The Growth and Challenges of Islamic Finance in Thailand

ZAKARIYA HAMA*, MUHAMMAD ROFLEE WAHAMA & MUHAMMAD AFEEFEE ASSALIHEE

ABSTRACT

The study investigates the growth and challenges encountered by Islamic finance within the context of Thailand with recommendations are provided to address these challenges. This study utilised both descriptive and analytical methods. The data was gathered and examined from a range of sources and an in-depth personal interview with an individual knowledgeable about Islamic Finance in Thailand. The preliminary results of the study reveal the growth and expansion of Islamic finance in Thailand has presented numerous challenges. Despite of that, it has managed to secure a substantial share of the overall financial system. In 2022, the aggregate value of Islamic financial assets experienced a year-on-year growth of 5.56%, reaching a total of THB 128,825 million. These assets were distributed among various segments. The largest segment was Islamic banking, which accounted for 62.18% of the total assets, with an asset size of THB 80,110 million. The second largest segment was other Islamic financial institutions, with an asset size of THB 36,143 million, representing 28.06% of the total assets. The Takaful segment followed, with an asset size of THB 10,427 million, accounting for 8.09% of the total assets. Lastly, the Islamic fund segment had an asset size of THB 2,145 million, making up 1.67% of the total assets of Islamic financial assets. The study indicates the significant challenges encountered by the Islamic finance industry, primarily pertain to the legal and regulatory framework governing Islamic finance, with specific emphasis on Islamic cooperatives, takaful operations, and the imposition of double stamp duty on Islamic contracts. Furthermore, the absence of a centralised Shari’ah supervisory body for all segments of Islamic finance, as well as the lack of institution-level Shari’ah supervision, pose considerable difficulties.

Keywords: Islamic banking, Islamic capital market, Islamic finance, Islamic insurance, Islam in Thailand

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Islam was introduced to Thailand, previously known as Siam in the thirteenth century. This occurred through interactions with Persian, Arab, and Indian traders who visited the central region of Siam. In the south region, previously known as Patani, Islam was introduced during the thirteenth centuries by Arab traders. Additionally, in the north region, Islam arrived in the nineteenth century through the migration of Chinese, Indian, and Bengali Muslims. Islam is officially Patronage in Thailand, and it is the second largest religion in the kingdom (Chalayandecha 1996: 24,193). The Muslim community has played a significant role in the historical, political, and cultural fabric of Thailand. (Bajunid 1999: 210-211). According to the Religious Information Centre, which operates under the Ministry of Culture Muslim’s population in Thailand constitutes approximately 5.41% of the total population of 66,090,475 million individuals (National Statistical Office 2023: 3). This demographic is primarily concentrated in the southernmost provinces of Narathiwat, Pattani, Yala, and Satun, where they comprise a significant portion, ranging from 65% to 85%, of the local population.

Furthermore, the majority of these individuals are of ethnic Malay descent (Liow 2009: 12). The Thai legal framework pertaining to the Muslim population within the country was established through the issuance of the Royal Decree on Islamic Patronage in 1945 and the enactment of the Royal Act of Mosques in 1947. These legislative measures led to the establishment of Mosque Committees and Muslim Religious Councils, which were tasked with overseeing the operations of mosques (Brown 2017:5). Subsequently, these entities were consolidated under the Administration of Islamic Organisations Act, B.E. In the year 2540 (1997). Currently, Thailand enacted four Royal Acts pertaining to Islamic Affairs. The application of Islamic Law in the provinces of Pattani, Narathiwat, Yala, and Satun Act B.E.2489 (1946) The Hajj Affairs Promotion Act, B.E. 2524 (1981), The Administration of Islamic Organisations Act, B.E. 2540 Act (1997) and the Islamic Bank of Thailand Act, B.E. (2002) (Zakariya Hama 2017: 178-179).

The Islamic finance industry has experienced significant growth since the establishment of the first Islamic commercial bank in Miti Ghamr, Egypt in 1963. (ISRA 2016: 114), the industry has consistently achieved an average annual growth rate of 15%. Islamic finance encompasses various components, including Islamic banking, Islamic capital market, and Islamic insurance (Takaful), (INCEIF 2017: 352). Over time, the industry has witnessed substantial expansion in terms of market participants, expertise in structuring financial products, and the diversity of transaction types. The financial product in question exhibits a dynamic and robust nature, demonstrating its ability to compete effectively with traditional financing options. It frequently appears in conjunction with, or as a viable substitute for, conventional financing products. (Dewar & Hussain 2020: p.ix), The global Islamic Financial Services Industry demonstrated robustness and resilience in the face of adverse global financial circumstances during the year 2022. The industry underwent structural advancements and exhibited a projected value of USD 3.25 trillion, a growth from its previous value of USD 3.06 trillion in 2021. Islamic banking maintained its dominant position within the Islamic Financial Services Industry (IFS), boasting an impressive asset size of USD 2.25 trillion, which accounted for 63.90% of the total global IFSI assets. The Islamic capital markets segment, encompassing Sukuk, Islamic funds, and Islamic equities, possesses a substantial asset size of USD 965 billion, representing approximately 29.80% of the total market. The Takaful segment, which has an asset size of USD 30 billion, represents 09.00% of the total (Islamic Financial Services Board 2023: 5-6).

