

# The Evolution of Regulatory Landscape of Islamic Finance in Negara Brunei Darussalam: Issues and Challenges

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**Keywords:** Negara Brunei Darussalam, Regulatory Framework, evolution, Islamic finance, issues and challenges, Islamic Finance in Brunei.

**Abstract:** Islamic Banking was first introduced in Brunei Darussalam in the early 1990s and according to ICD Thomson Reuters Islamic Finance Development Indicator 2014, Brunei Darussalam ranked 10th out of 92 countries that practise Islamic Finance. This makes Brunei Darussalam a well-placed to grow an international role in investment management of Islamic products, and in the provision of *takaful*. The purpose of this paper is to review the history of Islamic banking in Brunei from 1578 until today, including issues and challenges to the growing market in Islamic regulatory framework of Islamic finance in Brunei. The study analysed data from Brunei History Centre for chronological synchronisation. The findings shows that despite of being a small country, Brunei embraces a solid growth. Based on an extensive literature review and case study, this paper aims to highlight future improvement in *shariah* governance, regulatory, judiciary and *Shariah* standards. Finally, greater attention should be given to the fundamental principles of Islamic finance in order to ensure the expansion as intended by the Financial Blueprint as a hub for Islamic Finance is materialised.

## 1 INTRODUCTION

The growth of Islamic finance in Brunei can be categorised into three (3) categories. The capital market, Takaful and banking. Applying the dual banking system equipped Brunei with strategic equilibrium. Bruneian banks have a reputation for high capital adequacy ratios (CAR). In 2015, the banking sector's average CAR was 21.5%, which is well above the minimum regulatory requirements of 10%. Current minimum (quantum of) capital requirements for locally incorporated banks and overseas incorporated banks are BND100 million and BND1 billion, respectively. These serve to ensure that banks operating in Brunei Darussalam are financially robust. The quality of Brunei Darussalam's banks is reflected by their unanimous investment grade credit ratings (AMBD, 2016). Statistics shown that financial sector contributes to 3% for total GDP (AMBD, 2016) recent statistics by the Department of Economic Planning and Development show the financial sector's share to GDP at around 5.1%. Building upon the platform developed and leveraging the myriad of opportunities in Asia - the world's fastest growing region - *Wawasan 2035* envisages that, by 2035, the financial sector's contribution to GDP will have expanded to 8% of GDP (AMBD,

2016). To maintain their currently good credit ratings, Bruneian owned and incorporated banks need to be demonstrably well-capitalised and maintain CAR at levels above the international minimum (8% of risk adjusted exposures) (AMBD, 2016).

## 2 METHOD

The study employs library research. Data collected from the Residential Report on Borneo, primary legislations, Acts, Standards and reports were analysed to ensure the chronological synchronisation.

## 3 RESULTS

The findings shows that despite of being a small country, Brunei embraces a solid growth. The study has divided phases of growth into three phases. Three (3) phases as follows;

- a) The first phase from 1935- 1980 (45 years)
- b) The second phase from 1981-2011(30 years)
- c) The third phase from 2011-current

## 4 THE FIRST PHASE FROM 1935-1980 (45 YEARS)

The first phase has witnessed the slow movement in the banking system. The focus at this stage was towards stabilizing the monetary system rather than the banking system. This is evident from the enactment of the Coins (Import and Export) Act 1909 to control the flow in and out of gold, silver copper coins. There were about nine (9) banks established during this period. In 1935, Post Office as Saving Deposits was established. Only in mid-1940's, the Hong Kong and Shanghai Banking Corporation began to operate in Brunei and registered as a branch of a foreign bank. In May 1958, the Standard Chartered Bank was established. There were no financial regulations governing the banking activities during this period (Latif, 2004). The banking practices relied solely on English laws.

### 4.1 Oil and Gas Industry

The fast growth in oil industry resulted in several new banks established. The National Bank of Brunei Berhad was established in 1964. Other banks were established such as in the Malayan Banking in 1960, the United Malayan Banking Corporation in 1963, the National Bank of Brunei Berhad in 1964 and the Citibank in 1971. The Overseas Union bank was established in 1973 and the Island Development Bank was established in 1980. The Motor Vehicle Insurance third Party Risk Act Cap 90, was enforced on 28<sup>th</sup> of February 1950 to make provision for the protection of third parties against risks arising out of the use of motor vehicles. Since 1909, there are laws governing bankers and coinage. Section 2 of the Coins (Import and Export) Act 1909, defines a "banker" as any company incorporated in Brunei Darussalam including any company registered under Part IX of the Companies Act (Chapter 39) and carrying on the business of banking under a licence issued under any written law in force in Brunei Darussalam; "money-changer" means a person who carries on the business of money-changing as his chief business.

