

E-BOOK

# ISLAMIC FINANCIAL SYSTEM

PART 1

OVERVIEW OF ISLAMIC BANKING AND FINANCIAL SYSTEM

*first edition*



**NUR RIANA I ZAINORA**



# **ISLAMIC FINANCIAL SYSTEM PART 1**

## **OVERVIEW OF ISLAMIC BANKING AND FINANCIAL SYSTEM**

**1**

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Finally, we would like to thank everybody who was important to the successful realization of this ebook. We have a great expectation that our ebook will be beneficial and useful for anyone who is interested in reading this ebook.

- Nur Riana & Zainora –

# **PREFACE**

**Authors offer a much needed overview of Islamic banking and financial system in Malaysia and also in certain Muslim countries. Focusing on Islamic banking and financial system, the ebook draws attention to the banking practices in the age of Prophet (SAW) and His immediate companions and also banking practices during the time of Bani Umayyah and Bani Abbasiyah. The authors also outline the development of Islamic banking in the modern era and certain Muslim countries. Ebook of Islamic Financial System Part 1 concludes with explaining the structure of financial system in Malaysia and also differentiate the Islamic banking structure in Malaysia with Middle East.**



# ABOUT AUTHORS



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# ISLAMIC FINANCIAL SYSTEM PART 1

## Overview of Islamic Banking And Financial System





## Learning Outcomes

**At the end of this topic, you should be able to:**

- a. Describe the Islamic banking in the early days of Islam**
- b. Outline the development of Islamic banking in the modern era**
- c. Explain the development of Islamic banking in Muslim countries**
- d. Explain the financial system in Malaysia.**





