

DYNAMICS OF THE FINANCIAL STABILITY OF ISLAMIC BANK- ING IN MALAYSIA: Current Perspective Analysis

Mohamad Zaim Isamail

MARA University of Technology, Malaysia (Segamat Campus)
KM. 12, Jalan Muar, 85000 Segamat, Johor, Malaysia
email: mohamadzaim@uitm.edu.my

Muhammad Ikhlas Rosele

University of Malaya, Malaysia
50603 Lembah Pantai, Kuala Lumpur, Malaysia
email: ikhlas@um.edu.my

Mohd Farhan Md. Ariffin

University of Technology Malaysia, Malaysia
Jalan Universiti, 80990 Johor Bahru, Johor, Malaysia
email: mohdfarhan.ma@utm.my

Munawar Rizki Jailani

Institut Agama Islam Negeri (IAIN) Lhokseumawe, Indonesia
Jl. Medan – Banda Aceh, Alue Awe, Lhokseumawe, 24352 Aceh, Indonesia
email: munawarjailani@iainlhokseumawe.ac.id

Syaimak Ismail

MARA University of Technology, Malaysia (Segamat Campus)
KM. 12, Jalan Muar, 85000 Segamat, Johor, Malaysia
email: syaimak@uitm.edu.my

DOI: 10.30631/al-risalah.v20i2.599

Submitted: August 14, 2020; Revised: November 03, 2020; Accepted: November 08, 2020

Abstract: This article discusses the financial stability of Islamic banking in Malaysia by focusing on the analysis of current perspectives. In addition, it also discusses the references used to describe Islamic-based financial stability. To achieve this objective, this study would analyse the resources to ascertain the arguments on how such financial stability is viewed from an Islamic perspective. This study was conducted using a qualitative method through library research by searching for references from sources such as *al-Qur'an* and its interpretation, *al-Hadith* of the Prophet Muhammad peace be upon him and also arguments by Islamic scholars. The results of this study showed that certain texts in *al-Qur'an* and *al-Hadith*, as

foundation based on authentic sources. In the context of Islamic banking in Malaysia, various aspects need to be taken into account to ensure that these banking institutions continue to remain relevant in the domestic and international financial arena. In this regard, to ensure the stability and strength of Islamic banking institutions in Malaysia, these institutions need to fully adapt the banking model recommended by the *shari'ah*, which would not only strengthen this industry but also make it capable of facing challenges and being resistant to financial crises and economic imbalances.

Keywords: Financial Stability, Islamic Banking, Malaysia, Islamic Perspective

Abstrak: Tulisan ini meniduskusikan tentang kestabilan keuangan perbankan Islam di Malaysia dengan fokus pada analisis persepektif kontemporer. Selain itu, ia juga membahas sumber-sumber rujukan yang digunakan dalam menguraikan kestabilan keuangan berdasarkan prinsip-prinsip Islam. Untuk mencapai tujuan tersebut, artikel ini akan menganalisis sumber-sumber yang digunakan untuk mencari hujah bagaimana kestabilan keuangan ini dilihat dari sudut Islam. Metode yang digunakan adalah metode kualitatif dengan melakukan kajian perpustakaan dengan mencari rujukan-rujukan seperti *al-Qur'an* dan tafsirnya, *al-Hadith* Nabi Muhammad SAW dan pendapat para ulama kontemporer. Tulisan ini menyimpulkan bahwa terdapat nas-nas *al-Qur'an*, *al-Hadith*, dan juga pandangan-pandangan ulama yang mengakui kestabilan keuangan yang memiliki dasar yang kuat berdasarkan sumber-sumber yang shahih. Dalam konteks perbankan Islam di Malaysia, berbagai aspek kestabilan keuangan perlu diperhatikan demi memastikan institusi perbankan Islam terus kekal dan relevan dalam kancah keuangan domestik dan internasional. Karena itu, institusi-institusi keuangan tersebut perlu mengadaptasi sepenuhnya model perbankan berdasarkan syariat Islam demi, tidak hanya mengukuhkan industri tersebut, tetapi juga mampu menghadapi tantangan-tantangan serta krisis keuangan dan ketidakseimbangan ekonomi.

Kata Kunci: Kestabilan Keuangan, Perbankan Islam di Malaysia, Perspektif Islam

Introduction

The importance of studies on financial stability has attracted the attention of several parties such as Andrea Maechler, Srobona Mitra, and DeLisle Worrell (2005),¹ as well as Javier Suarez and Oren Sussman (2007)² in

terms of showing how certain variables impact financial stability. A study conducted by researchers Oriol Aspachs, Charles A. E. Goodhart, Dimitrios P. Tsomocos, and Lea Zicchino (2007)³ pointed to a measure of instability or financial instability in the United Kingdom (UK). Another study conducted by researchers Martin Čihák and Heiko Hesse (2008)⁴ asserted that financial stability is an

¹ D G Second Annual, "Exploring Financial Risks and Vulnerabilities in New and Potential EU Member States," in *Second Annual DG ECFIN Research Conference: Financial Stability and the Convergence Process in Europe* (2005): 1-32.

² Javier Suarez and Oren Sussman, "Financial Distress, Bankruptcy Law and the Business Cycle," *Annals of Finance* 3, no. 1 (2007): 5-35.

³ Oriol Aspachs et al., "Towards A Measure of Financial Fragility," *Annals of Finance* 3, no. 1 (2007): 37-74.