### 4.2 The Coins (Import and Export) Act 190

The Coins (Import and Export) Act 1909 was enacted to regulate the import and export of coins into and from Brunei Darussalam. section 5 (1) states that any person who in contravention of any notification

published under section 3 or 4 imports or exports or attempts to import or export any coin in such notification specified to the amount of \$5 in nominal value or upwards in the case of copper or bronze coin, or of \$25 in nominal value or upwards in the case of silver coin, shall be guilty of an offence: Penalty, a fine of \$2,000, and any coin so imported or exported or attempted to be imported or exported in contravention of any such notification shall be forfeited.

The mushrooming of unregulated money lending activities with high interest led to the enactment of Money Lenders Act effective in 1922. In order to control the exorbitant charge of interest, the law was introduced. "Money lenders" means any person who habitually lends money at interest: Provided that this expression shall not include the Government or a banker who is licensed as such under the provisions of section 4 of the Banking Act. No person was allowed to carry on the business of a moneylender unless he is registered as such and has obtained a licence from the State Secretary (sec 3(3) Money Lenders Act, 1922). The rate of interest to be charged on loans shall not exceed 15 per cent per annum if secured and 24 per cent per annum on note of hand only (sec 5 sec 3(3) Money Lenders Act, 1922) Section 6 required every moneylender shall keep a register showing the name, sex, age and nationality of every person to whom a loan is made, the amount actually lent, the rate of interest, and the security if any; and such register shall be produced for the inspection of any magistrate on demand.

### 4.3 The Banking Act 1957

The Banking Act, Cap 95 was introduced on 1<sup>st</sup> of January 1957 to regulate deposit taking activities. The Act defines deposit as a sum of money or any precious metal, any precious stone or any article which is comprised, in part or in whole, of any precious metal or precious stone, and any other article or thing as may be prescribed by the Minister, received, paid or delivered on terms (a) under which it will be repaid or returned, with or without interest or at a premium or discount; or (b) under which it is repayable or returnable, either wholly or in part, with any consideration in money or money's worth. This was repealed by section 131 of the Banking Order, 2006 [S 45/2006] w.e.f. 04-03-2006. It is interesting to note that at this stage, the acceptance of deposit does not confine only to paper money by also precious stones. In comparative, Malaysia adopt the same definition on deposit and incorporated into Islamic Financial

Services Act 2013 as well as the Financial Services Act 2013 only in 2013.

On 5th August 1966, the Participating Governments of Malaysia, Singapore and Brunei, signed an agreement to amend clause 18(a) of the Currency Agreement to allow the Board of Commissioners of Currency to continue to issue currency for the three countries for a further period of six months until 11th June 1967. The original provision was that the Board would have to relinquish its powers to issue currency notes not later than 11th December 1966, and coins a year later. On 12<sup>th</sup> of June 1967, Bank Negara Malaysia, the Board of Commissioners of Currency, Singapore and the Brunei Currency Board replaced the Board of Commissioners of Currency, as the sole currency issuing authorities in Malaysia, the Republic of Singapore and the State of Brunei respectively. In 1967, The Brunei Currency Board (BCB) was established by the 1967 pursuant to section 3(1) of the Currency Act.

Under Section 9(1) of the Currency Act, the Board has the sole right to manage and issue currency notes and coins in Brunei Darussalam. According to section 13 of the Act, such currency notes and coins are legal tender at their face value, unless mutilated or imperfect. In 1967, the Currency Interchangeability Agreement between Singapore and Brunei allowing both countries to interchange the currencies at par. Under this agreement, the authority and banks of both countries are obliged to accept and exchange each other currencies without charge.

The individual currencies are acceptable as customary tender when circulating in the country in which they are not legal tender. For 45 years, this phase witnessed the growth of financial system alongside the monetary system. The Currency Interchangeability Agreement between Singapore and Brunei in 1967 allowing both countries to interchange the currencies at par. Under this agreement, the authority and banks of both countries are obliged to accept and exchange each other currencies without charge. The individual currencies are acceptable as customary tender when circulating in the country in which they are not legal tender (AMBD, 2016). There was no legal provisions at this stage for Islamic Banking.

