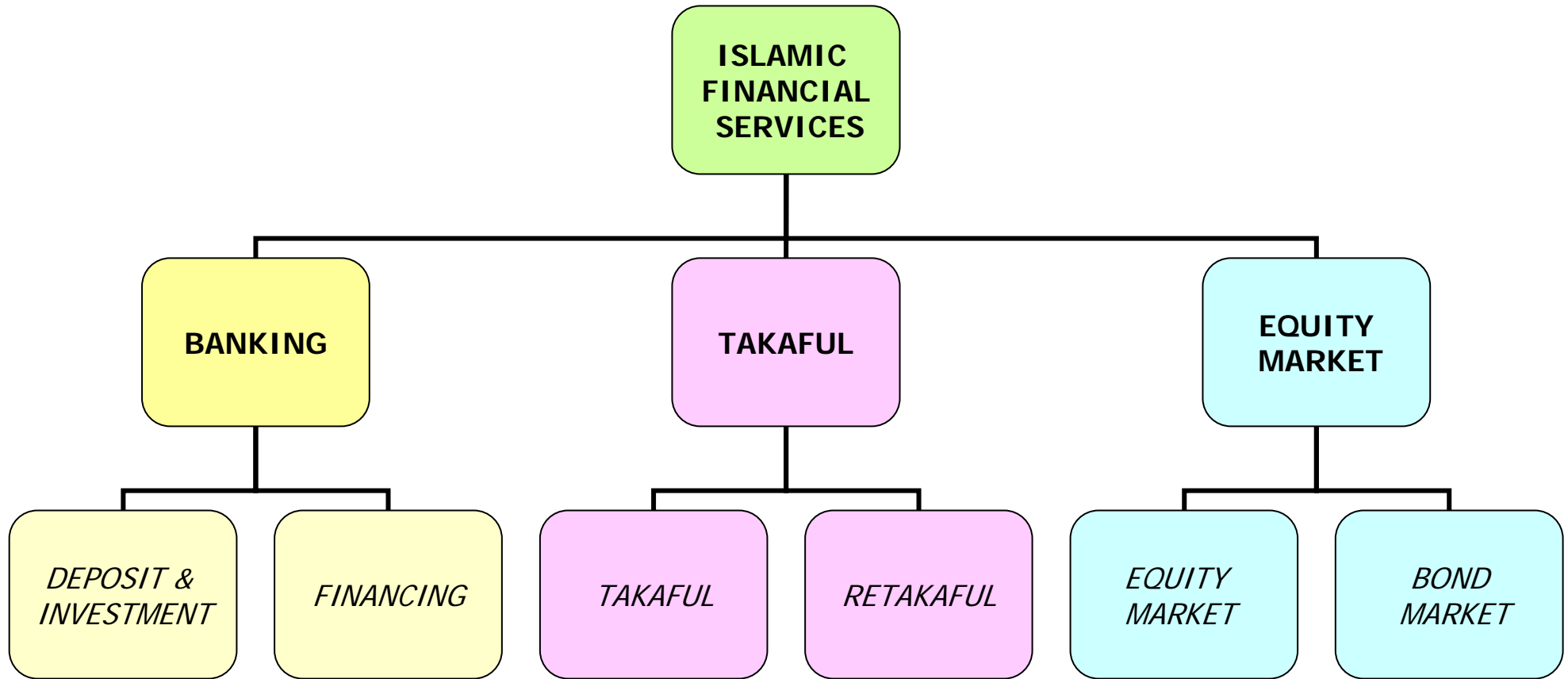


# FINANCIAL SYSTEM IN MALAYSIA

## 3. FINANCIAL MARKET



# ISLAMIC FINANCIAL SERVICES



BANK NEGARA MALAYSIA

- Islamic Banking Act '83
- Banking & Financial Institution Act '89

BANK NEGARA MALAYSIA

Takaful Act ' 84

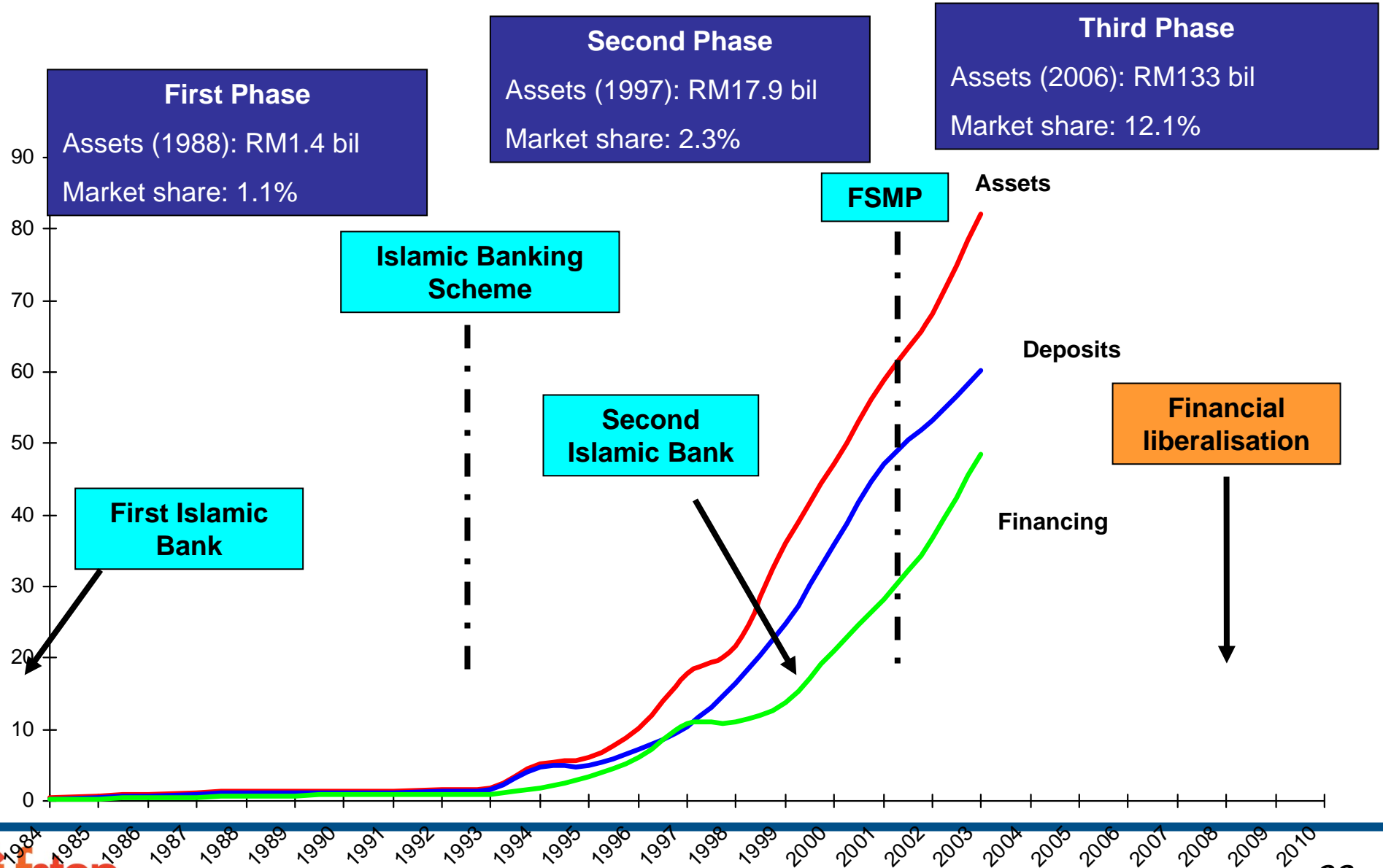
SECURITIES COMMISSION

- Securities Commission Act '83
- Contract Act '65

- Full-fledge Islamic Banks – 11
- Participating banks in the Islamic Banking Scheme
  - (i) Commercial Banks – 8
  - (ii) Investment Banks – 4
  - (iii) Development Financial Institutions – 5
- Registered Takaful Operators - 8

# ISLAMIC BANKING DEVELOPMENT

# PHASES OF DEVELOPMENT – ISLAMIC BANKING



## Banking Sector: Performance as at 31 December 2006

	Islamic Banking		Conventional Banking	
	Size (RM)	Annual Growth (%)	Size (RM)	Annual Growth (%)
<b>Assets</b>	133.0 bil	20.5	1,090.2 bil	22.8
<b>Financing / Loans</b>	78.5 bil	12.3	593.0 bil	6.3
<b>Deposits</b>	98.8 bil	18.2	810.0 bil	13.0
<b>Profit before Zakat/tax</b>	1.7 bil	9.6	13.0 bil	4.7

