ISLAMIC FINANCE IN BRUNEI

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ABSTRACT

Rapid development in Islamic finance industry in Brunei is very encouraging. Although its true potential is yet to be explored, it continues to make great progresses. With the establishment of the Brunei International Financial Centre (BIFC), under the newly formed monetary authority, Authoriti Monetari Brunei Darussalam (AMBD), it soon passed an international banking order covering international Islamic banking and Takaful. This article explores the development of Islamic finance in Brunei and analyzes its legal and regulatory framework. The challenges and obstacles are also highlighted. This article concludes with a series of suggestions and recommendations on how to strengthen Islamic finance industry in Brunei.

KEYWORDS: Authoriti Monetari Brunei Darussalam (AMBD), Brunei International Financial Centre (BIFC)

INTRODUCTION

The starting point and motivation for Bruneian Islamic finance industry was a decree or Titah of His Majesty the Sultan and Yang Di-Pertuan on the 25th September 1990 in a meeting of the Islamic Council/Majlis Ugama Islam of Brunei:

“If we are not able to do something, it does not mean that we just sit still and do nothing. If we are really unable because we do not have skilled labor or the expertise, and yet we are in dire need to meet the demands, say for example, of Fardhu Kifayah¹, then what is wrong in following the international practice or traditions of nations by the mutual exchange of information or undergoing training or, if necessary, the hiring of experts on temporary employment with us to help us make our projects succeed the way we plan and desire? For example, [in] the matter concerning the Islamic financial system, the most popular nowadays is the Islamic bank. It is no longer a dream or imagination, but we are informed that there are already more than fifty Islamic commercial banks in Islamic countries This is also one of the obligations of Fardhu Kifayah for each of the said Islamic countries, including our State of Brunei Darussalam....” (Pehin Tuan Imam Dato Paduka Seri Setia Ustaz Haji Awang Abdul Aziz bin juned, 2008, p.169)²

Islamic banking market in Brunei was then formally initiated in 1991 when Tabung Amanah Islam Brunei` (TAIB), the country’s first Islamic trust fund was established to help Brunei’s local Muslims undertake their pilgrimage to Mecca.

In 1993, Island Development Bank was converted into the first full-fledged Islamic bank in Brunei under the

¹Fardhu Kifayah refers to obligations that are compulsory to all Muslims but these obligations are considered discharged when someone took the responsibility and perform them. It is not necessary for everyone to perform them. For example, learning medicine is essential and falls under the category of Fardhu Kifayah. As long as someone studied medicine and become a doctor, the obligation is deemed fulfilled. However, if no one in the society studied medicine and there is no doctor as a result, everyone will suffer the sins for their collective failure to observe the obligation.

The next big thing in Bruneiian Islamic finance industry is the formation of Bank Islam Brunei Darussalam in 2005. BIBD is Brunei’s largest bank and flagship Islamic financial institution. It was formed by the 2005 merger of two earlier local Islamic financial institutions, Islamic Bank of Brunei and Islamic Development Bank of Brunei. With majority government shareholding, it is also committed to Brunei Darussalam's National Vision 2035 of attaining developed nation status. Its share holder include Brunei Ministry of Finance, Sultan Haji Hassanal Bolkiah Foundation, Fajr Capital Limited, and some 6,000 individual Bruneian investors.

Traditionally, Islamic banking in Brunei offers products that are supported by classical *Muamalat* concepts such as *al-Bai’ Bithaman Ajil* (home financing, overdrafts and facilities), *Mudharabah* deposits, *Wadiah* accounts, *ar-Rahnu* (pawnbroking), *Ijarah Thumma al-Bai’* (hire purchase) and *Murabahah* letters of credit.

In 2006, the Islamic finance industry leaps further with the issuance of Brunei’s first sovereign *sukuk* (Islamic bond) by the Ministry of Finance. In the same year, the 2006 Syariah Financial Supervisory Board Order was introduced to regulate and approve the offering of Islamic financial products and business services to the public.

Despite the formation of Islamic bank and the issuance of *sukuk*, legislative reform only begins with the introduction of the Islamic Banking Order (IBO) 2008 and *Takaful* Order 2008. Like its counterpart the Banking Order, 2006 for conventional banking, the IBO provides for the issuance of a general commercial Islamic banking licence and an Islamic merchant banking licence to cater for corporate advisory and corporate banking services. The capital requirements are reportedly attractive by international standards to serve as a catalyst to attract participation in the local market from foreign Islamic institutions.

Significant legislation introduced recently includes:

- The Deposit Protection Order 2010: for the protection of ordinary depositors who deposit money in banks, including Islamic banks, against default.
- The Autoriti Monetari Brunei Darussalam 2010: a central bank for Brunei with functions including the supervision and regulation of Islamic banks.
- The Accounting Standards Order 2010: to set and regulate accounting standards in Brunei. It is not yet known whether there is any need to cater for certain aspects of Islamic banking and finance under the standards.

The Deposit Protection Order 2010 came into effect on January 1, 2011. The Ministry of Finance said that the order is set to provide “for the introduction and administration of a deposit protection scheme, the establishment of the Brunei Darussalam Deposit Protection Corporation, its functions and for matters connected therewith”.

Basically, to prevent financial risk and to enhance the confidence of the depositors, the government, under the Deposit Protection Order 2010, requires banks to set aside funds as reserves. The deposit protection scheme therefore protects depositors, whether individuals or businesses, against loss of their deposits in the unlikely event of a member institution failing to honour the transaction.

Bruneian Islamic finance industry leaps further with the launching of *Musyarakah Corporate Financing* by BIBD.

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3The Brunei Darussalam Deposit Protection Corporation is a body corporate which administers the deposit protection scheme which provides protection to depositors in respect of their deposits up to a maximum of $50,000 placed with member institutions in the event that such member institutions are unable to meet its deposit liabilities. The scheme is in-line with international best practice and has already been introduced in various countries.
in 2009. In 2009, BIBD was also mandated lead arranger for the Islamic Development Bank’s USD 850m *sukuk* issuance as well as a joint lead manager for General Electric Capital Corp’s USD 500m *sukuk* issuance, which was awarded Best *Sukuk* Deal by Euromoney.\(^4\)

In 2010, the foundation for the establishment of a strong regulator for Bruneian Islamic finance industry was created. The Autoriti Monetari Brunei Darussalam Order 2010 was passed. The Order, amongst other things, provides for the establishment of Autoriti Monetari Brunei Darussalam (AMBD), its Board and matters connected to the objects, operation, administration, functions, powers and duties of AMBD that includes relations between AMBD and the Government; relations between AMBD and the banks and financial institutions; and consequential and related amendments to other written laws that govern the activities supervised by AMBD.

