

PROMOTING ASEAN ISLAMIC BANKING INTEGRATION: PROSPECT AND INCLUSIVE FRAMEWORK

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Abstract

The implementation of the ASEAN Banking Integration Framework (ABIF) seeks to integrate the system of banking across the ASEAN region. Given the prevalence of dual banking systems across ASEAN, Islamic banking has a substantial opportunity for regional integration, and facilitating cross-border banking activities is a vital policy measure to capitalize on this. This study seeks to improve the framework for integrating Islamic banking within ASEAN by systematically reviewing and meta-analyzing how the current ASEAN Banking Integration Framework (ABIF) has been implemented. The review findings will be synthesized with existing literature to perform a thematic analysis of the challenges and opportunities facing ASEAN Islamic banking integration. A total of 39 articles, sourced from WoS and Scopus-indexed journals, were used as the primary data for this review. In alignment with established scholarship, this study posits that the successful integration of Islamic banking within ASEAN is contingent upon the implementation of robust, harmonized regulatory frameworks and standardized practices, particularly with respect to *Sharia* compliance. Additionally, bilateral cooperation in cross-border Islamic banking can serve as a catalyst for wider Islamic banking integration in ASEAN.

Keywords

Islamic bank, banking integration, regulatory harmonization, ASEAN, ABIF

INTRODUCTION

Banking integration initiatives are essential for achieving broader financial integration in Southeast Asia. (Suryasnia et al., 2016) To foster closer economic ties, the Association of Southeast Asian Nations (ASEAN) created the ASEAN Economic Community (AEC) and, in 2014, introduced the ASEAN Banking Integration Framework (ABIF) to further integrate the region's banking sector. (Wijaya et al., 2019) ABIF provides a framework for the Qualified ASEAN Banks (QABs) to expand their operations into new markets within ASEAN, offering opportunities for increased market access and operational flexibility. (Asian Development Bank, 2015). ABIF mandates that QABs must be well-capitalized, have robust risk management systems, and comply with international best practices in corporate governance and risk management. (Bawana et al., 2024a) The QABs are required to develop innovative products that cater to the evolving needs of their customers.

Furthermore, with ASEAN at the forefront of global Islamic banking expansion, Islamic banks, leveraging their unique profit-sharing model, are poised to benefit from increased opportunities in the region. (M. S. A. Hamid, 2022) Since the regulatory frameworks for Islamic banking institutions in ASEAN are largely based on conventional banking models, the integration of Islamic banking can be more feasible and accelerated by leveraging existing banking infrastructure through the establishment of Islamic banking windows and subsidiaries, which can streamline operations and reduce costs. (Haqqi, 2017). This also facilitates Islamic banks to operate as qualified ASEAN Islamic banks within conventional banking groups. Additionally, the ability of Islamic financial institutions to maintain stability and profitability during economic downturns has led to increased investor interest in Islamic finance as a means of diversifying investment portfolios. (Malini, 2020)

However, Islamic bank integration presents significant challenges, notably the lack of harmonized *Sharia* interpretation, which can lead to *Sharia* risk within portfolios. (Shah et al., 2021) Discrepancies in national regulations concerning Islamic banking products, risk management and capital adequacy also pose significant obstacles to integration. (Haqqi, 2017) Another challenge stems from the fact that some ASEAN countries lack adequate legal frameworks for Islamic banking and finance, (Bawana, 2021) a situation further complicated by the coexistence of dual banking systems (conventional and Islamic) within the region, which hinders regulatory alignment.

Therefore, this study aims to explore the potential for integrating Islamic banking across ASEAN nations and to propose a framework to facilitate this integration. This study begins by exploring the possibilities and hurdles associated with implementing ABIF and ASEAN banking integration. The following stage entails a comprehensive analysis of the opportunities and challenges of Islamic banking integration in ASEAN, intending to develop a recommended framework grounded in a thematic analysis of the existing literature. To address the research objectives, three specific research questions were developed:

1. What were the principal research topics and trends of ABIF and ASEAN Islamic banking identified in the extant literature?
2. What are the benefits and challenges of implementing the ABIF?
3. What are the future possibilities for integrating Islamic banks in ASEAN?