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DAYS OF ISLAM**

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IN THE MODERN ERA**

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IN MUSLIM COUNTRIES**

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# 01

## Describe the Islamic Banking in the Early Days of Islam



01

## **Describe the Islamic Banking in the Early Days of Islam**



**A**

**Define Islamic Banking**

**B**

**Describe the banking practices in the age  
of Prophet (SAW) and His Immediate  
Companions**

**C**

**Explain the banking practices during the  
time of Bani Umayyah and Bani  
Abbasiyah**



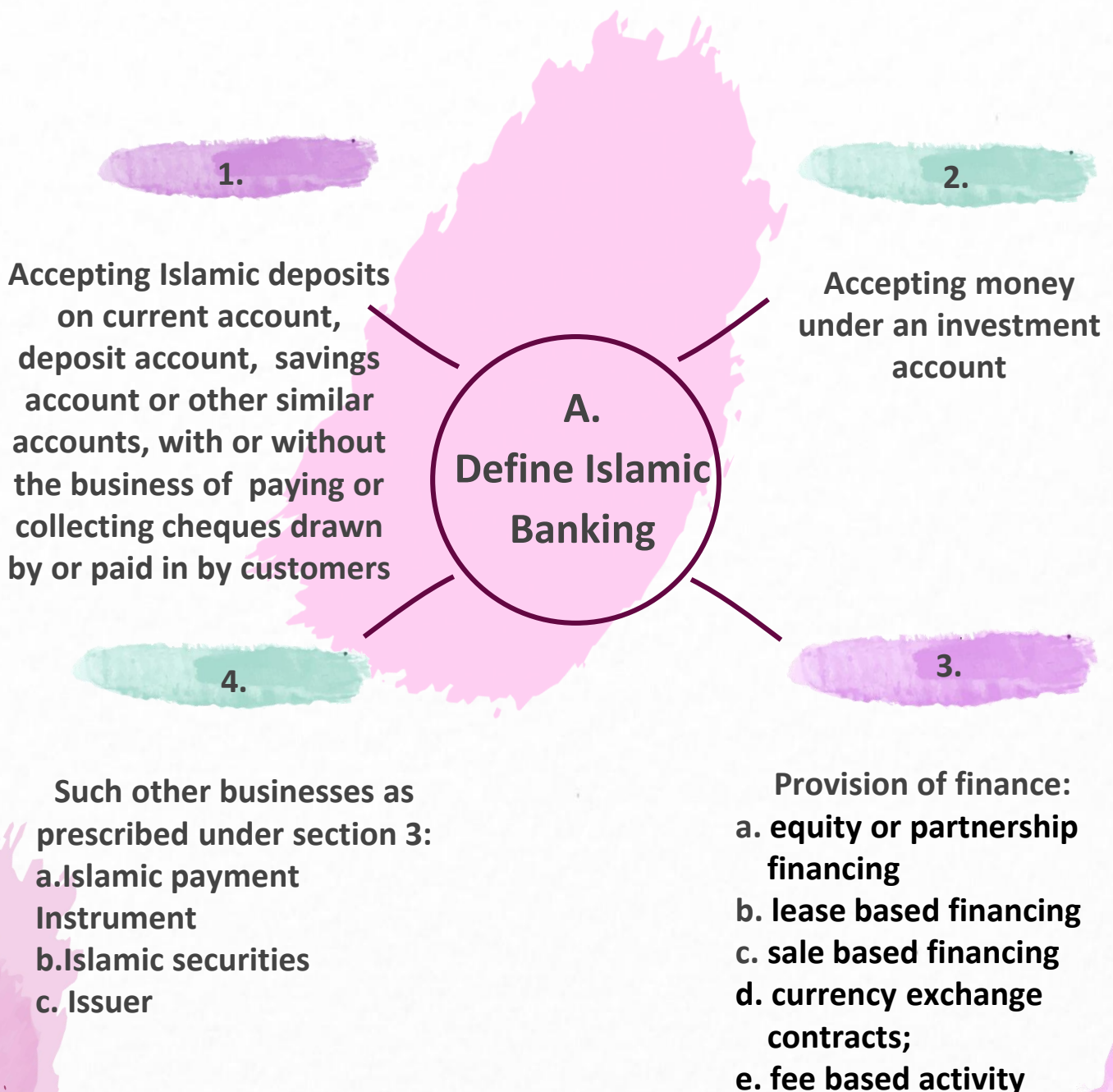
# 01 (A)

## Define Islamic Banking





**According to Islamic Financial Services Act 2013 Section 2(1), “Islamic banking business” means the business of**



## 01 (B)

**Describe the banking practices  
in the age of Prophet (SAW)  
and His Immediate  
Companions**



## B. Describe the banking practices in the age of Prophet (SAW) and His Immediate Companions

1.

The only known organised Islamic financial institution during the time of Prophet (SAW) was called 'Baitul Mal'.

2.

The objective is to manage the financial affairs of the Islamic state . It is not generally accept deposits nor grant loans. Public money and valuables were kept by trustworthy individuals such as the Prophet (SAW) and Zubair bin al-Awwam.

3.

The Prophet (SAW) was entrusted by the people of Mecca with safekeeping their money. In this concept, the trustee did not have the right to use the funds.

4.

Zubair bin al-Awwam chose to only receive money as a loan (qard) – had a right to make use of it and had the obligation to return it intact.

5.

Ibnu Abbas was noted to have transferred some money to Kufah. Same goes to Abdullah bin Zubair in Mecca, who sent money to his brother Hisab bin Zubair, who lived in Iraq – activities related to remittance and bills of exchange.

**01 (C)**

# **Explain The Banking Practices During The Time of Bani Umayyah and Bani Abbasiyah**





## C. Explain The Banking Practices During The Time of Bani Umayyah and Bani Abbasiyah



1.

In the era of Bani Abbasiyah, multifunction banking practices were undertaken by individually.

2.



When various types of currencies were in circulation, special expertise is required to distinguish one coin from the others. Each coin had its own precious metal content and its own value.



3.

Special expertise in money exchange were naqid, sarraf and jihbiz.

4.



Wide circulation of saq (cheques) as an instrument of payment.



5.

Money could be transferred across countries without the need to move the physical money.