With a special secretariat for Islamic advisory services, along with a unit for banking and specialised market supervision and another for takaful, insurance and capital market supervision, all part of a wider directorate charged with monitoring and developing regulatory issues in Brunei’s financial sector, the AMBD is expected to maintain an attentive eye on the banking and insurance industry, both its Islamic and conventional segments. This unified monetary authority should be able to reduce redundancy and bureaucracy, while increasing efficiency through synergy.

Since the establishment of the Autoriti Monetari Brunei Darussalam (AMBD) in 2010, prudential standards have been issued by the body to ensure lasting stability in the financial market in Brunei. The result has been fruitful, as manifested in the promotion of new banking products and the development of enhanced technology, as well as a more steady financial environment.

In the same year (2010), it was reported that Brunei Investment Agency is investing in Fajr Capital\(^5\), a Dubai-based investment firm together with other leading institutions including Khazanah Nasional Berhad, the sovereign fund of Malaysia. The investment firm have a reported funding of an initial $700 million and will focus primarily in investment in financial services in key Muslim markets including Brunei to develop the Islamic financial industry\(^6\).

One year later, in 2011, the Monetary Authority of Brunei Darussalam is established. It is formally known as Autoriti Monetari Brunei Darussalam (AMBD). AMBD is a statutory body, acting as the central bank of Brunei Darussalam which undertakes several core functions, chief of which is the formulation and implementation of monetary policies, the regulation and supervision of financial institutions as well as currency management. Four divisions previously under the Ministry of Finance merged to form AMBD, namely:

- The Financial Institutions Division or FID
- The Brunei Currency and Monetary Board or BCMB
- The Brunei International Financial Center or BIFC
- Part of the Research and International Division or RID

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\(^4\)In 2013, Brunei Gas Carrier won the IFN Awards for best Structured Finance Deal of the Year through Brunei Gas Carrier US$170 million Islamic Financing Facility.

\(^5\)Headquartered in the Dubai International Financial Centre, Fajr Capital is a leading principal investments firm with a focus on financial services and other strategic sectors in high-growth Organisation of Islamic Cooperation (OIC) markets. Its main focus is the financial services, infrastructure, healthcare, energy and resources, education, and food and beverage, amongst others.

At year-end 2012, Bruneian Islamic finance industry is already in the right track. BIBD’s assets stood in excess of B$ 6 billion, with a net profit after Zakat and taxation of B$ 119 million. With a Group tier 1 capital of above B$ 1,025 million and an adequacy ratio of 25.7%, BIBD has significant capacity to expand its business. BIBD, headquartered in Bandar Seri Begawan, have fourteen branches at strategic locations in Brunei’s four districts, and has the largest network of ATMs in the country. BIBD leads the Brunei market in assets, financings and deposits. It is also the preferred payroll bank for Government employees.

In the last two years, BIBD has taken serious initiatives to introduce equitable Islamic products. Amongst the equity-based products (not asset-based) developed recently are:

- The Musharakah (partnership) to finance SMEs;
- Musharakah Mutanaqisaha: A home-ownership financing in which the bank assumes ownership risks.

In 2013, the Securities Market Order 2013 was issued. This Order is a meaningful step towards promoting Brunei Darussalam as a regional financial center and Islamic finance center. The Order is wide ranging in its relevance and regulates both conventional finance and Islamic investment businesses. Briefly, the Order manages and controls financial services and financial products, including derivatives and other structured financial products, through its ability to regulate two principal areas, namely: (a) ‘regulated activities’; and (c) public offering of securities in Brunei Darussalam. Under these two sub-heads, activities relating to investments businesses and dealings in securities will come within the scope of the Order although there are certain exemptions afforded where the public is not involved.\(^7\)

In addition to that, in a policy move that would change the Islamic finance environment, Minister of Development Yang Berhormat Pehin Orang Kaya Indera Pahlawan Setia Hj Suyoi Hj Osman in his capacity as deputy chairman of the Autoriti Monetari Brunei Darussalam (AMBD) announced that the central bank will be looking to extend the sukuk tenure to have longer maturity dates and to create a secondary market in the near future. The Sultanate has historically been issuing short-term sukuk with a maturity of 91 days.

In addition to legal reform, the sukuk is also developing. Previously, sukuk has not made much headway in the kingdom. The first Sukuk Ijarah was initiated by the Islamic Development Bank of Brunei (now merged into BIBD) and BLNG in 2006. Subsequently a short-term money market Sukuk Ijarah Program was issued by the government of Brunei Darussalam. Neither issuance is traded in the secondary market. The latest, Series 97, was issued on November 14, 2013, and matures on February 13, 2014 at a rental rate of 0.15 percent. According to the AMBD website, the total of these two sukuk issuances amounted to US$200 million.

Although secondary Sukuk market is not very well developed owing to surpluses in the economy, Islamic modes of project financing for oil, refinery and other large scale developmental projects hold great potential. Currently, BIBD managed the landmark Brunei Gas Carriers (BGC) deals worth US$170 million and US$184 million respectively.\(^8\)

In April 2013, the AMBD inked a memorandum of understanding (MoU) with Bank Negara Malaysia (BNM) to “further strengthen cooperation in the financial sector” between Brunei and Malaysia. While the specifics of the MoU were not revealed, the press statement issued during that time stated that both central banks will be working together in the development of Islamic finance as one of the agenda. Then, in October 2013, the Securities Commission of Malaysia and

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the monetary authority of Brunei, Autoriti Monetari Brunei Darussalam signed an MoU to further facilitate cross-border activities: especially in Islamic capital markets.

By 2013, the number of Islamic financial institutions in Brunei is 2 while the number of Takaful operators stand at 4. Islamic banking assets are estimated to be US$6.0 billion, gross Takaful contributions US$220.3 million while total sukuk issuance is US$4.71 billion.