The study is organized as follows: Section two offers a thorough review of existing research on the ABIF, general banking integration, and Islamic banking integration. Section three outlines the research methods used in this study. Section four presents the study's findings and analysis. Section five concludes the study, noting its limitations and offering recommendations for future research.

LITERATURE REVIEW

Theory of Banking Integration

The integration of banking systems is a consequence of the broader process of financial integration. (Fecht et al., 2015; Karim et al., 2024) Political and economic factors, such as government policies, regional cooperation, and global economic trends influence banking integration. (Carroll et al., 2020) Banking integration refers to the process of increasing interconnectedness between different banking systems. (Arribas et al., 2020) This can involve various aspects, such as cross-border banking activities, regulation harmonization, and the development of common standards. (Remolona & Shim, 2015)

The increasing interconnectedness of global economies, driven by factors such as trade liberalization and capital flows, has led to a surge in demand for cross-border financial services, thereby accelerating banking integration. (Wijaya et al., 2019) The advent of digital technologies, such as artificial intelligence and blockchain, has revolutionized financial industry by reducing transaction costs, enhancing efficiency, and contributing to enabling seamless cross-border financial transactions. (Rusydia & Assalafiyah, 2021)

Integrating Islamic banking systems within a broader regional or global framework can unlock significant potential benefits. (Malini, 2020) Islamic banking can contribute to economic growth by providing Shariah-compliant financing for various sectors. Its risk-sharing principles can enhance financial stability by mitigating systemic risks. (Suripto & Supriyanto, 2021) The increasing global Muslim population and the growing interest in ethical finance have created a global need for Islamic financial services and products. The integration of Islamic banking may be achieved by strengthening cooperation among ASEAN member states to harmonize regulatory frameworks and promote cross-border banking activities, and collaborating with other Islamic finance hubs, such as the Gulf Cooperation Council (GCC) countries, to share knowledge as well as best practices. (Wijayati & Suyunus, 2019)

The ASEAN Banking Integration Framework (ABIF) and Regulatory Adaptation

ASEAN central bank governors approved a framework to integrate banking across the region. This framework aims to standardize regulations in five key areas: financial reporting and transparency, capital

adequacy, bank failure resolution, limits on large exposures, anti-money laundering, and consumer protection. ABIF should prioritize the removal of regulatory and operational barriers through bilateral agreements to enable seamless cross-border banking activities among ASEAN member states. (Handayani & Abubakar, 2018a)

The ABIF represents a shared understanding among member nations, outlining agreed-upon principles and objectives for banking integration. According to (Wijaya et al., 2019), the ABIF aims to achieve three primary objectives: first, to remove obstacles preventing foreign financial institutions from entering ASEAN markets; second, to ensure fair treatment of these foreign institutions by eliminating discriminatory practices; and third, to harmonize banking regulations across the region. While the ASEAN Banking Integration Framework establishes the overall objectives, each member nation is responsible for determining how to achieve them. The sole mandatory requirement is that every country must allow at least one foreign bank to operate within its borders by 2018.

Furthermore, the ABIF may facilitate the resolution of distinct regulatory challenges pertaining to Islamic banking, notably *Sharia* compliance, still through the reinforcement of bilateral agreements. As examples, pursuant to a bilateral agreement between Malaysia and Indonesia, CIMB and Maybank, two prominent Malaysian banking institutions, have extended their Islamic banking presence into Indonesia, establishing CIMB Niaga Syariah and Maybank Syariah, respectively, through the acquisition of Indonesian local banks. (Bawana et al., 2024b) In order to optimize operational procedures and achieve regulatory harmonization, these banks employ an Islamic window structure. CIMB, as an illustration, utilizes this strategic model to facilitate product diversification from its conventional parent and ensure adherence to *Sharia* compliance, in accordance with the legal opinion (*fatwas*) issued by Indonesian National Sharia Council (*Dewan Syariah Nasional/DSN*). (Ghalba & Wandebori, 2013)

RESEARCH METHODOLOGY

Employing qualitative approaches, this study conducts a two-phase analysis of the body of extant literature. The initial phase involves a systematic review of the literature to address research questions one and two, while the second stage will employ thematic analysis to address research question three. The findings from the systematic literature review will be analyzed thematically, supplemented by additional references, to develop a framework for the prospects of Islamic banking integration in ASEAN.