**02**

# **Outline the Development of Islamic Banking in the Modern Era**



## 02

### Outline the Development of Islamic Banking in the Modern Era

1.

The first attempt came in Malaysia mid-**1940s**. A plan to invest prospective pilgrim savings in real estate and plantations in accordance with shariah was however unsuccessful

2.

In the late **1950s** in a rural area of Pakistan. The establishment of Mit Ghamr Local Savings Bank marked a new milestone in the revolution of the modern Islamic banking system. The bank was considered to be the most innovative and successful experiment with interest free banking but then closed down for various reasons.

3.

In Malaysia the Pilgrims Saving Corporation was incorporated and it was launched on September 30, **1963**. It changed its name to Pilgrims' Administration and Fund (Tabung Haji) and it took its final shape as a government sponsored and supervised financial institution that collects savings and invests them in accordance with Shariah.

## 02

### Outline the Development of Islamic Banking in the Modern Era

4.

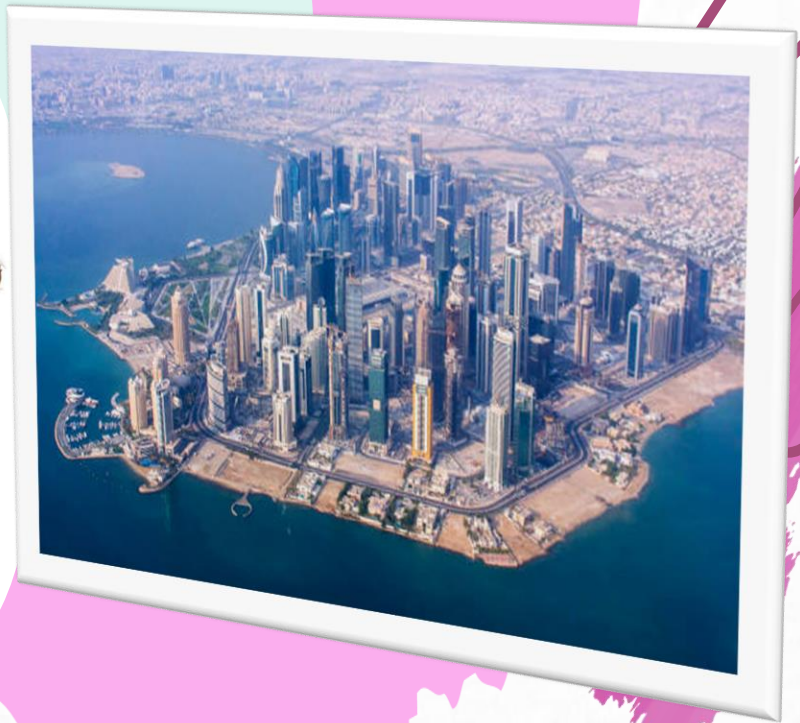
The Nasir Social Bank was established in Egypt in the year of **1971**. The bank was declared as an interest free commercial bank, although its charter made no reference to Islam or shariah.

5.

Bank Islam was established in July 1983 as Malaysia's first financial institution to be shariah compliant. Today, the bank has a strong presence in the domestic for the personal and commercial needs of Muslims and non Muslims alike.

**03**

## **Explain the Development of Islamic Banking in Muslim Countries**

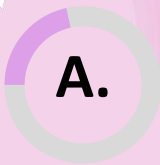




03

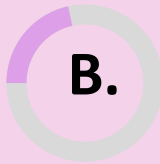
## Explain the Development of Islamic Banking in Muslim Countries

Identify The Development Of Islamic Banking In Certain Muslim Countries:



A.

Iran



B.

Jordan



C.

Pakistan



D.

Egypt



## A. Iran



1. In Iran, certain administrative steps were taken in February 1981 to eliminate interest from banking operations.



2. In August 1983 the usury free Banking Law was introduced. Therefore, banks were required to become interest free by 21<sup>st</sup> March 1984.



3. The whole system was converted to an interest free in March 1985. It allowed to accept 2 types of deposits which were Qard Hassan and investment term deposits.