Source: Bank Negara Malaysia Financial Stability and Payment Systems Report 2006



The operation of Islamic banking and finance in Malaysia are governed by the following acts:

**Islamic Banking Act 1983 (IBA):** Full-fledged Islamic banks i.e. Bank Islam, Bank Muamalat, RHB Islamic, Hong Leong Islamic, CIMB, Amlslamic, Affin Islamic, EONCAP Islamic & Kuwait Finance House

**Bank and Financial Institutions Act 1989 (BAFIA):** Commercial banks, Finance companies, Merchant banks, Discount houses. e.g. Maybank, Public Merchant, HSBC

**Development Financial Institutions (DFIA) Act 2002:** e.g. Bank Pembangunan, SME Bank, Bank Rakyat, BSN.

## Islamic Banking Act 1983

“Islamic bank” means any company which carries on Islamic banking business and holds a valid license; and all the offices and branches of such a bank shall be deemed to be a bank”

“Islamic banking business” means banking business who aims and operations do not involve any element which is not allowed by the Religion of Islam”

Required to establish Shariah Advisory Body

# LEGAL FRAMEWORK OF AN ISLAMIC BANK

ISSUE/MATTER	AUTHORITIES	ACTS/RULES/ REGULATIONS
1. Incorporation/ Establishment	Commissioner of Companies Malaysia (SSM)	Companies Act 1965
2. Management	Shareholders, Board of Directors, Management Committee	Memorandum & Articles of Association IBA 1983, BNM GP1-i
3. Licensing/ Supervision	Ministry of Finance Bank Negara Malaysia	IBA 1983
4. Operations	Relevant Authorities	Rules of Shariah & Relevant Laws, BNM GPs
5. Shariah Supervision	Bank's Shariah Committee BNM's Shariah Advisory Council (SAC)	Rules of Shariah

## BAFIA 1989

Under Section 124 of BAFIA, banks and FIs are allowed to operate Islamic banking or Islamic financial business and is not affected by provisions IBA.

“Islamic financial business” means any financial business the aims and operations of which do not involve any element which is not approved by the Religion of Islam”

Required to establish Shariah Advisory Council

## DFIA 2002

Under Section 129 of DFIA, prescribed institutions are allowed to operate Islamic banking or Islamic financial business and is not affected by provisions in IBA.

“Islamic financial business” means any financial business the aims and operations of which do not involve any element which is not approved by the Religion of Islam”

Required to establish Shariah Advisory Council

## GOVERNMENT INVESTMENT ACT 1983

To enable the Govt. to receive moneys from Islamic banks for a fixed period of time.

It empowers the Govt. to issue Government Investment Issues (GII) with returns in the form of discretionary gifts (rather than interest)

This is to comply with the prescribed liquidity requirements

## REAL PROPERTY GAIN TAX ACT 1976

The Islamic sale transaction such as the BBA, a financing mode that involves “a purchase and sell transaction” between bank and customer that tantamounts to ‘acquisition’ and disposal under the RPGT Act. The Finance Act 1986 provides amendment in RPGT to accommodate this transaction so as not to burden the bank’s customers by an additional incidence of tax.

The Stamp Act 1949 (as amended by Act A723 of 1989) by Section 14A provides the Shariah sale transaction to be taxed based on the principal (financing) amount.

## JURISDICTION OF THE CIVIL COURTS

Granting of financing facilities by banks though based on Shariah principles are commercial transactions, therefore come within the jurisdiction of the civil courts

The Shariah Courts have no jurisdiction to hear commercial cases. Furthermore, the courts can hear cases involving Muslims only.

