

## **Islamic Banking in Malaysia: Prospect and Challenges**

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In the latest development, Islamic financial systems in Malaysia has grown and improved significantly compared to 23 years ago, when it was first promulgated. Currently there are 4 Islamic banks, 12 commercial banks, 7 discount houses, 4 merchant banks and one finance company offering Islamic financial services and products with an estimated total asset amounting to US\$ 106 billion at the end of 2005. The continuous growth of Islamic financial institutions and the expansion in wide range of instruments, services, and products is an evidence of the potential impact affected to the current financial system in Malaysia. Study on Islamic financial institutions performance in Malaysia, has attracted many scholars locally and abroad. The complexity of the financial sector and its interaction with other economic sectors in this multi-ethnic society, provide reasonable opportunities for researchers to explore the richness of the theme.

This paper will explore some of the characteristics of the Islamic financial institutions in Malaysia from different perspectives. It provides some brief explanations on the foundation and the evolution stages of Islamic financial institutions in Malaysia. The rationale of the establishment highlights the legislative roots which will govern the institutions. Hence, emulate the understanding on how Islamic banking in Malaysia emerged and survived in the dual financial system. Furthermore, this study found that the state intervention is vital in order for the Islamic banks to grow rapidly by promoting various compatible instruments in the market.

**Key Words:** Islamic Financial Institutions, Multi-Ethnic society, Growth, Instruments, Legislation.