In December 2013, the Council of the Islamic Financial Services Board (IFSB) resolved to appoint its Chairman and Deputy Chairman for the year 2014. The Managing Director of Autoriti Monetari Brunei Darussalam (AMBD), H.E. Dato Mohd Rosli Sabtu will steer the Chairmanship of the IFSB, while H.E. Agus D.W. Martowardjo, Governor, Bank Indonesia was appointed Deputy Chairman. H.E. Dato Mohd Rosli Sabtu will take over the helm of the international standard-setting organisation from H.E. Sheikh Abdulla Saoud Al-Thani of Qatar Central Bank. This is expected to have very positive effects to Islamic finance industry in Brunei.

Since Brunei aspires to adhere to Islamic principles, the selection of Islamic finance as the preferred method to handle financial transaction in the country is not difficult to be appreciated. With adequate legal and regulatory framework, strong political will and cooperation from key players in the industry, Islamic finance in Brunei seems promising.

However, there are challenges. The major challenges in developing Brunei’s economy include high labor costs, a shortage of skilled labor, a small domestic market and a large bureaucracy but small entrepreneurial class. To certain extent, these challenges are also extended to its Islamic finance industry. Fortunately, these challenges can be overcome.

**DOMESTIC MARKET OR GLOBAL?**

To accelerate the development of Islamic finance industry in Brunei, the motivation and aspiration must be clear. Is it to cater to the domestic need or to seize bigger slice from the global market on Islamic finance? Different motivation will lead to different strategy and policy. It is also possible to aim for both but then the policies must be tailor-made so that both targets can be measured and achieved.

**Domestic Market**

The percentage of the Muslim population in Brunei is high and this contributed to the popularity of Islamic financial products there. Having introduced the Islamic finance option more than two decades ago, Syariah-compliant banking now accounts for around 40 per cent of the local market, a figure some experts believe would rise to 60 per cent by 2017.

Islam is Brunei’s official religion with 64 percent of the population being Muslim, mostly Sunnis of Malay origin who follow the Shafi school of Islamic law, similar to Malaysia. Since the 1930s sultans have used rising oil revenues to provide an extensive social welfare system and promote Islam, including subsidizing the Hajj (pilgrimage), building...

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9The Islamic Financial Services Board (IFSB) has introduced prudential standards for the Islamic financial services industry - in all key areas of capital adequacy, risk management, corporate governance and Shariah governance. Their implementation would in turn promote more consistent regulatory and supervisory frameworks across borders.

10 Peter Church (ed), *A Short History of South-East Asia* (5th edn, Wiley 2009) 8
mosques, and expanding the Department of Religious Affairs.\(^{12}\) The domestic market for Islamic finance is however not that big since the population is only around 408,000, and only half is local.\(^{13}\)

However, this is not a problem. For the locals, various Islamic financial products can be offered to cater to domestic needs. Islamic financial products are important as it enables the locals to fulfill their religious needs. Islamic finance enables Muslims to conduct their daily transactions in ways that are Shariah-compliant. The holy Qur'an has talked about the prohibition of usury or *riba* in many places in chronological order.\(^{14}\)

While catering to the religious needs of the locals is understandable, it would be a great waste of opportunity if the global market were not targeted simultaneously. The size of Islamic finance market is around US$1.6 trillion with an estimated potential of at least US$5 trillion.

**Global**

The Islamic finance and banking in Brunei is flourishing and the global community is actually keen to tap into the lucrative sector within the key areas of infrastructure development and other areas. For example, the ambassador of the Russian Federation to Brunei, Victor A Seleznuev, said that Russia has also started to tap into the Islamic finance and banking sector and added that with Brunei's experience in the field, both countries could benefit.\(^{15}\) Previously, the Brunei Deputy Minister of Culture, Youth and Sports, Datin Paduka Hjh Adina Othman, went on an official visit to hold talks with the Vice President of the Republic of Sakha, His Excellency D E Glushko, at the vice president's office in the city of Yakutsk, Russia (a region rich with oil, gas, coal, timber and all kinds of ores) on July 6. His Excellency added that there are a lot of possibilities for Bruneian companies to invest in these areas.

In 2013, it was reported that Bank of Tokyo-Mitsubishi UFJ and Sumitomo Mitsui Banking have organized a syndicated loan of $184m for Brunei Gas Carriers (BGC).\(^{16}\) The loan complies with Sharia law, which prohibits the charging of interest. The loan is being paid to a special-purpose company that will buy LNG ships and lease them to BGC. Instead of interest, the Japanese banks will receive charter fees.

To truly benefit from the Islamic finance industry, attempts should also be made to convert Brunei into a regional center for shariah-compliance wealth management as well. This is not too difficult as Brunei itself is already blessed with good cash flow originating from its oil and gas industry.

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\(^{12}\) ‘Islam in Brunei’

\(^{13}\) As a result, international Islamic banks are not inclined to open new branches in Brunei. I addition, it was also announced that BIBD is sufficient to cater to the local needs in Brunei.

\(^{14}\) Surat Ar-Roum, 39: “And that which you give in *riba* (to others), in order that it may increase (your wealth by expecting to get a better one in return) from other people’s property, has no increase with Allah.” ; Surat Ale-Emran, 30: “What can be translated as, "O you who believe! Do not take *riba* doubled and multiplied, but fear Allah that you may be successful.” ; Surat Al-Baqarah, 275 & 276: “What can be translated as, “Those who deal with *riba* will not stand (on the day of Resurrection) except like the standing of a person beaten by Shaitan (Satan) leading him to insanity. That is because they say: “Trading is only like *riba*,” whereas Allah has permitted trading and forbidden *riba*. So whosoever receives an admonition from his Lord and stops dealing with *riba* shall not be punished for the past: his case is for Allah (to judge); but whoever returns to dealing with *riba*, such are the dwellers of the (Hell) Fire—they will abide therein. Allah destroys *riba* and will give increase for *Sadaqat* (deeds of charity, alms, etc.) and Allah does not like the disbelievers, sinners.”; Surat Al-Baqarah, 278 & 279: "O you who believe! Fear Allah and give up what remains (due to you) from *riba* (from now onward), if you are truly believers. And if you do not do it, then take a notice of war from Allah and His Messenger but if you repent, you shall have your capital sums. Deal not unjustly, and you shall not be dealt with unjustly."

