

COMPARATIVE ANALYSIS OF REGULATION AND SUPERVISION OF ISLAMIC BANKING BETWEEN MALAYSIA AND GAMBIA

Mohd Faisol Ibrahim^{1*}, Nik Mohd Fadhil Nik Mohammad², Musa Manjang³

^{1,2,3} Faculty of Economics and Muamalat, Universiti Sains Islam Malaysia

ABSTRACT

This paper attempts to provide analyse the regulation and supervision of Islamic bank in Malaysia and the Gambia. Islamic banking first gained its appearance in Egypt at Mit Ghamar by Ahmed El Najjar in 1963. As a result this paper aimed to discuss and analyse on regulation and supervision between Malaysia and the Gambia. Islamic banking has experience worldwide acceptance by early 2003. During that period, there were at least 255 Islamic banks around the world. It is also evidenced through pass studies that Islamic banking has developed tremendously within the past decades. However the industry is still not great as conventional in almost all the operating regions. This implies that there are still lot to be done in terms of issues facing the industry. It signals that majority of banking users in all operating areas still have not adopted and it might not have been aware of the Islamic banking system. Regionally, operations and models in the operation of Islamic banking are different. As a result, this study will look and analyses issue that are principally similar and will also look into operational difference that are peculiar to each nation and way forward. The study basically compares on the development standard, models issues and challenges on regulation and supervision of Islamic banking between these two nations. This study uses a qualitative approach. This study discovers that in Malaysia and Gambia banking institutions have a different Islamic banking system.

Keywords: Islamic banking, Islamic regulation and supervision, Malaysia, Gambia.

Introduction

Islamic banking is defined as a banking system that is based on the principles of Islamic law (also known Shariah) and guided by Islamic economics. Two basic principles behind Islamic banking are the sharing of profit and loss and, significantly, the prohibition of the collection and payment of interest. Collecting interest is not permitted under Islamic law. Islamic banking refers a system of banking or banking activities that is consistent with Islamic law and principles and guided by Islamic economics (Nasser & Juriah, 2013).

* Corresponding Author : Mohd Faisol Ibrahim, Faculty of Economics and Muamalat, Universiti Sains Islam Malaysia. E-mail: faisol@usim.edu.my

The first Islamic bank in Malaysia, Bank Islam Malaysia Berhad was introduced in 1983 in order to provide shariah compliant financial products and services (Sudin, 1996). In 1993, commercial banks, merchant banks and finance companies were allowed to offer Islamic banking products and services under the Islamic Banking Scheme (IBS). These institutions however, are required to separate the funds and activities of Islamic banking transactions from that of the conventional banking business to ensure that there would not be any co-mingling of funds. Since then until the end of 2003, the numbers of IBS banking institutions have increased to 36, comprising 14 commercial banks (of which 4 are foreign banks), 10 finance companies, 5 merchant banks and 7 discount houses.

Malaysia's Islamic Finance industry had existed for more than thirty (30) years, continues to grow rapidly supported by conducive environment, comprehensive financial structure, and adopted global regulatory and legal best practices. Today, the Islamic finance industry is considered to be a dynamic industry, which is a competitive alternative to conventional financing (Mohd Faisol & Rosila, 2014).

Today, Malaysia has a 16 of full-fledged Islamic banks including several foreign owned entities; conventional institutions who have established Islamic subsidiaries. The creation of 16 Islamic banks in Malaysia will providing a healthy competition in Islamic banking industry (Mohd Faisol, 2016). Its operations and principles are guided by Islamic economics (Ariff., 2006). Islamic banking performs the same intermediary function like conventional one, but does not receive a pre-determined interest from borrowers and does not pay a predetermined interest to the depositors; the amount of profits is based on the profit-sharing agreements with the depositors and also with the borrowers. In addition, there are fee-based banking services that are similar to the conventional banks as long as there is no pre-determined interest payment receipt in the transaction. Thus, Islamic banking is considered as a different banking stream as it prohibits interest and replaces it with profit share, and the profit share depends on the extent of the risk participation of the parties. The absence of pre-determined rewards is based on Quranic commands and as interpreted using Shariah principles. The main difference between Islamic banks and the contemporary banks is that, while the latter is based on the conventional interest-based principle, the former follows a principle of interest free financing and profit and loss sharing (PLS) in performing their business as intermediaries, (Aburime & Alio., 2009). Over the past several decades, the growth in Islamic banking and its socially responsible principles have attracted attention all over the world including Malaysia and Gambia. Meanwhile, the growth of Islamic banking system in Malaysia has enhanced to an introduction of Islamic financial innovations (Hanudin, 2010).