⁴ Martin Čihák and Heiko Hesse, "Islamic Banks and Financial Stability: An Empirical Analysis,"

extremely important aspect for every banking institution, regardless of Islamic or conventional banking. These researchers also explained certain factors that impact the financial stability for selected Islamic banks. Their study employed the annual panel data approach, utilising a combination of time series data and cross sections of balance sheets, income statements, and cash flows issued by BankScope, which had been audited from 1993 to 2004. Results from the detailed research conducted by these previous researchers concluded that there are gaps in the study that need to be filled and need to be studied. Thus, this present study on the financial stability of Islamic banking in Malaysia will be able to fill the gaps of the previous studies. Previous studies have only focused on the methods of determining the positive or negative impacts. Basically, the theory of financial stability has not been touched to support the results obtained from past studies. Past researchers also have not associated each of these problems with authentic references from the Qur'an, hadith, and other Islamic sources.

Therefore, this article is a highly significant study at this time. Since the occurrence of the Covid-19 pandemic crisis, Islamic banking institutions in Malaysia in particular have been considering this financial stability as a key issue to be concerned with. Therefore, it is the responsibility of every Islamic banking institution in Malaysia to ascertain which reference sources can be used to address this financial stability from an Islamic conceptual view. Of course, Islamic-based financial stability is different from the practices used by conventional banks. Through this study, views from current *ulama'* also describe this financial stability. This situation can be seen not only from the perspective of *al-Qur'an* and *al-Hadith* as the main references, but also from views of current *ulama'*

or Islamic scholars. Of course, this study was undertaken based on the existing literature gaps by touching on the analysis from a current perspective. This article begins with an introductory section followed by the theory and concept of financial stability. Later, it also touches on the concept of stability from an Islamic perspective, followed by discussion on the concept of stability for Islamic banking in Malaysia. Finally, the article is summarised in the conclusion section. Researchers hope that this study can guide financial practitioners, academic researchers, and even the community in understanding the issue of financial stability from the current perspective.

Overview of Financial Stability

In this section, a general survey related to financial stability was conducted to explain the theoretical and general overview of financial stability. Thus, to initiate this related survey, the researchers started with the definition of financial stability, followed by the general concept of financial stability, the importance of financial stability, and the key indicators in financial stability.

1. Definition of Financial Stability

Stability is a noun derived from the word stable which describes the state of being stable.⁵ The word stable is defined as unchanging, unshakable, steady, firm, calm, and unwavering. According to an *English-Malay Dictionary*, stability can be defined as strength and stability.⁶ In addition, the Dictionary of Economics has defined stability to refer to the level of equilibrium or pricing that is achieved despite the shock of the sys-

⁵ Dewan Bahasa dan Pustaka, *Kamus Dewan* (Kuala Lumpur: Dewan Bahasa dan Pustaka, 2010), p. 1522.

⁶ Dewan Bahasa dan Pustaka, *An English-Malay Dictionary* (Kuala Lumpur: Dewan Bahasa dan Pustaka 1991), p. 1579.

tem resulting in the price moving away from the equilibrium level.⁷ As for the word finance, it refers to areas that emphasise comprehensive and effective decision-making techniques in matters related to a bank's finances, including making investment decisions, obtaining, and distributing sources of funds.⁸

Thus, when the words "stability" and "finance" are combined, the condition refers to the smooth running of institutions and markets that form the financial system, as well as the confidence created in the operation of major financial institutions and markets in the economy.⁹ However, the scope and discussion of financial stability is not only assessed through the smooth running of a banking institution, as financial stability is also seen from several other aspects, such as instrument development and policy, and policy structuring. Therefore, there are several other general definitions that also explain the concept pertaining to financial stability. Among them are:

Andrew D. Crockett (1997) explained that financial stability is related to the environment, i.e. the institutions in a financial system remain intact and are able to continue to meet the demands of depositors without the intervention or support of others.¹⁰ In addition, Garry J. Schinasi (2004) regarded financial stability as a situation that encourages business development, as well as attract de-

positors and investors to make commitments in the short or long term.¹¹

Meanwhile, other researchers such as Sir Andrew Large (2003) explained that financial stability plays a role in influencing the economic growth of a country, as well as mobilising savings and generating financing preparation activities.¹² Frederic S. Mishkin (1999) described financial stability as a reflection of the integrity and resilience in the financial system to support the efficient provision of resources and risk distribution throughout the economy. It is also used in preparing to face a bad economic cycle and any economic shock, as well as preventing unexpected disruptions in the mediation process, and maintaining public trust in the financial system.¹³

Thus, in light of various previous views on financial stability, the researchers can conclude that the current understanding of financial stability carries the meaning of strength, where the bank has a stable asset and liability structure that includes sufficient liquidity and capital, good level of financing and investment, and stable deposit facilities.

2. General Concepts of Financial Stability

Islamic and conventional banking institutions in Malaysia need to have a strong, stable, and robust financial system to support the provision of efficient resources and risk distribution throughout the economy. If financial instability occurs, it will have an impact on the economy by incurring very high costs due to the effects of transmission or overflow to other parts of the economy. In a

⁷ C. S Nagpal, *Dictionary of Economics* (Kuala Lumpur: Crescent News (KL) Sdn. Bhd, 1995), p. 323.

⁸ Fadilah Jasmani, *Kamus Perbankan*, vol. 1 (Kuala Lumpur: Dewan Bahasa dan Pustaka, 1998), p. 142.

⁹ Mahfooz A. Ansari, *Taking on the World: Globalization Strategies in Malaysia*, edited by Sieh Lee Mei Ling (Kuala Lumpur: Institut Terjemahan Negara Malaysia Berhad, 2007), p. 332.

¹⁰ Andrew Crockett, "Why Is Financial Stability A Goal of Public Policy?," *Economic Review-Federal Reserve Bank of Kansas City* 82 (1997): 5-22.

