Legal obstacles in establishing Islamic banking in Maldives

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Abstract: Maldives is a hundred percent Muslim country. Though the laws in Maldives are influenced by common law and civil law systems, the spirit of the laws are based on Islamic principles. However, when it comes to the banking system, it is poignant to state here that the only known banking system to the country is based on conventional or usury friendly system. Up until now there are only six banks operating in the country. And none of them is an Islamic bank. It has been frequently questioned on why it is so difficult to set up an Islamic Bank in a hundred percent Muslim country? People say that the demand is there, so what is there to worry? But the truth is that the challenges we face are more than what any one could think of. As rightly pointed out, the demand for Islamic banking is there. But what about the legal infrastructure, political support and the economic resources which are needed to invest to convert the banking system? Lack of human resources in the country is also not a small problem. And political instability has exacerbated the situation. In the past years, there have been several failed attempts made to introduce the Islamic banking system to the country. But due to lack of proper legal frame work in the country and some other financial reasons Islamic banking were never introduced. Now finally we see a green signal from the Central Bank of Maldives for establishment of Islamic bank. Towards the end of last year the Central Bank of Maldives have announced public to apply for jobs designed for the Islamic bank which is intend to be open soon! The main purpose of this paper is to look at the obstacles in introducing Islamic banking in Maldives. The challenges it is facing and the ways to curb it. It is argued here that as a Muslim nation establishment of
References:


1. Introduction
Islamic banking is a global, universal trend today. Not only Islamic countries, but the secular countries like the European countries have adopted Islamic banking. This is because Islamic bank has proven itself as a competitive business rather than an ideological trash disguised with the word of banking. Maldives is a hundred percent Muslim country, but the only known banking system in the country is conventional banking which deals with riba or usury.

Maldives is a homogenous country in terms of its shared history, language (Dhivehi), religion (Islam) and culture. The population of the country is 310,473 (World Bank, 2008), but there are foreigners who are also living in the country. The main source of income for the country is from tourism. Fishing and agriculture has declined in the recent years simply because there is no way for the farmers and the fishermen to get financial aid. The aid given by the government is insufficient for them to pursue with the industry. Tsunami which hit the country in 2004 has exacerbated the scenario and the farmers and the fishermen whose farms and fishing vessels were destructed have no way to re-build their life but only with the mercy of the government, which is hard to get. But there is a possibility to re-build these poor people's lives and to revive these industries provided that financial assistance can be obtained in a convenient way.

The youth population of the country is 119,929 people.¹ Among this only few are able to go abroad and obtain higher education. The country has currently 3 colleges which offer up to bachelor degree only. The government offers less than 100 scholarships for education per year. There is a private organization known as Villa foundation also which offers a few scholarships to the youths. The lucky youths would be able to get a scholarship from the government and pursue higher education in overseas and these youths might not be able to obtain education in the field they desire. And the youths even luckier than this would be able to go overseas and obtain education in what ever field they want if their parents have the ability to send them. For the rest of the youths who are unable to get a scholarship or whose parents are incapable of sending them abroad to study would have to remain in the country and work, sacrificing their dreams. There is no financial institution in the country which offers an education loan without interest. An Islamic bank could definitely provide assistance to these needy youths to brighten their future.

The services and the income in the country are distributed unequally among the country. This maybe due to geographical barrier created due to Islands being scattered randomly in the sea. Proper education, health care and jobs are not in the Islands except the capital, Male' and the tourist resorts. The population in the islands is poor. If they desire jobs with good salary and advanced services, they have no choice but to immigrate to Male', the capital and this is the reason why the capital

¹i.e. between 15-35, according to Ministry of Planning and National Development of Maldives (2006).
which is only approximately two square kilometers is congested with more than 55,130 people. There is discrimination in the salary of the islanders and the people working in Male', even though the job title and the work they do is the same. For example nurses working in the islands would get less than that of the nurses working in Male', the capital, and the allowances they get would also be different. Hence, in order to develop the islands of Maldive except Male', citizens need financial assistance. Islamic bank has a social and moral function other than the profit maximization which the conventional banks only target and Islamic banks can invest to develop these islands.

Furthermore, the couples who want to start a married life have problem in starting it, simply because no matter how hard they work, it would be hard to get enough money to celebrate the wedding and to find space to live. This is the main reason the newly married couples have to get divorce within a short period of time. Normally, after marriage if the two couples are from Islands, the man would send the wife to his or her island because of the expenses. And there are more than three or four families living in less than 500 sq feet.