## A. Iran



4. Banks were mainly channeling their funds towards mark up instead of profit sharing.



5. However, International banking was still based on interest.



## B. Jordan



1. In Jordan Islamic Bank for Finance and Investment was established in 1978 as the first Islamic bank in Jordan.



2. The objective of the bank is to practice financing, banking and investment activities in compliance with the provisions of Islamic shariah law.



3. It ranks as the 3rd biggest bank in Jordan in terms of total assets and deposits.



## B. Jordan



4. The Bank plays an effective role in developing the economic and social activities as evidence by the growing number of people to deposit their savings with the bank.



5. In order to fulfill the objective of the bank to increase its presence in the country to reach all citizens who is interested to use Islamic banking products (such as Mudarabah, Musharakah, Murabahah etc), the bank has increased its network, which comprised of 52 branches and 12 cash offices.



## C. Pakistan



1. Islamisation of the banking system took place in the end of 1970s. Superior Task Force had been setup to eliminate interest in the banking system.



2. In June 1980, the state Bank of Pakistan started using profit sharing and mark up methods.



3. In January 1981, all banks had a counter for accounts based on profit-sharing and shariah based services commenced.



## C. Pakistan



4. In January 1985, all financial transactions became interest free.



5. In July 1985, all deposits placed became interest free.



## D. Egypt



1. The establishment of Mit Ghamr Local Savings Bank at Egypt had received overwhelming support from customers.



2. Due to the turbulent political situation and changes in Egypt, the bank had been taken under taken by the National Bank of Egypt and the Central Bank.



3. Therefore it reduced the number of depositors drastically.

## D. Egypt



4. Development of Islamic banks in Egypt: Nasser Social Bank, Faisal Islamic Bank, Islamic International Bank for Investment and Development Egyptian Saudi Finance Bank.