¹¹ Garry J Schinasi, "Defining Financial Stability," *IMF Working Paper* 4, no. 187 (2004): 1-19.

¹² Andrew Large, "Financial Stability: Maintaining Confidence in a Complex World," *Financial Stability Review* (2003): 170-74.

¹³ Frederic S Mishkin, "Global Financial Instability: Framework, Events, Issues," *Journal of Economic Perspectives* 13, no. 4 (1999): 3-20.

challenging global financial environment, which is vulnerable to uncertainty, banking institutions also need to be resilient financial intermediaries.¹⁴ Therefore, banking institutions need to intensify efforts in improving governance efficiency, addressing stress tests, and strengthening the capital management process so that they can remain resilient in the face of various economic and financial conditions. This effort is also supported by the ongoing assessment of standards that consider current changes taking place domestically as well as globally.¹⁵

In addition, to ensure that financial stability is maintained, banking institutions need to allocate optimal funds for economic activities that can generate high social returns.¹⁶ This also means that any matter involving the closure of some institutions, the increase in asset value volatility, the correction of the economic system, and disciplinary mechanisms will not be considered a threat to financial stability as long as there is no contagion and the possibility of high systematic impact. In such cases, they are seen as minor disturbances from a perspective of stability.

In addition, banking institutions also need to ensure that financial stability is sustainable on an ongoing basis, although financial institutions are often exposed to situations of uncertainty, dynamism, interconnectedness, and are heavily involved in the evolution of institutional and market infrastructure.¹⁷ This means that every part of the

financial system needs to operate continuously and be in good condition, but can still operate alternately from time to time. In addition, to ensure that the financial stability of these banking institutions occur continuously, another approach needs to be implemented by strengthening the culture of conducting research¹⁸. In addition, there is a need to forge good cooperation by creating a great synergy of expertise in conducting research and development for the purpose of financial stability among banking institutions.

3. The Importance of Financial Stability

Maintaining stability in the financial sector is a challenge that must be faced by every banking institution. In fact, financial stability also gives an idea of how a bank is able to cope with the current economic environment.¹⁹ Therefore, measures and efforts to strengthen and develop this financial system require consistent evaluation so that the financial stability can be achieved to provide many advantages to various parties. At the same time, this financial stability is the stand of the central bank itself in ensuring that the banking institutions under its supervision remain strong in the emphasis on the economic sectors of a country. For example, since a country's economic sector experiences different growth rates, the central bank has various guidelines that require banking institutions to provide special treatment to those sectors. The purpose of these guidelines is to provide the relevant sectors with the opportunity to develop at a separate rate. In addition, with the supervision and inspection under the central bank's guidelines on

¹⁴ Z Aziz, "Building A Comprehensive Islamic Financial System: New Financial Opportunities," in *International Conference on Islamic Insurance (Takaful): Promoting New Financial Opportunities*]. London, UK, 2003, 1-13.

¹⁵ Bank Negara Malaysia, *Laporan Kestabilan Kewangan dan Sistem Pembayaran 2010* (Kuala Lumpur: Bank Negara Malaysia, 2010), p. 7.

¹⁶ Thorsten Beck, Ross Levine, and Norman Loayza, "Finance and the Sources of Growth," *Journal of Financial Economics* 58, no. 1-2 (2000): 261-300.

¹⁷ Zeti Akhtar Aziz, "Kestabilan Kewangan: Kerjasama Serantau Dan Global," in *Sidang*

Kemuncak Ke-8 Lembaga Perkhidmatan Kewangan Islam, 2011, 82.

¹⁸ Zeti Akhtar Aziz, "Kewangan Islam Dalam Ekonomi Yang Mencabar," in *Kolokium Akademi Syariah Antarabangsa Kewangan Islam*, 2012, 1-2.

¹⁹ Gabriel Caldas Montes, "Uncertainties, Monetary Policy and Financial Stability: Challenges on Inflation Targeting," *Brazilian Journal of Political Economy* 30, no. 1 (2010): 89-111.

these banking institutions, it becomes an obligation for such banking institutions to comply so that the balance of growth in the economic sectors can be overcome.

In addition, the importance of financial stability can provide confidence to the public. Public confidence in the banking institution is a determinant of a bank's security, and even exceeds the importance of the bank's own capital. Furthermore, the public should also be assured on the stability and robustness of banking institutions through ongoing supervision and inspection of banking institutions by the central bank, which restrain bank operations through established rules and procedures.²⁰ In fact, the mountaineering confidence of the public in the banking institution also contributes to a country's more competitive economic environment, as well as benefit the banking institution itself in offering different products and services that have added value. It is also able to help in increasing its role in the private sector in the process of economic growth.

In addition, financial stability is also important to depositors because they are the main source of funds for a banking institution. However, at the same time, banking institutions need to be responsible in ensuring that the interests of depositors are fully secured. In view of this importance, supervision and inspection from the central bank will ensure that banking institutions perform their responsibilities properly as depositors are generally unaware of a bank's operations and conditions due to the various concepts and valuation techniques that are difficult to understand.