The conventional banks currently operating in Maldive are operating in Male', except the Bank of Maldive, which also have branches in other islands. Other islanders do not have access to these banks. The Bank of Maldive (BML) which was established in 1982 is a partly government owned bank. The other banks are branches of State Bank of India (SBI) established in 1974, Habib Bank Limited (HBL) established in 1976 and Bank of Ceylon (BOC) established in 1981, branch of the Hong Kong Shanghai Banking Corporation (HSBC) established in 2002 and a branch of Mauritius Commercial Bank Ltd (MCB) established in 2008. BML also carries out limited development banking activities.

In the past years, there have been several failed attempts made to introduce the Islamic banking system to the country. But due to lack of proper legal framework in the country and some other financial reasons Islamic banking were never introduced. Now finally we see a green signal from the Central Bank of Maldive for establishment of Islamic bank. Towards the end of last year the Central Bank of Maldive have announced public to apply for jobs designed for the Islamic bank which is intend to be open soon, how soon is yet to be determined.

In this paper the main focus would be on explaining the legal obstacles faced in establishing Islamic banking in the country with reference to the existing legal framework of the country. In the course of doing this reference is made to the conventional banking operation in Maldive. And finally, the recommendation to facilitate establishment of Islamic banking in Maldive is given. It is sincerely hoped that in a near future Islamic banking would be introduced to the country for the sake of the Muslim population who do not want to involve in riba transactions.

1 Male' is the capital of Maldive.
2. Banking and the banks in Maldives

The Maldives Monetary Authority is the central bank of Maldives. Maldives Monetary Act 1981 established the central bank of the Maldives. The word “bank” is defined in this Act as “a financial institution whose business includes the acceptance of deposits of money transferable by cheque from one person to another”. \(^3\) The Act also defines “banking business” as follows:

the business of receiving funds from the public or from a member or members thereof through the acceptance of money deposits payable upon demand or after a fixed period or after notice, or any operation through the frequent sale or replacement of bonds, certificates, notes or other securities, and the use of such funds either in whole or in part for loans or investments for the account and at the risk of the person doing such business; and any other activity recognized by the Maldives Monetary Authority as customary banking practice which a financial institution engaging in the activities [sic] which may additionally be authorized to do. \(^4\)

It shall be noted here that the word “includes” in defining “bank” proves that the definition is not exhaustive. Hence a bank may do things other than accepting deposits transferable by cheque from one person to another. This definition is broad in this sense. The definition of “banking business” also not only includes the abovementioned things, but the Maldives Monetary Authority may include anything other than that which it deems fit to be called as a banking business.

The main type of relationship that would be created from the latter definition between the customer and the banker is that of debtor and creditor relationship as held in the case of Foley v Hill. \(^5\) There cannot be multi-contractual relationship created as in the case of Islamic banking, unless and until the Maldives Monetary Authority declares Islamic banking activities within the ambit of “banking business”.

In order to amend the meaning of “banking business” the Act need not be amended. But the Act has delegated the power to include anything which the Maldives Monetary Authority thinks fit to be added to the definition, but they cannot reduce anything included in the definition without going to the parliament and amending the Act itself.

Currently there are six conventional banks operating in the country. And the activities they carry out are very limited and the access to these banks is not to the whole of the population; only the Bank of Maldives operates in other islands except in Male', the capital. This is indeed unfortunate. In short it can be said that the whole banking industry of Maldives in monopolized by the Bank of Maldives.

Bank of Maldives Limited (BML) was established on 11 November 1982. At present BML is majority owned by the Government, which holds a 51 percent

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\(^3\) Section 2 of Maldives Monetary Act 1981
\(^4\) Section 2 (1) and (2) of MMA 1981
\(^5\) (1848) 2 HLC 28
shareholding directly, with a further 24 percent being held by State owned enterprises - the Maldives Transport and Contracting Company (MTCC), Atoll community organizations and the government employees' provident fund. The general public holds the remaining 25 percent of shares. Currently there are 24 branches operating under the Head Office, of which, 18 branches are situated in the atolls. BML concentrates on general commercial banking activities, with limited development banking activities being undertaken as a special project, conducted through a separate development banking cell.

State Bank of India (SBI) is the largest commercial bank in India, with over 9000 branches across the nation and an international presence in 34 other countries covering all time zones. The Malé branch was established on 4 February 1974, and concentrates on commercial banking activities within the country.

Habib Bank Limited, a leading financial institution in Pakistan has more than 1700 branches in its home country, and 55 branches/affiliates internationally in 26 countries. The Malé branch was established on 11 April 1976, and undertakes commercial banking activities.