5. The Faisal Islamic Bank was the first to have a formal shariah board consisting of selected Ulama from Egypt.



**04**

## **Explain the Financial System in Malaysia**





04

## Explain the Financial System in Malaysia

A

Define the financial system in Malaysia

B

Illustrate the structure of financial system in Malaysia

C

Differentiate the Islamic banking structure in Malaysia with Middle East

# 4 (A)

## Define the financial system in Malaysia



## **A. Define the Financial System in Malaysia**



**Financial System in Malaysia is Divided into 3:**

- a. Banking System**
- b. Non-Bank System**
- c. Financial Market**

## **A. Define the Financial System in Malaysia**



### **a. Banking System**

**Consists of Bank Negara Malaysia, Commercial Banks, Investment Banks and Islamic Banks**



## **A. Define the Financial System in Malaysia**



### **b. Non Banking System**

**It is divided into 5 groups:**

**i. Development and financial  
Intermediaries**

**ii. Saving Institutions**

**iii. Employees Provident and Pension  
Funds**

## **A. Define the Financial System in Malaysia**



### **b. Non Banking System**

**It is divided into 5 groups:**

**iv. Insurance Companies (including Takaful)**

**v. Other financial Intermediaries**

## **A. Define the Financial System in Malaysia**



### **c. Financial Markets**

**Consists of Islamic capital market, Islamic money market, derivatives market and foreign exchange market.**

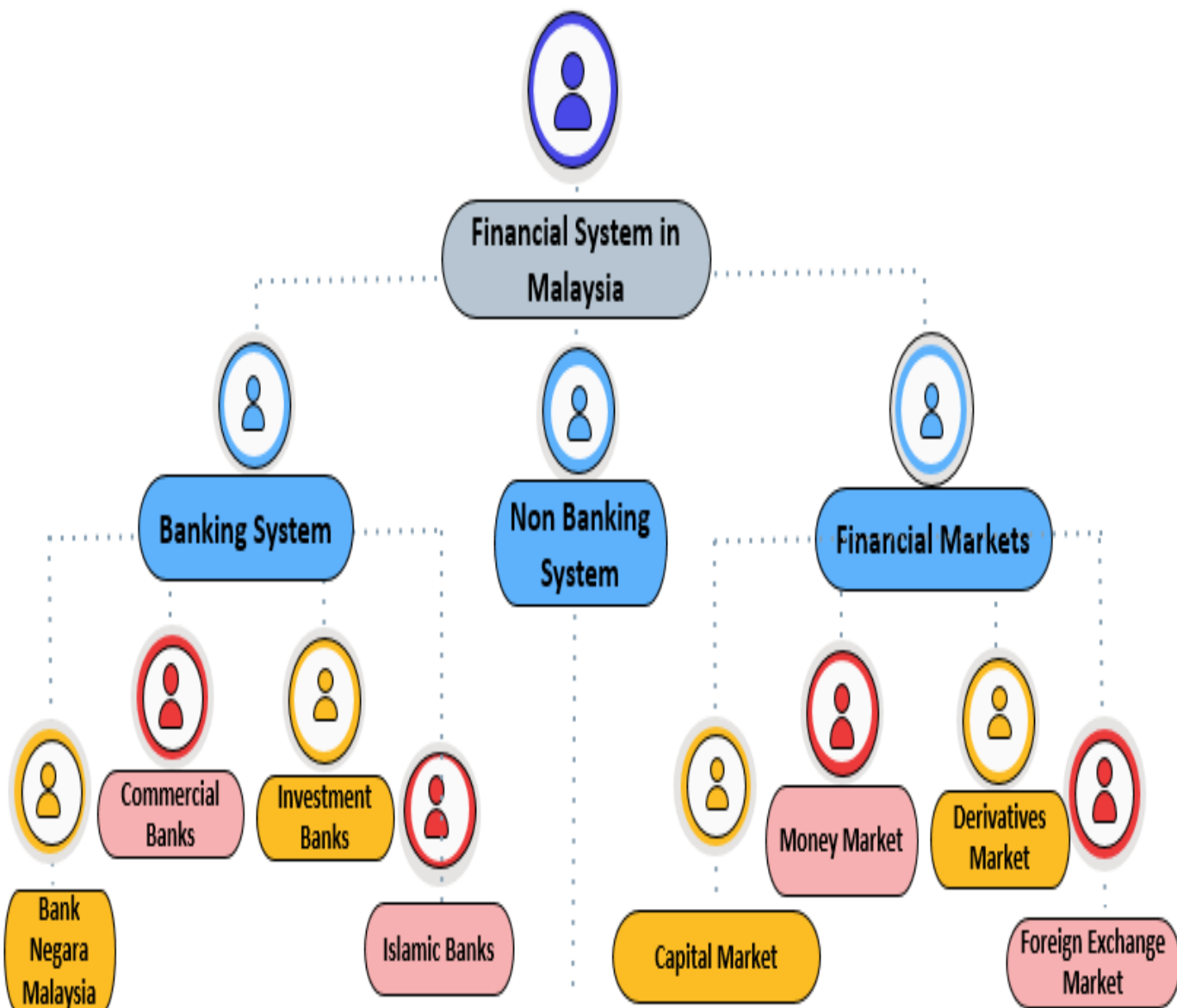
## 4 (B)

