

Islamic Banking in Brunei

11.1 Introduction

The Sultanate of Brunei Darussalam (the Abode of Peace) is situated on the north-west coast of the island of Borneo, at 5 degrees North of the equator. The total area of 5769 square kilometres borders Sarawak in Malaysia, and the South China Sea.

European presence in the south-east region grew around the mid-sixteenth century, and from the end of the sixteenth century to the nineteenth century, Brunei began to lose its grip on the empire, which was besieged by problems such as wars, internecine strife, insurrection and piracy. By 1904, Brunei which had become a British protected State in 1888, had shrunk to a small Sultanate surrounded on three sides by Sarawak and to the north by the South China Sea.

Sultan Omar Ali Saifuddien was the twenty-eighth Sultan of Brunei. His rule lasted from 1950 to 1967 during which period his vision and prudence propelled Brunei towards prosperity and modernity.

The early 1960s saw a series of talks taking place on Tunku Abdul Rahman's proposal to group the Federated Malay States, Singapore, Sarawak, Sabah and Brunei Darussalam into a federation called Malaysia, which was formed in 1963. It was a period of transition but the Sultan was keen to maintain a separate Bruneian identity and opposed all attempts made to merge Brunei with Sarawak and North Borneo.

Sultan Omar Ali Saifuddien abdicated in 1967, paving the way for his eldest son, the current sultan to ascend the throne as the twenty-ninth Sultan of Brunei. Brunei Darussalam resumed its international responsibilities as a fully independent and sovereign nation shortly after midnight on 31 December 1983, after almost one hundred years of British protection.

From 1984 onwards, Brunei Darussalam attained membership with ASEAN, OIC, the Commonwealth and the United Nations.¹⁷⁸

Islam was enshrined in the Brunei Constitution during its unique constitutional status of a British-protected Malay sultanate. In this instance, the law applicable to Muslims is contained in legislation which is a copy of the Kelantan (Peninsular Malaysia) Act. The advantage of this model for Brunei is that it gives scope to indigenous customary law (*adat-isiadat*) relating to the ranking and function of royal and semi-royal sets of traditional officials.

The tiny Sultanate of Brunei followed Malaysia's example in 1985 when the Sultan decreed an Islamic banking option. Although the government did not actually put an Islamic bank into operation until 1992, it has actively supported that bank and has provided subsidies that permit it to pay competitively attractive dividends to depositors. A profitable Islamic insurance sector has also been established.

Political stability and the vision of His Majesty the Sultan and Yang DiPertuan have made it possible for Brunei Darussalam to achieve sustainable economic prosperity and stability which has benefited the whole population. Brunei Darussalam continues to register reasonable growth despite the turmoil of oil price and the financial crisis in Asia. Central

¹⁷⁸www.brunet.bn.

to this economic achievement is the government's Five-Year National Development Plans, which provide strategic guidelines and direction for the economy. The country continues to pursue an economic diversification policy away from the traditional reliance on the oil and gas sector in order to enjoy rapid growth like that of its partners in the Asia-Pacific Region (APR).

11.2 Brunei International Financial Corporation (BIFC)

Brunei has for many years been a significant player in the ASEAN region. Its very strong ties with the United Kingdom, Singapore and regional countries have led to the build-up of considerable commercial activity. The economy has been dominated by the oil and liquefied natural gas industries and government expenditure patterns. Brunei Darussalam's exports consist of three major commodities, namely: crude oil, petroleum products and liquefied natural gas. Exports are destined mainly for Japan, the United States and ASEAN countries. Recently, however, the country has entered a new phase of development in its drive towards economic diversification and maturity.

Unlike many IFCs, Brunei has the advantage of already being an affluent society, which means that the country's motives in establishing an IFC regime are more subtle and socio-economic in nature than simply to generate and income-stream to supplement tourism.

The aims of establishing the IFC in Brunei include developing the capacity to

- Diversify, expand into and grow the value-added financial service sector of the economy of Brunei and the APR.
- Provide a secure, cost-effective, sensibly regulated IFC facility, which will offer a safe harbour for the conduct of

significant regional and international business for corporate and private clients.

- Attract overseas professionals to assist in running the IFC to the highest standards.
- Encourage expatriate professionals to become involved in training and development of rewarding opportunities for professionally qualified and trained Bruenians in the International Business Sector.
- Increase returns for the hospitality, transport and amenity industries, including eco-tourism.
- Position Brunei as an equal partner in the globalisation of financial and commercial activity, and thereby, to generate greater communication with and between other nations.

In order to achieve these goals, Brunei intends to deploy its sovereignty, wealth and human resources in a conservative but assertive manner so as to establish a jurisdictional environment which will be tax-free, and free from excessive government regulation. Brunei IFC offers a range of international legislation carefully crafted to permit flexible, cost-effective capabilities which are right up to date. Such capabilities include the full range of facilities necessary for the efficient conduct of global business.