This financial strength is also able to provide importance to banking institutions in the internationalisation of the financial system, which provides many benefits such as

²⁰ Bank Negara Malaysia, "Akta Bank Negara Malaysia 2009," accessed on April 22th, 2016, <http://www.bnm.gov.my/>.

more opportunities for technology transfer, new expertise, and wider innovations, as well as new product offerings. In addition, increased foreign participation in the domestic financial market is also able to contribute to increased liquidity and more competitive pricing in the domestic financial market, as well as encouraging more efficient distribution of capital in the economy. The implementation of internationalisation is also able to contribute to the expansion and development of the domestic financial market, especially in the capital market; thus, proving the importance of access to financing for investment activities.²¹

4. Key Indicators In Financial Stability

The financial strength and stability of the banking institution requires effective regulatory and supervisory measures on every policy it implements. In fact, the approach taken by the banking institution also contributes to its own security and integrity. Typically, regulatory and supervisory measures are carried out based on the CAMEL system, which offers several key indicators of the strength and stability of banking institutions that are also adopted by the *International Monetary Fund* (IMF).²² Among the indicators are as follows;

Capital Adequacy: Capital adequacy is the basis of financial stability of banking institutions in the face of any shock to the balance sheet. Capital is an absorber that protects a bank when it faces an unfavourable return situation. In addition, banking institutions must adhere to established banking rules to protect depositors by ensuring the stability of the financial and banking system through capital adequacy as outlined in the

²¹ Zeti Akhtar Aziz, "Kestabilan Kewangan Global Dan Pengantarabangsaan Sistem Kewangan in Ekonomi Sedang Pesat Membangun," in *Euromoney Conference*, Doha, Qatar, 2012, 1-5.

²² Lorraine Buerger, *Camels Ratings: What They Mean and Why They Matter* (New York: Schiff Hardin LLP, Director Corps, 2011), pp. 3-4.

international standards by the Basel Committee on Banking Supervision (BCBS).²³ Banks nowadays need to have sufficient capital to deal with possible risks, especially credit risk. In addition, banking institutions also need to have an in-depth awareness of the importance of identifying, assessing, monitoring, and controlling credit risk while ensuring that they have sufficient capital to address the risks faced.²⁴

Asset Quality: Asset quality is a key determinant of a bank's financial efficiency. High-risk and low-quality assets may not only adversely affect financial performance and profitability, but may also result in significant losses resulting in bankruptcy. In this case, the assets owned by the bank consist of various fixed assets and current assets. In the inspection work, every detail of the asset needs to be inspected. Based on the asset structure of the bank, the biggest component is the loan. Thus, the inspection is more focused on bank loans. The quality of the loan portfolio will be assessed by checking and reviewing the loans issued by the bank. Subsequently, the loan will be given certain classes based on several criteria and this process is called loan classification, which is the most important inspection activity.²⁵ Loan classification is divided into three, namely sub-standard loans, doubtful loans, and bad loans. This classification is to ensure that the provision of bad and doubtful loans is always at an adequate level for the purpose of tracking non-performing loans (NPLs).

²³ Omar Masood et al., "Operational Risk in Islamic Banks: Examination of Issues," *Qualitative Research in Financial Markets* 3, no. 2 (2011): 131-51.

²⁴ S F H Catherine and Y Nurul Izza, "A Preliminary Study on Credit Risk Management Strategies of Selected Financial Institution in Malaysia," *Jurnal Pengurusan* 28 (2009): 47.

²⁵ Timothy W. Koch and Scott Macdonald, *Bank Management* (United States: Thomson South Western, 2003), pp. 256-257.

Management: Management refers to the board of directors and officers who conduct the business of a bank. The importance of the management quality, among others, can determine the quality of assets, profits, and performance of the bank while ensuring that the interests of depositors are not neglected. In addition, in the process of examining the management of the bank, technical, leadership, and administrative abilities are also taken into account. Even assessments conducted on an ongoing basis by the board, such as the frequency of board meetings, the scope and content of matters discussed in the meeting, the involvement of each board member in bank affairs, the activities of board members that conflict with the interests of the bank, and the compliance with the board laws are also adjusted. Subsequently, inspections should also be made on the consistency of policies, objectives, and procedures in all aspects of management as formulated by the board of directors and set by the government, such as recruitment, layoffs, and even salary schemes.

Profitability: The profitability of a bank is seen to be able to give returns to depositors and shareholders. In fact, every profit earned can be used as a major source of capital accumulation. Therefore, it is not an exaggeration if this profit is said to be the driving force in the banking industry.²⁶ In addition, every profit earned can be used as an absorber to losses, since high profits reflect good asset quality as well as stability in asset-liability management.²⁷

Liquidity: Liquidity refers to a bank's ability to meet depositors' demands, requests for financing purposes, as well as its ability to cover operating expenses. Under

²⁶ Siti Rohani Yahya, *Konsep Asas Ekonomi* (Kuala Lumpur: Dewan Bahasa dan Pustaka, 1985), p. 206.

²⁷ Andrea Michaela Maechler, Srobona Mitra, and DeLisle Worrell, "Decomposing Financial Risks and Vulnerabilities in Eastern Europe," *IMF Working Paper* 7, no. 248 (2007): 1-35.

this framework, banks are required to focus on fund management practices to ensure that each composition of assets and liabilities is capable of generating profits while ensuring the security. In addition, consistent assessments need to be made of policies, practices, and procedures in asset and liability management to ensure that each liquidity is adequate and complied with. With adequate excess liquidity, banks will have the ability to meet depositors' unexpected withdrawal requests.

The Concept of Stability from the Islamic Perspective

The Islamic banking system in Malaysia is an intact and competitive alternative financial system that works in tandem with the conventional banking system. In fact, the Islamic banking system in Malaysia has been re-practiced since the 1970s.²⁸ Through the Islamic banking system in Malaysia, several concepts have been practiced by Islamic banks to ensure that the Islamic banking system in Malaysia is always unique and comprehensive. Among the concepts practiced by Islamic banks are trust, justice, stability, prohibition on bribes, accurate scales and measurements, and so on. As an example of the concept of stability, although in *al-Qur'an*, *al-Hadith*, and even *fuqaha'* do not mention it directly, there are some propositions that emphasise the aspect of maintaining such a stability.