The Preferred Reporting Items for Systematic Reviews and Meta-Analysis (PRISMA) framework is addressed ensuring the rigor and transparency of the systematic literature review (SLR) process. This framework provides a meticulous methodology for conducting systematic literature reviews, including identifying eligible studies, assessing their quality, and extracting relevant data. (Joseph et al., 2023) The PRISMA framework also offers a systematic approach for formulating research questions, searching for relevant literature, and critically appraising the quality of included studies. (Ishak & Jiun, 2021) Further, this study adhered to the PRISMA guidelines, ensuring a transparent and reproducible systematic

literature review process.

The first stage of the systematic literature review involved identifying relevant databases and search terms to locate potential studies. The databases of the Web of Science (WoS) and Scopus were searched extensively for relevant literature, covering peer-reviewed articles published between 2015 and 2024. Expanding the search parameters, including additional keywords and relaxing inclusion criteria, can increase the number of relevant studies identified. To identify relevant studies, the keywords "ASEAN Banking Integration Framework" and "ASEAN Islamic banking" were used to search the topic field in WoS and the title, abstract, and keyword fields in Scopus. The database searches yielded 41 articles from WoS and 42 from Scopus. Table 1 shows previous sources of studies based on Scopus subject areas and WoS categories.

Table 1 Number of Sources by Database

Database	Count	Database	Count
Web of Science Categories		Scopus Subject Areas	
Economics	11	Business, Management and Accounting	14
Environmental Studies	2	Economics, Econometrics and Finance	12
International Relations	2	Social Sciences	16
Political Science	2		
Business	8		
Business Finance	7		
Law	2		
Multidisciplinary Sciences	1		
Management	5		
Religion	1		
Total	41	Total	42

Source: Compilation by Authors

The identification and removal of duplicate studies were essential to ensure the rigor of the review process. A total of 24 duplicate sources from WoS and Scopus databases were identified, 6 records were excluded as they did not meet the “open access” criterion, and 14 records were removed as they were not relevant to the topic of study.

The next stage involved a screening process to discover relevant studies based on predetermined inclusion and exclusion criteria. After a rigorous screening process, 44 of the 83 initial records identified from WoS and Scopus were excluded due to irrelevance or lack of accessibility, leaving 39 articles eligible for further analysis. Of the 39 records, 2 were proceedings articles. There were 5 proceeding articles previously, however, 2 of these articles were excluded due to inaccessibility, and another was deemed irrelevant to the study focus.

The final stage entails the meticulous selection of eligible studies based on predefined criteria. (Ayob et al., 2022) The article selection process was conducted in three stages. The first step involved reviewing

the titles and abstracts of the identified sources. Next, selection criteria based on the research questions were applied, and the relevant data were compiled. Studies with inaccessible full texts were excluded from the review. Finally, the selected studies were consolidated and evaluated for their relevance and suitability. These studies will be referenced in the following sections to support the analysis and discussion of the research findings. Figure 1 provides a visual representation of the selection process.