11.3 The Exclusion of Money Laundering a First Priority

As a sovereign nation of high repute, capable, for example of hosting the September 2000 APEC Summit, Brunei is serving notice at the outset that criminal abuses of its financial systems will not be tolerated. The country is taking these steps voluntarily, rather than under pressure. This reflects responsible economic and social attitudes.

The first series of legislation enacted for the IFC regime therefore included the Money-Laundering and Proceeds of (serious) Crime measures implemented to international

standards. Severe Drug Trafficking legislation has been in place for some time, whilst meaningful and enforceable regulation of the Trust, Company Administration, Insurance and Banking industries has already been legislated for before these activities commence.

11.4 Parallel Jurisdictions

The consequence of this legislation means that Brunei now operates as a “dual jurisdiction” whereby the international legislation offers offshore facilities alongside the usual range of domestic legislation which is based on the English law owing to Brunei’s status as a British protectorate. The jurisdictional distinction is thus jurisprudential rather than physical.

The judicial system is common to both domestic and international law and in this respect, Brunei is fortunate in His Majesty’s choice of senior members of the judiciary, all of whom are highly respected judges drawn from Commonwealth countries. All the members of Brunei’s Court of Appeal are distinguished Commonwealth judges, whilst final civil appeals are made to the Privy Council in London. In a recent judgement, Dato Sir Denys Roberts, KCMG, SPMP, a former Chief Justice of Hong Kong who for some years has held that office in Brunei had occasion to observe: “There has never been any interference by the executive with the judiciary, which has remained staunchly independent...” The importance of such a strong and experienced “British/Commonwealth” judiciary in an Asian regional context cannot be overstated.

11.5 Islamic Banking in Brunei

Banking in Brunei operates in a financial world where conventional capitalism sits side by side with an Islamic system that avoids usury or interest. The sultanate, where the majority of

250 000 inhabitants are Muslim, has ambitions to become an international financial centre. It plans to do so by excelling in both Islamic and conventional banking.

Brunei has been keenly promoting Islamic banking as an alternative to conventional banking during the past decade. There are three Islamic financial institutions in the country: the Islamic Bank of Brunei (IBB), Tabung Amanah Islam Brunei (TAIB or Islamic Trust Fund of Brunei) and Islamic Development Bank of Brunei (IDBB). The latter, wholly owned by the government, converted to the Islamic system in late 2000. At the time, the Sultan Haji Hassanal Bolkiah said: "It is a milestone for our country and will become much more significant in proportion to our status. We are confident that our way of doing business will be widely accepted by the world at large. This is not only because it brings profits but it also offers fairness and at the same time prevents exploitation."

In early 2001, a working capital credit fund was launched with the objective of injecting liquidity into Brunei's economy to stimulate industries, especially small and medium-sized enterprises (SMEs), which are considered the main plank for economic growth. In the past, SMEs complained that the banks were reluctant to give loans. Eight commercial banks — including the three Islamic banks — are supporting the fund in a joint effort with the government, which offers low interest not exceeding 4 per cent a year. The main principle of the scheme is that all of its loans are commercial ones, subject to terms and conditions of each participating bank.

Haji Abu Bakar, chairman of the IBB, says the number of Islamic banks has grown tremendously over the last thirty years but there are still questions and challenges to be resolved. "The greatest challenge is to demonstrate that the Islamic principles in banking and finance are practical and suitable in daily lives."

Established in 1993, when it replaced the International Bank of Brunei, the IBB conducts its savings and loans operations in accordance with Islamic law. The IBB comes under a group of companies known in *fiqh* (jurisprudence) as *al-'inan* companies. As previously noted, an *al-'inan* company refers to a partnership between two or more people in which their assets are used to trade and the profits obtained are distributed among themselves. As explained earlier, the majority of "*ulama*" (scholars) are of the opinion that *al-'inan* companies are both permissible and valid (*'sah*). According to the Shafie school, it is not a prerequisite that all members of the partnership in an *al-'inan* company be Muslims in order to make it *'sah*. All the other three schools also agree with this condition. This means that non-Muslims may own shares in the Islamic Bank of Brunei Berhad because an Islamic Bank is an *al-'inan* company and Islam does not require that all members of the partnership be Muslims.¹⁷⁹

The world of banking is not excluded from the endeavour of establishing justice. There is no difference in the transactions of an Islamic Bank whether the customer is a Muslim or a non-Muslim. All customers are served equally on the basis of justice. IBB states that it is prepared to provide services and advice that may be required by its customers, regardless of their race or religion. Similarly, the distribution of dividends is done fairly in accordance with the customer's rate of investment and irrespective of whether they are a Muslim or a non-Muslim. The Islamic Bank does not and will not charge service fees that differ according to the different customers, for example Muslims are charged a lower fee whilst non-Muslims are charged a higher fee.¹⁸⁰

¹⁷⁹See "Questions and answers on Islamic banking", *Islamic Bank of Brunei Berhad*, p. 15.