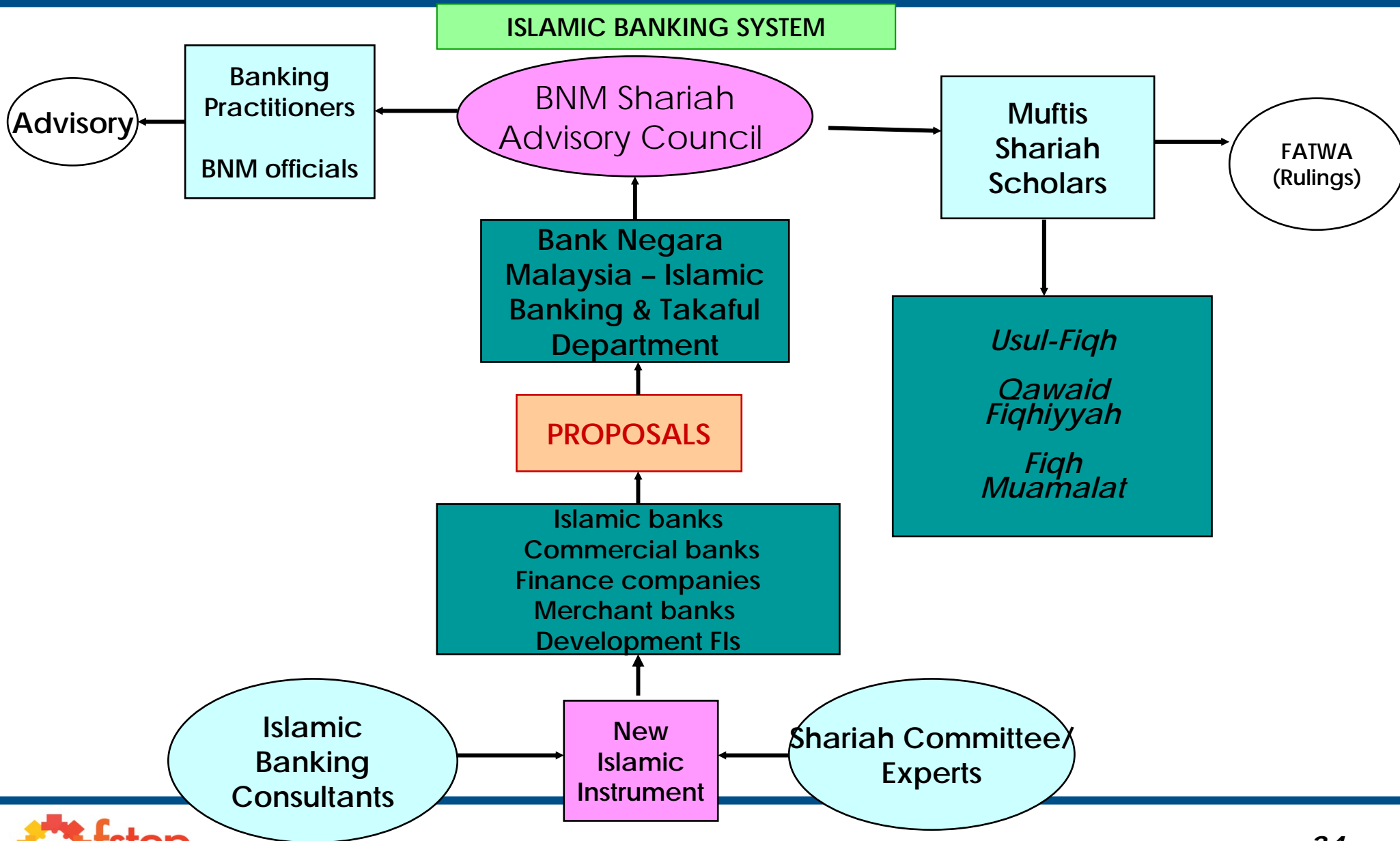
Among the earlier cases that were decided by the Civil courts include Tinta Press (1987), Adnan Bin Omar (1994) and Dato Hj Nik Mahmud Bin Daud (1996) all of which involved Bank Islam Malaysia Berhad.



All the Islamic banks and financial institutions that offer Islamic banking and finance are regulated and supervised by the Central Bank of Malaysia (BNM)

The Shariah Advisory Council at BNM is the supreme body that govern the Shariah matters of all the banks and FIs after amendments made to the Central Bank Act, IBA, BAFIA and DFIA

The department responsible at BNM is Islamic Banking & Takaful Department.