\(^{15}\) ‘Russia Eyes Islamic Finance Sector in Brunei’, *RAQABA*
\[^{15}\]http://www.raqaba.co.uk/?q=en/content/russia-eyes-islamic-finance-sector-brunei

\(^{16}\) ‘Japanese get into Islamic financing’ *Seashipnews* (29 January 2013)
\[^{16}\]http://seashipnews.com/news_content.php?id=3w3c539
Brunei has the expertise and regulatory support that will allow it to enter the global Islamic financial market in the asset management sector. To complement existing workforce, credible and established foreign experts can also be recruited on short-term or long-term basis.

Furthermore, Brunei’s agencies such as the Ministry of Finance and its investment agencies have years of experience in this sector, and thus can be used as a leverage. Furthermore, the trends in the market are now heading towards diversifying Islamic assets where he said that asset managers should have the freedom to invest in a wider range of syariah compliant products.

The slow growth of Islamic wealth management sector is a reason for concern. Iqbal Khan, CEO of Fajr Capital (a global Islamic investment firm which owns a minority stake in the government-backed Bank Islami Brunei Darussalam), previously expressed his concern over the growth of the Islamic wealth management sector, saying that its progress is still very much tethered to the current global economic landscape, which unfortunately has not rebounded as hoped:

“Islamic wealth management is firmly rooted in value-producing economies, and does not carry features similar to hedge funds. It is based on the real economy, and there are opportunities in REITs, Waqf and endowment funds. However, the elements that caused the credit crisis are still in existence, contributing to the fragile global economy, and a less positive outlook.”

The huge global market should be targeted. Moody’s Investors Service believes that the full potential is at least US$5 trillion although currently, it only accounts for around 5 percent of the global financial industry. There is a huge market for Islamic finance. The first being Muslims, which compose about 20 percent of the world population. James Hume, executive vice president of the Dubai International Financial Centre, noted:

An increasingly educated populace with growing self-assuredness and awareness of their Islamic roots is becoming alert to the shortcomings of conventional finance and more vocal in demands for alternatives.

In the Middle East alone at least US$1.5 trillion in project financing is expected in the next ten years, and most of it will have strong Islamic financing aspects. Investment opportunities from MENA (Middle East and North Africa) region should not be underestimated:

- The Gulf States control around 40 percent of the world’s known oil reserves and nearly a quarter of global natural gas reserves.
  In 2012, the Gulf states are estimated to earn around $572 billion in oil earnings in compared to $538 billion in 2011.
- By 2006, the foreign assets of the Gulf Cooperation Council (GCC) had already reached US$1.9 trillion.
  The net foreign assets of the six-member bloc are estimated to hit $2.1 trillion in 2013.
- The net capital outflows from the Gulf States in 2006 alone were US$200 billion.

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• The McKinsey Global Institute estimated that the GCC’s accumulated foreign wealth could reach US$8.3 trillion by 2020.

A clear policy to increase share in global Islamic finance industry by Brunei will be very useful from various perspective. By becoming international wealth management center, Brunei will have the necessary expertise to make itself more self-sufficient and independence. The benefits of focusing on global market by building adequate capacity cannot be underestimated. While currently Brunei is blessed with good supply of oil, such supply is not unlimited. Furthermore, it is possible that new technology will emerge to replace oil. In any event, Brunei must prepare itself for such possibility.

There are similarities between Brunei and UAE. Most sovereign wealth funds in the UAE obtain their reserves from revenues accrued in the oil and gas industry. Similar to the UAE, Brunei Investment Agency has sovereign reserves of US$40 billion which are also derived from oil production activities. Brunei sovereign wealth fund (SWF) would be better managed once Brunei possesses world class-level internal expertise.

In addition, by becoming a global or regional wealth management center, Brunei would be able top tap investment from MENA region and others interested in diversification.

Currently, rich Muslim investors and sovereigns faced restrictions from Western countries, largely due to Islamophobia. If Brunei manages to set itself as international shariah-compliant wealth management center, Brunei would be able to attract these neglected investors as well.

Islamophobia

Following the attacks on 11 September 2001, all things Islamic came under a cloud of suspicion, and Islamic finance and Islamic banks were certainly no exception. Discrimination against Muslims increased significantly following the September 11 attacks, with Muslims stereotyped as violent and prone to terrorism without any opportunity to rebut. In 2013, Brunei itself was targeted and severely condemned by Western media merely for declaring that Brunei chooses to apply Islamic law.

There are around 1.3 billion Muslims in the world, and that means that one out of every five or six people on the planet is Muslim. However, the equity and wealth shared by Muslim communities is just around 4 percent and many Muslim countries such as Indonesia, Bangladesh, Afghanistan and Pakistan are largely poor with no media power. Furthermore, almost all of the eminent media is owned and controlled by Western countries with much of it significantly contributing to the negative perceptions and images of Islam that have become so commonplace. A case study of American network news coverage post 9/11 supported the view that objective coverage of Islam is a myth, not just in America, but also around the world.

Muslims, especially those from the Middle East, are almost always portrayed as terrorists with the intention to kill the innocent populations of Western countries in Hollywood movies. As a consequence, hatred towards Islam and Islamophobia are on the rise. Mosques in various places have been defaced and burned and Muslims are treated suspiciously, especially those trying to adhere to the Islamic dress code. Requests have also been made by some politicians

24 "Global sovereign wealth fund assets dominated by countries in the Middle East” Islamic Finance News (28 August 2013) <http://www.islamicfinancenews.com/listing_article_ID1.asp?nm_id=32162&searchid=7751>
to refuse citizenship to followers of Islam.

Applications to build non-Islamic places of worship have typically been freely granted, but applications to build mosques have become sensitive and many have been rejected. Therefore, it is not surprising that the negative perceptions towards Islam which generated strong hatred for Muslims have contributed to the various attacks on Islamic finance, many of which have been based on prejudice and bias. Virtually every work in the abundant ‘secrets of terrorist financing’ literature has alleged that the purpose of Islamic finance is to fund terrorism.27

One of the National Security Adviser during Bill Clinton’s second term and the top official in charge of the surveillance of Bin Laden’s networks at the time, alleged that “it would be difficult to track down Osama Bin Laden’s money because it was hidden in ‘underground banking, Islamic banking facilities.’”28 Blanket accusations that Muslims are terrorists, or even violent people, are unwarranted and unjustifiable, but that has not stopped individuals from insisting that Islamic finance should be discouraged because ‘terrorists might use it’.