Since 1998, the Thai government has actively promoted the establishment of various forms of Islamic finance systems in order to facilitate financial transactions for Thai Muslims in accordance with Shari’ah principles. The Islamic banking sector in Thailand is regulated and overseen by the Central Bank of Thailand. The Securities and Exchange Commission possesses comprehensive regulatory jurisdiction over the monitoring of performance within the Islamic capital market, while the office of the insurance commission is responsible for overseeing the takaful sector. This paper aims to examine the establishment and growth of Islamic finance in Thailand, along with the
challenges it faces. The objective is to provide recommendations for the further development of Islamic finance in Thailand. The study adopts a descriptive and analytical methodology.

The Establishment and Growth of Islamic Finance in Thailand

Islamic finance in Thailand, similar to other countries, encompasses various components of Islamic banking, such as Islamic windows and fully-fledged Islamic banks. Other segments of Islamic institutions include Islamic bank asset management, Islamic cooperatives, and Islamic leasing. The Islamic capital markets encompass various financial instruments, including Islamic equity shares, Islamic funds, and Sukuk. Furthermore, it is worth noting the presence of the Takaful segment.

The inception of Islamic finance in Thailand can be traced back to the 20th century, specifically with the establishment of the first Islamic cooperative in 1987. This cooperative took the form of an Islamic saving cooperative and was categorised as one of the segments of Islamic financial institutions under the purview of the Ministry of Agriculture and Cooperatives. Subsequently, in 1998, an Islamic saving cooperative was introduced within a conventional bank, followed by the establishment of a full-branch Islamic bank within a conventional bank in 2002. Finally, in 2003, the full-fledged Islamic Bank of Thailand was established, representing a distinct segment within the realm of Islamic banking. The establishment of the first Islamic fund occurred in 2004, marking the inception of the Islamic capital market. This was followed by the introduction of the first Family takaful operation in 2005, which served as the inaugural takaful segment. In 2009, the securities market witnessed the introduction of a Shariah index. Subsequently, in 2010, Amanah Leasing Public Company was established. Notably, 2011 saw the issuance of a Notification and Royal Decree on Sukuk, while in 2012, a Notification and Royal Decree on Tax Exemption Sukuk was issued. The year 2016 witnessed the establishment of Islamic Bank Asset Management (IAM), and in 2023, regulations pertaining to Islamic Fund were fully implemented.

Table 1: The Growth of Islamic Finance in Thailand from the year 1987 to 2023.

<table>
<thead>
<tr>
<th>Years</th>
<th>The Growth of Islamic Finance</th>
<th>Segment</th>
</tr>
</thead>
<tbody>
<tr>
<td>1987</td>
<td>First Pattani Islamic saving cooperatives.</td>
<td>The other Islamic financial institution.</td>
</tr>
<tr>
<td>1998</td>
<td>First Private Islamic window of the Srinakorn Bank</td>
<td>Islamic banking.</td>
</tr>
<tr>
<td>2002</td>
<td>Islamic Banking Branch of Krung Thai Bank.</td>
<td>Islamic banking.</td>
</tr>
<tr>
<td>2003</td>
<td>Islamic Bank of Thailand.</td>
<td>Islamic banking.</td>
</tr>
<tr>
<td>2004</td>
<td>MFC Islamic Fund by MFC Asset Management.</td>
<td>Islamic capital market.</td>
</tr>
<tr>
<td>2005</td>
<td>First Family Takaful Product of Finansa takaful operator.</td>
<td>Takaful.</td>
</tr>
<tr>
<td>2009</td>
<td>Shariah Index.</td>
<td>Islamic capital market.</td>
</tr>
<tr>
<td>2010</td>
<td>Islamic Leasing by Amanah Islamic Leasing.</td>
<td>The other Islamic financial institution.</td>
</tr>
<tr>
<td>2011</td>
<td>Notification &amp; Royal Decree on Sukuk Issuance and Tax Exemption.</td>
<td>Islamic capital market.</td>
</tr>
<tr>
<td>2012</td>
<td>Notification &amp; Royal Decree on Tax Exemption</td>
<td>Islamic capital market.</td>
</tr>
<tr>
<td>2016</td>
<td>Islamic Bank Asset Management.</td>
<td>The other Islamic financial institution.</td>
</tr>
<tr>
<td>2022</td>
<td>Latest Islamic Barakah cooperatives.</td>
<td>The other Islamic financial institution.</td>
</tr>
<tr>
<td>2023</td>
<td>Islamic Fund Regulation.</td>
<td>Islamic capital market.</td>
</tr>
</tbody>
</table>
The Islamic financial assets in Thailand demonstrated a growth trend from 2018 to 2019, with an increase from THB 125,881 million to THB 126,580 million. However, there was a subsequent decline in 2020 and 2021, with the value decreasing from THB 123,756 million to THB 122,043 million. Nevertheless, the assets experienced a subsequent recovery in 2022, reaching THB 128,825 million.

In 2022, the aggregate value of Islamic financial assets experienced a year-on-year growth of 5.56%, reaching a total of THB 128,825 million. These assets were distributed among various segments within the Islamic financial industry. The Islamic banking segment accounted for the largest portion, with assets totaling THB 80,110 million, representing 62.18% of the total. The other Islamic financial institutions segment followed, with assets amounting to THB 36,143 million, accounting for 28.06%. The Takaful segment held assets valued at THB 10,427 million, making up 8.09% of the total. Lastly, the Islamic fund segment had assets worth THB 2,145 million, accounting for 1.67% of the overall Islamic financial assets.
The Islamic Banking Segment

The Islamic banking segment represents the largest proportion of Islamic financial assets between the years 2018 and 2022.

