THE DEVELOPMENT OF ETHICAL BANKING CONCEPT AMONGST THE MALAYSIAN ISLAMIC BANKS

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ABSTRAK


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INTRODUCTION

The modern day of Islamic banking often referred to the establishment of Mit Ghamr Savings Bank in Egypt in 1963. The bank’s operation which adhered to Shariah requirements has become an eye opener for many people on the capabilities and potentials of an Islamic bank. As a result, the growth of Islamic banks mushroomed particularly in Muslim countries.

Realising the potentials of Islamic banking in terms of commerciality and its sounds principles and operation, the concept of Islamic banking has been adapted and embraced by many international banks, for example HSBC, the Llyods and Standard Chartered. The attention given to the development of Islamic banking has even attracted the world’s most prominent financial centre, the United Kingdom to start working on preparation towards the setting up of Islamic financial component in their financial system. Islamic Bank of Britain Plc has become the first full-fledged Islamic bank in the United Kingdom (http://www.islamic-bank.com, December 16, 2009).
An analysis carried out by Furneaux and Hijazi (2008) indicates that Islamic assets are estimated to be US$1.4 trillion by 2010. Increasing demand for products and services based on Islamic principles has led to the growth of Shariah compliant banking assets worldwide to an estimated US$700 billion in 2008. It was reported that the world’s top 100 Islamic banks managed to grow their assets by an average rate of 29.7% in 2008, at a time when their conventional counterparts were struggling to deal with the global financial crisis (http://www.islamicfinancenews.com, December 16, 2009).

Despite the greater attention given and the rapid development of Islamic banks, it will not change the philosophical aspects of the banks which have become their strong foundation and framework. The philosophical aspects of the Islamic banks derived from the primary sources; Al-Quran and Hadith, and enriched with the secondary sources; the ijma’ (consensus) and qiyas (logical reasoning). Choudhury and Malik (1992) and Naqvi (1994) and Pervez (1990) mention that Islam is not only a religion but it covers various facets of life inclusive of worldly affairs, for instance economics, politics, legal aspects and societal interactions. As such, Chapra suggests that Islamic banks must consider the welfare responsibilities and religious commitments in order to achieve the Islamic economic objectives, including social justice, equitable distribution of income and wealth, and promoting economic development of Islamic banks (taken from Lewis and Algoud, 2001).

Three elements that distinguish Islamic banking from conventional banking are the avoidance of riba’ (interest), gharar (excessive uncertainty) and maisir (the gambling element).

THE OVERVIEW OF MALAYSIAN ISLAMIC FINANCIAL SECTOR

Malaysia’s first Islamic bank, Bank Islam Malaysia Berhad (BIMB) was established in 1983, and amongst the raison d’être of the establishment of BIMB is to provide an alternative avenue for the people to involve in financial matters which is free from interest or riba, excessive uncertainty or gharar and elements of gambling or maisir. This is then followed with the introduction and implementation of Interest-free Banking Scheme which allows selected conventional financial institutions to offer Islamic banking services to their clients. Bank Muamalat Malaysia Berhad (BMMB) has changed the landscape of Malaysian financial sector when its establishment marked the second full fledged Islamic bank in the country. The blueprint of Malaysian Financial Sector (2001-2010) envisaged that the future of Islamic financial sector must be liberalised gradually, equipped with trained human capital, supported with sounds judiciary system to deal with Islamic finance matters and comprehensive Shariah framework that can fulfil the
aspiration of the government to achieve 20% of the financial market share and to position Malaysia as regional Islamic financial hub (Haron & Wan Azmi: 2009).