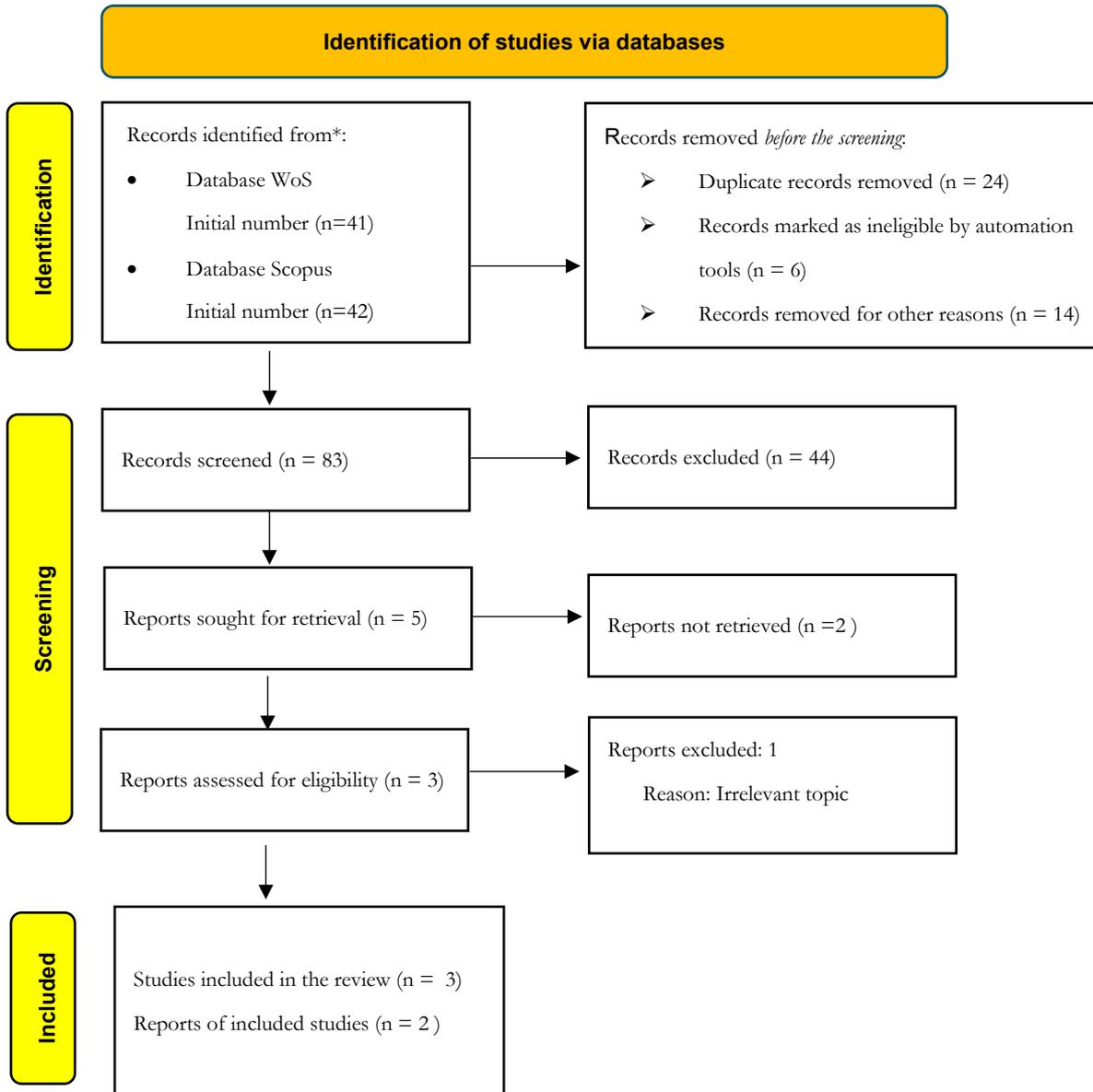


Figure 1: Reporting items for SLR

Sources: adapted from the PRISMA framework

To address the third research question on future possibilities for ASEAN Islamic bank integration, a systematic literature review (SLR) and supplementary articles were analyzed using keyword coding assisting ASEAN Islamic bank integration to identify supporting factors. Subsequent to the initial analysis, thematization was carried out using established literature as a framework, by generalizing from the various

keyword codes that have been obtained.

Meanwhile, figure 2 illustrates the temporal distribution of the included studies, with 2018 being the year with the highest number of publications. The upward trend suggests a growing interest in the research topic, and it is anticipated that this trend will continue in the coming years.