Figure 2: Illustrates the aggregate value of assets held by Islamic banks segment in Thailand.

[Figure showing the aggregate value of assets held by Islamic banks in Thailand from 2018 to 2022.]


In the year 2022, there was a 4.55% year-on-year increase in the total assets of the Islamic banking segment. These assets reached a size of THB 80,110 million, representing 62.18% of the overall assets within the Islamic financial sector. The total assets of Islamic banking in Thailand are primarily supported by the assets of a fully-fledged Islamic bank, namely the Islamic Bank of Thailand, which accounts for 95.13% of the total assets. Additionally, the assets of the Islamic windows of the Bank for Agriculture and Agricultural Cooperative contribute 4.87% to the overall assets of Islamic banking in the country.

The Islamic Bank of Thailand

The establishment of an Islamic Bank under the authority of the government, governed by its own legal framework, was a deliberate objective of the Government. Consequently, the Ministry of Finance was tasked with the responsibility of formulating The Islamic Bank of Thailand Act 2002, which subsequently received parliamentary approval in October 2002. The establishment of the Islamic Bank of Thailand, also known as IBANK, was authorised by the Islamic Bank of Thailand Act 2002 and is subject to regulation by the Ministry of Finance. The Bank initiated its operations on June 12, 2003, with a paid-up capital of 1 billion baht. Its headquarters, which also served as the inaugural branch, was located in Klongton, Bangkok. The Bank's business expansion persisted with the acquisition of Krung Thai Bank PCL's Shariah Banking Services in November 2005, in accordance with the government’s policy. During its early operational phase, ibank exclusively concentrated on the segmentation of the Muslim market. Nevertheless, the Bank recognises the potential for growth in providing Shariah banking services to the wider population. As a result, it undertakes the creation and development of additional services, while also actively promoting an ethical culture, social responsibility, adherence to Islamic principles, and the implementation of good governance within its operational framework. These factors enable ibank to distinguish itself from competitors and
establish itself as a viable banking option for individuals of all religious backgrounds. In October 2007, the Ministry of Finance assumed majority ownership of iBank, resulting in the Bank’s transition to a state-owned enterprise. Presently, the Ministry of Finance, which serves as the primary shareholder of the bank, has increased its ownership to nearly 100 percent (99.59%) subsequent to the revision of the Islamic Bank of Thailand Act 2002. The revised legislation, known as the Islamic Bank of Thailand Act 2018, came into effect on July 18, 2018. This act grants the Ministry of Finance the authority to hold a majority stake of more than 49 percent in the bank for a specified duration. Currently, the financial institution known as iBank boasts a total of 94 branches that are strategically located across the entire nation. The bank’s depositors can be categorised into two groups: Muslims, who constitute 58% of the total, and non-Muslims, who make up the remaining 42%. On the contrary, it is observed that out of the customers availing finance from Islamic Banks, only 32% identify as Muslim, while the remaining 68% belong to non-Muslim communities, with a notable representation from the Buddhist community (Islamic Bank of Thailand 2022: 12).

The Islamic Bank of Thailand experienced a rise in total assets from 2018 to 2019, reaching THB 80,590 million and THB 81,320 million respectively. However, these figures declined in 2020 and 2021 to THB 76,360 million and THB 72,860 million respectively, primarily attributed to the impact of the Covid-19 pandemic during this period. Subsequently, the total assets increased to THB 76,210 million in 2022, exhibiting a year-on-year growth rate of 4.60% in the same year.


**Islamic Windows in Conventional Banking**

The initial introduction of Islamic banking services within a commercial bank occurred in 1998, when Srinakorn Bank became the first institution to offer Islamic windows. This development followed the Central Bank of Thailand’s announcement regarding the provision of Shari’ah-compliant banking services. The initial endeavour to introduce Islamic banking services can be traced back to the Government Saving Bank in 1998. Subsequently, in 1999, the Bank for Agriculture and Agriculture Cooperatives followed suit. In 2002, Krung Thai Bank further expanded this initiative by establishing “Islamic windows” and “Islamic Branches” (Wacharapan 2000: 24-25).

The assets of the Islamic financial institution, Bank for Agriculture and Agriculture Cooperative, exhibited a consistent growth trajectory from 2018 to 2022. The total assets increased from THB 2,490 million in 2018 to THB 2,980 million in 2019, THB 3,230 million in 2020, THB 3,760 million in 2021, and finally reached THB 3,900 million in 2022. This represents a year-on-year growth rate of 3.72% in 2022.

At present, the provision of Islamic banking services in Thailand is limited to the Islamic banking window or Islamic banking fund offered by the Bank for Agriculture and Agricultural Cooperatives. However, it is noteworthy that the Government Savings Bank and Krung Thai Bank have assumed the role of holding the Islamic Bank of Thailand, rather than providing Islamic windows. Hence, the pertinent legislations encompass the Bank for Agriculture and Agriculture Cooperative Act 1966 and the announcement issued by the Central Bank of Thailand pertaining to Shari’ah banking services.
The other Islamic Financial Institution

The subsequent significant portion of Islamic financial assets during the period spanning from 2018 to 2022 pertains to the category of other Islamic financial institutions.

Figure 3: Illustrates the aggregate value of the remaining the other Islamic financial assets in Thailand.