Conflicting logic plagues these accusations because real terrorists do not want their money to be easily identifiable and would definitely shy away from Islamic finance, which is subjected to a great deal of scrutiny from the authorities. Those involved in terrorism are more likely to receive their funding from other sources including piracy, money-laundering and secret donations and it would be highly counterintuitive to attempt to use Islamic finance for such activities.

Despite this discrimination, in the years following the September 11 attacks, the Islamic finance industry did not crumble and collapse. Instead, it experienced dramatic growth and major transformations while progressively shifting to better products. Criticisms and condemnations of Islamic banks were no doubt a motivating factor in the serious efforts to standardize, rationalize and streamline Islamic finance. Blanket discrimination against Muslims and Muslim countries, particularly those in the Middle East, have also contributed to the development of Islamic finance in certain jurisdictions such as United Kingdom and Southeast Asia, particularly Malaysia because some wealthy Muslims and Muslim countries decided to diversify their wealth outside Western countries due to the prevalence of poor treatment and negative perceptions.

Furthermore, the risk that their assets might be unfairly frozen merely because they were Muslims also contributed to the shifting of assets and investments outside Western countries. Islam is one of the most misunderstood religions and its negative portrayal in media and much of society has been detrimental to the development of Islamic finance.

According to the 2009 survey on religious attitudes, a shocking 58 percent of the Americans interviewed agreed that Muslims face more discrimination than any other religious group in the United States but claim that Muslims deserve it.29

With a proper strategy for improving the relationships between Muslims and non-Muslims in place and a more efficient use of the media to reduce negative perceptions, it is possible to ensure a brighter future in which kindness and mutual understanding leads the way. Due to the strong and systematic bias and discrimination in the West towards Muslims, especially those from the Middle East, many wealthy investors and Middle-Eastern Muslim countries are looking

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for alternatives. This has contributed to the growing Islamic finance market outside the United States. Furthermore, non-Muslim investors have also contributed to this expansion with the market for sukuk increasing from close to zero in 2001 to US$100 billion in 2007, in part because non-Islamic investors have acquired a substantial percentage of the sukuk market.\footnote{Ibrahim Warde, ‘The Relevance of Contemporary Islamic Finance’ (2009) Berkeley J. Middle E. and Islamic L., 165.}

Brunei entered the Islamic finance sector around 1993. The Islamic finance sector accounts for 40 percent of the total banking market in the country. Islamic financial products already play a defining role in the domestic economy, with Shariah-compliant banking holding around half (40 percent) of the market share and a total forecast of between 55 and 60 percent in the next five years. The performance of the Sultanate’s Islamic banks compares favorably to that of its neighbors’. The segment, for instance, holds a 20 percent market share in Malaysia, widely seen as an international leader in Islamic finance, and accounts for just 2 percent of financial services in Indonesia. By becoming a regional center for shariah-compliance wealth management, Brunei would also set itself as Islamic financial hub. However, to do this, the policy should not focused solely on domestic needs. There should be a good a balance between domestic needs and global interest

LEGAL AND REGULATORY FRAMEWORK

The legal framework of conventional finance, unmodified, is not suitable to cater to Islamic finance. This does not mean that that a new separate regulatory and legal framework for Islamic finance is needed in all aspects. Where similarity exists, the principles and concepts can be extended to Islamic finance e.g. in matters like transparency, accountability, conflict of interest etc. This assists Islamic finance, as the regulators do not have to start from scratch. Furthermore, the long experience of conventional finance could be used to make Islamic finance industry more resilient.

It is necessary to have an adequate legal and regulatory framework for Islamic finance but it must also be understood that there are many things beyond its reach:

The success of and spread of a product or of an institutional-operational Model for the financial industry must not be allowed to depend on the rules. It is not the regulator’s or supervisor’s job to determine the economic needs of the market, the products and the services that firm and households need. Selection of the enterprises that offer financial services and products is up to the market. Market participants, for their part, must observe the rules, whose objective in the financial sector is to ensure stability, transparency, investor protection, and hence a level playing field among financial institutions.\footnote{M. Fahim Khan and Mario Porzio, \textit{Islamic Banking and Finance in the European Union: A Challenge} (Edward Elgar 2010) 196}

To strengthen Islamic finance industry, there must be proper legal and regulatory framework. The Shariah Financial Supervisory Boards (SFSB) Order introduced in 2006 enhances the Shariah governance and supervision and accords the board the power to make Shariah rulings on Islamic transactions.

The first Islamic banking legislation of Brunei Darussalam to regulate the Islamic banking industry is The Islamic Banking Act of Chapter 168 enacted on Dec 2, 1992. This provided the legislative vehicle for the institution of Islamic banking.

The Ministry of Finance in 2008 introduced the Islamic Banking Order 2008, intended at expanding the Islamic banking sector in Brunei while increasing the competitiveness among players by creating a level playing field as well as
strengthening the supervision and regulation of Islamic banking activities. This new legislation also aims to attract foreign participants to strengthen the industry as a whole and to nurture local knowledge and expertise.

In the same year, Takaful Order 2008 was introduced. The Order is a new comprehensive legislation to govern the activities of the domestic takaful industry and provide the legal platform for a level playing field between conventional insurers and takaful operators. The Takaful Order of 2008 has made some changes where there are different requirements for Takaful operators to carry out Family Takaful and General Takaful. As a result, the local Takaful companies need to re-strategize their business models since given the small local market size and increasing operational costs, the profit margins will reduce considerably. The apparent move would be for the Takaful business to be less dependent on standard insurance products such as the car insurance, which is their existing dominant sector, and to venture into new opportunities such as corporate industrial activities. As comparison, the newly passed (Malaysian) Islamic Financial Services Act 2013 also require Takaful operators to choose either Family Takaful or General Takaful with dateline already set.

The previous Islamic Banking Act of 1992 consist of seven parts; the core parts covering issues on licensing, financial requirements, ownership, restrictions on business, supervision and control of Islamic banks. The new 2008 Order is more detailed in its text, comprising of 11 parts. The main core of the text covers similar grounds but is all-inclusive and up-to-date with the ever-changing banking environment.

The 2008 Order also re-defined 'Islamic banking business' as a business whose aims and operations are not contrary to *Hukum Syara*, this meaning, the Laws of Islam according to the four major schools of *Ahlus Sunnah Wal Jamaah*. It is interesting to note that in the matter of definition, licensed offshore companies (under the International Banking Order 2000) is also now allowed to carry on Islamic banking business. This will accelerate the development of the industry.

