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The Islamic Banking System in Malaysia

Some Issues

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ABSTRACT

Malaysia's commitment to developing a complete Islamic banking system began in 1983, when the first Islamic bank commenced operations. Although in the years since then the Malaysian Islamic banking system has managed to portray itself as a feasible alternative to conventional banking, certain issues have arisen. Questions such as public acceptance and the lawfulness of the Islamic principles in use as well as their applicability need consideration. This paper highlights the development of the Islamic banking system in Malaysia and the points that still need to be addressed to make this system more feasible and acceptable to both Malaysians and Muslims in other countries.

I. INTRODUCTION

The establishment of the Mit Ghamr Local Savings Bank of Egypt in 1963 marked a new milestone in the development of the modern Islamic banking system. This rudimentary effort was then refined and further developed by Muslim jurists and scholars. The period between the second half of the 1970s and the early 1980s was considered a boom period for the Islamic banking system as many Islamic banks gained a footing in Muslim countries. Currently more than 150 interest-free financial institutions operate in both Muslim and non-Muslim countries, including countries previously within the Soviet bloc. These institutions provide banking services comparable those offered by interest-based institutions, including insurance, pawnbroking, and stock market transactions.

As in most Muslim countries, the first Malaysian Islamic bank was established during Islamic banking's growth period. Since then, much has altered in the country's overall financial system. It has even been claimed that the Islamic financial system in Malaysia is now offering the most progressive array of services in the Islamic economic world. Besides a complete range of conventional Islamic banking services and products, Malaysian banks are now providing access to Islamic insurance and Islamic pawnbroking. The Malaysian Islamic financial market is moving out of its infancy toward greater maturity by also providing securities and financial derivatives that comply with *sharīᶜa* requirements.

The Malaysian Islamic financial system has developed rapidly, yet there remain a number of unresolved legality issues concerning which it will be desirable to consider the views of scholars. The second section of this paper will take up the development of the Islamic financial system in Malaysia, while the third will deal with some of the issues that still remain to be decided. The fourth and final section will be devoted to conclusions.

II. THE DEVELOPMENT OF THE ISLAMIC FINANCIAL SYSTEM IN MALAYSIA

Islamic finance, comprising banking and investment that fulfill the strictures of the *sharīᶜa* or Muslim religious law, has long been recognized as a niche industry. Its peculiar features have isolated it from the rest of the world of finance. However, in response to the need for an alternative financial system to meet urgent, growing demand for Islamic finance, Western and Islamic economists as well as financiers are now developing new products to link Islamic finance and its underutilized capital pool to the global finance system.

The last two decades have witnessed the rapid growth of Islamic banking around the world, both in volume and numbers. Islamic banking has established itself as an emerging alternative to interest-based banking and is taking root in both Muslim and non-Muslim countries. Islamic banks operate in over sixty countries, most of them in the Middle East and Asia. In Iran, Pakistan, and Sudan, the entire banking system has been converted to Islamic banking. Outside the Islamic world, many countries, including Denmark, Luxembourg, and China, offer Islamic banking facilities. In Britain, the Institute of Islamic Banking and Insurance was established to spread information

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about Islamic finance, and London has emerged as the major center of activity. Islamic banking is the fastest growing segment of the credit market in Muslim countries, which have Islamic banks, even when conventional banking institutions still dominate the banking system. Banks in Muslim countries have developed their own methods for dealing with the ban on interest and speculation.

In Malaysia, the first move toward the development of an Islamic financial system was initiated with Islamic Banking Act 1983 and Government Investment Act 1983. In the same year, following hard on these acts, the first Islamic bank, Bank Islam Malaysia Berhad (BIMB), was established. Proving that Islamic finance was filling a felt need, BIMB recorded strong growth a year later. Total assets doubled from $170.7 million at the end of 1983 to $369.8 million at the end of 1984, with sharp increases of deposits from $91.0 million to $274.9 million, and of loans from $40.7 million to $249.8 million.

BIMB has been pioneering Islamic banking within Malaysia's banking system since its establishment more than a decade ago, expanding its menu of services rapidly. At present three subsidiaries are providing such services as leasing, trust funds, general *takāful* (insurance), nominees, and stockbroking.