**Illustrate the structure of financial system in Malaysia**

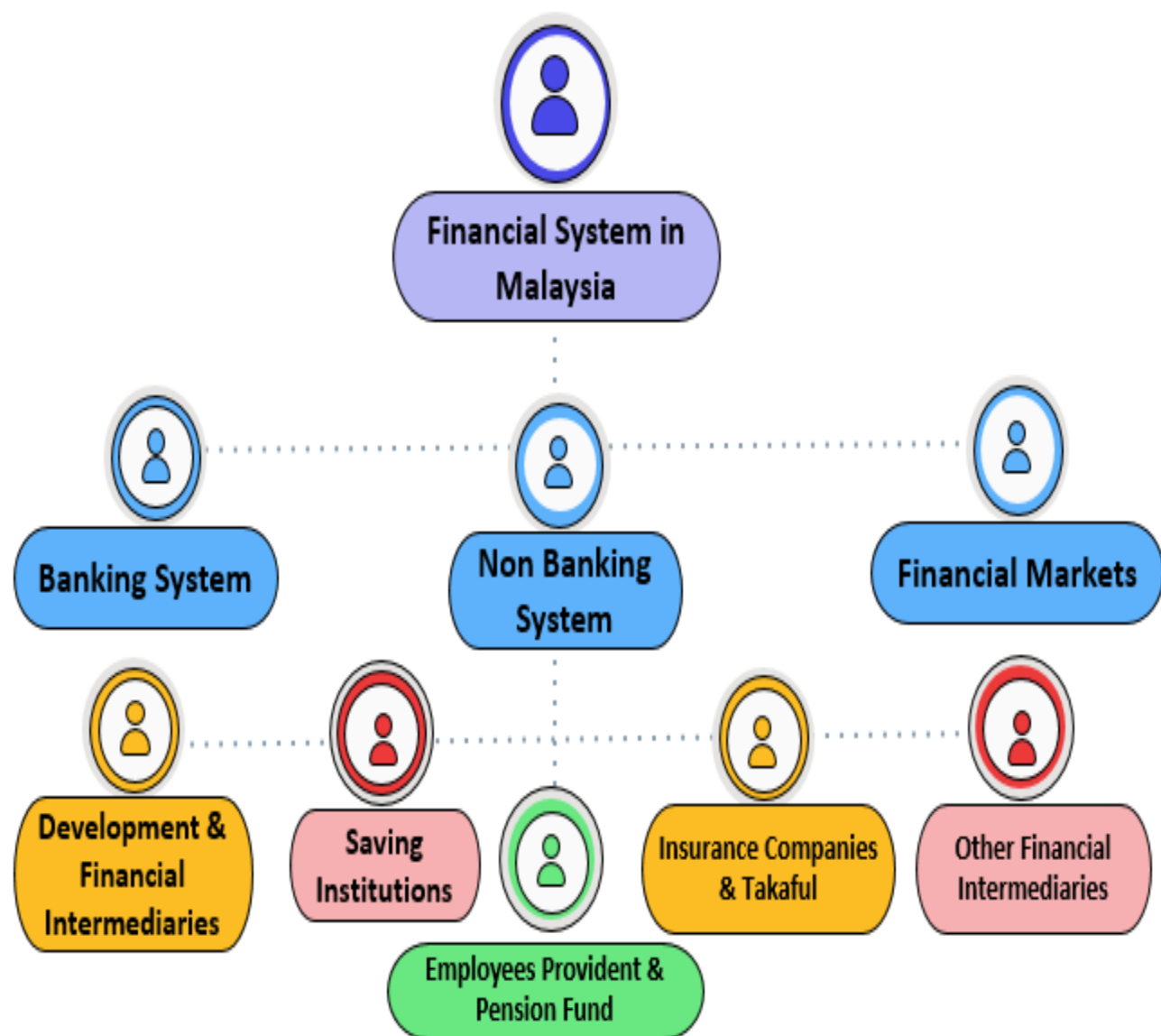




# STRUCTURE OF FINANCIAL SYSTEM IN MALAYSIA



# STRUCTURE OF FINANCIAL SYSTEM IN MALAYSIA



## 4 (C)

# Differentiate the Islamic banking structure in Malaysia with Middle East



# Differentiate the Islamic banking structure in Malaysia with Middle East

i

Islamic banking structure in Malaysia.

ii

Countries with specific manifestations of Islamic finance practice.

iii

Differentiate the Islamic banking structure in Malaysia with Middle East.



# 4 (C)(i)

## Islamic banking structure in Malaysia



# Islamic banking structure in Malaysia



1. Malaysian financial system practices dual banking which are conventional and Islamic Banking.



2. The Islamic banks and financial institutions form part of the whole system.



3.