Based on the study, principally, both Malaysia and the Gambia have no differences. The peculiarity meanwhile centred on the models and agendas. Malaysia for instance, having currently 17 Islamic banks in operation, the models of its Islamic banking has been design to be an Excellency in Islamic banking. According Zulkifli (2009 and IFSA 2013), by the virtue of section 16B of the Central Bank of Malaysia Act 1958 (CBA), Islamic banks is regulated supervised by Bank Negara Malaysia. According to this Act sharia Banks in Malaysia are mandated to establishment Shariah Advisory committee at bank level and adhere to Shariah Advisory Council (SAC). According the Law, the SAC is the final authority in matters relating to Islamic banking and any other sharia related business and the Takaful. According to the Act, the SAC of BNM will be referred to by the court or arbitrator in disputes involving Shariah issues in Islamic banking & finance and Takaful. In the case of the arbitrator, the SAC's resolution "shall be binding" on the arbitrator.

In the case of the court, the SAC's resolution "shall be taken into consideration" on the court (advisory). The BNM also issues "Guidelines of the Governance of Shariah Committees for Islamic Financial Institutions (BNM/GPS1)" which provides that a Shariah body which is to be known as a "Shariah Committee "is to be established by each and every Islamic banks, Islamic windows & Takaful operators. Most importantly, the relationship of all these Shariah Committees plays a

complementary role to the SAC of BNM. According to the two DRS. restrictions imposed on the Members of SAC of BNM are not allowed to serve in the Shariah Committee of any financial institutions (by virtue of 16B (6) of the CBA 1958) One Shariah advisor can only serve as a member of Shariah Committee in one financial institution in the same industry (Islamic banking and Takaful are considered as different industries). The Islamic banks in UK for example are still under the conventional setup, mainly because of government's secular policy and relatively smaller size of Islamic banking as compared to its conventional counterparts but as a whole Malaysia is in forefront among the four countries, with completely harmonized and developed regulatory systems for Islamic banks (Sad Khan, Sarfaraz Tanveer, Abdul Qadir & Raja Ahmed 2015)

However the Gambia as in most African countries, the governance of the Islamic banks has different dimensions. According section 4 of the 1992 constitution amended in 1993 of the constitution and central bank of the Gambia, Islamic banks are required by law to appoint sharia committee at only bank level. In other word, no Shariah Advisory Board at Central Bank of the Gambia. But has "Supreme Islamic Council "attached to Ministry of interior or religious affair ministry that supervises issues regarding Islam. The central bank and Government of the Gambia gives authority to supreme Islamic council to act and deal with matters of Islam and Shariah.

Research Methodology

The paper will be exploratory study in selected countries using qualitative approach. This article adopts qualitative research using secondary data based on several literature works on regulation and supervision of Islamic banking and also based on the official websites of Central Bank of Malaysia (Bank Negara Malaysia) and the Central Bank of the Gambia. The secondary data was also gathered from different variety of sources related to the study, such as journals, online journal in Google scholar, books, and few articles related to the study.

Regulation And Supervision Of An Islamic Bank In Malaysia

Bank Negara Malaysia (BNM) has broad powers of supervision and control over banking institutions licensed under the Financial Services Act (FSA), and the Islamic Financial Services Act or IFSA (Azman et al., 2014). From this statement, it is understood that In Malaysia, the highest authority body to regulate and supervise banking institutions is Bank Negara Malaysia (BNM), when it says "banking institutions" it means both conventional and Islamic banks are under the power of BNM. BNM was established and operated in 26 January 1959, it has been 57 years since the establishment. The current governor and chairman is Tan Sri Dato' Sri Dr. Zeti Akhtar Aziz, she will be replaced by new governor in the end of April 2016 due to the end of contract.