However, the Islamic system did not begin to take off seriously until March 1993, when the Ministry of Finance introduced legislation regulating an "Interest-Free Banking Scheme" or *Skim Perbankan Tanpa Faedah (SPTF)*. As in most Muslim countries, where many of the first Islamic banks were development banks, the most promising field to start with was pilgrims' funds, a source of finance with considerable potential. In 1969 the Malaysian Pilgrims' Management Fund and Fund Board were founded to pool Muslim savings and manage pilgrimage expenses.

The central bank, Bank Negara Malaysia (BNM) boosted the growth of a Malaysian Islamic financial system by pioneering an Islamic interbank system. Malaysia has a full-fledged Islamic banking system, running in tandem with a Western-style banking system. Among the Muslim countries that offer Islamic financial systems, Malaysia is in the forefront of Islamic banking R&D. The BNM for example, in 1993, approved a total of 21 Islamic financial products for domestic financial institutions. The variety of Islamic financial products and the large number of participants, coupled with the development of the Islamic interbank system, the latter initiated as the start of a full Islamic secondary market, provided the prerequisites for the viability of a domestic Islamic financial system. The Islamic interbank money market has recorded and increase in volume from RM158 billion in 1998 to RM436 billion in 1999 (BNM Annual Report, 1999).

To further accelerate the growth of the Islamic banking sector, BNM has implemented new measures. In 1996, the new financial disclosure model form, the GP8, was introduced to promote transparency and disclosure of Islamic banking operations. This was followed by the setting-up of full-fledged Islamic banking branches (instead of the Islamic banking "windows" offered in the conventional banks), and the *Sharīʿa* Advisory Council (SAC). The Council would be repealed once amendments to the Central Bank Act (1958), the Islamic Banking Act (1983), and the Takaful Act (1984) were completed.

As a consequence of the liberalization of the banking industry in 1993, Islamic banking services under the Interest-Free Banking Scheme (IFBS) have come to be offered by 50 other financial institutions including commercial banks, finance companies, merchant banks, cooperative banks, and discount houses

Although the Islamic banking system was, like other financial institutions in the country, adversely affected by the 1997 Asian financial crisis, Malaysia's rapid and vigorous economic recovery has made it possible for the system to experience some spill over effect. The total assets of the Islamic banking sector increased from $21.6 billion to RM35.7 billion by the end of 1999, registering a sharp growth of 65.3%. Total deposits mobilized showed a steady growth rate of 50.6% (BNM Annual Report, 1999).

The latest development in Malaysian Islamic banking is the establishment of a second Islamic bank, the Bank Muamalat Malaysia Berhad (BMMB), by merging Bank Bumiputra Malaysia Berhad and Bank of Commerce (Malaysia) Berhad. BMMB started operations on October 1, 1999.

Apart from these rapid moves undertaken by BNM to foster an active Islamic banking system, much attention is now being focused on applying Islamic principles to the equity market, an effort being vigorously made in all the Muslim countries that experienced the turmoil of the recent financial crisis. Like other Muslim countries with a population predominantly Muslim, Malaysia has an established stock market. Solid progress has been made in the preparations for putting in place the infrastructure necessary to facilitate stock trading in accordance with Islamic principles. In 1994, BIMB Securities, Malaysia's first stockbroker firm, was founded. Apart from providing Islamic brokerage houses and Islamic managed funds, it has been possible to establish a separate "Islamic Index." This index follows 179 permissible stocks traded on the Kuala Lumpur Stock Exchange (New Horizon, 1996). Muslim investors have been able to invest directly in *®alāl* (permitted) counters. Conventional securities firms have also set up their own Islamic stockbroking windows to advise investors on *®alāl* stocks. As of July

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1996, 364 stocks of the 633 listed on the Kuala Lumpur Stock Exchange (KLSE) are considered *®alāl*. On April 17, 1999, the KLSE *Sharīᶜa* Index was launched to facilitate investment in instruments conforming to the *sharīᶜa*.