Bank of Ceylon (BOC), a leading Sri Lankan national bank inaugurated a branch in Malé on 7 May 1981. The bank has a network of 291 branches in Sri Lanka, 800 correspondent banks and international branch offices in 5 countries. Though BOC is associated with companies in merchant banking, capital development and investment, property development, among others, the Malé branch is only involved in commercial banking.

The HSBC Group, one of the largest banking and financial services organizations in the world, has its headquarters in London and some 7,000 offices in 81 countries and territories. Through a global network linked by advanced technology, HSBC provides a comprehensive range of financial services worldwide. The Malé branch of HSBC was established on 11 March 2002, and concentrates on corporate and personal banking.

The Mauritius Commercial Bank Limited (MCB) is the leading bank in the Mauritius. There are 42 domestic branches of MCB in the Mauritius and MCB has majority ownership in three foreign subsidiaries namely in Seychelles, Mozambique and Madagascar. MCB also operates in Paris. The Male' branch of MCB was established on 4th May 2008, and undertakes commercial banking activities.

The point to be taken here is that within the current legal infrastructure of the country, only conventional banks has the room to operate in the country. Further deliberations on the banking legal framework of the country would prove this.
2.1. Existing Banking Legal framework in the country

The conventional banks existing in the country are governed by Regulation for Banks and Financial Institutions, which is made in pursuance to section 36 read with sections 29 to 34 of the Maldives Monetary Act 1981. This is a subsidiary legislation in which everything related to the operation of banks and financial institutions are enumerated. There are five main parts in this regulation. The first part is the introductory part and the other parts deals with acceptance of regulations, licenses, and financial requirements and the limitations and finally, audit, information and inspection.

In the introductory part of the regulation it is mentioned that the regulation shall come into effect on the July 1, 1988. In the second part of the regulation it is provided that banks or financial institutions who wish to operate in Maldives shall sign a copy of the written token in the section.

This is to ensure that all banks and financial institutes operating in Maldives would be subject to the rules of the regulation. The token of acceptance is phrased in the following manner:

"This is to confirm that as a condition for holding licence issued by the MMA under Art. 29 (1) of the MMA Law, the...................................................... (name of bank/financial institution.) agrees to abide by the MMA Regulations for Banks and Financial Institutions as amended from time to time and such rules, orders, directions or guidelines as may be issued by the Authority.

Manager/Agent"

Section 1 of this regulation is about the license given to the banks and the financial institutions. In this section it is stated that in pursuance to section 29 (1) of the Maldives Monetary Authority Act 1981, a local financial institution shall not carry out business in Maldives or abroad, nor shall a foreign financial institution do business in Maldives, without a license granted by the Authority authorizing the licensee to do such business. And this license shall indicate the type of banking business licensee is authorized to do. It is also required for any person who, at the effective date of the regulation was doing banking business in Maldives with license should within 90 days from the date of obtaining license must also provide the same information that all the new banks and financial institution who wants to apply for license under the regulation is required to submit, i.e., an authenticated copy of the instrument under which the institution is organized; the address of its head office, and the name and address of every member of the board, and of its principal officers; such financial data as the Authority may require, which may be different for local and foreign financial institutions; full particulars of the business it

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5 Reprinted on 1st August 2000
7 Section 1 (1) (a)
8 Section 2 (1) (a)
9 Section 2 (1) (b)
10 Section 2 (1) (c)
proposes to do, the location of the principal and other places of business in Maldives where it proposes to do business, and such additional information as the Authority may require. All these documents shall be signed by the members of the board of the applicant, or by any principal legally authorized to do so.

In considering an application for a license, the authority shall inspect the legitimacy of the documents submitted, the financial status and history of the applicant, the character and experience of its management, the adequacy of its capital structure, the convenience and needs of the community it intends to serve, the operations it intends to do, and the earning prospects afforded by the area primarily to be served.

2.2. Obstacles in introducing Islamic banking in Maldives

The banking legal framework of the country is needed to be changed in a way to cater the Islamic banking needs. The current banking regulation of the country is made to accommodate conventional banks only. Hence without the necessary legal changes it would be impossible to introduce Islamic banking to the country. For example, section 2 of the Maldives Monetary Act 1981 defines security as "a written instrument evidencing mortgage of property or a pledge in respect of a loan". In Islamic banking qard al hasan or benevolent loan is uncommon. The whole banking business is carried in the basis of profit and loss sharing between the customer and the bank. Hence, it is questionable whether Islamic banks could take security because it does not advance loan. So if an Islamic bank starts to operate under the existing legal framework, it would not be able to take security from the clients.