The total assets of other Islamic financial institutions experienced a decline from THB 33,883 million in 2018 to THB 32,480 million in 2019. However, there was subsequent growth observed in the years 2020 to 2022, with the total assets increasing to THB 33,565 million, THB 33,597 million, and THB 36,143 million, respectively.

In 2022, there was a 7.58% year-on-year increase in the total assets of the other Islamic Financial Institution. These assets amounted to THB 36,143 million, representing 28.06% of the overall Islamic financial assets. This segment received support from various entities, including an Islamic Bank Asset Management, an Islamic cooperative, and Amanah Islamic leasing. These entities contributed 54.49%, 33.75%, and 11.76% respectively to the total assets of the other Islamic financial assets.

The Islamic Bank Asset Management Company Limited

On September 27, 2016, the Cabinet passed a resolution to establish the Islamic Bank Asset Management Company Limited (IAM). The primary objective of IAM is to be responsible for accepting non-performing loans and collaterals transferred by the Islamic Bank of Thailand for the purpose of managing, distributing, negotiating, improving, restructuring, collecting debts, and pursuing legal proceedings in accordance with the law. IAM was officially incorporated as a legal entity in accordance with the provisions of the Civil and Commercial Code, operating as a limited company since 29 September 2016. Initially, the company had a registered capital of 25 million Baht, which was subsequently increased to 500 million Baht on 30 August 2018. Currently, the state enterprise known as IAM is acknowledged, with all of its shares being held by the Ministry of Finance (Islamic Bank Asset Management, 2021: 8).
The total assets of Islamic Bank Asset Management have exhibited a consistent decline from 2018 to 2022, with values of THB 24,550 million, THB 22,086 million, THB 20,676 million, THB 20,317 million, and THB 19,694 million, respectively. This downward trend in assets can be attributed to the inherent nature of the institution’s business, which involves the management of non-performing financing, the sale of collaterals and non-performing assets. Consequently, the assets have experienced a year-on-year decrease of 3.07% in 2022.

The legislation pertaining to the field of Identity and Access Management is the Emergency Decree on Asset Management Company 1998. The registration was conducted under the Emergency Decree to facilitate the acquisition or transfer of assets, as well as the provision of asset management services related to non-performing assets. This registration is in accordance with section 4/1 of the aforementioned law.

The Islamic Cooperative

The inaugural Islamic cooperative in Thailand was officially incorporated in accordance with the Cooperatives Act 1968 on October 30, 1987, operating under the designation of the Pattani Islamic Savings Cooperative. Islamic cooperatives have proliferated across the country, with a significant concentration in the southern, central, and northern regions. such as Ibnu Affan Islamic cooperative and Fatoni university cooperative in Pattani, Ibn Auf Islamic cooperative and al Amin Setun cooperative in Setun, Al-Islamiah Islamiah cooperative and Husni Islamic cooperative in Phuket. As-siddiq Islamic cooperative, al Huda service cooperative and al Aman Islamic cooperative in Songkla. Saqaffah Islamic cooperative, al Tanmiah Islamic cooperative, Nurul Islam Islamic cooperative and al Barakah Islamic cooperative in Krabi, Bina Islamic cooperative and Shahabah Islamic cooperative in Yala, al Ameen Islamic cooperative in Nakonsritammarat, al Fajr Islamic cooperative in Trang, Barakah service cooperative in Pannga, Sachtichon Islamic Cooperative and Sathachon Islamic Cooperative in Bangkok as Capital of country and Muslim Chaingmai Cooperative in Chaingmai north of Thailand. (Interview with Director of Thailand Islamic Cooperative Network, Manager of The Federation Islamic Cooperative of Thailand)

The aggregate assets of Islamic cooperatives experienced a significant increase from 2018 to 2022, with values of THB 6,230 million, THB 6,856 million, THB 9,124 million, THB 9,499 million, and THB 12,198 million, respectively. Furthermore, there was a year-on-year growth rate of 28.41% in 2022.

The Federation of Islamic Cooperatives in Thailand has established a Shariah Committee at the federation level, while certain Islamic cooperatives have also formed their own Shariah committees. The operations have to comply to latest amended Cooperative Act (No.3) 2019. Under the Act, they are regulated by Cooperation Promotion Department and audited by Cooperative Auditing Department, Ministry of Agriculture and Cooperatives which will support the cooperative in operation, good governance, accounting system, increase the capacity of business management and the efficiency of their operation. Nevertheless, within the realm of law and regulation, Islamic cooperatives are not officially acknowledged as a distinct category of cooperatives, and there is no obligatory mandate for the establishment of a Shariah Committee to oversee their operations. (Interview with the Director of the Islamic Cooperative Research and Development of Thailand)