As such, in 2004 Kuwait Finance House (KFH) was awarded license to begin operation in Malaysia, followed by Al-Rajhi Banking & Investment Corporation and the Asian Finance Bank (a consortium made up of several foreign financial institutions) that made up the first three foreign Islamic banks in the country (Sidhu, 2007). Subsequently, in 2005 the government through the Central Bank proposed the then current Islamic window to be transformed to Islamic subsidiary that will enable them to venture into bigger markets of finance and banking which they were unable to do due to the limitation as Islamic window. The new structure will be regulated by Islamic Banking Act (IBA) instead of Banking and Financial Institution Act (BAFIA). To date, there are 17 Islamic banks in Malaysia inclusive of full-fledged and Islamic subsidiary, six of which are foreign banks (http://www.bnm.com.my, December 16, 2009).

The latest development pertaining to Islamic financial sector is the unveiling of Malaysia International Financial Center (MIFC) in August 2008 with the aim to establish Malaysia as an Islamic financial hub. The blend of various agencies; regulatory bodies, government agencies, financial institutions, human capital development and professional services companies are combined under this initiative. There are lots of privileges given towards the MIFC in terms of tax exemption, flexible movement of funds, relaxed policy on ownership and supports given by the government agencies in tandem with the objectives of the investors and government as well, to make profit for the former and to lift the country’s economic developments for the latter (http://www.mifc.com, December 16, 2009).

THE CURRENT DEVELOPMENT OF ETHICAL BANKING CONCEPT AMONGST MALAYSIAN ISLAMIC BANKS

Every depositor and investor yearns to have handsome returns on their investments or savings; however a sensible one will intend to ensure that the returns are not tampered with elements that contribute to the declination of quality of life and environment. The risks of jeopardising social and environmental spectrums had led to the formulation of the Equator Principles.

The Equator Principles were formulated by a group of multinational financial institutions together with the World Bank in 2003 (http://www.equator-principles.com, December 16, 2009). These principles are intended to serve as a common baseline and framework to be implemented by participating financial institutions when engaging with their project financing activities.
The institutions are expected to honour the principles by informing and ensuring that its clients will comply with the social and environmental policies as promulgated in the Equator Principles. To date, there are 68 banks declared as Equator banks but none of them are Islamic bank, except those parent banks having Islamic subsidiaries (none of them are Malaysian).

Based on the environmental standards of the World Bank and the social policies of the International Finance Corporation (IFC), the principle laid down in the Equator’s agreement is appropriate to measure the coverage of conventional bank on ethical issues. Overall, there are 19 issues that need to be addressed by the participating banks before approving a financing. In general the issues concern on human safety and security, property, cultural heritage, flora and fauna preservation, sustainable energy and natural resources. They are issues that go beyond traditional definition of ethical conduct and synonymous with the notion of sustainability. In contrast, local Islamic banks apparently do not have any specific policy or manual that explicitly deals with those issues.

To the ratification of The Equator Principles, the Association of Islamic Banking Institution Malaysia (AIBIM) issued a response in its website (http://aibim.com/content/view/2224/77/) saying:

"Apart from the fact that the Equator Principles are confined to project financing only, the real problem lies in the structure of conventional finance which provides no incentive to actually evaluate the criteria in an integrated way. Critics have increasingly dismissed the Equator Principles as toothless and mere greenwash as they have no monitoring procedures nor are there any punishments for those signatories who contravene the principles."

In fact, AIBIM went on saying that Islamic banking is actually inherently ethical as it is based on the Islamic Shariah Law that places social welfare as one of its main objectives. Therefore, suggesting that there is little, if any, need to be part of the programme nor a specific policy or program in place.

In shedding the light on ethical banking of Islamic banks, Abuznaid (2009) clarifies that there are two dimensions of ethics for the Muslim; towards Allah and towards other human being. It is often seen that many Muslims missed another component of living creatures, even though many Islamic literatures have discussed about them, which is the nature (flora and fauna). Almost a similar issue happened towards Malaysian Islamic banks. Although they are very committed in ensuring the products are Shariah
compliant and the financing activities are not involved in haram businesses, the Islamic banks seem to neglect the impact of their business activities towards the nature.