# COMPARISON : ISLAMIC VS CONVENTIONAL BANKING

# COMPARISON-CONVENTIONAL & ISLAMIC BANKING

	CONVENTIONAL BANKING	ISLAMIC BANKING
FUNCTION	<b>Lender &amp; borrower</b>	<ul style="list-style-type: none"><li>- custodian of goods</li><li>- entrepreneur</li><li>- financier</li></ul>

# COMPARISON-CONVENTIONAL & ISLAMIC BANKING

	CONVENTIONAL BANKING	ISLAMIC BANKING
DEPOSIT	<b>Interest-based deposit</b>	<b>- safe custody - investment</b>
LOAN/ FINANCING	<b>Interest- based loan</b>	<b>- Debt financing - Equity financing</b>

# ISLAMIC VS CONVENTIONAL BANKING

ISLAMIC BANKING	CONVENTIONAL BANKING
<ol style="list-style-type: none"><li data-bbox="70 368 602 411">1. ISLAMIC/CIVIL LAW</li><li data-bbox="70 519 754 562">2. ISLAMIC BANKING ACT 83</li><li data-bbox="70 748 727 862">3. FREE FROM PROHIBITED ELEMENTS</li><li data-bbox="70 976 650 1176">4. INTEREST FREE. PROFIT AS THE MAIN INCOME</li></ol>	<ol style="list-style-type: none"><li data-bbox="1056 368 1369 411">1. CIVIL LAW</li><li data-bbox="1056 519 1665 634">2. BANKING &amp; FINANCIAL INSTITUTION ACT 92</li><li data-bbox="1056 748 1203 791">3. N/A</li><li data-bbox="1056 976 1686 1090">4. INTEREST AS THE MAIN INCOME</li></ol>

# ISLAMIC VS CONVENTIONAL BANKING

ISLAMIC BANKING	CONVENTIONAL BANKING
5. SHARIAH COUNCIL / ADVISOR	5. N/A
6. SHARIAH COMPLIANT PRODUCTS**	6. N/A
7. DEBT & EQUITY BASED PRODUCTS	7. DEBT BASED PRODUCTS
8. CIVIL COURT ( ISLAMIC/CIVIL LAW)	8. CIVIL COURT ( CIVIL LAW )

# ISLAMIC BANKING PRODUCTS AND CONTRACTS USED



# DEPOSIT PRODUCTS

1. SAVINGS ACCOUNT
2. CURRENT ACCOUNT
3. INVESTMENT ACCOUNT

# CONTRACT - DEPOSIT PRODUCTS

## 1. WADIAH (Safe custody)

Wadiah Yad Dhamanah (Guaranteed safe custody)  
-applied in Savings & Current Accounts

## 2. MUDHARABAH (Trustee profit sharing)

-applied in Mudharabah Investment Account & Savings Account

# AL-MUDHARABAH DEPOSITS



1. DEPOSITOR INVESTS A CERTAIN AMOUNT OF MONEY E.G. RM100,000 FOR A SPECIFIC PERIOD E.G. 1 YEAR. BOTH PARTIES AGREE ON PROFIT SHARING RATIO (E.G. 70:30) I.E. 70% OF GROSS PROFIT TO BE DISTRIBUTED TO DEPOSITOR AND 30% TO BANK.