Islamic Leasing

Amanah Leasing Public Company initially operated as a business unit under the umbrella of Nava Finance and Securities Public Company Limited, with a focus on providing financial services. The company is involved in the provision of loans for hire purchase and personal loans, specifically through the use of automobile titles as collateral. Additionally, the company offers loan services for the purpose of inventory acquisition. The comprehensive integration of diverse automobile service businesses within a complete operational cycle. In the latter part of 2010, the company proceeded to
allocate 200 million baht worth of capital increase shares to the Islamic Bank of Thailand. Furthermore, the financial institution has initiated a tender offer to acquire an additional sum of 265.5 million Thai baht. The Islamic Bank acquired a 49% stake in the company, resulting in a significant portion of the total shares sold. Consequently, the company underwent a name change to Amanah Leasing PCL and adopted the abbreviated form "AMANAH" for securities trading purposes. In the year 2022, the company's credit portfolio is observed to be experiencing ongoing growth and expansion. The primary area of focus for the company pertains to the used car loan market and personal loans that necessitate the utilisation of the automobile title as collateral, commonly referred to as Auto Finance. Presently, the company's loan portfolio consists of approximately 86% used car loans, 13% auto finance loans, and 1% other types of loans. Furthermore, the company has conducted its operations in alignment with Shariah principles and ethical standards. This adherence to business policy is in accordance with the Islamic Bank of Thailand, which holds a significant stake in the company. (Amanah Leasing, 2023: 2-3)

The aggregate assets of the Islamic leasing stable experienced a gradual increase from 2018 to 2022, with values of THB 3,103 million, THB 3,538 million, THB 3,765 million, and THB 4,251 million, respectively. Furthermore, in 2022, there was a year-on-year growth rate of 12.27%.

**Islamic Insurance**

The Islamic insurance segment constitutes the third significant portion of Islamic financial assets during the period spanning from 2018 to 2022. Takaful is a form of insurance characterised by a cooperative structure, wherein individuals who are exposed to similar risks or potential losses voluntarily pool their financial resources to provide compensation for fellow members who experience such losses (INCEIF 2012: 58).

The inaugural Takaful operation was established in Thailand in 2005 by Finansa Life Assurance public company, subsequently acquired by Philip Life Assurance public company in 2015. This venture introduced the provision of family Takaful products. On the contrary, in 2007, Dhipaya Insurance public company became the pioneering insurance company to introduce a general or non-life Takaful product. At present, several insurance companies provide Takaful products through Takaful operations. These include Muang Thai Life Assurance public company, which began offering Takaful products in 2008, Thai Life Insurance public company, which entered the market in 2012, and Dhipaya Life Assurance public company, which introduced Family Takaful products in 2013. In the years 2009, 2012, 2014, and 2023, Muang Thai Insurance, Southeast Insurance, Krungthai Panich Insurance, and Wiriyah Insurance public company respectively introduced general takaful services. (Interview with the Director of the Dhipaya Takaful Division)

In essence, the functioning of Takaful services within the framework of the Life Insurance Act 1992, non-life insurance Act 1992, Insurance Commission Act 1997, the registration order pertaining to Takaful products issued by the office of insurance commission pose challenges in practical. Furthermore, these acts do not incorporate adequate provisions for Shari’ah governance in the operations.
Figure 4: Illustrates the aggregate value of assets held by Takaful entities in Thailand.

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Assets of Takaful (THB Million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td>8,037</td>
</tr>
<tr>
<td>2019</td>
<td>9,053</td>
</tr>
<tr>
<td>2020</td>
<td>9,597</td>
</tr>
<tr>
<td>2021</td>
<td>10,346</td>
</tr>
<tr>
<td>2022</td>
<td>10,427</td>
</tr>
</tbody>
</table>

Source: Office of insurance Commission Annual Report 2018-2022, Interview with Director of Dhipaya Takaful Division.

In the year 2022, there was a year-on-year increase of 0.78% in the total assets of takaful. These assets amounted to THB 10,427 million, representing 8.09% of the overall Islamic financial assets. The total assets of Takaful exhibited a consistent increase from 2018 to 2022, with values of THB 8,037 million, THB 9,053 million, THB 9,597 million, THB 10,346 million, and THB 10,427 million recorded for each respective year.

The Islamic Capital Markets

The Islamic capital markets constitute a substantial element within the broader financial system. They play a crucial role in fostering economic growth by facilitating the mobilisation of funds and serving as an effective conduit for channelling these savings towards the financing of long-term projects for both governmental and private sector entities. Additionally, they offer essential liquidity to participants in the market by means of an efficiently operating secondary market (ISRA 2015: 4).

Equity Shares in Islamic Finance

The principal instruments in the Islamic equity market consist of shares, which represent ownership rights in companies. A share is a form of ownership in a company’s capital that is not divided. The investment in shares grants investors partial ownership of a company, allowing them to potentially earn profits based on the company's future performance, provided that the shares are involved in activities that align with Shari’ah principles (ISRA 2015: 16).

In Thailand, the recognition of Shari’ah-compliant status for listed companies is not overseen by a dedicated governmental entity. Rather, this responsibility is delegated to the FTSE Shari’ah Index. The FTSE SET Shariah Index has been specifically developed to serve as the underlying benchmark for investment products that adhere to Shari’ah principles, with a particular emphasis on companies listed on the Stock Exchange of Thailand (SET) that are deemed to be compliant with Shari’ah standards. Yasaar Ltd, an organisation with a global network of expert Shari’ah scholars, conducts independent screening. The emergence of Shariah-based equity shares can be traced back to the introduction of the FTSE index on April 23, 2009. This development was made possible through a collaboration between the Stock Exchange of Thailand (SET), FTSE Group, and Yasaar, a prominent
global Shariah consultancy firm. The index in question encompasses the components of the FTSE SET All-Share Index that adhere to Shariah principles as determined by the Yasaar screening methodology. According to the Yasaar screening methodology which is reviewed semi-annually in June and December, Companies engaging in restricted business activities, for instance, conventional Binance, alcohol, pork-related products or non-Halal food production, entertainment, tobacco and weapons manufacturing, shall be first filtered out through a screening process. After companies have been screened by their business sector activity, the remaining companies are further examined on their financial ratios to ensure that those companies are Shariah compliant. Only those companies that pass financial ratios will be considered Shariah compliant. These financial ratios include debt as well as cash and interest-bearing items must be individually less than 33.33% of total assets. Accounts receivable and cash must be less than 50% of total assets and total interest and non-compliant activities income should not exceed 5% of total revenue (FTSE Russell 2023: 3).