Having a progressive and sound domestic Islamic banking system is just a beginning for Malaysia in its ambition to become a leading example of a country with a financial system that can be a viable alternative to interest-based banking. The country's bankers and regulators have already positioned Malaysia to become a regional Islamic financial center. With the establishment of an international Islamic bank in Labuan, Sabah, this vision is now becoming a reality.

III. Issues Related to the Malaysian Islamic Financial System

This paper will focus on the issues related to the Malaysian Islamic financial system that are in need of remedial actions. Among these are (1) the seriousness of Islamic financial institutions about fulfilling their objectives; (2) adherence to *sharīᶜa* principles (3) the level of *sharīᶜa* compliance; and (4) public acceptance of products and services.

A. The Fulfillment of Objectives

As suggested by Khan (1983), Islamic financial institutions are intended to promote, foster, and develop banking services and products based on Islamic principles. Islamic banks are also responsible for promoting the establishment of investment companies or other business enterprises as long as their objectives are not forbidden by Islam. The main principles of Islamic banking are prohibition of interest in all transactions, and the requirement that business and trade activities be based on fair and legitimate profit. Islamic banks are required to pay *zakāt* (alms tax) and to develop an environment beneficial to society. Similarly, Ali (1988) believed that an Islamic financial system cannot be introduced merely by eliminating *ribā* but also requires adoption of Islamic principles of social justice and the introduction of laws, practices, procedures and instruments supportive of justice, equity, and fairness.

Islamic financial institutions, therefore, are not expected to have the same objectives and philosophies as those of other business entities. Their objectives and philosophy should be in line with tradition and the revelations of the Qur'an. Hence, while ordinary business entities are likely to make profit their primary objective, Islamic banks have to balance profit and moral values. Islamic banks' commitment to moral objectives are not only highlighted in their corporate mission statement and objectives but also in the way they do business.

A number of Islamic banks, like Islami Bank Bangladesh Limited (IBBL), Jordan Islamic Bank (JIB), and Bank Muamalat Indonesia (BMI), actively promote social welfare. IBBL, besides aiming to introduce a welfare-oriented banking system, has also succeeded in achieving economic equity and justice by creating activities intended to help the underprivileged to increase their income as well as creating job opportunities for youth. These social welfare activities are channeled through a special body, the Islamic Bank Foundation. By the end of 1998, the Foundation had established two modern hospitals, one at Dhaka and the other at Rajshahi, a service center, a sales outlet, and several other projects for the socioeconomic development of the country. The Foundation has also established two types of training institutes, a vocational institute for unemployed youth, and a college providing religious and moral teaching. In line with the objective of raising the economic status of the poor, the Foundation has established a retail center where the public can have access to products manufactured by poor and distressed women. The Foundation also maintains special funds to help flood victims and the victims of other disasters.

Just like Islamic Bank of Bangladesh, Jordan Islamic Bank (JIB) plays an important role in promoting social, spiritual, and ethical values in the community. Since its inception, JIB has allocated some portion of its net profit to be donated to Jordanian universities, scientific research, and vocational training. As for the social welfare, JIB continues to donate to communities, charitable associations, and mosques, as well as to other social welfare and religious activities, like providing cash prizes to winners of Qur'an recital competitions and also to newlywed couples to cover their marriage expenses. The Bank also sends deserving underprivileged on the minor pilgrimage (*umra*). JIB continues its *qar∞ ®asan* loans to needy persons faced with unavoidable financial burdens, such as bridegrooms. Other social activities that the bank continues to undertake are the financing of craftsmen and mutual insurance funds.

Though it has the objective of making realistic profits and ensuring optimal corporate growth, Bank Muamalat Indonesia (BMI) continuously makes positive social welfare contributions to the Muslim community. Among the activities on its social agenda are: (1) small enterprise development; (2) a people's economic empowerment project; (3) a ZIS fund; (4) an international development foundation fund; and (5) a financial institution pension fund. Under the small enterprise development program, BMI provides profit-sharing financing schemes to small enterprises. By the end of 1998, 14.73% of BMI's total loans were made under this scheme. The aim of the people's economic empowerment project is to enhance the development of Islamic financing units at

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Islamic boarding schools. By end 1998, 3000 students and 160 staff at 1500 boarding schools were benefiting from this project.