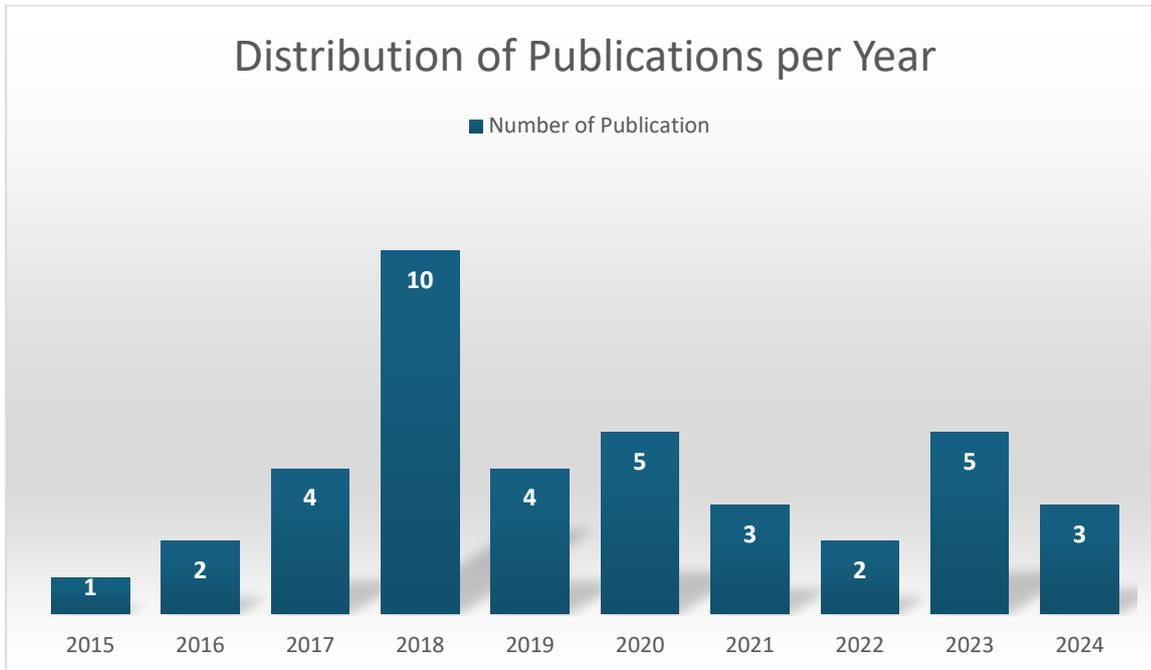


Figure 2: Distribution of Publications per Year

Sources: Compilation by Authors

RESULT AND DISCUSSION

This section presents the findings of the systematic literature review, organized thematically to address the specific research questions outlined in the introduction.

1. *The principal research topics and trends of ABIF and ASEAN Islamic banking identified in the extant literature*

This study question has been addressed using the VOS Viewer application. The primary topics discussed in the publications have been broadly summarized through an analysis of the keywords, titles, and abstracts. The generalization of discussions is listed in the following stage, which is then processed to produce a map using bibliographic data. The number of occurrences a keyword appeared was chosen to be 2.

Figure 3 examines the study's focus and trend topics from earlier research. In this section, the study findings indicate that the most frequently discussed topics about ABIF and banking integration are related to the ASEAN Economic Community (AEC), ASEAN, and earnings management. Existing research has heavily focused on Islamic banks in ASEAN. Analysis of the Figure 3 also reveals a paucity of scholarly

research about Islamic banking (including Islamic banks) within the context of the ASEAN Banking Integration Framework (ABIF) and the ASEAN Economic Community (AEC), thereby presenting a fertile ground for future academic investigation