Table 2: Presents the breakdown of the ICB supersectors.

<table>
<thead>
<tr>
<th>ICB Code</th>
<th>ICB Super sector</th>
<th>FTSE SET Shariah</th>
<th>FTSE SET All-Share</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No. of Cons Net M Cap (THBm) Wgt %</td>
<td>No. of Cons Net M Cap (THBm) Wgt %</td>
<td></td>
</tr>
<tr>
<td>1010</td>
<td>Technology</td>
<td>8 328,012 9.43</td>
<td>10 335,248 4.25</td>
</tr>
<tr>
<td>1510</td>
<td>Telecommunications</td>
<td>10 324,359 9.32</td>
<td>14 474,526 6.40</td>
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<tr>
<td>2010</td>
<td>Health Care</td>
<td>11 375,416 10.79</td>
<td>14 582,313 7.85</td>
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<tr>
<td>3010</td>
<td>Banks</td>
<td>- - 1,165,295 15.72</td>
<td>8 1,165,295 15.72</td>
</tr>
<tr>
<td>3020</td>
<td>Financial Services</td>
<td>1 991 0.03</td>
<td>22 266,337 3.59</td>
</tr>
<tr>
<td>3030</td>
<td>Insurance</td>
<td>- - 74,052 1.00</td>
<td>6 74,052 1.00</td>
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<tr>
<td>3510</td>
<td>Real Estate</td>
<td>11 337,043 9.69</td>
<td>34 563,294 7.60</td>
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<tr>
<td>4010</td>
<td>Automobiles and Parts</td>
<td>5 22,093 0.64</td>
<td>6 25,445 0.34</td>
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<td>4020</td>
<td>Consumer Products and Services</td>
<td>4 43,351 1.25</td>
<td>9 58,660 0.79</td>
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<td>4030</td>
<td>Media</td>
<td>2 4,424 0.13</td>
<td>11 60,283 0.81</td>
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<td>4040</td>
<td>Retailers</td>
<td>8 132,269 3.80</td>
<td>13 347,773 4.69</td>
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<td>4050</td>
<td>Travel and Leisure</td>
<td>2 29,478 0.85</td>
<td>11 209,685 2.83</td>
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<tr>
<td>4510</td>
<td>Food Beverage and Tobacco</td>
<td>16 123,788 3.56</td>
<td>34 335,995 4.53</td>
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<tr>
<td>4520</td>
<td>Personal Care Drug and Grocery Stores</td>
<td>2 9,132 0.26</td>
<td>4 369,730 4.99</td>
</tr>
<tr>
<td>5010</td>
<td>Construction and Materials</td>
<td>13 53,363 1.53</td>
<td>21 103,393 1.39</td>
</tr>
<tr>
<td>5020</td>
<td>Industrial Goods and Services</td>
<td>26 643,453 18.50</td>
<td>38 851,883 11.49</td>
</tr>
<tr>
<td>5510</td>
<td>Basis Resources</td>
<td>5 10,523 0.30</td>
<td>7 12,780 0.17</td>
</tr>
<tr>
<td>5520</td>
<td>Chemicals</td>
<td>2 13,951 0.40</td>
<td>4 130,270 1.76</td>
</tr>
<tr>
<td>6010</td>
<td>Energy</td>
<td>16 983,396 28.27</td>
<td>18 996,705 13.44</td>
</tr>
<tr>
<td>6510</td>
<td>Utilities</td>
<td>8 43,577 1.25</td>
<td>26 451,145 6.08</td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td></td>
<td><strong>150 3,478,619 100</strong></td>
<td><strong>310 7,414,812 100</strong></td>
</tr>
</tbody>
</table>

Source: FTSE Russell 2023:3

The size and quantity of Shariah-based equity funds have experienced significant growth within the last decade. At present, the index consists of 150 companies, which accounts for approximately 48.4% of the total number of 310 companies. The index comprises various sectors, including industrial goods and services, food and beverage, energy, health care, construction and materials, and real estate, which exhibit a significant number of constituents. However, it is worth noting that financial services are not represented in the index.
The Islamic Fund

From 2018 to 2022, the Islamic capital market segment, specifically the Islamic fund sector, constituted the fourth and smallest portion of Islamic financial assets. Islamic funds, which operate within the framework of Shari'ah-compliant principles, are responsible for the professional management and investment of funds on behalf of both institutional and retail investors. These funds are subject to regulatory oversight and typically aggregate funds from the general public to invest in a diversified portfolio of securities (ISRA 2015: 17).

The precise definition of Islamic funds or Islamic Unit Trust is not explicitly provided in the Securities and Exchange Act of 1992. The Act solely provides a definition for the term "Mutual Fund Management," which refers to the administration of investments within a mutual fund initiative. This involves the issuance of investment units for sale to the general public, with the resulting proceeds being utilised to invest in securities, derivatives, other properties, or to generate profit through holding such assets. Additionally, alternative methods of investment or profit procurement may also be employed.