In this section, some concepts of stability will be explained by referring to *al-Qur'an*, *al-Hadith*, and views of *fuqaha'*.

1. The Concept of Stability in the Qur'an

In *al-Qur'an*, Allah s.w.t once instructed Prophet Yusuf a.s. to make preparations to

²⁸ Mustafa Dakian, *Sistem Kewangan Islam: Instrumen, Mekanisme, dan Pelaksanaan di Malaysia* (Kuala Lumpur: Utusan Publications & Distributors Sdn. Bhd., 2005), p. 33.

face a famine crisis (currently translated as equivalent economic crisis and recession) that will hit Egypt at that time. He instructed the Egyptians to cultivate crops for seven years and to store food supplies in the face of a long drought. This can be seen through the meaning of Allah s.w.t.'s commandment as below:

Yusuf replied: "You shall sow vigorously for seven years in a row, then whatever you reap leave it on its stalks except a little of what you make for food. Then, will come after that period, seven years of severe drought, which will consume the food you have prepared for it except a little of what you store (to be used as seed). Then, will come after that year in which the people will receive the blessings of rain and on them they will be able to squeeze (grapes, olives, etc.)".²⁹

Among the important essence that can be taken from the above verses is the need for a strategic action to be taken to control and minimise the potential expected risks on stability, as well as to submit appropriate risk management methods. If no action had been taken, it could have resulted in greater harm and even interfered with the well-being of all Egyptians at that time.³⁰

The concept of protection against stability can also be seen through the command of Allah s.w.t. in Surah al-Baqarah verse 282, which encourages believers to record all debt transactions, as well as the need to present witnesses amongst men or women. In this regard, the Bank Negara Malaysia *Shar'iah* Supervisory Board (BNM) has announced that the need for a man or two men or two women to be witnesses is accurate and mandatory. This requirement is certified suffi-

²⁹ Surah Yusuf (12): 47-49

³⁰ Asyraf Wajdi Dusuki and Shabnam Mokhtar, *The Concept and Operations of Swap as a Hedging Mechanism for Islamic Financial Institutions* (Kuala Lumpur: International Shari'ah Research Academy for Islamic Finance (ISRA), 2010), pp. 1-58.

cient to maintain current practice where contracts are usually witnessed by advocates and solicitors. This rule has eliminated many uncertainties, especially for those who are of the view that it also involves the testimony of lawyers.³¹ This is in line with the words of Allah s.w.t. in Surah al-Baqarah verse 282 which emphasises the concept of protection against instability, as well as recording all debt transactions in addition to the need to present witnesses amongst men or women.

O you who believe! When you conduct a business with a receivable debt that is given until a certain time then you should write (the debt and the time of payment). And let a writer among you write it justly (true). And let not a writer refuse to write as God has taught him. Therefore, let it write and let the debtor plan (fill out the debt letter clearly). And let him fear Allah his Lord, and let him not diminish anything from the debt. Then, if the debtor is stupid or weak or he himself cannot plan (the contents of the letter), then it should be planned by the guardian fairly (true) and you should have two witnesses from among you. Then, if there are no two male witnesses, then it is permissible, one man and two women from those whom you agree to be witnesses, so that if one forgets the two female witnesses then one can be reminded by the other. And let not the witnesses refuse when they are called as witnesses. And do not get tired of writing about debt over a period of time, whether small or large. That is, it is fairer in the sight of Allah and more correct (strengthens) the testimony of the witnesses, and also closer to not raising your doubts. Unless it is about the cash business you distribute to each other, then there is nothing wrong if you do not

³¹ Nik Norzrul Thani, Mohamed Ridza Abdullah and Megat Hizaini Hassan, *Law and Practice of Islamic Banking and Finance* (Petaling Jaya: Sweet & Maxwell Asia, 2010), p. 253.

write it down. And be a witness when you trade. And let no scribe or witness be bothered. And if you do (that which is forbidden), then indeed it is a wicked deed (rebellion) that you have. So, fear Allah and (remember), Allah (with this evidence) teaches you and Allah always knows everything.³²

Next, if the loan transaction takes place but no record is taken, Allah s.w.t. introduces the concept of collateral on the debtor. The concept of collateral, among others, aims to instil awareness among debtors to be responsible in settling their debts, as well as trying to prevent losses to the creditors.

And if you are on a journey while you do not get a writer, then there must be a guarantee item held. But, if some of you believe in the other, let him who is trusted fulfil his trust (his debt) and let him be pious to Allah s.w.t, his Lord. And do not hide it, indeed, his heart is dirty (sinful). Allah is Aware of what you do.³³

Among the most important parts that can be taken from the above verse is about the concept of full trust in a person who needs to be accompanied by self-preparation in the face of any possible loss in matters involving business and investment. In this situation too, if transactions involving credit administration, investment management, and so on, are not well managed and prudent, it will invite various implications such as hostility, chaos, and instability, that ultimately lead to a country's economic collapse.

2. *The Concept of Stability in al-Hadith*

Apart from the arguments on stability according to the perspective of the Qur'an, propositions are also presented according to the perspective of the *al-Hadith*. Through the perspective of this *al-Hadith*, there is a story in which the Prophet s.a.w. indirectly

³² Al-Baqarah (2): 282

³³ Al-Baqarah (2): 283

showed his efforts to avoid a state of imbalance and instability. This story has been recorded through the meaning of the *al-Hadith* which reads:

Indeed, Allah alone sets the price, withholds, makes room and provides sustenance. I really hope that I will meet Allah (later) in a situation where no one claims that I oppressed him in blood or property.