## 5 THE SECOND PHASE FROM 1981-2011 (30 YEARS)

The second phase witnessed the strengthening of financial system towards sustainability. So many things going on during this phase. The Islamic Banking Act 1992 was first enacted on 2<sup>nd</sup> December 1992 to regulate and control the activities of Islamic banking institutions. In September 1990, His Majesty the Sultan of Brunei initiated the formation of Islamic bank in Brunei. In his royal speech to the Islamic Religious Council Meeting. His Majesty the Sultan of Brunei initiated the formation of Islamic bank in Brunei. In his royal speech to the Islamic Religious Council Meeting held in September 1990, he stressed that the establishment of an Islamic bank is important because it is a '*fard kifayah*' obligation for each Muslim country and *Negara* Brunei Darussalam. This command is the apex of Islamic banking foundation. The setting up of a committee known as Formation of Islamic Bank Committee (Latif, 2004).

*Perbadanan Tabung Amanah* Islam Brunei is a body corporate established in Brunei Darussalam under the *Perbadanan Tabung Amanah* Islam Brunei Act (Cap 163). TAIB was officially launched by His Majesty Sultan Haji Hassanal Bolkiah Mu'izzaddin Waddaullah ibni Al-Marhum Sultan Haji Omar 'Ali Saifuddin Sa'adul Khairi Waddien, Sultan and *Yang Di-Pertuan* of *Negara* Brunei Darussalam, the Present Monarch who is also the Supreme Executive Authority of the Country on the 29th September 1991. The launching of TAIB marked a new beginning for Brunei Darussalam as TAIB was the first Financial Institution that conducted all its activities in accordance with Islamic faith. (TAIB, 2017).

The pawn brokers Act 2002 was introduced to regulate the pawn broking system according to *Hukum Syara'*. Consist of 37 provisions with two schedules, the pawn broking Act signifies *Shariah* as the rule of life. Pawnbroker is defined as any person who, under a valid licence, carries on the business of receiving articles from pawners as security and grants them loans under the provisions of this Order. It is interesting to note that Brunei recognises the function of *Shariah* court in the banking system. Provision no 2(3) states that if any conflict or doubt arises when interpreting any word or expression relating to *Hukum Syara'*, it shall be the discretion of the *Syariah* Courts to decide the meaning of such word or expression. Unlike other Commonwealth countries, Malay text shall prevail as written in the Pawnbroker's Act 2002. In addition, this Act is applicable for both Muslim and Non-Muslim. Section 6 further clarifies, that *Syariah* court shall have the

exclusive jurisdictions to entertain any claim in relation to pawn broking activities which is under the Part II of the *Syariah* Court Act (Ch 184). "Court" means the *Syariah* Subordinate Courts, the *Syariah* High Court or the *Syariah* Appeal Court, as the case may be, established under subsection (1) of section 6 of the *Syariah* Courts Act (Chapter 184). "Court" here means the *Syariah* Subordinate Courts, the *Syariah* High Court or the *Syariah* Appeal Court, as the case may be, established under subsection (1) of section 6 of the *Syariah* Courts Act (Chapter 184). The Banking Act 1957 was repealed by section 131 of the Banking Order, 2006 [S 45/2006] w.e.f. 04-03-2006.

The Banking Order 2006 mainly to cater the conventional banking system was introduced. The Act consists of 131 provisions with four schedules. The Hire Purchase Act was enacted in the same year. Another landmark break through was the *Syariah* Financial Supervisory Board Order was enacted. An Order to establish the *Syariah* Financial Supervisory Board and to provide for the control of the administration and business dealings of financial institutions concerning Islamic products and any matters connected therewith and incidental thereto (S1(2) *Shariah* Financial Services Board (2006)). The Order introduced the two-tier relationship of governance between the SFSB at AMBD with the *Shariah* Advisory Board at Local IFI level. AMBD is the *Syariah* Governance Framework (SGF).

The purpose of this framework is to help ensure that the structure, processes, products and services of Islamic Financial Institutions (IFIs) are in accordance with *Syariah* principles. In addition, the *Syariah* audit will continue to be conducted to ensure that the post approval of Islamic products and services continue to comply with *Syariah* principles. Another initiative will be to provide a product approval guideline which will provide a set of procedures for the IFIs to follow when determining the category of approval required from SFSB/AMBD for new Islamic financial products or any enhancement/variation made to an existing product (AMBD, 2016). Islamic Banking was further strengthened by the Islamic Banking Order 2008. The Act consist of 131 sections with four schedules. Islamic banking business is defined as business of aim and operations are in accordance with *Hukum Syara'* which consist of receiving deposits or other repayable funds from public, paying or collecting cheques drawn by or paid in by customer, the granting of financing facilities to customers and includes such other businesses as the authority may authorise for the purpose of the Order.

