

## Chapter 1

# **The Islamic Banking Timeline (1890–2010)**

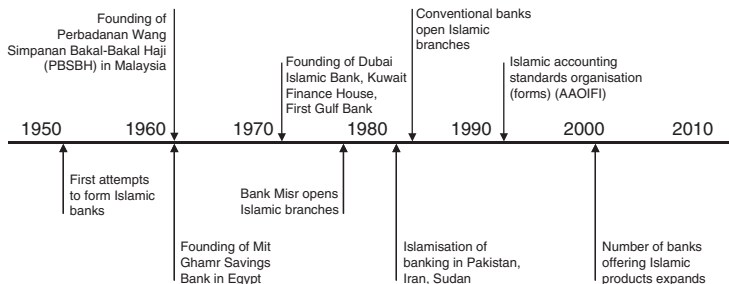
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## 2 Frequently Asked Questions in Islamic Finance

Islamic finance has grown to be a US\$1 trillion industry, after taking off in the private sector in Gulf States, such as Dubai, in the 1970s.

The *Sharia*'a-law compliant system, which prohibits interest, is the national norm in Sudan and Iran, and in a parallel banking system in Malaysia, Bahrain and a few other Gulf States.

The landmark events in the industry's evolution are summarised here chronologically.



- 1890s      Barclays Bank opens its Cairo branch to process the financial transactions related to the construction of the Suez Canal. This is understood to be the first commercial bank established in the Muslim world. As soon as the bank's branch was opened, Islamic scholars initiated a critique of bank interest as being the prohibited *riba*.
- 1900–1930      The critique also spreads to other Arab regions, and to the Indian subcontinent. In this debate, a majority of scholars subscribed to the position that interest in all its forms constitutes the prohibited *riba*.
- 1930–1950      Islamic economists also initiate the first critique of interest from the Islamic economic perspective and attempt to outline *Sharia*'a-compliant alternatives in the form of partnerships.

- 1950s Islamic scholars and economists start to offer theoretical models of banking and finance as a substitute for interest-based banking. By 1953, Islamic economists offered the first description of an interest-free bank based on two-tier *Mudaraba* (both collection of funds and extension of financing on a *Mudaraba* basis). Later they showed that financial intermediation can also be organised on a *Wakala* basis.
- 1950s–1960s First experimental Islamic banks develop interest-free savings and loans societies in Pakistan and the Indian subcontinent. Egypt and Malaysia experiment with pioneering ventures in the 1960s. New banks develop during the 1970s as oil money pours into the Gulf states.
- 1960s Banking applications and practices in finance based on Islamic principles begin in Egypt and Malaysia. The landmark events include the rise and fall of Mit Ghamr (Egypt) Saving Associations during the period 1961–1964 and the establishment of Malaysia's Tabung Haji in 1962. Tabung Haji has since flourished and has become the oldest Islamic financial institution in modern times.
- Operational mechanisms for institutions offering Islamic financial services (IFS) began to be proposed and a number of books on Islamic banking based on profit and loss sharing/bearing and leasing were published.
- 1970s Islamic banks emerge with the establishment, in 1975, of the Dubai Islamic Bank and the Islamic Development Bank (IDB). Also in 1975, *fuqaha* (Muslim jurists) objections to conventional insurance became pronounced, laying the ground for an alternative structure, *takaful*. *Murabaha* was developed as the core mechanism for the investment of Islamic banks' funds.
- Academic activities were launched with the first International Conference on Islamic Economics, held in Mecca in 1976. The first specialised research institution – the Centre for Research in