The above *al-Hadith* shows the Prophet's reluctance to set pricing because he felt that such actions not only cause traders to be oppressed but also trigger market imbalances. This situation is also due to the increase in prices that occurred at that time due to the increase in import prices which was already expensive.³⁴

Among the important essence that can be highlighted in the previous *al-Hadith* and should be practiced by Islamic banks is through their own role in becoming intermediaries of funds between depositors and borrowers. Even Islamic banking institutions in Malaysia are trustees of funds which have been contributed by the depositor to be spent for profit. However, Islamic banking institutions in Malaysia are not allowed to charge interest rates that are too high that may oppress borrowers in the repayment of their financing. If this situation occurs, it also contributes to the imbalance in the banking practices.

Apart from that, other stories show that the concept of risk management was also used by the Prophet s.a.w. in dealing with problems and losses while ensuring continued stability. One hadith related to this had been narrated by Anas bin Malik r.a.:

Anas bin Malik r.a. narrated a man asking Rasulullah s.a.w. about his camel: 'Rasulullah, I need to tie it and trust in

Allah or I need to untie and trust in Allah?' Rasulullah replied: Tie and trust in Allah.

The above *al-Hadith* explains that the Prophet s.a.w suggested that mankind should always strive to reduce risk, protect themselves from losses, and not leave any matter to Allah s.w.t alone. Islam teaches its people to be prepared in the face of any possibility that may occur in the future. If the people are not prepared, they will face various risks such as theft, loss, damage, and others that normally exist in financial affairs. In this regard, the Prophet s.a.w. also gave the impression that Islam does not hinder any effort in managing risk as long as the effort does not violate the principles of *mu'amalat*. In meeting the objectives of banking's financial stability, risk management needs to be implemented efficiently and systematically to ensure liquidity, ability to pay financial claims, and profit motives at a consistent optimal level.

3. *The Concept of Stability According to Fuqaha'*

In addition to the references obtained from *al-Qur'an* and *al-Hadith*, there are also views expressed by some groups of *fuqaha'* on stability. According to the view put forward by Shams al-Din Abu 'Abd Allah Muhammad, stability can be achieved when a society practices ethical values to create a harmonious environment. Such a situation is also able to educate the community to cooperate in the production process and further increase the production of products and services, as well as able to improve their standards of living. It is different when a society commits bad practices such as lying, cheating, and exploiting, as well as practicing dishonesty, because these traits lead society towards unstable and tense situations which in turn contribute to the downfall or instability of the economy.

³⁴ Sanep Ahmad and Surtahman Kastin Hasan, *Ekonomi Islam, Dasar dan Amalan* (Bangi: Penerbit Universiti Kebangsaan Malaysia, 2010), p. 123.

In addition, Muazzam Ali (1988) observed that stability can be gained through the principles of justice and equality in finance, where Islamic banking institutions in Malaysia need to practice the principles of social justice as a whole while introducing *Shari'ah*-compliant laws, practices, rules, and procedures. Islamic banks also need to balance and combine moral practices based on morality with business realities that place profit as their main objective.³⁵ If emphasis is given to moral factors alone, there is a high probability that the banking institution will experience imbalances and losses, which in turn lead to its foreclosure. If such a situation occurs, the depositors are also harmed due to losing their deposits; in fact, this situation also harms the Muslim ummah as a whole. Similarly, if the profit factor alone is given priority, then it will deviate from the path of Islam, which is based on the principles of justice and equality.

Islamic Financial Stability in Malaysia

This section details the related concept of stability in Islamic banking, as well as the opportunities and challenges faced by Islamic banking institutions in Malaysia today.

1. The Concept of Stability in Islamic Banking in Malaysia

The Islamic system has clearly managed to dominate human civilization for centuries. Like other commercial banks, the business travel and operations of Islamic banks are in the form of an intermediary institution between two groups of customers. In fact, with the intermediary services among the two groups, the *Shari'ah* laws and regulations that are the basis of the bank's travel and operations are intended to provide justice to all

parties involved in the business transaction. Apart from that, the *Shari'ah* principles that are practiced and applied in every Islamic banking institution in Malaysia are also able to contribute to the overall stability and strength.³⁶

In essence, the differences in the concept of financial stability can be seen through the role of *maqasid al-shari'ah* (the objective of sharia)³⁷ and ethical values that are universal in every Islamic banking in Malaysia itself. This *maqasid al-shari'ah* is the mainstay with every decision made by Islamic banks, and must be guided by the original laws from *al-Qur'an* and *al-Hadith*. For example, structuring the balance sheet for Islamic banks by mobilising assets and liabilities through basic Islamic principles of *Mudarabah*, *Musharakah*, *Ijarah*, and others, is able to create a close cooperation between banking institutions and customers. Financing products based on the concept of *Mudarabah*, for example, are able to promote more fertile economic development and help to balance income and wealth distribution. This situation is also able to ensure the sustainability of fellow human beings while maintaining stability for Islamic banks.³⁸

Islamic banking institutions in Malaysia also have *Shari'ah* values in line with universal values, by always emphasising positive relationships with customers and maintaining a transparent system management.

³⁶ Bank Negara Malaysia, "Kewangan Islam dan Kestabilan Kewangan Global," accessed on March 28th, 2019, <http://www.bnm.gov.my/>.

³⁷ Edi Kurniawan, "Distorsi Terhadap Maqasid al-Syari'ah al-Syatibi di Indonesia," *Al-Risalah* 18, no. 2 (2018): 184-86; Busyro Busyro, "Using Zakâh for the Establishment of Islamic Centers and Maqâsid al-Syâri'ah's Relativities," *Al-Risalah* 19, no. 1 (2019): 75-80; Edi Kurniawan, et al. "Early Marriage, Human Rights, and the Living Fiqh: A Maqasid al-Shari'a Review," *Al-Risalah* 20, no. 1 (2020): 1-15.