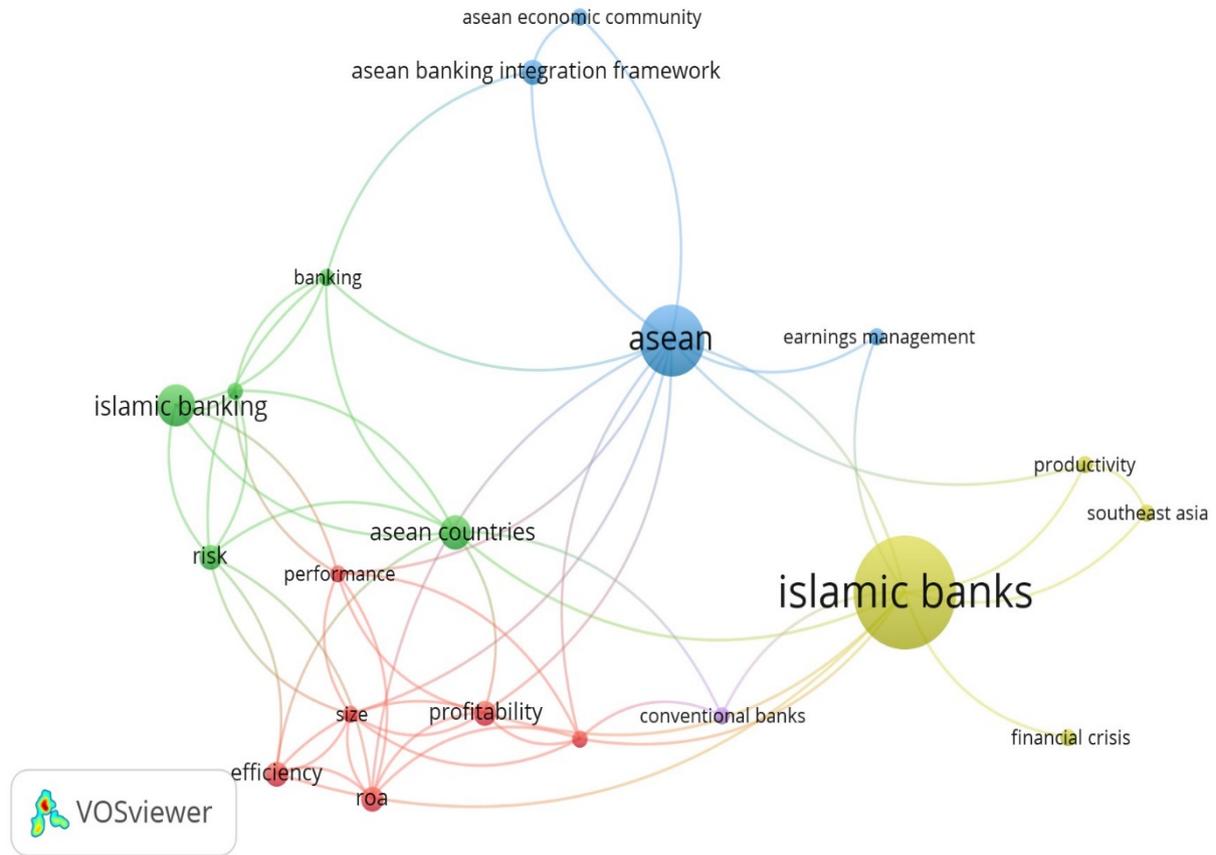


Figure 3: Prominent literatures’ topics

Sources: Data Processed by Authors

2. *The potentials and challenges of implementing the ABIF*

Table 5 summarizes the potential for ABIF and Islamic banking (IB) integration. Each article has been examined to identify some variables that may benefit. A substantial number of articles show that ABIF positively created the ASEAN potential market and that IB integration can promote the stability of regional economies from crisis.

Table 5: The Potentials of ABIF and IB Integration

No	The potential of ABIF and IB Integration	Ref
1	Compared to conventional banks, Islamic banks are less susceptible to financial crises and pandemics.	(Baidhowi, 2018; Misman & Bhatti, 2020; Nurlaily, 2022; Othman et al., 2018; Rahayu & Septiarini, 2019; Salman et al., 2024; Subramanian et al., 2017; Suropto et al., 2023)