Islamic banking and finance can be operated in the following manners:

- i. Full-fledge Islamic bank
- ii. Commercial bank with Islamic windows
- iii. Commercial bank with Islamic windows and full-fledge Islamic Branches.

# Islamic banking structure in Malaysia



4. Besides banking, the system also allows Islamic financial and securities markets that include quoted shares, private bonds and unit trust.



5. Takaful or Islamic insurance forms part of the system to support the Islamic financial activities which cannot be catered by the conventional insurance.

## 4 (C)(ii)

### Countries with specific manifestation of Islamic finance practice





## COUNTRIES WITH SPECIFIC MANIFESTATIONS OF ISLAMIC FINANCE PRACTICE

01

**ISLAMIC BANKING SYSTEM ONLY**

IRAN

SUDAN

03

**DUAL SYSTEM**

(Islamic banking system operating in parallel with the conventional system)

MALAYSIA

BAHRAIN

PAKISTAN

**CONVENTIONAL PLUS SYSTEM**

(The system is basically a conventional system with few Islamic banking institutions operating on the fringe of the banking system)

04

UK

THAILAND

BANGLADESH

# Differentiate the Islamic banking structure in Malaysia with Middle East



# Differentiate the Islamic banking structure in Malaysia with Middle East



01

## ISLAMIC BANKING SYSTEM ONLY

**Islamic banking system only** is referring to finance or banking activities that adhere to shariah or Islamic law.



02

## DUAL BANKING SYSTEM

The Islamic banking products offered in Malaysia's **Dual system** are much more sophisticated. The Islamic bankers operating in the dual system would have no choice but to create similar sophisticated products on an Islamic basis. This will be an ongoing process, whereby the level of sophistication in the Islamic banking system will continuously be upgraded.



03

## CONVENTIONAL PLUS SYSTEM

In the case of the **conventional plus system**, Where the Islamic banking institutions operate on the fringe of the domestic banking system and the services they offer are not as comprehensive nor as sophisticated as the conventional system. The small scale nature of the operations of the Islamic banking institutions in these countries also make their services less efficient and more costly compared to the conventional institutions.

# *Let's Do Some Revision!*

## Q1

The only person who received the money as a loan (qard) during banking practices of Prophet (SAW) was \_\_\_\_\_

Select one:

- a. Ali bin Abu Talib
- b. Umar Al Khattab
- c. Ibnu Abbas
- d. Zubair bin Al-Awwam

## Q2

The only known organized Islamic Financial Institution during the time of Prophet (SAW) was called:

Select one:

- a. Waqf institution
- b. Madrasah
- c. Ar Rahnub
- d. Baitul Mal

## Q3

To channel financing, to transfer money and to accept deposits are banking practices during the age of :

Select one:

- a. Prophet (SAW)
- b. Bani Umayyah
- c. Abdullah bin Zubair
- d. Hisab Bin Zubair

## Q4

Under financial intermediaries, it includes banking system and \_\_\_\_\_

Select one:

- a. non banking services.
- b. non banking and financial intermediaries.
- c. non banking products.
- d. non financial service products.



# Let's Do Some Revision!

## Q5

Faisal Islamic Bank which provides deposits and financing facilities is an Islamic bank in \_\_\_\_\_:

Select one:

- a. Sudan
- b. Egypt
- c. Pakistan
- d. Turkey

## Q6

The following are financial institutions under banking system in Malaysia EXCEPT \_\_\_\_\_

Select one:

- a. Bank Simpanan Nasional
- b. Am Investment Bank Berhad
- c. Hong Leong Bank Berhad
- d. Affin Islamic Bank Berhad

## Q7

The following are the non Bank financial intermediaries **EXCEPT** \_\_\_\_\_

Select one:

- a. Berjaya Sampo Insurance Berhad
- b. Bank Simpanan Nasional
- c. HSBC Amanah Malaysia Berhad
- d. Social Security Organization

## Q8

Which of the following is **NOT** one of the banking activities practiced in the era of Bani Umayyah and Bani Abbasiyah?