³⁸ Zaharuddin Abd. Rahman, *Panduan Perbankan Islam: Kontrak & Produk Asas* (Kuala Lumpur: Telaga Biru Sdn. Bhd., 2009), p. 92.

³⁵ Muazzam Ali, "A Framework of Islamic Banking," in *Directory of Islamic Financial Institutions*, ed. John R. Presley (New York: Croom Helm, 1988), p. 3.

Through the governance carried out, Islamic banking institutions in Malaysia always strive to operate in accordance with Islamic laws by providing facilities and services to Muslim and non-Muslim communities to achieve capability and stability.

In addition, Islamic banking institutions in Malaysia also have *Shari'ah* values in line with ethical values to ensure that financial stability continues to be preserved. This situation can also be seen when Islamic banks always avoid activities that involve gambling, fraud, and even speculative ones that can obviously have a negative impact on the banking institution. Such examples are not only immoral, but are also able to erode and demolish a banking institution with uncertainties and financial instability as these activities are the root cause of immoral things.

2. Current Opportunities and Challenges

Around 2019, Bank Negara Malaysia (BNM) stated that financial stability in Malaysia remains intact despite Malaysia facing an increasingly challenging environment. From observation, financial weakness occurs due to the slowdown in global growth, as well as the clash between geopolitical countries. As a result, volatility in the prices of financial assets and commodities is unavoidable. Tensions between certain foreign countries have also affected foreign demands and regional growth prospects. For the Malaysia itself, this situation is also upsetting, based on a review by the Malaysian Government Securities in two global benchmark indices, which in turn has led to several episodes of increasing volatility in the domestic financial markets. However, as a result of a systematic and efficient management, every risk associated with the domestic financial stability can largely be curbed with the support of relatively resilient domestic economic growth, in addition to sound market conditions and strong financial institutions.

In fact, this situation also reflects that the banks in Malaysia have been cautious with the uncertain environmental situation. In addition, with the support of strong capital and liquidity buffers, as well as sustainable profits, the situation compels the banks in Malaysia, especially Islamic banks, to remain stable and strong. Although the current global issue of the Covid-19 pandemic issue is seen as a threat to commercial banks, especially Islamic banks in Malaysia, with strategy, management, and continuous monitoring, Islamic banks can maintain stability and strength.

Conclusion

The results of this study showed that certain texts from the Qur'an and hadith, and views from scholars, acknowledge financial stability to have a strong foundation. Apart from that, it is the responsibility of Bank Negara Malaysia (BNM) to maintain financial stability in line with the current economic environment. With guidance and references from the authentic sources mentioned earlier, financial practitioners may bring Islamic banking institutions in Malaysia towards a more glorious representation of Islam. From the study conducted pertaining to financial stability, it is observed that financial stability is a very broad concept and needs further research. In fact, it is also the main foundation of a country's economic strength. In the context of Islamic banking in Malaysia, various aspects need to be taken into account to ensure that such banking institutions continue to remain relevant in the domestic and international financial arena. In this regard, to ensure the stability and strength of Islamic banking institutions in Malaysia, they need to fully adapt the banking model recommended by the *Shari'ah* which will not only strengthen this industry, but also make it capable of facing challenges while being resistant to financial crises and economic imbalances.

Bibliography

Journals

Aspachs, Oriol, Charles A E Goodhart, Dimitrios P Tsomocos, and Lea Zicchino. "Towards A Measure of Financial Fragility." *Annals of Finance* 3, no. 1 (2007): 37-74.

Aziz, Z. "Building A Comprehensive Islamic Financial System: New Financial Opportunities." In *International Conference on Islamic Insurance (Takaful): Promoting New Financial Opportunities*]. London, UK, 1-13, 2003.

Beck, Thorsten, Ross Levine, and Norman Loayza. "Finance and the Sources of Growth." *Journal of Financial Economics* 58, no. 1-2 (2000): 261-300.

Busyro, Busyro. "Using Zakâh for the Establishment of Islamic Centers and *Maqâṣid al-Syârî'ah*'s Relativities." *Al-Risalah* 19, no. 1 (2019): 75-80.

Catherine, S F H, and Y Nurul Izza. "A Preliminary Study on Credit Risk Management Strategies of Selected Financial Institution in Malaysia." *Jurnal Pengurusan* 28 (2009): 47.

Čihák, Martin, and Heiko Hesse. "Islamic Banks and Financial Stability: An Empirical Analysis." *Journal of Financial Services Research* 38, no. 2-3 (2010): 95-113.

Crockett, Andrew. "Why Is Financial Stability A Goal of Public Policy?" *Economic Review-Federal Reserve Bank of Kansas City* 82 (1997): 5-22.

Edi Kurniawan. "Distorsi Terhadap Maqasid al-Syârî'ah al-Syatibi di Indonesia." *Al-Risalah* 18, no. 2 (2018): 184-86.

Edi Kurniawan. "Early Marriage, Human Rights, and the Living Fiqh: A Maqasid al-Shari'a Review." *Al-Risalah* 20, no. 1 (2020): 1-15.

Large, Andrew. "Financial Stability: Maintaining Confidence in a Complex World." *Financial Stability Review*, 2003, 170-74.

Maechler, Andrea Michaela, Srobona Mitra, and DeLisle Worrell. "Decomposing Financial Risks and Vulnerabilities in Eastern Europe." *IMF Working Paper* 7, no. 248 (2007): 1-35.

Masood, Omar, Marliana Abdullah, Shahida Shahimi, and Abdul Ghafar Ismail. "Operational Risk in Islamic Banks: Examination of Issues." *Qualitative Research in Financial Markets* 3, no. 2 (2011): 131-51.