The commitment of Malaysian Islamic financial institutions varies. In the case of Bank Islam Malaysia Berhad (BIMB), its corporate objective and the social welfare activities it undertakes are used as an indicator of its commitment to its moral obligations. Initially, the aim of BIMB was "to provide banking facilities and services in accordance with Islamic principles to all Muslims as well as the whole population of Malaysia. The Islamic principles meant here are essentially those belonging to the body of *sharīᶜa* rules on commercial transactions related to banking and finance. The bank's efforts to provide these banking facilities and services are undertaken within the framework of its viability and capability to grow and expand continuously." (BIMB, 1985). The present objectives of BIMB are more focused and reflect the current direction and the philosophy of its top management. They are to:

1. Provide its customers with Islamic banking facilities and services of the highest possible quality;
2. Attain viability and a sufficient level of profitability to sustain growth;
3. Develop and foster a competent and innovative management imbued with high standards of integrity and Islamic banking professionalism;
4. Develop a motivated workforce inculcated with the appropriate work ethic, fully committed to the Bank and to efficient and courteous service to the customer;
5. Strive constantly to protect its shareholders' interests; and
6. Be conscious always of its responsibilities and duties as an Islamic corporate citizen.

Over the 15 years since its establishment, BIMB has accomplished many of these objectives. Its assets have grown from $145 million ($1 = RM 3.8) at the end of the first year of operations to $1,780 million as of June 1999. This success notwithstanding, BIMB has yet to discharge its moral responsibilities to the same extent as the Islamic banks in Bangladesh, Jordan, and Indonesia. Although BIMB has engaged in several initiatives to fulfill its moral obligations, the most significant has been paying its *zakāt* regularly. At the end of the 1998-1999 financial year, for example, a total of $315,500 had been paid in. Clearly, to be known as institutions that uphold Islamic business principles, it will be appropriate for Islamic banks in Malaysia actively to engage in social welfare projects. Activities using *qar∞ ®asan* or *mu∞āraba* principles must be introduced to finance small business. For this purpose, the kind of activities undertaken by Islamic banks in Bangladesh, Jordan, and Indonesia might well be considered for adoption.

B. The Use of *Sharīᶜa* Principles

The *sharīᶜa* principles for products and services of Islamic banks can be classified broadly into four categories: (1) profit-and-loss sharing; (2) the fee or charge basis; (3) free service; and (4) ancillary principles. Although a number of principles have been adopted for determining how Islamic banks shall conduct operations, it is the consensus of Muslim scholars that they belong to two clusters, i.e., strongly Islamic and weakly Islamic. Principles can be considered strongly Islamic if they conform to Islamic objectives both in form and in substance., while "weakly Islamic" refers to conformity with Islamic norms in form but not in substance. The basis for judgment as to the strength or weakness of a given principle is the extent to which that mode contributes to the achievement of the objectives of the Islamic economy. Thus, only those principles that share risk between providers and users of funds, can be considered strongly Islamic. Muslim scholars consider only two principles, i.e., *mu∞āraba* and *mushāraka*, as strongly Islamic, the remaining principles being recommended only in cases where risk-return sharing cannot be implemented (Mirakhor, 1987).

Since the early days of the modern Islamic banking system, scholars have recommended that Islamic banks apply profit-and-loss sharing principles for both deposit taking and financing (see Ahmed et, al. 1983; Siddiqi, 1983; Qureshi, 1985; and CII Reports, 1983). While these principles are widely used in deposit taking, their application in financing has been minimal. Islamic banks prefer fee-based transactions because of the simplicity, lower risk, and pre-determined fixed rate of return, as well as their conformity to the banking status quo, with its traditional emphasis on creditworthiness and the creditor-debtor relationship. It is believed that the fee-based transactions open the door to interest (Ahmed, et. al, 1983).