For example, in the current banking regulation of the country the word "interest" or riba is referred to. Following is quoted from the regulation:

"Provided that any such advances, extensions or guarantees of credit shall be made on substantially the same terms, including interest rates and collateral, as those prevailing for comparable transactions with other persons;..."

It can be argued here that the mentioning of the word "interest" in the regulation proves that interest is accepted under the banking regulation of the country though it is riba. But the bank is not obliged to utilize interest and hence there is no problem with the above provision. The rest of the banking regulation is also consistent with Islamic law. The licensing requirement is in compliance with Islamic law. Therefore, what is the real legal predicament in introducing Islamic banking to Maldives?

It is essential to create a qualified shari'ah advisory board in the central bank and the Islamic banks as well. So right now the banking laws are silent about the

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11 Section 2 (1) (d)
12 Section 2 (1) (c)
13 Section 2 (1) (f)
14 Section 2 (2)
15 Section 3 (a)
16 Section 9(1)(c)(v)
shari'ah advisory councils. Hence there is need to amend the law to create the room to introduce the watch dog of Islamic banking to the country before the islamic banking is introduced.

Another problem faced to the country is that it lacks professional experts in Islamic banking field. There are few graduates who have knowledge in Islamic banking and the need to train people in this field is essential to create competitive products in the country. Even there are few people qualified in Islamic commercial matters who could act as shari'ah advisors in the banks. It shall be noted here that no all people who are qualified in Islamic law is qualified to advice in Islamic commercial matters which is very scientific. So at the initial stage of the banking the scholars specialized in the field has to be imported from abroad.

There is also the possibility that the bank located in Maldives might have a problem in investing the money in “halal” or lawful things. Maldives is a small nation dependant on tourism only. And in tourism investment is made on alcohol and pork which are prohibited in Islam. However, Islamic banks can play a vital role in re-structuring the economy of the country in the sense that it can provide assistance to farmers and fishermen. This way in future there is a possibility of an emergence of a halal industry in Maldives.

Another threat to the creation of Islamic banking is the political discontent in the country. The “rayyitunge majlis” the parliament of the country has a vital role to pass the laws relating to Islamic banking as soon as possible. But due to unnecessary political upheavals these bills are delayed and until now remains as bills. The support from the government to establish an Islamic bank is essential at the pioneer stage. But the lack of the government support is making the whole legal process long.

2.3. Possible Islamic Banking Instruments for Maldivians
There are various types of Islamic banking instruments which can be introduced to the locals of Maldives. Educational funding schemes for youths; house renting schemes for the newly wedded couples using Musharakah Mutanaqisah, Islamic credit card scheme to the normal people using ujir, financial aid for ship builders and house construction companies using istisna schemes and assisting the farmers by using salam can be provided.

An Islamic Bank can play a vital role in opening the doors to invent an Islamic tourism industry by investing in the tourism industry of Maldives by with Musharakah and Mudharabah mechanisms. Indeed, investing in Islamic tourism would be profitable for the banks. Islamic Bank also can play a vital role in the distribution of zakat money to the population evenly. The balance of the zakat money can be used to give benevolent loan or gard al Hasan to the needy in the society.
The bank can also develop the society by helping financially to build the roads and to give the electricity to the lesser developed areas. The Tsunami affected areas need a swift building of good houses. Currently, some of these people are living in temporary house tents, which are made out of metal roofing sheets. Maldives is a hot country and living inside metal roofing sheets is indeed unbearable.

3. Recommendations

It is recommended here that if Islamic banking is needed to be introduced to the country there is a radical change which is needed to be brought to the existing banking legal framework of the country. There is need to re-define the “banking business” and “security” mentioned in the Maldives Monetary Act 1981. This is because this Act is the central bank Act of the country, the general law.

The best way to overcome the legal challenges is to introduce a statute special for Islamic banking, like the Islamic banking Act of Malaysia. This way it will create way to introduce full fledged Islamic banks into the country operating parallel to the conventional banks currently operating in the country. It is believed that a feasible way to pioneer Islamic banking to Maldives would be to follow the Malaysian approach rather than the Pakistani approach.

In Malaysia, banking was introduced gradually, parallel to the conventional banks. The necessary changes to the law were brought slowly. But on the other hand, in Pakistan the whole banking laws were amended to accommodate Islamic banking and this method can be called the transformation of the banking business. Gradual improvement in the legal infrastructure and learning from the mistakes practically done would enhance the legal infrastructure more.