In addition to Islamic banking, Brunei also aims to increase the penetration rate of Takaful and insurance products among its population. Figures show that Takaful take-up in Brunei has grown; with assets held by Takaful providers more than doubling between March 2011 and June 2013, from US$150 million to US$349 million – slower than for conventional providers, according to data from the Autoriti Monetari Brunei Darussalam. Briefly, the Bruneian Islamic banking and Takaful are governed by the Islamic Banking Order 2009 and Takaful Order of 2008 respectively. In addition, there is also the statutory Tabung Amanah Islam Brunei (TAIB) Act to regulate the Islamic finance sector. Other governing acts include the Finance Companies Act and the Deposit Protection Order.

Beside comprehensive legal framework, it is also essential to have strong regulatory support. In January 2011 a new unified monetary authority was established. Before the creation of the Autoriti Monetari Brunei Darussalam or ‘Monetary Authority of Brunei Darussalam’ (AMBD) in 2011, the regulatory bodies included the Ministry of Finance, the Financial Institutions Devisions, the Brunei Currency and Monetary Board, the Brunei Investment Agency, the Revenue and International Research Divisions and the Brunei International Financial Centre (BIFC). The AMBD is a statutory body that acts as the central bank of Brunei. Its core functions include the formulation and implementation of Brunei’s monetary policies, the supervision of Brunei’s financial sector and currency management.

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From the legal and regulatory aspect, the implementation of the international regulatory and supervisory standards and best practices for Islamic finance is necessary. The Islamic Financial Services Board (IFSB) has introduced prudential standards for the Islamic financial services industry - in all key areas of capital adequacy, risk management, corporate governance and Shariah governance and their implementation would promote more consistent regulatory and supervisory frameworks. A survey conducted by the IFSB in 2011 indicated that 9 countries have implemented the standards issued by the IFSB and that 18 countries are expected to implement them within the next five years. Their consistent implementation will be vital since this harmonization will also facilitate consistent participation in Islamic finance across borders and contribute towards global financial stability.\(^\text{35}\)

**CHALLENGES AND OBSTACLES**

**Tax Issue**

Unnecessary hurdles from taxation perspective need to be abolished. Previously, there are complaints that the Stamp Act, Cap. 34 (based on the English Stamp Act of 1819) and the Land Code, Cap 34 (enacted in 1909), might hinder the growth of Bruneian Islamic finance industry by creating and maintaining an unequal playing field with conventional banks: and should therefore be updated.

Regulatory treatment is necessary to ensure the success of Islamic finance. Tax incentives have played an important role in creating a level playing field for Brunei’s Islamic finance industry. Previously, the taxation imposed on Islamic banking was similar to that levied on its conventional counterparts, resulting in Islamic financial institutions being subjected to a 30 percent corporate tax and an additional 2.5 percent zakat contribution.

The conventional financial system differentiates equity-based financing and investments, and credit financing or loan. Since under Islamic finance, usury or interest is prohibited, this cause some obstacles when it operates in a system tailored for the conventional system as the regulatory and legal framework favor credit financing and loan by providing many initiatives:

More specifically, tax law could be quite problematic to Islamic banks, especially since tax law has always treated equity finance and debt finance differently. This means that Islamic banks will not have the same tax treatment as conventional banks, which are based on debt finance. There are two aspects of the taxation problem regarding the financial products of Islamic banks: first, the extra taxes generated by Islamic bank transactions; and second differentiation made between interest and profits …\(^\text{36}\)

A new legal framework is needed for Islamic financial product to avoid extra taxation:

[T]he Murabaha (mark-up) contract is used by Islamic banks to replace personal loans offered by conventional banks. The Murabaha agreement includes two purchasing options, which are taxable transactions although both purchased contracts belong to one transaction, it is still due double stamp duty this means that the cost of this service offered by Islamic banks is far more than that which a customer of a conventional bank would pay for the same service. The same problem can be addressed with regard to Islamic mortgages, where stamp duty land tax will be charged twice: once when the Islamic bank buys the property; and again when the customer completes...

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\(^{36}\) Abdul Karim Aldohni, *The Legal and Regulatory Aspects of Islamic Banking: A Comparative Look at the United Kingdom and Malaysia* (Routledge 2011) 109
purchasing all ‘units’ from the banks and obtains the legal title. There could also be stamp duty land tax on the lease to occupy the property.\textsuperscript{37}

Under conventional legal framework, interest is given special treatment, can be offset against the payment of tax and in other words, it is tax deductible. Since the interest element is totally eliminated from Islamic finance Islamic banks have no deductions to make in their tax bill. Furthermore, the rewards achieved by equity finance structures to offer similar services to conventional banks, are taxable.

In order to avoid extra taxation and unfair treatment to Islamic financial institutions, established Islamic financial hubs like Malaysia and Iran has long created a level playing field by taking initiatives to ensure fairness.

However, other jurisdictions that are relatively new to Islamic finance are still developing the legal and regulatory framework in relation to taxation. One example is Australia. On 26 April 2010, the then Australia’s Assistant Treasurer and the Minister for Financial Services, Corporate Law and Superannuation announced that a comprehensive review of Australia’s tax laws on Islamic finance will be made.\textsuperscript{38} On 18 May 2010, the then Assistant Treasurer announced the terms of reference for the Board’s review and the Discussion paper elaborated that the Board has been asked to\textsuperscript{39}:

- ‘Identify impediments in current Australian tax laws (at the Commonwealth, State and Territory level) to the development and provision of Islamic financial products in Australia;
- Examine the tax policy response to the development of Islamic financial products in other jurisdictions (including the United Kingdom, France, South Korea and relevant Asian jurisdictions); and
- Make recommendations (for Commonwealth tax laws) and findings (for State and Territory tax laws) that will ensure, wherever possible, that Islamic financial products have parity of tax treatment with conventional products.’

In conducting the review, it was reported that the Board should consider the following:\textsuperscript{40}

- The tax treatment should be based on economic substance of the products rather than form.
- Where an Islamic financial product is economically equivalent to a conventional product, the tax treatment should be the same.

Tax incentives are important. Tax incentives play an important role in creating a level playing field for Brunei’s Islamic finance industry. Previously, the taxation imposed on Islamic banking was similar to its conventional peer which exposed Islamic financial institutions to 30% corporate tax and an additional 2.5% zakat contribution.

