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Praise and glory be to Allah (SWT), the Most Gracious and Most Merciful. Bless and prayer be upon His Messenger Prophet Muhammad (SAW). I consider this book as my small and humble contribution to the Muslim ummah. It is very true that I was only able to complete this book by the blessing of Allah (SWT).

Thus, I would like to express my thorough and sincere gratefulness to Allah Almighty, who has given me the opportunity to write and complete this small book relating to Islamic banking and finance in Malaysia.

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Islam is a comprehensive way of life, which strikes the balance between the spiritual and the material needs of human being. One of the very important aspects in human life is the need for a comprehensive system in order to govern their life including the material needs in the financial matters. The emergence of Islamic banking and finance is often related to the revival of Islam and desire of Muslims to live all aspects of their live in accordance with the teachings of Islam.

Indeed, Islamic banking and finance is one of the components in Islamic financial sector that plays very vital role to generate the growth of economic, besides Islamic money market, capital market and takaful especially for Malaysian economy. On the other hand, Islamic banks can generate in halal activities, promote profit loss sharing, quest for justice, ethical and sanctify contract. Hence, Islamic bank is expected to run according to Shariah principles, mobilizing and utilizing the financial resources for the sake of Muslim ummah.

In addition, the Islamic banking system in Malaysia seems to prefer a sale-based mode of financing over other modes of financing. This might be due to the fact that the sale-based mode of financing can contractually guarantee a fixed flow of income to the financiers and investors as compared to other modes of financing. The main objective of the offering of these types of products and services in Islamic banking and financial institutions is to eliminate the element of riba (interest), which is clearly forbidden in Shariah.

A humble effort has been made through the publication of this book in order to explore the system, issues and challenges for Islamic banking and financial institutions as the sole alternative for Muslim society in practicing permissible muamalat transactions in the banking and financial sectors.

Although the Islamic banking and financial institutions have been introduced since 1983 in Malaysia, by the formation of Bank Islam Malaysia Berhad, still Islamic banking and financial institutions have been associated with numerous negative conceptions. Also, Muslim community still cannot understand the actual concept of Islamic
banking and financial institutions and some of them regarded these institutions merely an imitation of conventional financial institutions. Badly, some of them considered these two Islamic financial institutions are oppressed and not practicing true Islamic principles.

This book entitled “Islamic Banking and Finance in Malaysia: System, Issues and Challenges” gives a new dimension for Muslim ummah in Malaysia to be involved intensively in Islamic banking and financial institutions without worrying about the misconception accused by certain parties, so that they are able to transact with peace and according to the approved Shariah rules.

Through this book, the author has tried to answer many questions regarding Islamic banking and financial institutions: Are Islamic banking and financial institutions similar to conventional financial institutions? How can the Muslim society participate extensively for the success of Islamic banking and financial institutions in Malaysia? Do Islamic banking and financial institutions provide better alternative for Muslims to manage their financial needs? Do these Islamic banking and financial institutions operate comprehensively according to the Shariah principles and philosophies?

Furthermore, this book tries to provide fundamental knowledge and understanding on Islamic banking and financial institutions in order to remove any misunderstanding and explore current and future issues and challenges to the industry. In this book, eight most important topics related to Islamic banking and finance in Malaysia have been introduced to the reader. Hopefully, the publication of this book may provide a true picture of the Islamic banking and finance in Malaysia, allowing its practical application by all.
CHAPTER ONE

ISLAMIC BANKING SYSTEM

Introduction

Islamic banking system refers to a system of banking or banking activity that is consistent with the principles of Islamic law (Shariah) and it is governed by the law of God. In this current global economic environment of extraordinary challenges and uncertainties, Islamic banking and finance is becoming very much a part of the journey to bring the world towards a new level of stability, prosperity and international integration.

Since the 1970s, Islamic banking has emerged as a new reality in the international financial scene. Its philosophies and principles are however, not new, having been outlined in the Holy Qur’an and the Sunnah of Prophet Muhammad (SAW) more than 1,400 years ago. The emergence of Islamic banking is often related to the revival of Islam and the desire of Muslims to live all aspects of their live in accordance with the teachings of Islam.

In Malaysia, separate Islamic legislation and banking regulations exist side-by-side with those of the conventional banking system. The legal basis and act for the establishment of Islamic banks was the Islamic Banking Act (IBA) which came into effect on 7th April 1983. The IBA provides Bank Negara Malaysia (BNM) with powers to supervise and regulate Islamic banks, similar to the case of other licensed banks. The Government Investment Act 1983 was also enacted at the same time to empower the Government of Malaysia to issue Government Investment Issue (GII), which are government securities based on Shariah principles.

Thus, this chapter will explain the norms of Islamic banking system as one of the integral part of Islamic finance in the light of the Quran, Sunnah and Muamalah (Islamic Commercial law), and how these principles are regarded as the best alternative for Muslim society in particular and all mankind in general. This chapter will be divided into three topics namely overview of Islamic banking, Islamic banking system as well as Islamic banking and economic development.


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