There is also need to train people in Islamic commercial field, so that the country would not have to import the watchdogs, the shari'ah advisors from abroad. Local shari'ah advisors would indeed have the advantage of creating products which is more friendly and needed by the customers. This is because Islamic banking products are based on creativity and it is created in accordance with the need of the customers rather than replicating the existing products in the conventional banks. Doing this might cause loss of confidence among the customers.

Furthermore, the court judges need to be given special training on Islamic commercial matters, so that they would be able to hear the technical matters involved in Islamic banking. In most of the countries in the world, the dilemma now is having judges who are well-versed in Islamic commercial matters. The Malaysian case of BIMB v Adnan Omar would prove the complexity which might be faced if judges are ignorant about the Islamic commercial matters.

17 [1994] 3 CLJ 735
18 For example, the judge in this case did not know the difference between muqasah (set-off) and ibra (rebate).
4. Green Signal to initiate Islamic Banking

As proven in this paper, Islamic banking has an evergreen prospect in Maldives. The demand is there and the population is impatiently waiting for it to be arrived in the country. The talks to establish an Islamic bank in Maldives has been going for more than ten years now. There are individuals like Dr. Abdullah Shiham, now the advisor for Maldives Monetary Authority, who have been advocating for Islamic banking in the country. But due to lack of support from the government the efforts did not produce any visible results.

The MMA established its Islamic Finance Unit (IFU) in 2008 to facilitate the setting up of the Maldives Islamic Bank which is a USS4 million initiative under the supervision of the Islamic Corporation for the Development of the Private Sector (ICD). The board of directors of ICD, along with the MMA, had also agreed on the shareholding structure of the bank, with the government of Maldives and the ICD holding 40% each, and 20% to be held by a technical partner. The Islamic Development Bank was also roped in to provide USS300,000 for the establishment of the Maldives Islamic Bank. However, since then news has quietened on the creation of the bank, with recent rumors of Noor Islamic Bank coming onboard. Following words were quoted in February 2010 addition of Islamicfinanceasia.com:

Mr. Fazeel Najceb, the governor of the Maldives Monetary Authority, had also affirmed the republic's support for up and coming Islamic banks, stating that the authority would not hinder any efforts by interested parties to apply for Islamic banking licenses in the republic despite the lack of a proper regulatory system. Najceb had also denied any possible political agendas for the delay in forming Islamic banks, clarifying that the authority had yet to receive any license applications.19

This is the latest development in the country with regard to the establishment of Islamic banking in the country.

5. Conclusion: Should all conventional in Maldives be changed to Islamic banks?

Islamic banking has market it Maldives. Maldives is a hundred percent Muslim country and the whole population is impatiently waiting for a day in which they could do banking without interest. But this does not mean that the conventional banks currently operating in the country shall be closed down. Instead these conventional banks shall be allowed to work parallel to the Islamic banks. This is because like in any other country in the world today, in Maldives also there are foreigners living and among them there are non-Muslims who might want to use conventional banks rather than Islamic banks. By operating parallel to conventional

banks the Islamic banks indeed would be forced to be competitive and innovate new products to attract customers. In time if Islamic bank is better it would be successful. But intentionally sending away the conventional banks by using law as a weapon would not do any good to the banking industry.

It is believed here that Islamic banking would benefit the whole country. Salam utilized through microfinance enterprise can offer assistance to the farmers and the fishermen in the Islands. Tawarruq would be an ideal way to help the couples who want to get married to ease their initial step in life. Ijarah can provide a way to buy furniture and vehicle in an affordable way. Istisna may be utilized to assist the contractors in the construction industry. And Sukuk would be viable to develop the roads and the facilities in the Islands.

In order, to make this trance a reality, great endeavors is needed from the government too. Then only the laws and the accessory assistance to operate an Islamic bank in Maldives can be offered to the willing parties. It is hoped that in a near future, with the mercy of God, an Islamic bank would be soon established in the country. In 2008, it was reported in the newspapers that Dhulai’s Noor Islamic Bank announced that it has entered into a joint venture to establish the first Islamic bank in Maldives. In this January 2010, it was reported in “haveeru” a leading newspaper of the country that the government has signed an agreement with the private sector arm of the Islamic Development Bank to introduce Islamic banking services in the Maldives and the signing ceremony between the Maldives and the Islamic Cooperation for the Development of the Private Sector (ICD) was held during an annual meeting of the World Bank and International Monetary Fund in Istanbul, Turkey. The news also said that an Islamic bank would be soon established in the country and how soon is yet to be determined. Definitely the wheels have been ostensibly set in movement for the materialization of Islamic finance in the country. It is now a question of whether there are any keen drivers to make an impact on the Maldivian fragile economic landscape.

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