The objectives of Bank Negara Malaysia as outlined in the Central Bank Act (CBA 2009) are to regulate and supervise financial institutions which are subject to the laws enforced by the Bank, to promote monetary stability and a sound financial structure, to act as a banker and financial adviser to the Government, to issue currency and keep reserves safeguarding the value of the currency, and to influence the credit situation to the advantage of the country. There are a few more functions of BNM according to the CBA 2009, but it is important to focus only on a few things which is relates with the regulation of Islamic banks. As stated above, it is can be understood that BNM is the highest authority, and it is the one who regulates and supervises conventional banks and Islamic banks in Malaysia. Anything relates with the financial and banking matters either its conventional or Islamic, they must refer to the BNM first before they can implement a particular action.

There is another authority body in Malaysia named Securities commission (SC). The SC is a statutory body established under the Securities Commission Act 1993 and is the primary regulatory authority for capital market activities in Malaysia (Azman et al., 2014). A bank (either it is Islamic or conventional) is not doing banking activities and money activities only, they always will participate in capital market activities such as stocks and bonds. Therefore, anything relates with the capital market, the conventional and Islamic banks must refer to the Securities Commission (SC), meanwhile any activities relate with the banking and money activities will be referred to the Bank Negara Malaysia (BNM).

Apart from BNM and SC, all Islamic banks in Malaysia are compulsory to follow principle and requirement from Islamic Financial Services Act (IFSA 2013), while conventional banks are regulated under Financial Services Act (FSA 2013) and monitored by BNM. Not only Islamic banks, but Conventional banks (with Islamic windows), and Takaful companies also must follow the acts stated in IFSA 2013. Previously, all these segments have been treated in separate acts, such as follow.

Nowadays, Malaysia is the heaven for banking institutions for two main reasons, firstly Malaysia has a comprehensive banking system ranging from domestic banks to offshore banks and secondly worth to say, Malaysian government wishes to formulate Malaysia, as a hub for Islamic financial system in the region of South East Asia (SEA) as well as in the other regions (Rostinah et al., 2008).

The Different Acts Applied For Different Segments Before The Introduction Of IFSA 2013

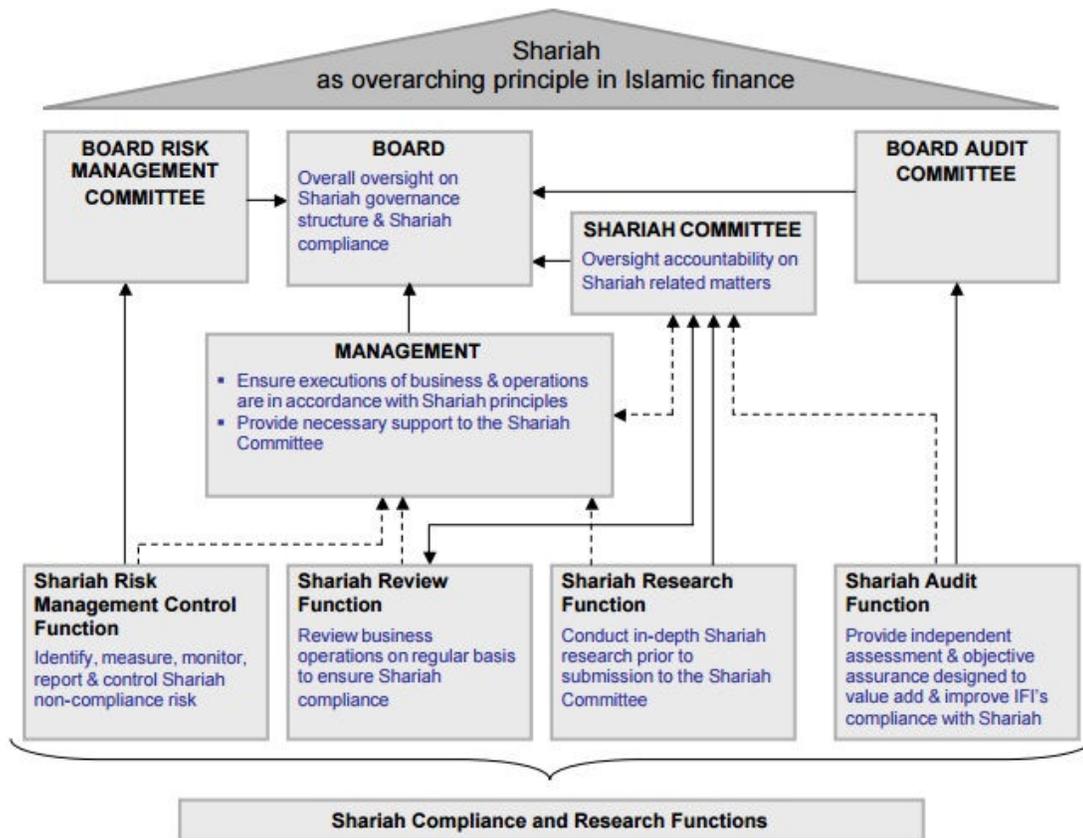
No	Islamic Segments	Acts
1.	Islamic Banks	Islamic Bank Act 1983
2.	Conventional banks with Islamic windows	Bank and Financial Institution Act 1989 (BAFIA)
3.	Takaful companies	Takaful Act 1984