The Shariah Advisory Council (SAC) of Securities Commission has laid very detailed regulations on the criteria that are used as a benchmark to distinguish between Shariah compliant businesses and vice versa. (John, 2009: 39). Items contradicted with the Shariah as clarified by the SAC are:

i) financial services based on interest
ii) gambling
iii) manufacture or sale of non-halal products or related products
iv) conventional insurance
v) entertainment activities that are non-permissible according to Shariah
vi) manufacture or sale of tobacco-based products or related products
vii) stock-broking or share trading in Shariah non-approved securities
viii) hotels and resorts
ix) other activities deemed non-permissible according to Shariah based on ijtihad (process reasoning of Islamic jurists based on the primary sources to get the ruling)

Generally, most of the Malaysian Islamic banks abide with the same regulations. The regulations laid down by the Securities Commission can be deemed as the list of unethical activities that must be avoided by Islamic financial institutions. Involving in any of the activities is regarded as haram, and haram is considered unethical (Abuznaid: 2009). Ahmad (1999) elaborates that Islamic finance is guided by the notions of halal (permissible) and haram (forbidden) that oversee all the economic activities (taken from Hamid: 2006). These parameters are the main criteria in Islam that differentiate between ethical and non ethical activities, in the eyes of Shariah.

The competition between Islamic financial instruments and their conventional rivals has pushed the Islamic finance side to be more creative, bold and innovative when developing new products. Even though the products will comply with Shariah’s requirements, there is a tendency that the commercial element supersedes the social needs. Stiglitz elucidates that “markets were marked by asymmetries of power, information and a lack of concern for social justice” (taken from Tan, 2007:8). He also stresses that Islamic banking should be concerned with the underlying principles when pursuing the process of developing a new product.
It is important to note that the ethical banking concept within the Islamic banking environment is parallel with the concept of *halalan tayyiban* which means permisssible and pure or good. The Islamic banking might be providing financial services based on the *Shariah* compliant process however, the later stage which is the utilisation of the funds might not be compatible with *Shariah*, due to the fact that it is the responsibilities of the borrower to act within the *Shariah* spectrum and the Islamic bank cannot interfere in the usage of the funds. For instance, a person comes to the Islamic bank to borrow certain amount of money. After the due diligence process on the person's creditworthiness then the person is granted the loan. Hence, the usage of the borrowed money is beyond the Islamic bank's control.

Wilson (2003:5) on his comparison towards ethical and Islamic banking has cited five ethical areas developed by the UK's Co-operative bank (a leading bank in ethical's concept); human rights, armaments, trade and social involvement, environmental impact and animal welfare. Subsequently, he criticises the Islamic banks that even though guided by the *Shariah* which propagates on the fairness and justice towards human being, are seen left behind in championing the ethical issues. This is antagonising the Islamic economics forefathers' epistemology who envisioned that Islamic banking as a product of Islamic economics should incorporate Islamic moral economy or the ethics as an ideal through which economic and social policies dealing with economic life, as well as every aspect of human life, are assessed (Chapra, 2000; Siddiqi, 1981 and Naqvi, 1981 and 1994).

It is worthwhile to note that the key distinction between ethical and Islamic banking concept is caused by the formulation or existence of the principles. Wilson clarifies that, "... there are fundamental differences between ethical practices derived from religious teaching and those designed to appeal to popular secularist morality. Those involved in Islamic finance would regard their ethics as being enduring, as ultimately they are based on holy revelation, whereas ethics derived from social values are inevitably more transitory" (Wilson, 2003:2). As such, the term of ethics can be changed over time depending on the circumstances and society. Something which is regarded as taboo in the 1800's in the Western world is now considered as acceptable. One example is sex before marriage; though this example is quite extreme, but that is what actually exists in the current Western society whereby having children before marriage is considered normal in the society. In contrast, the halal and haram laid down in the Holy Quran is fixed and applicable at all time.