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\textsuperscript{37} Abdul Karim Aldohni, \textit{The Legal and Regulatory Aspects of Islamic Banking: A Comparative Look at the United Kingdom and Malaysia} (Routledge 2011) 109
Currently, Islamic financial instruments are subject to 2.5% Zakat contribution from the required 30% corporate tax. With Zakat receiving an exemption from the stamp duty, this creates a level playing field on a par with conventional instruments. Brunei formulated the Credit Bureau in September 2012 to improve the risk management practices of banks and finance companies.

Lack of Experts and Manpower

According to Asian Institute of Finance (AIF) CEO Dr Raymond Madden, the Islamic finance industry requires more professionals and skilled talents who not only have dual knowledge of both Shariah and finance, but also possess soft skills such as leadership and effective communication.

The current shortage of qualified Islamic finance professionals is a challenge that poses a serious threat to the growth and development of the industry. If this issue is not addressed immediately, talent shortage may be an impediment to growth. Brunei needs to address the limited pool of human resources to further the development of the Islamic finance sector.41

Universiti Islam Sultan Sharif Ali (Unissa) is offering an undergraduate degree programme in Islamic finance. In addition, local online educational and consultancy service provider, Crescent, also developed a graduate degree in Islamic banking and finance to complement its existing list of courses dealing with the various aspects of Shariah-compliant finance. Universiti Brunei Darussalam (UBS) also offered courses on Islamic banking and practice. In mid-April 2012, the UBD announced it would be reviewing its curriculum for its Islamic finance courses to ensure their content was relevant to the sector, a process that would also include seeking input from the industry itself.

The Centre For Islamic Banking and Management (CIBFM), which was established in early 2010 by the Ministry of Finance to address key challenges in Islamic financial practice and to assist in the development of human resources for the sector, as well as other institutions, was also working to deepen the pool of qualified personnel in Brunei.

CIBFM was restructured under the Autoriti Moneteri Brunei Darussalam (AMDB) with an aim to become the human talent development platform for the financial industry in Brunei Darussalam. As a Centre of Excellence, it provides professional learning and development solutions in major disciplines such as Banking, Finance, Insurance, Capital Market as well as Management and Professional Studies.

The Centre also dedicates itself to promoting Islamic banking and finance through the provision of programs at various levels.

Another development that should boost Islamic finance’s educational stocks was the announcement by Bank Islam Brunei Darussalam (BIBD) that it would be sponsoring a chair of Islamic banking and finance, leadership and entrepreneurship at the Faculty of Business, Economics and Policy Studies (FBEPS).42

Brunei will have to wait for some time before human resource investments in Islamic finance begin to pay full dividends despite the sector already profiting from 20 years of experience and a generation of professionals that have

41 A deeper analysis reveals that the situation is more complicated. While it is true that the industry lacks sufficient manpower, the industry is actually demanding. Many graduate in Islamic finance worldwide struggle to find employments in the financial sector. The industry is looking for those with dual knowledge in the conventional and Islamic finance. In addition, most prefer those with certain specialization and expertise.

grown up inside the industry.43

**Limited Financial Products**

Islamic financial products are quite limited in Brunei but there are reasons to believe that the situation will change soon. For example, Standard Chartered Bank Brunei (SCB) has plans to introduce Islamic banking products by 2013 to cater for the growing demand in Syariah-compliant banking services in Brunei, its chief executive officer said.44 Standard Chartered was the first international bank in Malaysia to offer Islamic banking products in 1992 and since 2003, in the UAE, Pakistan and Bangladesh.

Besides Standard Chartered Bank Brunei, the AmBank Group is also eyeing Brunei. The AmBank Group are working towards establishing an Islamic bank in Brunei. Speaking to The Brunei Times, the chairman of the AmBank Group, Tan Sri Azman Hashim, said the Bank is hoping that the Brunei government will issue the Malaysian financial house with a license.

**THE WAY FORWARD**

Education and training is the first way forward. To develop Brunei as a center for Islamic finance, it is essential to groom sufficient local talent simultaneously. Brunei’s leading educational facilities seek to support the government's policy of developing the Sultanate as a center of Islamic financial excellence. In addition, the CIBFM, which was established by the Ministry of Finance to tackle key challenges in Islamic financial practice and to assist in the development of human resources for the sector, as well as other institutions, are also working to deepen the pool of qualified personnel in Brunei Darussalam.45

The Universiti Brunei Darussalam (UBD), along with the Sultan Sharif Ali Islamic University and other centres, offer a range of courses on various aspects of Islamic finance and in mid-April 2012, the UBD announced it would be reviewing its curriculum for its Islamic finance courses to ensure their content was relevant to the sector, a process that would also include seeking input from the industry itself.46

It should be a priority to nurture local talent to strengthen the industry. Programmes that tie in with empowerment should also be available. Many corporations complain about young graduates not being equipped to make that transition from university to the workforce.

Secondly, it is essential to attract foreign experts with high-level knowledge and practical experience in the Islamic finance industry to help train personnel in Brunei in an effort to improve their general quality. In addition to that, Brunei can proceed with cooperative ties with more standard setters and regulators, international financial institutions, organizations, established universities and non-governmental societies from other countries in order to recruit more talent.

Thirdly: cooperation with other key players. Currently, various cooperative measures are being taken by Brunei

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with important key players in Islamic finance industry. However, to truly benefit from this cooperation, Brunei needs to have a clear policy with clear objectives and targets.

The issue of collaboration is very essential. According to Bank Negara Malaysia’s Governor Dr. Zeti Akhtar Azizat the Brunei Darussalam Islamic Investment Summit 2013:

“Whilst there needs to be continued efforts at the national level to develop the institutional foundations for Islamic finance that will foster effective and efficient financial flows, and ensure that financial stability is preserved, the new wave of internationalization for Islamic finance requires increased collaboration across jurisdictions to strengthen the international financial infrastructure of Islamic finance going forward into the future, this will be particularly important given that the international environment has become more challenging. This is to ensure that the greater internationalization of Islamic finance takes place in an environment of financial stability”47

Cooperation between countries is essential. In December 2013, it was reported that Malaysia and Brunei have agreed to enhance cooperation between the national banks of the two countries in the Islamic finance sector. This was agreed in conjunction with the signing of a deal by Malaysian prime minister Najib Tun Razak and Sultan Hassanal Bolkiah of Brunei, for Malaysia and Brunei to jointly drill for oil and gas in the area near the offshore border shared by the countries between the northern parts of Sarawak, Brunei and Sabah.48