2. BANK UTILISES THE MONEY IN VARIOUS FORMS OF INVESTMENT OR FINANCING

3. PROFIT

LOSS

70%

30%

100%

# FINANCING PRODUCTS

## 1. CONSUMER FINANCING

- Home financing
- Car financing
- Personal financing

## 2. COMMERCIAL FINANCING

## 3. CORPORATE FINANCING

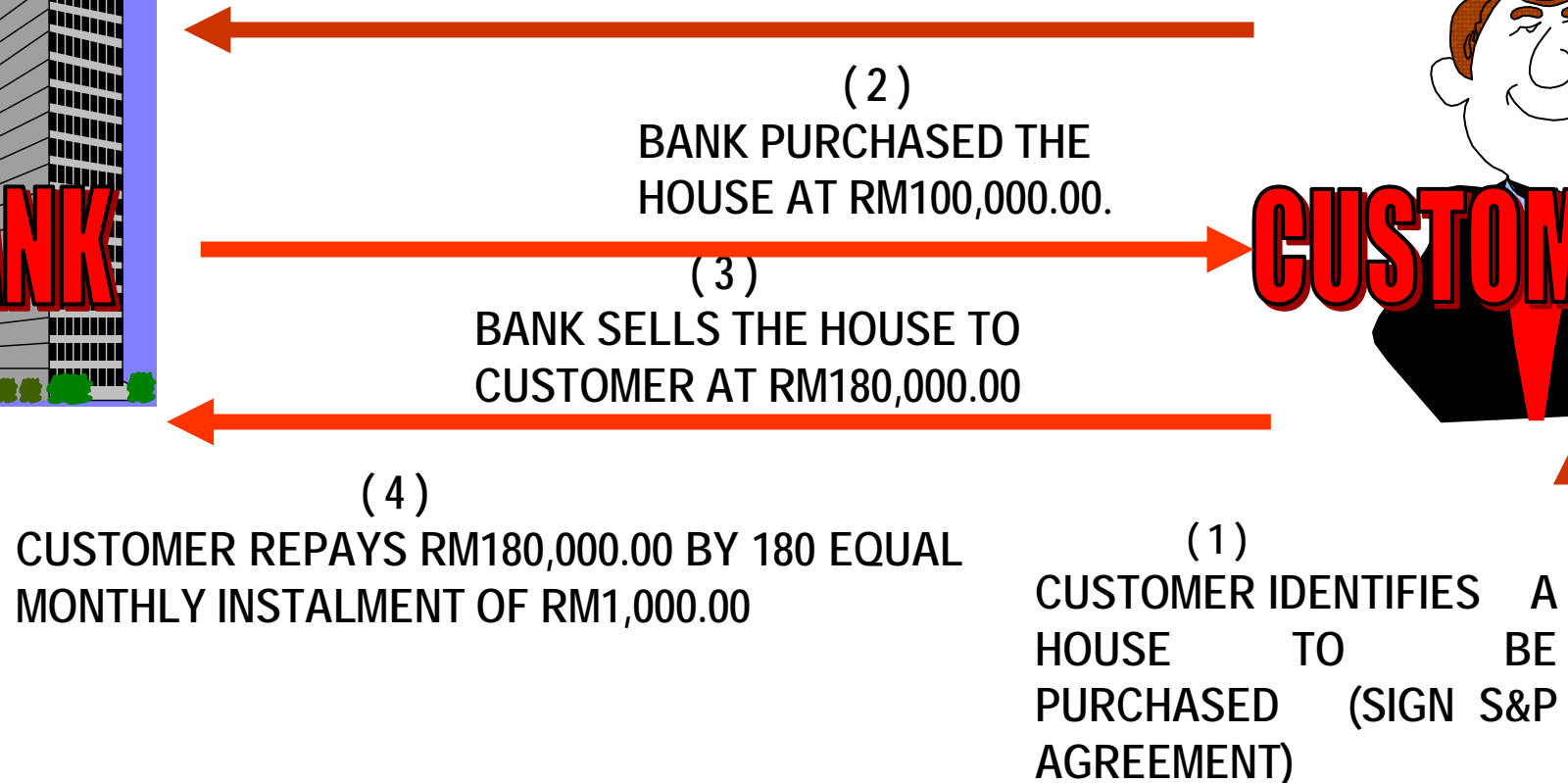
# CONTRACT- FINANCING PRODUCTS

1. AL-BAI BITHAMAN AJIL (Deferred Payment Sale)
  - applied in Home financing, Land financing
2. MURABAHAH (Deferred Lump Sum Sale)
  - applied in Murabahah Working Capital Financing
3. IJARAH (Leasing)
  - applied in Vehicle Leasing, Equipment Leasing etc.

# FINANCING PRODUCTS

4. MUDHARABAH (Trustee Profit Sharing)  
-applied in project financing
  
5. MUSYARAKAH (Joint-venture profit sharing)  
-applied in project financing
  
6. IJARAH THUMMA BAI ( Leasing ending with sale)  
-applied in car financing

# BBA FINANCING – House Financing



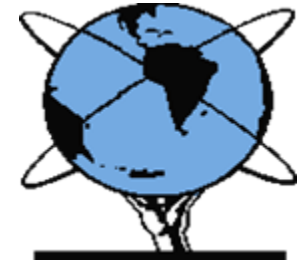
# CURRENT DEVELOPMENT OF ISLAMIC BANKING & FINANCE



- Malaysian Islamic banking system – strong performance in 2006, higher profitability and remained well capitalised
- Islamic banking assets increased to about USD34 billion ( about 13% in terms of market share)
- Takaful sector stands at USD1.7 billion
- Malaysian Islamic capital market has been equally encouraging. Islamic corporate bond now amounting to USD36 billion or 48% of the total corporate bond issuance in Malaysia