Mishkin, Frederic S. "Global Financial Instability: Framework, Events, Issues." *Journal of Economic Perspectives* 13, no. 4 (1999): 3-20.

Montes, Gabriel Caldas. "Uncertainties, Monetary Policy and Financial Stability: Challenges on Inflation Targeting." *Brazilian Journal of Political Economy* 30, no. 1 (2010): 89-111.

Schinasi, Garry J. "Defining Financial Stability." *IMF Working Paper* 4, no. 187 (2004): 1-19.

Second Annual, D G. "Exploring Financial Risks and Vulnerabilities in New and Potential EU Member States." In *Second Annual DG ECFIN Research Conference: Financial Stability and the Convergence Process in Europe*, 1-32, 2005.

Suarez, Javier, and Oren Sussman. "Financial Distress, Bankruptcy Law and the Business Cycle." *Annals of Finance* 3, no. 1 (2007): 5-35.

Zeti Akhtar Aziz. "Kestabilan Kewangan: Kerjasama Serantau Dan Global." In *Sidang Kemuncak Ke-8 Lembaga Perkhidmatan Kewangan Islam*, 82, 2011.

—. "Kestabilan Kewangan Global Dan Pengantarabangsaan Sistem Kewangan in Ekonomi Sedang Pesat Membangun." In *Euromoney Conference, Doha, Qatar*, 1-5, 2012.

—. "Kewangan Islam Dalam Ekonomi Yang Mencabar." In *Kolokium Akademi Syariah Antarabangsa Kewangan Islam*, 1-2, 2012.

Books

A. Ansari, Mahfooz. *Taking on the World: Globalization Strategies in Malaysia*. edited by Mei Ling, Sieh Lee. Kuala Lumpur: Institut Terjemahan Negara Malaysia Berhad, 2007.

Abd. Rahman, Zaharuddin. *Panduan Perbankan Islam: Kontrak & Produk Asas*. Kuala Lumpur: Telaga Biru Sdn. Bhd., 2009.

Ahmad, Sanep and Hasan, Surtahman Kas-tin. *Ekonomi Islam, Dasar dan Amalan*. Bangi: Penerbit Universiti Kebangsaan Malaysia, 2010.

Ali, Muazzam. "A Framework of Islamic Banking." in *Directory of Islamic Financial Institutions*. edited by R. Presley, John. New York: Croom Helm, 1988.

Bahasa dan Pustaka, Dewan. *An English-Malay Dictionary*. Kuala Lumpur: Dewan Bahasa dan Pustaka 1991.

_____. *Kamus Dewan*. Kuala Lumpur: Dewan Bahasa dan Pustaka, 2010.

Buerger, Lorraine. *Camels Ratings: What They Mean and Why They Matter*. New York: Schiff Hardin LLP, DirectorCorps, 2011.

C. S Nagpal. *Dictionary of Economics*. Kuala Lumpur: Crescent News (KL) Sdn. Bhd, 1995.

Dakian, Mustafa. *Sistem Kewangan Islam: Instrumen, Mekanisme, dan Pelaksanaan di Malaysia*. Kuala Lumpur: Utusan Publications & Distributors Sdn Bhd, 2005.

Ismail, Shamsudin. *Pengurusan Bank Perdagangan di Malaysia*. Vol II. Kuala Lumpur: Dewan Bahasa dan Pustaka, 2003.

Jasmani, Fadilah. *Kamus Perbankan*. vol. 1. Kuala Lumpur: Dewan Bahasa dan Pustaka, 1998.

Malaysia, Bank Negara. *Guideline on Classification of Impaired Loans/Financing and Provisioning for Bad and Doubtful Debts*. Kuala Lumpur: Bank Negara Malaysia, 2003.

Malaysia, Bank Negara. *Laporan Kestabilan Kewangan dan Sistem Pembayaran 2010* (Kuala Lumpur: Bank Negara Malaysia, 2010).

Thani, Nik Norzrul, Abdullah, Mohamed Ridza and Hassan, Megat Hizaini. *Law and Practice of Islamic Banking and Finance*. Petaling Jaya: Sweet & Maxwell Asia, 2010.

W. Koch, Timothy and Macdonald, Scott. *Bank Management*. United States: Thomson South Western, 2003.

Wajdi Dusuki, Asyraf and Mokhtar, Shabnam. *The Concept and Operations of Swap as a Hedging Mechanism for Islamic Financial Institutions*. Kuala Lumpur: International Shari'ah Research Academy for Islamic Finance (ISRA), 2010.

Yahya, Siti Rohani. *Konsep Asas Ekonomi*. Kuala Lumpur: Dewan Bahasa dan Pustaka, 1985.

Websites

Bank Muamalat Malaysia Berhad. "Perbankan Islam untuk Bukan Islam dari Perspektif Syariah," accessed on March 29th, 2019. <https://www.muamalat.com.my/>

Bank Negara Malaysia. "Akta Bank Negara Malaysia 2009," accessed on April 22th, 2016. <http://www.bnm.gov.my/>.

Bank Negara Malaysia. "Kewangan Islam dan Kestabilan Kewangan Global," accessed on March 28th, 2019. <http://www.bnm.gov.my/>.

Bank Negara Malaysia. "Perbankan Islam dan Takaful Industri Perbankan Islam," accessed on March 29th, 2019. <http://www.bnm.gov.my/>.

Maybank Islamic Berhad. "Sistem Tadbir Urus Syariah dalam Institusi Kewangan Islam," accessed on March 29th, 2019. <https://www.maybank2u.com.my/>.