The table above shows different acts applied for different segments before the introduction of IFSA 2013 (one act applied for all Islamic segments). In IFSA 2013, there are 18 sections consist of rules and regulation of Islamic banks, conventional banks with Islamic windows, and Takaful companies such as authorization, Shariah requirements, payment systems, business conduct and consumer protection (IFSA 2013). Furthermore, according to Bank Islam, IFSA 2013 provides a comprehensive legal framework that is fully consistent with Shariah in all aspects of regulation and supervision for Islamic banks in Malaysia compared to the previous acts. For instance, in IFSA 2013, there is improvement in term of clarity and transparency of the fundamental requirements in Shariah, in addition, IFSA 2013 also enhance the way of conducting banking business and reinforce the protection of the customer in order to build public or customer confidence.

In order to ensure that the Islamic banking institutions are operate accordance to the Shariah principles, therefore a proper Shariah governance framework has been introduced in Malaysia. According to Mustafa et al (2012), Bank Negara Malaysia has applied the two-tier Shariah governance infrastructure that comprises of two important components, which are a centralized Shariah Advisory Council (SAC) at the BNM and an internal Shariah committee formed in each Islamic Financial Institutions. From this statement, it is understood that in Malaysia, there are two separate parties that will involve directly in the Shariah matter, they are Shariah Advisory Council (SAC) at BNM, and another one is Shariah Committee at Bank level (Zubaedy, 2015). So, what is the different between these two parties? The SAC was founded in May 1997, and it is the highest authority in the Shariah matters related with Islamic finance in Malaysia. According to the Central Bank of Malaysia act 2009, SAC was accorded the status of the sole authoritative body on Shariah

matters pertaining to Islamic banking, Takaful and Islamic finance. In addition, SAC is also a body who issues resolutions related with the Islamic banking, Takaful and Islamic finance. Meanwhile, Shariah committee at bank level is responsible to advise Islamic financial institution on the operations of the business including Islamic banking products are accordance to the Shariah principle. Apart from that, Shariah committee also obliged to endorse documentation, for instance documentation on products manual and other contracts. The diagram below shows the the Shariah governance framework model for Islamic financial institution prepared Bank Negara Malaysia:

Diagram: Shariah Governance Framework Model For Islamic Financial Institution



Source: Bank Negara Malaysia

The illustration above explains that Shariah committee, board risk management committee, management, and board audit committee are directly report to the BOD. Shariah review (SR) shall report to the Shariah committee and Management. Shariah audit (SA) shall report to the board audit committee and Shariah committee. Shariah research function shall report to the Shariah committee and Management. Lastly, Shariah risk management control function shall report to the board risk management committee and management. As for the current practice, it shows that Shariah Governance Framework Model (SGFM) is a very comprehensive framework that will ensure that all Islamic financial institutions in Malaysia are operate within the boundaries of Shariah.

All in all, the regulator of the financial institutions in Malaysia is Bank Negara Malaysia, and there is another authority named Securities Commission (SC) who supervises and regulates the capital market in this country. In addition, conventional banks are being regulated under FSA 2013, while Islamic financial institutions are being regulated under IFSA 2013. Apart from that, SAC at BNM is the highest authority in the Shariah matters related with Islamic finance in Malaysia, to compliment this, there is another party called Shariah committee at bank level in order to advise Islamic financial institution on the operations of the business.

