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## Islamic Banking Models in Malaysia An Overview



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### Historical Background

The independence gained by most Muslim countries in the 1950s and 1960s was undeniably a key that accelerated the Islamic revivalist movement which had developed in the Middle East and some parts of Asia by then. The movement then spilled over to Malaysia, and this eventually led the then government to set up an Islamic bank in Malaysia in July 1983. An earlier preliminary step towards its establishment had already been put in place with the setting up of Tabung Haji in 1963 as a platform for Muslims to deposit their savings for pilgrimage purposes.

### Bank Islam Malaysia Berhad and its ten years of exclusivity

Bank Islam Malaysia Berhad (BIMB) was launched on 1st July, 1983 by then Prime Minister Datuk Seri Dr Mahathir Mohamad after a two-year study carried out by the National Steering Committee (NSC) for the establishment of an Islamic bank in Malaysia. The launching of BIMB as the first Islamic bank in the country was eagerly awaited by the society. On the day of its launching a crowd lined up to open accounts with the bank. The Islamic Banking Act (IBA) 1983 was enacted and came into operation in April 1983 as legal support to govern the licencing and operation of the Islamic bank(s). In addition to that, the Government Investment Act (GIA) 1983 (later known as Government Funding Act 1983) was also gazetted to enable the government to issue Shariah-compliant investment certificates to facilitate the liquidity management of the Islamic bank.

In order to ensure the success of the first Islamic bank in the country, the regulator granted BIMB a ten-year exclusivity period. Within this period, BIMB was expected to build up its position in the market without having unnecessary competition from other Islamic banks. With unconditional support from the regulator and the government, BIMB managed to secure sizeable market share and was competitive with its conventional counterparts, offering Shariah-compliant products and services crafted

on the principles of wadiah, mudharabah, wakalah, musharakah and many more. The Takaful Act 1984 was enacted to add another key component of an Islamic financial system. It allowed the government to establish the first Islamic insurance company in the country, Syarikat Takaful Malaysia Berhad.

The starting up of Islamic windows structure: A new phase of Islamic banking

As BIMB had proved the viability of Islamic banking in the financial market in Malaysia, the regulator initiated another dimension of Islamic banking by introducing the 'Skim Perbankan Tanpa Faedah' (SPTF) in March 1993. The SPTF scheme allowed the conventional banks to participate in providing Islamic banking products and services to the market within their existing set-up in accordance with the guidelines issued by the regulator. To enable this, Section 124 of the Banking and Financial Institutions Act (BAFIA) 1989 was amended. With the amendment, the regulator was permitted to grant licences to the conventional banks to operate Islamic windows. It started with three banks: Malayan Banking Berhad (Maybank), United Malayan Banking Corporation (UMBC) and Bank Bumiputra Malaysia Berhad (BBMB). This was followed by other institutions. To facilitate the liquidity management of the Islamic banking players, which had increased to 21 in 1993, the regulator introduced the Islamic Interbank Money Market (IIMM), the first of its kind in the world to work in accordance with the principles of Shariah. This was a remarkable milestone in the history of the Islamic finance industry, initiated by Bank Negara Malaysia (BNM) as the regulator of the industry in Malaysia.

### Islamic Subsidiaries: Another step ahead

Islamic banking was further developed by the introduction of what is referred to here as the 'Islamic subsidiaries'. This, as indicated in the first Financial Sector Master Plan (FSMP), entailed the existing



conventional banks incorporating Islamic banks as their subsidiary companies under the purview of IBA 1983. This was another step initiated by the BNM as the regulator in promoting a higher degree of Shariah compliance. The Islamic subsidiary of any conventional bank would carry out its Islamic banking activities and operation as a full-fledged Islamic bank. The first institution licenced under the structure was RHB Islamic Bank in 2005. This was then followed by other conventional banks adopting the same approach. As of today, there are 11 Islamic subsidiaries in Malaysia out of 16 Islamic commercial banks.

### **Malaysian Models of Islamic Banking**

Chronologically, the Islamic banking models in Malaysia started with a full-fledged Islamic bank, followed by Islamic windows which eventually become Islamic subsidiaries. Indeed, the BNM should be applauded for the bold steps it has taken in responding to the market needs and ensuring greater compliance with the Shariah. Weaknesses were expected and discovered in each model that the BNM initiated. Malaysia had to experiment with its Islamic banking because there was no solid model from any other part of the world to emulate.

To flashback, BIMB was the sole Islamic bank for the first 10 years after its incorporation. Its establishment was a response by the government to pressure from the society for Islamic banking, which could be regarded as a need for the Muslims then. To tap the increasing demand of the market for Islamic banking products and services and to promote healthy competition in the financial sector, the Islamic windows of conventional banks were allowed to participate in the Islamic banking sphere in Malaysia. As the Islamic financial market grew tremendously all over the globe, Malaysia introduced its new structure, Islamic subsidiaries, to tap the market demand for a higher degree of Shariah compliancy and to respond to the hiccups and difficulties arising from the previous model.

The Malaysian models of Islamic banking represent a series of responses provided by the regulator on the basis of the necessity that surrounded the financial market. The lack of viable models of Islamic banking in the world prompted Malaysia to lead the global Islamic financial market with its humble efforts in introducing its own structures. In fact, Malaysia deserves to be regarded as the hub of Islamic finance in the world for its braveness and high reputation for innovation.

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