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- Islamic Economics – was established by the King Abdul Aziz University in Jeddah in 1978. The first *takaful* company was established in 1979.
- 1979 Pakistan becomes the first nation to 'Islamise' banking practices at state level. The process continued until 1985.
- 1980s More Islamic banks and academic institutions emerge in several countries. Pakistan, Iran and Sudan announce their intention to transform their overall financial systems so as to be in compliance with *Sharia'a* rules and principles. The governors of central banks and monetary authorities of the Organisation of Islamic Conference (OIC) member countries, in their Fourth Meeting held in Khartoum on the 7th and 8th of March 1981, called jointly, for the first time, for strengthened regulation and supervision of Islamic financial institutions. The Islamic Research and Training Institute (IRTI) was established by the IDB in 1981. In 1980, Pakistan passed legislation to establish *Mudaraba* companies. Other countries such as Malaysia and Bahrain initiated Islamic banking within the framework of the existing system. The International Monetary Fund (IMF) published working papers and articles on Islamic banking, while Ph D research and other publications on Islamic banking were on the increase in the West. The OIC *Fiqh* Academy and other *Fiqh* boards engaged in discussions as to how to apply *Sharia'a* principles to Islamic banks. Islamic mutual funds and other non-banking financial institutions emerged towards the middle of the 1980s.
- July 1983 Malaysia opens its first official *Sharia'a*-compliant bank, Bank Islam Malaysia.
- September 1983 Sudan reforms its banking system on Islamic principles after President Jaafar al-Numeiri establishes *Sharia'a* law. Dual banking system develops; Islamic in the north and conventional in the south.

March 1984	Iran switches to interest-free banking at the national level after passing a 1983 Islamic Banking law that was promised in the 1979 Islamic revolution.
By 1985	Islamic financial products are offered by more than 50 conventional banks around the globe. Other major banks followed by the 1990s.
February 26, 1990	International Islamic accounting standards organisation, the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), is established in Bahrain by the IDB.
1990s	Public policy interest in the Islamic financial system grows in several countries. The first AAOIFI standards were issued. The development of Islamic banking products intensified. Interest in Islamic finance increased in Western academic circles, and the Harvard Islamic Finance Forum was established. Large international conventional banks started operating Islamic windows. The Dow Jones and Financial Times Islamic indexes were launched. Systemic concerns and regulation, supervision and risk management issues gathered momentum. Several countries introduced legislation to facilitate Islamic banking and its regulation and supervision. Commercial event organisers discovered Islamic banking and finance conferences as a source of lucrative business.
1991	Indonesia's first officially sponsored Islamic bank, Bank <i>Muamalat</i> , is established.
2000s	Sovereign and corporate <i>sukuk</i> as alternatives to conventional bonds emerge and increase rapidly in volume. Bahrain issues Financial Trust Laws. International Islamic financial infrastructure institutions such as the Islamic Financial Services Board (IFSB), International Islamic Financial Market (IIFM), General Council for Islamic Banks and Financial Institutions (GCIBFI) and the Arbitration and Reconciliation Centre for Islamic Financial Institutions (ARCIFI), as well as other commercial support institutions such as the International

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Islamic Rating Agency (IIRA) and the Liquidity Management Centre (LMC), were established. The systemic importance of Islamic banks and financial institutions has been recognised in several jurisdictions.

The governments of United Kingdom and Singapore extended tax neutrality to Islamic financial services.

- By 2000 About 200 Islamic financial institutions have over US\$8 billion in capital, over US\$100 billion in deposits and manage assets worth more than US\$160 billion.  
About 40% are in the Middle East, another 40% in South and Southeast Asia and the remaining 20% are split between Africa, and Europe and the Americas.
- 2001 Malaysia's Financial Sector Master plan sets a target for Islamic finance to make up 20% of the finance sector by 2010. By 2009, its share of financial assets was about 17%.
- 2002 International standard setting organisation, the Islamic Financial Services Board, is established in Kuala Lumpur, Malaysia.
- 2004–2008 Investor interest in Islamic finance products grows strongly amid steady rise in oil prices and petrodollars flowing through oil-producing states. World oil prices peaked at over US\$147 per barrel in mid-2008 before sliding sharply.
- 2004 Islamic Bank of Britain, the European Union's first *Sharia'*a-compliant high street bank, opens in the United Kingdom.
- 2006 Dubai's main stock exchange, the Dubai Financial Market, announces that it is restructuring itself into the world's first Islamic bourse.
- 2008 Global credit crisis and economic slowdown send conventional financial markets into steep tailspin. New Islamic bond issuance falls two-thirds to a three-year low of US\$15.77 billion.

January 2009 Singapore launches the first Islamic bond programme as it vies with Malaysia.

February 2009 Indonesia, the world's most populous Muslim country, sells its first retail *Sharia*'a-compliant bonds, or *sukuk*.

October 2009 The IFC, a member of the World Bank Group, announced it would be the first non-Islamic financial institution to issue *sukuk*.

Late 2009 fears of the first major *sukuk* default emerge but the fears later subside.