Unconventional definition to the banking activities, *hukum syara'* is defined as the Laws

according to Shafiite, Hanafi, Maliki or Hanbali Sect of the *ahli Sunnah waljamaah*. The provision intended to accept the resolutions of *shariah* within the accepted and recognised school as stated therein. Deposit Protection Order, 2010 was introduced to administer the deposit protection scheme aimed at protecting depositors against the loss of their deposit in the unlikely event the member institution (banks/finance companies) unable to meet its obligations to depositors. The Takaful Oder was initiated in 2008 within this phase.

Another landmark breakthrough was the establishment of the Authority Monetary Brunei Darussalam. His Majesty the Sultan and *Yang Di-Pertuan Negara* Brunei Darussalam has consented to the Authority Monetary Brunei Darussalam Order, 2010 which commenced on 1st January 2011. The Autoriti Monetari Brunei Darussalam Order, 2010, 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.

*"Insya Allah, selaras dengan amalan terbaik antarabangsa, Kerajaan Beta juga akan melakar satu sejarah baru dalam hal ehwal kewangan, dengan penubuhan sebuah autoriti monetari yang digelar Autoriti Monetari Brunei Darussalam (AMBD) atau Monetary Authority of Brunei Darussalam yang akan berkuatkuasa pada 1 Januari, 2011. Badan ini akan bertanggungjawab, termasuk keatas dasar-dasar monetari, pengawalseliaan institusi kewangan dan pengurusan matawang."*

*– excerpt from His Majesty the Sultan and Yang Di-Pertuan Negara Brunei Darussalam Titah in conjunction with His Majesty's 64<sup>th</sup> Royal Birthday (15<sup>th</sup> July 2010) (<http://www.ambd.gov.bn/about-ambd> 2017).*

The establishment of AMBD indicates a new milestone in the development of the financial sector in Brunei Darussalam. It also underscores the commitment of the Government of His Majesty the Sultan and *Yang Di-Pertuan Negara* Brunei Darussalam in achieving and maintaining a sound and dynamic financial system; by continuously implementing appropriate measures, and embarking on necessary financial sector reforms in support of the national economic development objectives (AMBD,

2016). 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, i.e 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.

The AMBD Order 2010 consists of 79 sections with two (2) schedules. Section 1(2) of the AMBD Order 2010 states that the establishment and incorporation of the Authority Monetary Brunei Darussalam is to act as the central bank of Brunei Darussalam, to formulate and implement monetary policy, to advise the Government on monetary arrangements and to supervise financial institutions, and to provide for the transfer to it certain other functions and assets of the Government and for matters connected therewith or incidental thereto. The principal objectives of the establishment is clearly written as follows:

- (a) to achieve and maintain domestic price stability;
- (b) to ensure the stability of the financial system, in particular by formulating financial regulation and prudential standards;
- (c) to assist in the establishment and functioning of efficient payment systems and to oversee them; and
- (d) to foster and develop a sound and progressive financial services sector

## 6 THE THIRD PHASE FROM 2011-CURRENT

The author is of the view that this phase is towards internationalisation towards creating enabling financial stability. This phase also witnessed the diversification of economy as outlined in the Financial Blueprint Sector 2016-2035. The author would say this is the phase where the International financial strategic being embedded into the as policy of the country. In order to cope with the international standards, there are several laws and orders being enacted to ensure the Conventions are complied with. AMBD, as member of the International Organization of Securities Commissions (IOSCO) and a full signatory to the IOSCO Multilateral Memorandum of Understanding, the unit is also responsible in

ensuring continuous alignment to the best international standards and practices set by (AMBD, 2016) The securities markets recently saw regulatory reform through the introduction of the Securities Markets Order, 2013 which repeals the Securities Order, 2001 and the Mutual Funds Order, 2001. With the new legislation and accompanying regulations in place, a new streamlined licensing structure for capital market intermediaries has been introduced and minimum financial requirements have been enhanced with values ranging from BND100,000 to BND2 million depending on the regulated activities undertaken. These capital requirements are cumulative depending on the number of activities. The new legislation also provides for licensing, recognition or designation of a wide range of market operators including securities exchanges, clearing house, central securities depository, trading facilities and credit rating agencies. Furthermore, it aims to enhance investor confidence and protection with strengthened ongoing disclosure requirements (AMBD, 2016).