Resistance in financing to the profit-and-loss sharing principle by the management of Islamic banks is clearly seen in the figure for total funds channeled into these activities. In the case of Dubai Islamic Bank, for example, in 1998 the financing that adhered to the profit-and-loss sharing principle was only 10% of total financing. Similarly, the corresponding figures for Jordan Islamic Bank and Qatar Islamic Bank were only 3% and 4%.

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Like other Islamic banks, Bank Islam Malaysia Berhad also prefers to use the fee-based principle in financing activities. In 1988, only 1% of total financing was *mu∞āraba* and *mushāraka*. By 1993, the figure had increased to 2%, and at the end of financial year 1999 the figure gone back to 1%. After more than 15 years of existence is time for both Islamic banks in Malaysia and in other countries not to be overly dependent on fee-based financing. New strategies must be implemented to increase adherence to the profit-and-loss sharing principle.

The terminology used for these principles can be confusing. Malaysia, for example, is the only country where Arabic words are used for all the *sharī^{c}a* principles governing its Islamic banking operations. Other countries retain Arabic words for certain principles only, using the vernacular. The principles most widely used in the literature of Islamic banking in Malaysia are *al-wa∞ī^{c}a*, *al-wa∞ī^{c}a al-∞amāna*, *al-mu∞āraba*, *al-mushāraka*, *al-murāba®a*, *bay^c bi-thaman a^{c}jil*, *bay^c al-dayn*, *al-wakāla*, *al-kafāla*, *al-®awāla, al-ijāra*, *al-ijāra thumma al-bay^c, al-^{c}ujr*, *al-rahn, bay^c al-^{c}īna*, *al-istisnā'*, and *qar∞ ®asan*.

C. The Legality of the Principles

Although Malaysia is considered a success as a Muslim country that has successfully promoted Islamic banking to parity with conventional banking, scholars in other countries doubt the lawfulness of the *sharī^{c}a* principles used in its system (Al-Qaradawi, 1997; Homoud, 1999). One of the areas receiving heavy criticism is the issuance and trading of Islamic bills and bonds. The "Interest-Free Accepted Bill" or "Islamic Accepted Bill" was first introduced in 1991 with Islamic bonds gaining a foothold in 1992. The Islamic Accepted Bill is similar to the banker's acceptance used in conventional banking to facilitate international and domestic trade. However, the introduction of the Islamic bond was to help corporate bodies tap funds from the capital market (the details of these transactions are beyond the scope of this paper). The principles of *murāba®a*, *bay^c bi-thaman a^{c}jil*, *bay^c al-dayn* and *da^{c}wa ta'ajjal* are normally used in the issuance and trading of these documents. The use of *bay^c al-dayn* and discounting has drawn strong criticism from scholars, especially in the Middle East.

Criteria for these securities are (1) the existence of ownership, (2) securitization, (3) the issuance of securities, and (4) their being traded. In the case of Islamic bills, for example, the facility is provided only to customers who can produce evidence of involvement in either import (purchase) or export (sale) transactions. Upon presentation of evidence such as trade documents, bills of exchange, etc., single or multiple Islamic bills will be issued drawn on bank/purchaser for payment at maturity. The accepting/drawing bank receives a commission.

In the case of *bay^c al-dayn* or debt trading, this principle is widely used not only in the trading of Islamic bills but also in Islamic bonds. The issuance of these bonds is usually based on trade transactions based on the principles of *bay^c bi-thaman a^{c}jil*, *murāba®a*, *ijāra*, and the like between issuers and investor. The principle of *bay^c al-^{c}īna* is used when a deal is negotiated and completed. As in conventional banking, a certificate is issued indicating the maturity date. The issuer pays the amount to the holder of the certificate. The certificate known as '*shahdah al-dayn*' is considered '*al-mal*' or property to qualify as an object of sale. Therefore, the holder has the right to resell in the secondary market using the *bay^c al-dayn* principle. Malaysian scholars strongly believe that this principle is allowable in Islam, and that Islamic bonds may be sold to third parties for cash and at a lower price (see Ishak, 1997, and Rosly and Sanusi 1999 for further elaboration).