- Malaysia has put in place a comprehensive Islamic financial system that includes the legal, Shariah and regulatory infrastructure, supported by diversity of players and a wide range of products and services
- Malaysia launched the MIFC initiative last year in order to provide a more conducive business environment
- Malaysia has liberalised the foreign equity to a maximum of 49% in existing Islamic banks and takaful companies

- New licenses for International Islamic Bank and International Takaful Operator for the conduct of full range of Islamic banking or takaful and retakaful business in international currencies are being offered
- Tax holiday, stamp duty exemption and withholding tax exemption are also being offered

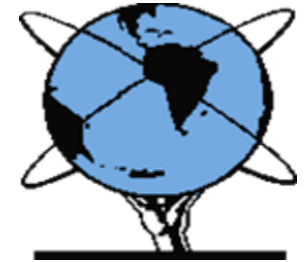


## Best Central Bank in Promoting Islamic Finance

1 <sup>st</sup>	Bank Negara Malaysia	58%
2 <sup>nd</sup>	Bahrain Monetary Agency	14%
3 <sup>rd</sup>	UAE - DIFX	6%

## Best Overall Provider of Islamic Financial Services

1 <sup>st</sup>	Dubai Islamic Bank	16%
2 <sup>nd</sup>	HSBC Amanah	15%

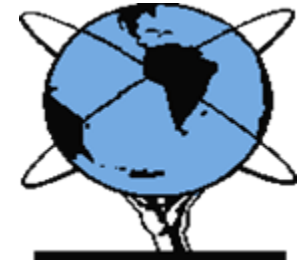


## Best Individual Islamic Banker

Iqbal Khan, HSBC Amanah

## Most Innovative Islamic Bank

1 <sup>st</sup>	Dubai Islamic Bank	11%
	Kuwait Finance House	11%
2 <sup>nd</sup>	Bank Islam Malaysia	9%
	HSBC Amanah	9%



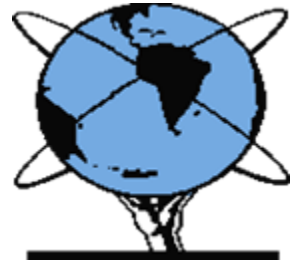
## Best Overall Retail Islamic Bank

1 <sup>st</sup>	Dubai Islamic Bank	24%
2 <sup>nd</sup>	Bank Islam Malaysia	13%
3 <sup>rd</sup>	HSBC Amanah	12%

## Best New Islamic Bank

1 <sup>st</sup>	Islamic Bank of Britain	15%
2 <sup>nd</sup>	Emirates Islamic Bank	14%
3 <sup>rd</sup>	RHB Islamic Bank	7%

- 40 Islamic banks (identified) hold nearly \$40 billion in assets
- Malaysia dominates with 17 institutions and 73% of total assets
- Annual growth for 2005 of 20.9% ( compared to 6.6% annual growth )
- Islamic Banking assets account for 12% of total banking sector asset in the country
- For other 19 institutions ( Islamic window) assets ranging from 2 to 13%



# LARGEST ISLAMIC BANKS (ASIA PACIFIC) - Research Report (2006) - AB

RANK 2006	ISLAMIC BANK	ASSET US\$	FINANCING US\$	DEPOSITS US\$
1	Maybank, Malaysia	6,417.1	4,532.6	3,694.5
2	Bank Islam, Malaysia	4,171.3	2,443.6	3,548.6
3	Bank Muamalat, Malaysia	2,715.0	1,047.6	2,478.2
4	AMMB, Malaysia	2,552.0	1,764.9	1,210.4
5	Public Bank, Malaysia	2,127.1	1,908.0	1,610.8