Regulation And Supervision of An Islamic Bank In Gambia

The Central Bank of Gambia, is a public institution that issues the currency, regulates the money supply, controls the interest rates and oversee the commercial banking system in the Gambia. It possesses a monopoly on printing the national currency, which serves as legal tender. It was established officially on March, 1971. The central bank of the Gambia was designed to act as an economic adviser to the government and function as a national bank that would conduct monetary policies to help channel government development and stabilization objectives into the economy (Sillah, 2005).

The primary function of the central Bank of the Gambia is to provide the money supply, but more active duties include controlling interest rates, and acting as a lender of last resort to the banking sector during times of financial crisis. It also has supervisory powers, to prevent banks and other financial institutions from reckless and fraudulent behavior. Under its monopoly, through section 3 (1) of the financial Act of 1992, the central Bank control both the capital market and the interest rate in the Gambia (Sillah, 2005).

Unfortunately, due to the size of the population and limited numbers of the Islamic financial institutions in the Gambia, there exist only one Islamic bank (AGIB) and one Islamic Insurance company (Takaful).

The banking Act of section 4 of the 1992 serves both the conventional and the Islamic banks with central Bank of the Gambia serves as the reference and the supervisory body for instance, accounting and auditing. Nonetheless, According to this Act, no Shariah Advisory Board serves at Central Bank of the Gambia, but has "Supreme Islamic Council "attached to Ministry of interior and religious affair to supervise issues regarding Islam. The Government of the Gambia and the central bank, authorizes the supreme Islamic council to act and deal with matters related to the Islamic banking. According section 4, Islamic banks are mandated to appoint sharia supervisor at individual bank level.

With less Islamic financial institution, and with a total current population of less than three million, an Islamic banking in the Gambia is operationally seen as a subset of the conventional banks, with difference in principles. As a British ruled nation, it operates under IFSB with reference and guardianship from the sharia supervisors. The system does not have body such as (SC) neither standard such as IFSA that purely meant to supervise the Islamic financial institutions.

Discussion

Based on the information of the general regulation and supervision of Malaysia and Gambia stated in the previous section of this paper, it can be understood that there are a few similarities

and differences in the implementation of supervision and regulation of Islamic banking between these two countries.

Obviously, both countries have similarity in term of the main function of central bank. In Malaysia, the authority body that regulates and supervises financial institutions (conventional and Islamic) is Bank Negara Malaysia. Meanwhile, in Gambia, the body that has been given the right to regulate and supervise the financial institutions (conventional and Islamic) is Central bank of the Gambia. Practically, there are no differences between these two central banks, except for a few things that will be discussed in the next paragraph.

In Malaysia, there are two main authority bodies that regulate and supervise financial institutions (eg; commercial banks, investment banks) they are Bank Negara Malaysia (BNM) and Securities Commission (SC). Basically BNM regulates and supervises the financial institutions in Malaysia pertaining the law, guidelines, and things related with the money market (eg; deposit and financing), meanwhile SC is given authority to supervise the capital market (eg; Stock and Sukuk). Therefore, anything relates with the capital market, the conventional and Islamic banks must refer to the Securities Commission (SC), meanwhile any activities relate with the banking and money activities will be referred to the Bank Negara Malaysia (BNM). In contrast, Gambia has applied different procedure where Central bank of the Gambia is given authority to supervise and regulate in both money market and capital market.

There are different acts applied for the Islamic banks and conventional banks in Malaysia, where IFSA is specifically for Islamic banks, and FSA is an act for conventional banks. It is differ from the Gambia, where both Islamic banks and conventional banks are following the same act which is The Banking Act 1992.

Furthermore, In Malaysia, Shariah Advisory Council (SAC) at Bank Negara Malaysia (BNM) is the highest authority in the Shariah matters related with Islamic finance, also act as advisor to the BNM pertaining Shariah matters. In contrast, there is no such authority in Gambia, no Shariah Advisory Board at Central Bank of the Gambia, but has "Supreme Islamic Council "attached to Ministry of interior or religious affair ministry that supervises issues regarding Shariah matters in Islamic finance.