In the case of *da^{c}wa ta'ajjal* or discounting, the legality of this principle is said to be based on the following traditions (*®adīth*) (see Ishak, 1997, for further elaboration):

> Narrated by Ibn Abbas when Rasulullah (peace be upon him) directed Bani Nadir to leave Medina, they said: "There are still debts due to us." Rasulullah (peace be upon him) then replied: "give a discount and ask for early payment."
>
> (Narrated by al-Baihaqi)

> "When Kaab was in a mosque discussing with Abi Hadrad how he would pay his debt to Kaab, they did not realize that they had raised their voices and enabled Rasulullah (peace be upon him), who was in his house, to overhear their discussion. Rasulullah then said: give a discount on the debt. Kaab then replied: I have already done so," whereupon Rasulullah asked Abu Hadrad to pay the discounted debt."
>
> (Narrated by al-Bukhari)

Da^{c}wa ta'ajjal is different from *ribā* because it has an element of *ra'fa* or compassion and assistance or support. Consent to reduce the loan or debt comes from the lender or seller, and it introduces an element of *ra'fa* and *takhfif* or lifting a burden from the borrower or buyer. Similarly, the use of this concept creates mutual goodwill for both parties, and this is one of the pillars of Islamic *mu^{c}āmalāt*.

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Usmani (1999), however, strongly believes that the principle of *bay^c al-dayn* is not permissible in Islam. He argues that debt corresponds to money, and any exchange must be equal in value. He also reiterated that the Islamic *Fiqh* Academy of Jeddah has unanimously approved the prohibition of *bay^c al-dayn*.

D. Public Acceptance

Since its introduction, Islamic banking products have been well accepted by Malaysians. This is reflected in the increasing totals for deposits and loans based on Islamic principles placed by Muslim and non-Muslim customers. In the case of BIMB, for example, at the end of June 1984 (the first year of operations), deposits and loans totaled RM241 million and RM162 million respectively. By the end of 1994 (the 10th year of operations) deposits totaled RM2548 million, and loans RM977 million. The corresponding figures for the financial year 1999 were RM5,617 million and RM3,404.

Public support of the Islamic banking system is also reflected in the use of Islamic banking products offered by conventional financial institutions. In 1994, the first year selected commercial banks were allowed to introduce Islamic deposit facilities, a total of RM1,463 million was collected in deposits. This figure includes deposits in current accounts (RM166 million), savings deposits (RM1,146 million), and investment deposit facilities (RM151 million). Since then, these three types of Islamic deposits have been receiving continuous support from the public. At end 1999, total deposits in commercial banks had increased to RM2,744 million. The figure for current accounts was RM3,954 million, and RM7,469 million and RM1,321 million for savings and investment accounts respectively.

Although total BIMB deposits and Islamic deposit facilities at commercial banks have increased significantly over the last five years, this does not means that the Malaysian public is uniformly receptive toward Islamic banking products. The comparative growth figures between Islamic and conventional deposits are good indicators of this. The growth of various types of deposit facilities in conventional and Islamic commercial banks is shown in Table 1. With the exception of 1995, the yearly growth figures for Islamic deposits have exceeded those for conventional deposits. Looking at the individual figures, we can also see that in many instances the growth of various types of Islamic deposit facilities was greater that the growth of deposits in the conventional system.

TABLE 1. ANNUAL GROWTH OF DEPOSITS IN COMMERCIAL BANKS

	1995	**1996**	**1997**	**1998**	**1999**
Conventional deposits					
Demand	14%	23%	–2%	–16%	31%
Fixed	31	28	26	6	14
Savings	8	23	–10	4	12
Total Deposits	**23%**	**26%**	**15%**	**2%**	**18%**
Islamic deposits					
Demand	88	120	209	–5	96
Investment	–4	23	51	162	39
Savings	123	87	35	19	30
Total Deposits	**19%**	**51%**	**91%**	**67%**	**52%**

Looking at Table 1, we may tend to conclude that Islamic banking products are becoming more popular among Malaysians. These growth figures alone, however, cannot answer several pertinent questions related to the

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development of Islamic banking in Malaysia. Such issues include whether all economic units in Malaysia are really keen on the idea of the superiority of Islamic banking over conventional banking; whether in promoting Islamic banking products commercial banks in Malaysia are really committed to adhering to the directives of the Central Bank; and whether the Islamic banking system has a bright future in Malaysia. Answers to some of these issues can be found by looking at the percentage of the deposits placed by Malaysian in the Islamic system against deposits in the conventional system. The percentage of funds placed in various types of deposit facilities available at commercial banks in Malaysia is shown in Table 2.