Wilson (2003) on his comparison between Islamic and ethical banking, has cited several areas of improvement for the Islamic banks. Amongst the areas he pointed out are the lack of information on the Islamic banks' websites and the unavailability of ethical banking policy of the Islamic banks.
While conducting this study, 11 websites of full-fledged and subsidiaries of Islamic banks were visited several times and the finding has strengthened Wilson's comments previously on the shortage of information and the non-existence of ethical banking policy. Having said that, some of the banks have provided information on their Corporate Social Responsibility programme, however, it can be concluded that the activities mainly deal with humans and do not directly relate to their official businesses' matters. Furthermore, some Islamic subsidiaries, do not have their own websites except those that inhabit the parents' banks websites resulting in scarce information about their activities.

In comparison to the Cooperative Bank of the United Kingdom, the bank has very detailed information in their website on their ethical policy and also their ethical investment scheme (http://www.co-operativeinvestments.co.uk, December 16, 2009). The interesting part of their ethical investment is that they have summarised the important issues that have been identified and solved before they regard and market them as ethical investment. See Table 1.

Table 1: Summary of Differences between the Cooperative Bank and Its Competitors.

<table>
<thead>
<tr>
<th>Issues to consider when analysing companies for investment</th>
<th>The Co-operative Investments</th>
<th>Most other providers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Management team</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Business strategy</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Financial performance</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Competitive advantage</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Industry trends &amp; changes</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Environmental impact</td>
<td>✓</td>
<td>X</td>
</tr>
<tr>
<td>Employee impact</td>
<td>✓</td>
<td>X</td>
</tr>
<tr>
<td>Supplier &amp; trading policies</td>
<td>✓</td>
<td>X</td>
</tr>
<tr>
<td>Board structure</td>
<td>✓</td>
<td>X</td>
</tr>
<tr>
<td>Risk management</td>
<td>✓</td>
<td>X</td>
</tr>
<tr>
<td>Executive salaries &amp; bonuses</td>
<td>✓</td>
<td>X</td>
</tr>
</tbody>
</table>

Source: http://www.co-operativeinvestments.co.uk/servlet/Satellite/1204616032483,CFSweb/Page/Investments-UnitTrustsAndISAs?WT.svl=footer
The bank has clarified that it will not support or provide services to clients whose businesses are in the categories of genetic engineering, arms trade, animal testing and activities that contribute to global climate change.

**MAQASID AL SHARIAH AS AN AVENUE TO DEVELOP ETHICAL BANKING POLICIES.**

Perhaps, to respond to Wilson’s call for Islamic bank to have a properly written ethical banking policy, Malaysian Islamic banks could use the concepts found in Maqasid al Shariah as the basis for its development and communication. Maqasid al Shariah is an area of study that looks into the objectives of the Shariah. If the study of Usool al Fiqh centers on the methodology in establishing legal rulings by looking into the primary and secondary sources of ruling (Al Quran, Sunnah, Ijma’ and Qiyas) that later becomes part of the Shariah, Maqasid al Shariah deals with the objectives that are inherent in the entire body of the Shariah. In other words, it talks about what is the Shariah trying to achieve when it gives a ruling on a certain issue.

Dusuki and Abdullah (2007) states that the uppermost objectives of the Shariah “rests within the concepts of compassion and guidance” that is manifested in the achievement of maslahah or public benefit. In some circles, the term maslahah (plural: masalih) and maqasid is being used interchangeably (Karnali 2002).

The pioneer in the study of Maqasid al Shariah is none other than al Ghazzali (d 505H) followed by al-Shaitibi (d 790H) and later (Karnali 2002). The Maqasid has three main categories in descending importance which are al-Darruriyyat (the essentials), al-Hajiyyat (the Complementary) and al-Tahsiniyyat (the embellishments).

Laldin (2007) states that al-Daruriyyat are “things that are vital and indispensable for life and existence and constitute the higher objective (maqasid) of the Islamic law. They occupy the highest position in the hierarchical order of islamic values”. Matters that fall into this category must be protected regardless of whomever it is; individuals, government or businesses. A collapse of any of these values would result in chaos and the death of society’s normal order (Kamali, 2002). Al-Daruriyyat covers five main values; which are the protection of religion, life, dignity or lineage, intellect and property.