Fourthly, there must be legal certainty, reflected in the existence of up-to-date legislation. Laws should be codified, e.g. the basic rules of classical concepts like Mudharabah, Musharakah and Ijarah, to reduce arguments and promote certainty, which benefits product developers and lawyers. As Islamic banking and finance gains in complexity, involving combinations of an array of Islamic classical concepts, this will become more difficult. For example, Riba, amongst a host of other legal issues, has been debated for 1,500 years with no conclusion. Inclusion of the four Madhhab with conflicting views produces flexibility but invites uncertainty in the law. The emphasis on legal certainty should not be construed as rejecting creativity or innovation. What is necessary is to have finality in deciding whether a product is shariah compliant or not. In Malaysia, the Shariah Advisory Council of Bank Negara Malaysia (SAC) was established in May 1997 as the highest Shariah authority in Islamic finance in Malaysia. The SAC has been given the authority for the ascertainment of Islamic law for the purposes of Islamic banking business, takaful business, Islamic financial business, Islamic development financial business, or any other business, which is based on Shariah principles and is supervised and regulated by Bank Negara Malaysia.49 As the reference body and advisor to Bank Negara Malaysia on Shariah matters, the SAC is also responsible for validating all Islamic banking and takaful products to ensure their compatibility with the Shariah principles. In addition, it advises Bank Negara Malaysia on any Shariah issue relating to Islamic financial business or transactions of Bank Negara Malaysia as well as other related entities.

In the recent Central Bank of Malaysia Act 2009, the role and functions of the SAC was further reinforced whereby the SAC was accorded the status of the sole authoritative body on Shariah matters pertaining to Islamic banking, takaful and Islamic finance. While the rulings of the SAC shall prevail over any contradictory ruling given by a Shariah body or committee constituted in Malaysia, the court and arbitrator are also required to refer to the rulings of the SAC for any proceedings relating to Islamic financial business, and such rulings shall be binding.

Overall, Islamic finance industry in Brunei seems promising. There is a strong support from the government and key players in the industry and the country is in the right track. However, to safeguard the future of the industry, there should be no compromise in nurturing new talents. Without sufficient experts and manpower, the development will be unnecessarily halted.

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1. *Fardhu Kifayah* refers to obligations that are compulsory to all Muslims but these obligations are considered discharged when someone took the responsibility and perform them. It is not necessary for everyone to perform them. For example, learning medicine is essential and falls under the category of *Fardhu Kifayah*. As long as someone studied medicine and become a doctor, the obligation is deemed fulfilled. However, if no one in the society studied medicine and there is no doctor as a result, everyone will suffer the sins for their collective failure to observe the obligation.


3. The Brunei Darussalam Deposit Protection Corporation is a body corporate which administers the deposit protection scheme which provides protection to depositors in respect of their deposits up to a maximum of $50,000 placed with member institutions in the event that such member institutions are unable to meet its deposit liabilities. The scheme is in-line with international best practice and has already been introduced in various countries.

4. In 2013, Brunei Gas Carrier won the IFN Awards for best Structured Finance Deal of the Year through Brunei Gas Carrier US$170 million Islamic Financing Facility.

5. Headquartered in the Dubai International Financial Centre, Fajr Capital is a leading principal investments firm with a focus on financial services and other strategic sectors in high-growth Organisation of Islamic Cooperation (OIC) markets. Its main focus is the financial services, infrastructure, healthcare, energy and resources, education, and food and beverage, amongst others.


9. The Islamic Financial Services Board (IFSB) has introduced prudential standards for the Islamic financial services industry - in all key areas of capital adequacy, risk management, corporate governance and Shariah governance. Their implementation would in turn promote more consistent regulatory and supervisory frameworks across borders.

10. Peter Church (ed), *A Short History of South-East Asia* (5th edn, Wiley 2009) 8

11. ‘Investing in the future of Islamic finance’ *The Brunei Times*(24 June 2012)
12. ‘Islam in Brunei’


13. As a result, international Islamic banks are not inclined to open new branches in Brunei. In addition, it was also announced that BIBD is sufficient to cater to the local needs in Brunei.

14. Surat Ar-Roum, 39: “And that which you give in riba (to others), in order that it may increase (your wealth by expecting to get a better one in return) from other people’s property, has no increase with Allah.” ; Surat Ale-Emran, 30: “What can be translated as, "O you who believe! Do not take riba doubled and multiplied, but fear Allah that you may be successful." ; Surat Al-Baqarah, 275 & 276: “What can be translated as, "Those who deal with riba will not stand (on the day of Resurrection) except like the standing of a person beaten by Shaitan (Satan) leading him to insanity. That is because they say: "Trading is only like riba," whereas Allah has permitted trading and forbidden riba. So whosoever receives an admonition from his Lord and stops dealing with riba shall not be punished for the past: his case is for Allah (to judge); but whoever returns to dealing with riba, such are the dweller of the (Hell) Fire-they will abide therein. Allah destroys riba and will give increase for Sadaqat (deeds of charity, alms, etc.) and Allah does not like the disbelievers, sinners.”; Surat Al-Baqarah, 278 & 279: "O you who believe! Fear Allah and give up what remains (due to you) from riba (from now onward), if you are truly believers. And if you do not do it, then take a notice of war from Allah and His Messenger but if you repent, you shall have your capital sums. Deal not unjustly, and you shall not be dealt with unjustly."

15. ‘Russia Eyes Islamic Finance Sector in Brunei’, RAQABA

http://www.raqaba.co.uk/?q=en/content/russia-eyes-islamic-finance-sector-brunei

16. ‘Japanese get into Islamic financing’ Seashipnews (29 January 2013)


18. Omar Hasan, ‘Islamic finance should diversify, analyst say’ Agence France-Presse (5 September 2010)

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40. ‘Review of the Taxation Treatment of Islamic Finance: Discussion paper’, The Board of Taxation, Australian Government, October 2010


41. A deeper analysis reveals that the situation is more complicated. While it is true that the industry lacks sufficient manpower, the industry is actually demanding. Many graduate in Islamic finance worldwide struggle to find employments in the financial sector. The industry is looking for those with dual knowledge in the conventional and Islamic finance. In addition, most prefer those with certain specialization and expertise.


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48. “Banks to strengthen ties” Islamic Finance News (10 December 2013)