# LARGEST ISLAMIC BANKS (ASIA PACIFIC) - Research Report (2006) - AB

RANK 2006	ISLAMIC BANK	ASSET US\$	FINANCING US\$	DEPOSITS US\$
6	RHB Islamic Bank, Malaysia	2,015.5	899.0	1,457.1
7	Islami Bank Bangladesh	1,856.7	Na	1,628.5
8	Faysal Bank, Pakistan	1,845.0	1,042.7	1,250.3
9	Hong Leong Bank, Malaysia	1,748.5	1,072.1	1,549.6
10	Islamic Bank of Brunei, Brunei	1,620.1	953.3	1,433.7

# HUMAN CAPITAL DEVELOPMENT

- “ While Islamic banking has made significant strides, there are challenges that needs to be addressed for Islamic finance to sustain its development ”

## The fourth challenge

“ The development of a sufficient pool of appropriately skilled Islamic finance practitioner needs to be accorded the highest priority ”

# MALAYSIA'S TOTAL TALENT MANAGEMENT SOLUTION IN ISLAMIC FINANCE



ISLAMIC BANKING AND FINANCE  
INSTITUTE MALAYSIA

INCEIF

INTERNATIONAL CENTRE FOR EDUCATION  
IN ISLAMIC FINANCE

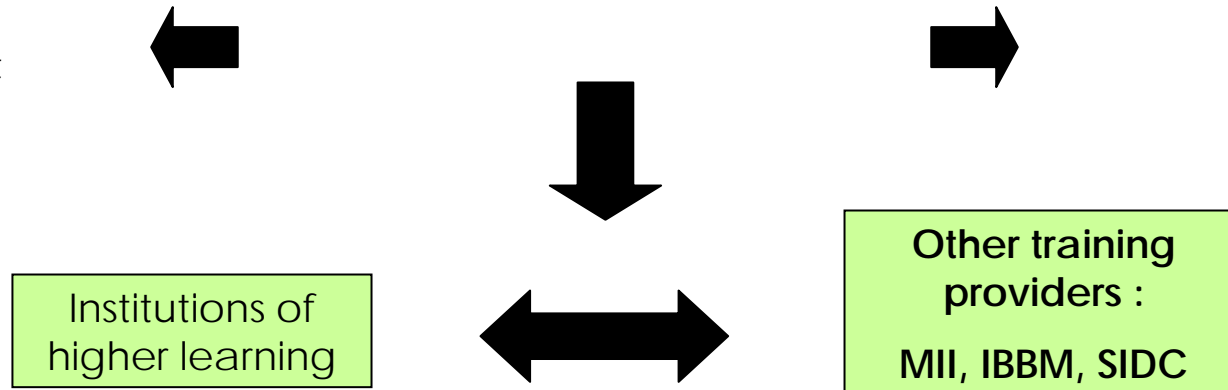


International Centre For Leadership In Finance  
Advancing Leadership Excellence

- Skill-based training
- Short courses
- Consultancy
- Research in product development

- Professional certification & PhD. program

- Industry leaders
- Executive development



Meeting the education needs of **all levels** of Islamic finance practitioners

# MALAYSIA'S TOTAL TALENT MANAGEMENT SOLUTION IN ISLAMIC FINANCE



ISLAMIC BANKING AND FINANCE  
INSTITUTE MALAYSIA

Was set up by BNM in 2001 as an industry-owned institute dedicated to producing well-trained, high calibre individuals and executives with the required expertise in Islamic finance industry



International Centre For Leadership In Finance  
Advancing Leadership Excellence

Was set up by BNM in 2003 to help create a pool of top management talent for the private sector in Malaysia, the region and beyond

INCEIF

INTERNATIONAL CENTRE FOR EDUCATION  
IN ISLAMIC FINANCE

Was set up by BNM in 2005 to develop and enhance human capital in Islamic finance in order to meet the growing needs of the global Islamic finance industry



**Associations for Islamic Banking and Takaful in Malaysia (AIBIM)** was established in **12 July 1995**. The main objective of AIBIM is to promote the establishment of sound Islamic banking systems and practices in Malaysia in cooperation and consultation with Bank Negara Malaysia or other regulatory bodies in Malaysia.

**Malaysian Takaful Association**

**Malaysian Takaful Association (MTA)** was formed in November 2002 with the main function of improving industry self-regulation through uniformity in market practices and promoting a higher level of cooperation among the players in developing the industry.

Thank you