The next level of the Maqasid is al-Hajiyyat or complementary interests. Although it is deemed as complementary, matters under this category are not seen as a completely separate category altogether as it seeks to support and protect al-Daruriyyat. Al-Hajiyyat focusses on the kind of...
interest of which if it is neglected, would cause hardship to the community but not to the level of total disruption to normal life (Laldin, 2007 and Kamali, 2002). An example of this is the ban on the sale and distribution of alcohol by the Syariah in order to prevent the consumption of it. Here, the ban on sale and distribution is complementary (Hajiyyat) to the ban on consumption (Darurriyyat).

The final level of Maqasid is the embellishments or al-Tahsiniyyat. Tahsiniyyat refers to interests that are if neglected can negatively affect the comfort in life but when realised would lead to refinement and perfection in the customs and conduct of people at all levels of achievement (Dusuki and Abdullah, 2007) such as encouragement of charity, cleanliness, moral virtues and avoiding extravagance. Its level of criticality is below that of Darurriyyat and Hajiyyat and serves to improve the general character of the Shariah.

In implementing or communicating ethical banking policies based on the Shariah, Malaysian Banks can start by saying that they give primary importance to the protection of five main areas i.e Islam, life, dignity, intellect and property, and elaborate further on each of these areas. For example, in the area where the protection of Islam is concerned, Islamic banks could say that they would not be interested in involving in businesses that are detrimental to Islam and its people such as providing loans to companies that make weapons that are going to be used against the Muslim population or companies that seek to harm any of the Islamic symbols like mosques or holy sites. Similarly, in protecting life, Islamic banks can also say that they would never involve themselves in environmentally unfriendly projects that is known to harm innocent lives or to companies that are known to have bad safety records. As for the protection of dignity, Islamic banks can say that they avoid involving in projects such as entertainment spots, prostitution and the like. In the case of protection of intellect, Islamic banks can say that they are happy to be aligned with projects that stimulates the intellect while staying away from projects that can impair or cause harm to one’s intellect such as the production of liquor and narcotics. Finally, for the protection of property the banks can stress that it serves to protect or safeguard the existing property of the people that they are in contact with therefore avoids projects that are uncertain and involve gambling elements.

To further strengthen ethical banking position, Islamic Banks further iterate that it is their interest to ensure that no harm is inflicted upon any party that they are involved with since the prevention of harm is central to Maqasid al Shariah (Dusuki and Abdullah 2008). Therefore Islamic Bank would try to avoid any harm to its shareholders, depositors, lenders, associates and others.
CONCLUSION

Despite the fact that Islamic banks are operating in an ethical manner which is guided by the Divine revelation as the primary source of reference, it is worthwhile to note that local Islamic banks are still unable to fully achieve the societal and environmental objectives. Cooperative Bank of Britain is the best example to be followed if one aspires to be a commendable ethical bank, in term of conceptual and implementation. Islamic banks, despite deriving their values from the Divine revelations, still have a missing link that needs to be discovered and implemented in their daily operations.

All is not lost however, despite the deficiencies of Malaysian Islamic banks. The foundation for ethical banking is already solidly in place since the Shariah, of which all Islamic banks derive its operational philosophy from, has within its structure already incorporated all the concepts brought forth by the contemporary view of ethical banking. The problem could only lie in the communication and further refinement of the Shariah banking implementation by these banks.

A future study on this subject is needed in order to measure empirically various dimensions of ethical banking concept in Malaysia and to undertake a comprehensive research towards the issue which, I regard a space for improvement for this paper.

References


How We Invest Your Money. Available at: http://www.cooperativeinvestments.co.uk/servlet/Satellite/1204616032483,CFSweb/Page/Investments-UnitTrustsAndISAs?WT.svl=footer (accessed December 17, 2009).