All in all, it can be concluded that these similarities and differences happened maybe due to the different market size of both countries where Malaysia has more than 30 Million of the population compared with Gambia that has only 3 Million of the population. Less number in population resulted less demand given by the population with less profit, and it will lead to the overlook on the industry.

Conclusion

In conclusion, the regulation and supervision of Islamic banking in Malaysia and Gambia are actually having a few similarities with huge differences. The authors believe that different treatment of the regulation and supervision of the Islamic banking has its own pros and cons. There is no discussion on which regulation and supervision is better, as the authors believe that both countries have their own style in managing Islamic banks in their countries. It is hoped that this paper will benefit both countries, even other countries to regulate and supervise the Islamic financial institutions even better by seeing on how other countries' regulate and supervise the Islamic financial institutions in their countries.

References

- Azman Othman Luk, Chen Lee Won, Lum Sher Vin, Karen Foong, Elaine Heung & Lim Teong Sit. (2014). Banking Regulation; Jurisdictional Comparisons, European Lawyer reference Series. UK, pp. 263-279.
- Ariff, M. (2006). *Comment on "The Economic Rise of China: Challenges and Opportunities for ASEAN"*. Malaysian Institute of Economic Research.
- Bank Negara Malaysia. (n.d.). *www.bnm.gov.my*. Retrieved March 20, 2016, from http://www.bnm.gov.my/guidelines/05_shariah/02_Shariah_Governance_Framework_20101026.pdf
- Bukhari. M. S. Sillah. (2005). Banking and Economic Growth: Case of the Gambia, Dissertation, University of Kiel
- Central Bank Of The Gambia. (n.d.). *www.CBG.gm*. Retrieved March 23, 2016, from <http://www.cbg.gm/>
- IFSA 2013 Retrieved March 20, 2016, from <https://zulkiflihasan.files.wordpress.com/2008/06/week-vi-cba-and-ifs.pdf>
- Hanudin Amin. (2010). Ijarah Thumma Al-Bay Facility In Labuan Car Markets: An Application Of Structural Equation Model. *Labuan e-Journal of Muamalat and Society*, 4(2010), 45-57.
- Mohd Faisol Ibrahim & Rosila Kamarudin. (2014). The Islamic Home Financing In Malaysia Istisna' Base On Debt: Qualitative Approach, *Labuan e-Journal of Muamalat And Society*, 8(2014), 27-38.
- Mohd Faisol, I. (2016). Analisis Kaedah Bayaran Zakat Harta Oleh Institusi Zakat Di Malaysia, *Journal of Muamalat and Islamic Finance Research*, 8, 27-38.
- Mustafa Mohd Hanefah, Z. S. (2012). *Governance And Shariah Audit In Islamic Financial Institutions*. Nilai: Universiti Sains Islam Malaysia.
- Nasser, S.A.S. Al, & Juriah Mohamed. (2013). Introduction of Islamic banking in Malaysia *Emerald Humanomics*, 29(2), 80-87
- Rostinah Supinah, Zuraidah Anis & Hanudin Amin. (2008). Banking Channels Adoption In Malaysia: An Analysis. *Labuan e-Journal of Muamalat and Society*, 2(2008), 17-26.
- Sad Khan, Sarfaraz Tanveer, Abdul Qadir Shah & Raja Ahmed Jamil. (2015). Comparative Analysis of Regulatory and Supervisory System of Islamic Banks: Evidence from Pakistan, Malaysia, Bahrain and United Kingdom, *Mediterranean Journal of Social Sciences*, 6 (6), 629-640.
- Sudin, H. (1996). *Prinsip dan Operasi Bank*. Kuala Lumpur : Berita Publishing Sdn Bhd
- Uhomoibhi Toni Aburime & Felix Alio. (2009). Islamic Banking: Theories, Practices and Insights For Nigeria, *International Review of Business Research Papers*, 5 (1), 321-339.
- Zubaedy, S. A. (2015). Shari'ah Governance Framework Model for Malaysian Islamic Banking and Finance: A Critical Analysis. *IOSR Journal of Business and Management (IOSR-JBM)*, 9-19.