The year 2004 witnessed the establishment and registration of the inaugural Islamic fund, known as the MFC Islamic Fund (MIF-G), by MFC Asset Management PCL. This event took place under the supervision of The Securities and Exchange Commission (SEC) of Thailand.

Figure 5: illustrates the aggregate value of assets held by Islamic funds in Thailand

![Total Assets of Islamic Fund](chart.png)


In the year 2022, there was a significant increase of 44.93% in the total assets of Islamic funds. These funds reached a size of THB 2,145 million, representing 1.67% of the overall Islamic financial assets. The total assets of the Islamic fund experienced a moderate decline from THB 881 million in 2018 to THB 747 million in 2019. However, they subsequently exhibited a significant increase, reaching THB 988 million in 2020, THB 1,480 million in 2021, and THB 2,145 million in 2022.

The issuance of guidelines by the Securities and Exchange Commission (SEC) of Thailand on August 9, 2023, pertains to the provision of support for the establishment, management, and disclosure of information pertaining to Islamic mutual funds. The objective is to establish standards that align with international norms and foster investor trust in Islamic mutual funds. This entails the augmentation of investment options and the broadening of the Muslim investor demographic. The effective date of this policy change is September 1, 2023. The implementation of the new regulations
for pre-existing funds necessitates compliance within a period of 180 days subsequent to the announcement's effective date (The Securities and Exchange Commission 2023: 1).

Presently, there exist six Islamic funds, namely the MFC Islamic funds, which include the MFC Islamic fund, MFC Islamic Long Term Equity Fund and MFC Global Sukuk Fund managed by MFC Asset Management PCL. Additionally, there are the Krung Thai Shariah Long Term Equity Fund (KSLTF) and Krung Thai Shariah Retirement Mutual Fund offered by Krung Thai Asset Management PCL. Lastly, the One Shariah Long Term Equity Fund managed by ONE Asset Management LTD, which has recently been acquired by DAOL Investment and Securities Thailand (Interview with the Director of Islamic DAOL Investment and Securities).

Sukuk

Sukuk are financial instruments within the Islamic capital market that cater to the requirements of entities seeking funds, including governments and corporations, who are in search of substantial financing that adheres to Shariah principles. Similarly, Islamic banks, Takaful companies, and other institutions that offer Islamic financial services are provided with a suitable Shari’ah-compliant instrument to invest surplus funds in longer-term transactions (ISRA 2017: 5).

According to Thai regulations, sukuk refers to a financial instrument that possesses the following characteristics: (i) it is a trust certificate issued by an asset trustee; (ii) it establishes the structure of a trust transaction with the aim of utilising funds obtained from the issuance of a financial instrument in a manner that aligns with Islamic principles, and; (iii) it clearly outlines in advance the conditions for repayment of the invested capital and the rate or proportion of benefits that the trust property is entitled to receive from the originator for the benefit of the financial instrument holders. Additionally, there must be a provision for the reimbursement of the invested capital and the rate or proportion of benefits that the trust property must pay to the financial instrument holders. The adherence to Islamic principles is required in determining the rate and proportion of benefit payments, as stated in the Securities and Exchange Commission's announcement on regulation to act as a trustee in sukuk transactions (Notification 18/2553: S1(1)).

The pertinent legislations concerning Sukuk in Thailand encompass the securities and capital market act 2007 as well as the Trust for Transactions in Capital Market Act 2007, which notably introduced the notion of trust into the Thai civil law framework. This legislation enables the establishment of asset trustees for the purpose of holding assets in trust and issuing Sukuk. It is based on the Decree issued in accordance with the revenue code, which includes the reduction of rates and the exclusion of Income Tax (No.554)2010. Additionally, it incorporates the provisions outlined in the Notification of the Capital Market Supervisory Board No.2/2554, which pertains to the issuance and sale of sukuk and the disclosure of information (Notification 2/2554). Furthermore, the Office of the Securities and Exchange Commission has issued the Notification of the Office of the Securities and Exchange Commission No 6/2554, which includes additional provisions regarding the issuance and offer for sale of sukuk (Notification 6/2554), along with relevant regulations and announcements. To yet, no sukuk has been issued.

Challenges and Recommendations

Islamic finance has experienced substantial growth and expansion across various sectors in Thailand. This progress has presented numerous challenges and recommendations that industry participants, regulatory authorities, and other stakeholders are currently endeavouring to analyse and ascertain.
The expansion of Islamic Finance in Thailand is encountering several challenges:

1. The challenge of establishing a comprehensive legal, regulatory, and rule framework is a crucial obstacle that must be effectively addressed to create a conducive environment for the growth and advancement of Islamic finance in Thailand. At present, there exists an inadequate legal, regulatory, and governance framework to effectively support the Islamic finance industry as a whole, particularly in relation to Islamic cooperatives and Islamic insurance. These sectors lack specific and distinct laws and regulatory bodies to oversee and regulate their operations. Islamic cooperatives are currently monitored and supervised under the Cooperatives Act, while Islamic insurance is monitored and supervised under the Life Insurance and General Insurance Acts. On the contrary, it is necessary to revise the existing legislation and regulations pertaining to the imposition of double stamp duty land tax on the acquisition of property by Islamic banks from sellers, as well as the subsequent resale of said property to customers through the diverse range of Islamic finance methods employed for home purchases. This amendment is crucial to eliminate the burden of dual taxation.