Select one:

- a. Cheque
- b. Loan or Qard
- c. Transfer of Money
- d. Investment

# *Let's Do Some Revision!*

## **Q9**

Which one of these are special expertise in banking practices during the time of Bani Umayyah and Bani Abbasiyah?

Select one:

- a. Naqid, Sarraf and Jihbiz
- b. Naqid, Sarraf and Muqtadir
- c. Naqid, Wazir and Jihbiz
- d. Naqid, Wazir and Muqtadir

## **Q10**

The country had converted their whole financial system to an interest free banking in March 1985 and accepted two types of deposits which were Qard Hassan and investment term deposits.

Select one:

- a. Egypt
- b. Jordan
- c. Iran
- d. Pakistan

This is referring to the country of\_\_\_\_\_

## LET'S CHECK THE ANSWERS

*You can scan the QR code to check your ready answer. Just use your smartphone and the answer is ready! All the best!*

scan me  
→



*Congratulations to those who get excellent results!*

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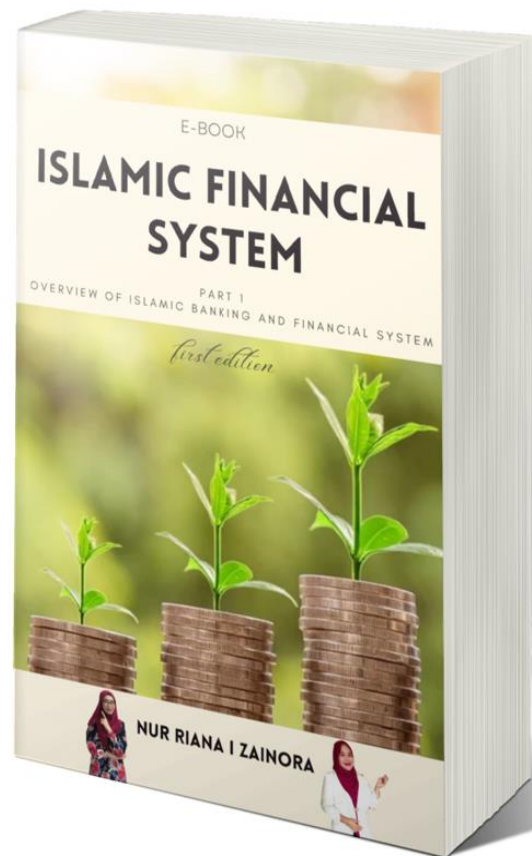
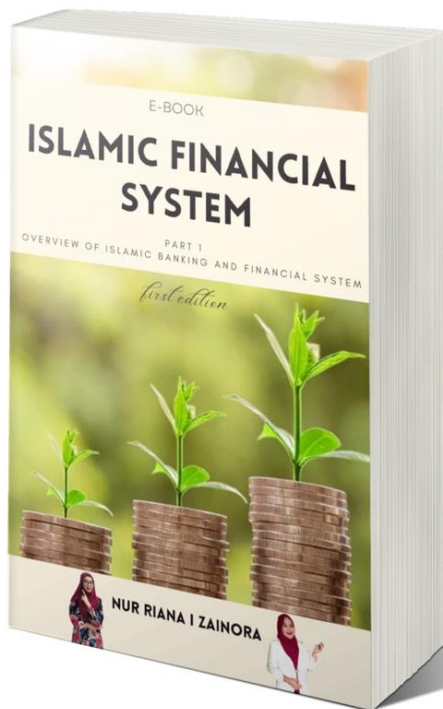
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## **Relevant Act:**

Islamic Financial Services Act 2013



***Whoever follows a path in the pursuit  
of knowledge, Allah will make easy  
for he a path to Paradise.  
- Prophet Muhammad (peace be  
upon Him) -***



**Thank You**

For any further suggestions and comments, please do not hesitate to contact us.

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## **OVERVIEW OF ISLAMIC BANKING AND FINANCIAL SYSTEM**

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