In order to ensure relevancy in the market, AMBD is undertaking many initiatives to align the remaining gaps relative to international standards, such as requiring banks and insurance/ *takaful* companies to prepare their financial statements in accordance to the International Financial Reporting Standards (IFRS). AMBD also is working towards enhancing the legislation and producing accompanying notices and guidelines to ensure that the regulatory framework is on par with the International Association of Insurance Supervisors (IAIS) Core Principles in proportion to the development of the market. Historically, Brunei Darussalam's *sukuk* issuances have mostly been sovereign *sukuk*. Since 2006, the Government has maintained a continuous program of *sukuk* (Islamic bonds) issuance, with progressively longer maturities. AMBD has issued the Financial Blueprint 2016-2025 delineates financing diversification projecting to strengthen the Islamic Finance. The Securities Market Order, 2013, with implementing regulations issued in 2015, has strengthened the regulatory foundation of Brunei Darussalam's capital markets sector. The Order outlines provisions for the public offering of securities including *sukuk* and other *Syariah* compliant securities.

## 7 ISSUES AND CHALLENGES

Based on the above, the growth of regulatory growth in Islamic banking and finance in Brunei Darussalam considerably fast. The first phase growth ranges among strengthening the position of currency and monetary identity. By separation of 1967, Brunei

started to hail as the main player in the banking industry resulted from the rapid and robust growth in oil and gas industry. However there are still improvements to be made as follows:

1. The need for establishment of *Muamalat* Court for dispute settlement. Currently, all disputes goes to the civil courts. *Shariah muamalat* issues are unique and requires interpretations and recognition in principles. In comparative, Malaysian has established *Muamalat* Court in 2014 but still facing difficulties among judges who are incompetent to understand *shariah*. Alternatively, a centre of alternative dispute resolution should be established.
2. In order to boost with rapid growth in islamic finance, AMBD should issue *Shariah* standards and Guidelines directing industries on the Modus operandi of each contract. Compliance of *shariah* is taken seriously in *shariah*, and therefore need Guidelines in order to faster the growth.
3. Products should be diversified and modified vehemently to suit the culture and custom of banking in faith in Brunei.
4. Over reliance Bank Islam Brunei Darussalam (BIBD) only is not a wise decision. It is reported that BIBD exposure to market is 60% (AMBD, 2016). There must be more players in the market to avoid any unexpected market risks in future.
5. The *muqtadha al-aqd* is an important elements to ensure the products is in line with *shariah*. Therefore it is pivotal to understand that *muqtadha al-aqd* is followed and recognised in the legal documents.
6. Brunei is a country that embraces and a strict follower of Shafie school of thought. The author believes the authority should treats the issuance of standards and guidelines as urgent. This is to control improper influences over the financial systems under the name of *ijtihad*.

## 8 CONCLUSION

The concluding remarks for the evolution of regulatory Landscape of Islamic finance in Brunei is moderate but solid. We can see many drastic changes has been done in the third phase. For every deed there are always issues and challenges. The author has full believe that Brunei will be the hub for Islamic Finance. With good reputation, in terms of political, economy and high societal values, Islamic finance will grow blossom. There are efforts to issue *shariah* guidelines and still in the pipeline. It is interesting to

note that the growth of Islamic banking in Malaysia have little influence over Brunei. However, we have witness the evolution endures their own identity. As envisaged, the products in Brunei banking should be diversified. However, diversification must be guided properly to safeguards the value of *shariah* compliance. The education and training must be made aggressively. The establishment of CIBFM was a good move for future human development. However, CIBFM should create a niche for Muslim identity but internationally recognised to suit Malay Islamic Monarch at the same time to adhere to the Brunei Vision 2035. They cannot replicate the existing training models available in the market. They have to renew vow on professional accreditation associate with professional bankers association. This is important to unlock the potential capable talent. *Shariah* governance framework is pivotal. A good governance framework reflects a good and well managed organisation. This is material to safeguards the *Shariah* compliance sanctity. Knowledge capacity among industry players is very important. Their knowledge will be enhanced through trainings and knowledge sharing session. The desk officer that deals with customers first hand, need to be upgraded and well informed. The misrepresentation from them may lead to the implication of *gharar yassir*. Relying on the concept of 'Negara Zikir' and 'Melayu Islam Beraja' Brunei has never being phased out in the Islamic Financial system. We notice in every single regulation and policy issued, emphasized was given to Islamic values. Applause should be given to the authority for being modest but solid.

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