2. In Thailand, the absence of a Central Shariah Advisory Council or Authority for Islamic finance has resulted in a lack of standardisation in the implementation of Islamic banking, other Islamic finance institutions, the Islamic capital market, and the Islamic insurance segment. Additionally, the unavailability of Shari'ah standards further exacerbates the issue of non-standardized practices in the field of Islamic finance.

3. There is currently no existing law or regulation pertaining to the requirement and appointment of Shari'ah Advisors or Committees for other Islamic financial institutions and the Takaful segment at the institutional level. However, it is worth noting that in the Takaful segment, it is common practice to appoint a Shariah committee for the operation of Takaful at the institutional level. In contrast, it is worth noting that not all Islamic cooperatives establish a Shari'ah committee at the institutional level; rather, they solely appoint such a committee at the Federation level. One notable feature of Islamic finance is the establishment of a Shari'ah advisory or supervisory board, which serves the purpose of ensuring adherence to Islamic principles and providing guidance to Islamic Financial Institutions.

4. There is a dearth of adequately skilled human resources who possess a comprehensive comprehension of Shari'ah-based financial services. Additionally, there is a scarcity of highly qualified human resources equipped with the necessary education and professional skills to effectively provide services that meet consumer expectations. Consequently, this shortage contributes to a deficiency in the development of innovative financial products.

5. There exists a limited level of comprehension, expertise, and consciousness regarding the public acceptance and consumer awareness of Islamic finance.

6. The insufficiency of shariah-compliant securities poses a significant challenge to the effective management of liquidity in Islamic finance. This is due to the crucial role played by a dynamic money market in the liquidity management of Islamic financial institutions, which relies on the availability of short-term tradable financial instruments. The availability of Shari'ah-compliant financial instruments is constrained. (Interview with Director of Islamic DAOL Investment and Securities, Director of Dhipaya Takaful Division, Director of Thailand Islamic Cooperative Network, Director of Islamic Cooperative Research and Development of Thailand,
Manager of The Federation Islamic Cooperative of Thailand, Director of As-Siddiq Islamic Cooperative, Head of Shari'ah Committee of Islamic Bank of Thailand).

Recommendations

The evolution of contemporary Islamic finance has consistently exhibited a strong correlation with notable events or trends within the socio-political and economic landscape of the respective eras. Once the credibility of Islamic finance is established and there is an enhanced level of understanding among regulators and industry participants, Islamic finance will be better positioned to capitalise on the trends of globalisation and liberalisation. Islamic finance can be effectively utilised to facilitate transactions in accordance with Shari’ah principles, ensuring a smooth process for consumers, customers, investors, and other stakeholders (Mohd Daud & Engku Rabiah Adawiah 2012: 108), there has been a development of diverse supporting infrastructure and Shari’ah compliant platforms to effectively and efficiently meet the operational requirements of Islamic financial institutions while adhering to Shariah principles (ISRA 2016: 188), it is suggested that to address the fundamental obstacles encountered by the Islamic finance sector in Thailand, the following measures should be taken:

1. To establish legislative and regulatory frameworks for Islamic cooperatives, it is proposed to amend the Cooperatives Act 1999 by including Islamic cooperatives as the eighth category of cooperatives within the act. Alternatively, the issuance of a Ministerial order could be considered to address this matter. Alternatively, it is proposed to establish a distinct legislative act specifically tailored to govern Islamic cooperatives.

2. This initiative aims to facilitate the registration, regulation, and oversight of entities involved in the licencing and supervision of Islamic Takaful operations. An example of such efforts includes the amendment of the Life Insurance Act B.E. In order to promote consistency in takaful business practises, improve operational efficiency, protect the interests of takaful participants, and establish sustainable takaful funds, it is suggested that the non-life insurance Act 1992 be amended to include provisions for Islamic insurance. Alternatively, the Office of Insurance Commission could issue guidelines on Takaful Regulation and Governance, it is necessary to either establish a separate act for Islamic insurance, known as the Takaful act, or refer to existing legislation. This is because the successful growth of Islamic finance relies on the presence of Takaful companies, which provide protection against unexpected risks for investments in Islamic finance.

3. To address the issue of non-standardized practises in the Islamic finance industry, it is proposed to establish a Central Shariah Advisory Council or Authority. This entity would be responsible for issuing Shari’ah standards and defining their operational requirements. These standards would encompass the most prevalent and applicable contracts and principles in Islamic finance. By implementing this measure, it is anticipated that the problem of non-standardization in the practise of Islamic finances.

4. To modify the existing legal, regulatory, or rule framework, it is necessary to implement the appointment of a Shari’ah committee for Islamic financial institutions and the Takaful segment.

5. Amendments to the tax statutes are necessary in order to accommodate Islamic banking services. Failure to do so may lead to a significant risk of double taxation imposed on Islamic banks due to the application of stamp duties and capital gains tax, which are currently deductible during asset transfers.
6. The enhancement and acquisition of new skills for all stakeholders involved in the field of Islamic finance are imperative.

7. There is a pressing requirement for heightened public consciousness regarding Islamic finance and the establishment of a conducive framework to facilitate the functioning of the Islamic financial system.

8. To establish a dynamic Islamic money market that effectively manages liquidity for Islamic financial institutions in accordance with the principles of Shari’ah.

References


**Personal Interviews**

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