TABLE 2. FUNDS DEPOSITED IN VARIOUS DEPOSIT FACILITIES OF COMMERCIAL BANKS

	1995	**1996**	**1997**	**1998**	**1999**
Conventional deposits					
Demand	22.17	21.56	18.23	14.86	16.44
Fixed	62.42	63.22	68.90	70.93	68.99
Savings	14.34	13.94	10.79	10.82	11.23
Islamic deposits					
Demand	0.19	0.33	0.88	0.81	1.35
Investment	0.67	0.65	0.85	2.17	2.54
Savings	0.21	0.30	0.36	0.41	0.45
Total (%)	**100%**	**100%**	**100%**	**100%**	**100%**
Total Deposits (RM Million)	**163,739**	**206,609**	**239,677**	**247,647**	**293,902**

Notwithstanding the fact that there are signs of positive development of Islamic banking in Malaysia, at Table 2 makes it inevitable to conclude that public acceptance of these alternatives to the conventional banking system is far from satisfactory. Half of Malaysia's population is Muslim. The coalition government is led by UMNO (a Muslim-based party). Therefore, when the total funds deposited in the Islamic banking system do not exceed 5% of total deposits in commercial banks, remedial action is necessary to increase the share of the Islamic sector. As the governing body of the Malaysian banking system, not only must the Central Bank introduce directives that can lead to the progressive development of Islamic banking but penalize those who neglect the serious promotion of the Ilamic alternative. The research findings of Haron et. al (1994) indicate that almost 100% of the Muslims and 75% of the non-Muslims they interviewed were aware of the existence of Islamic banking. Most of them expressed a desire to have a relationship with an Islamic bank if they had a complete understanding of the system. The study also found that people believed that Islamic banks are not meant for Muslim customers alone. Therefore, there is no public acceptance problem. On the contrary, the major problem here seems to be the way these services are provided.

IV. CONCLUSION

Even though the Islamic financial system in Malaysia is recognized as the most progressive in the Islamic world, the problems highlighted here need immediately to be examined closely and addressed. Some of these issues affect the foundations of the *sharīᶜa*, and will thus invite much-heated debate. They will inadvertently result in similarity to conventional banking. For example, the applicability of *bayᶜ al-dayn* and *daᶜwa ta'ajjal* principles is related to the management of bonds and Islamic bills. Islamic scholars in the Middle East disagree with scholars in

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other regions on the applicability of these principles. Their difference needs to be resolved Agreement would contribute to the spread of Islamic banking.

It is not only in Malaysia but elsewhere that a lack of interest is observed in Islamic banks in consistent application of approved Islamic financial principles. Unless this is corrected, Islamic banks will tend to seem imitative of conventional banking, especially when the concept of "cost of funds" in an Islamic bank is the same as that in a conventional one, blurring Muslim perception of the difference between Islamic and conventional banking.

The goals and philosophy of Islamic banking should be seen as different from those of conventional banking. If conventional banking operates solely from the profit motive, then an Islamic bank has to portray itself as a bank that operates on a basis of both profit and morality. When this situation prevails, society will be confident that Islam is a religion that promotes not only moral obligations between God and humankind, but also among human beings. Realizing the superiority of Islamic banking for promoting human welfare, society as a whole will ultimately adopt the Islamic financial system, not as an alternative to the conventional system, but as the main choice for banking transactions. To achieve this ongoing commitment, there is a need for a strong collaboration between the regulators and those who are bounded by the law, to ensure new laws and regulations in line with the *sharīʿa*. Finally, all involved in the Islamic financial system must conduct themselves with probity and have complete faith that it is a sound alternative to the conventional one.

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