¹⁸⁰*Ibid*, p. 13.

Eighty per cent of the IBB's paid up capital is owned by the Sultan Haji Hassanal Bolkiah and his family, with the balance held by Japan's Daiichi Kangyo Bank. Meanwhile, TAIB, which operates under a banking licence, is revamping its image. A new chairman recently took over and the focus is on customer service.

Prior to the formal establishment of the International Finance Corporation, several international conventional banks had already established their presence in Brunei. HSBC, Standard Chartered, Overseas Union Bank, Citibank, Maybank and Baiduri Bank, all operate in the Sultanate. The major accounting firms do business there, and around fifteen law firms practice in Brunei. Even with such advantages, the proximity of financial powerhouses such as Hong Kong and Singapore suggests that even a jurisdiction with tax burdens as low as Brunei's faces a challenge in establishing a global presence in international banking. Brunei is also investigating the possibility of establishing a "cyber park" to develop an indigenous IT industry; again, such startup efforts face serious competition in the region.

11.6 *Takaful* in Brunei

It is not known for sure when the development of the insurance industry started in Brunei. The impetus was the need to protect foreign businesses, especially the British's, in the 1940s and in the 1950s. Insurance companies at that time operated through a network office or an insurance representative's desk. They were the agents in Brunei, carrying out insurance transactions with overseas insurance companies, most of which were stationed in Singapore. After the growth of the insurance identity in Brunei, overseas branches of insurance companies were established followed by the establishment of local insurance companies. Finally, in 1995,

with the determined effort of the Islamic Bank of Brunei Berhad, an Islamic insurance company known as the IBB *takaful* Berhad was set up. Today, the IBB *takaful* is the largest Islamic insurance company in Brunei. It operated according to the Company Act, 1957, with the permission of the Ministry of Finance.

Non-Muslims are open to participate in the *takaful* plan of IBB — the situation is not much different from a Muslim buying retail products from shops and supermarkets owned by non-Muslims. However, *zakat* (charitable contributions) is not levied on non-Muslims; it is only levied on Muslims as clearly required by Islam.¹⁸¹

11.7 Latest Developments

Brunei and Bahrain have recently agreed to promote and encourage joint cooperation in investment and financial sectors. The two Muslim nations sealed their desire to deepen their friendship with a memorandum that would pave the way for them to strengthen bilateral economic relations as well as in other areas of cooperation. The two countries joined ranks by signing an MOU on 26 January 2003, aiming to make their relationships progress beyond the routine diplomatic and political domains.¹⁸² This historic move came as a highlight of the visit of Shaikh Khalifa Bin Salman Al Khalifa, the Prime Minister of Bahrain to Brunei. Brunei and Bahrain lauded their move to strengthen their ties as significant as it reflected the wish of both Islamic nations to deepen their relationships through more economic co-operation and investment. Both countries have agreed to focus on joint efforts to

¹⁸¹“Questions and answers on Islamic banking”, op cit, pp. 68–69.

¹⁸²*Brunei Bulletin*, 27 October 2003.

promote and encourage cooperation in the investment and financial sectors. The fields of co-operation, amongst others, include co-operation in investment, banking and financial services including Islamic banking, financial information and relevant training activities. Also in the itinerary was an initiative to create joint venture schemes to promote investment and financial sectors. The event was also seen as a good sign for Brunei's renewed efforts to accelerate its economic diversification programmes. Under the so-called strategy to "kick-start" the economic diversification plan, Brunei hopes to bring in about US\$4 billion foreign investment into the country to develop the special projects of Sungai Liang into a world class industrial zone and to develop Pulau Muara Besar as a first class global hub.¹⁸³

11.8 Conclusion

"We have made a lot of investments in Brunei over the past 54 years and I am glad to say that we are continuing to invest because we see this as a country that is going to grow," says Warner Manning, HSBC's chief executive in Brunei. "The new economy here has a long way to go. But then it is all relative and if you take a snapshot of the other ASEAN countries, Brunei is by no means at the bottom of the list." Manning believes that in some quarters, the idea of Brunei as an offshore centre is slowly beginning to grow. But the authorities are taking a cautious approach because they do not want the sultanate to be associated in the same category with some dubious tax havens elsewhere in the world. "The first message for Brunei is that they want to get on the best list," according to Manning. "The country has some good

¹⁸³"Historic Brunei-Bahrain MOU to boost Islamic banking", *Iran Trade Point*, 27 January 2003.

things going for it. First, they have done a great job putting together the legislation. Second, they have done a very good job in adopting best practice in the banking industry. So, they are doing all the right things here and now they need to sell it.”¹⁸⁴

Running in parallel to the conventional banking system reviewed above, it can be seen that Islamic banking in Brunei is also being launched from a solid Shari’ah-compliant platform.

¹⁸⁴“ASEAN: Brunei and the Philippines”, *Image World Ltd*, 16 September 2001.