2	The financial indicator of Islamic banks is more stable than that of conventional banks.	(F. S. Hamid & Yunus, 2020; Khan et al., 2023; Mawardi et al., 2022; Pratami et al., 2023; Suadi, 2020; Suropto, 2023; Suropto & Supriyanto, 2021; Viverita et al., 2024; Zahra et al., 2021)
3	ABIF and QABs aim to create a unified ASEAN financial market characterized by seamless cross-border banking activities	(De Jesus & Torres, 2017)
4	In the ASEAN region, the Islamic banking sector has grown significantly.	(Rani et al., 2020)
5	ASEAN member states have achieved significant progress in integrating their financial markets	(Mensah & Premaratne, 2018)

Sources: SLR Result by Authors

Table 6: The Challenges of ABIF and IB Integration

No	The challenges of ABIF and IB Integration	Ref
1	Most large local banks prioritize domestic growth over regional expansion	(Karim et al., 2024),
2	Banks with higher levels of capital are less likely to underperform compared to those with lower levels of capital	(Prasetyo et al., 2019)
3	National regulatory sovereignty may limit the extent of regional integration and financial stability	(Chan et al., 2018)
4	ASEAN banking markets are diverse, and each nation may respond differently to increased competition and liberalization	(Ventouri, 2018)
5	The ASEAN IB systems are relatively low efficiency	(Liem, 2019; Siswanti & Sukoharsono, 2019; Sufian & Kamarudin, 2015; Wanke et al., 2016, 2017; Wijayati & Suyunus, 2019)

Sources: SLR Result by Authors

However, Table 6 provides some challenges in the adoption of ABIF and IB integration. They include concerns about the level of efficiency and capital, barriers from national regulators, and the willingness of local banks to compete regionally.

3. The future possibilities for integrating Islamic banks in ASEAN

Based on the literature review, to direct the creation of an all-encompassing framework for the integration of Islamic banking in ASEAN, four main elements were identified. Table 7 summarizes the key themes identified through the thematic analysis, which have been used to develop the proposed AIBIF framework to address the challenges and opportunities of Islamic banking integration in ASEAN. Four key themes, including bilateral Islamic banking agreement enhancement, Islamic banking regulatory harmonization, Islamic product and service development, and consumer protection, should be prioritized by policymakers to support Islamic banking integration in ASEAN.

The diverse levels of economic development, regulatory frameworks, and financial market infrastructure among ASEAN member states pose challenges to the harmonization of banking standards

and the facilitation of cross-border banking activities. Bilateral agreements can serve as a mechanism for harmonizing regulatory frameworks and Shariah standards, thereby facilitating integration, and it also can streamline cross-border banking activities by reducing the number of regulatory authorities involved, better than multi-country agreements. Recently, some prominent ASEAN member states, including Malaysia-Indonesia, Malaysia-Thailand, and Indonesia-Singapore, have been assigned bilateral Islamic banking cross-border agreements.

The harmonization of Shariah standards, accounting principles, and prudential regulations across different jurisdictions is crucial for facilitating cross-border Islamic banking activities and promoting the integration of Islamic banking markets. The Islamic Financial Services Board (IFSB) and the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) are key players fostering the integration and standardization of Islamic banking practices globally. Collaborating with AAOIFI and IFSB can accelerate the process of harmonizing Shariah standards, leading to greater consistency and transparency in Islamic financial practices across different jurisdictions.

Islamic financial institutions need to focus on creating new and *Sharia*-compliant products and services to stay competitive and satisfy changing customer demands. Effective collaboration among Shariah supervisory boards, central banks, and other relevant authorities is essential to achieve this goal. While conventional banking products continue to dominate the market, there is a growing need for Islamic financial institutions to develop innovative *Sharia*-compliant products that can effectively compete with and complement conventional offerings.

To enhance their competitiveness and participate in cross-border banking activities, Islamic banks must fulfill the stringent criteria to qualify as Qualified ASEAN Banks (QABs), which includes strong capital adequacy, robust risk management practices, and adherence to international standards. Strategic mergers and acquisitions between Islamic banks can help to consolidate market share, enhance operational efficiency, and promote the development of a more integrated Islamic banking ecosystem

Table 7: The Recommendation of ASEAN Islamic Banking Integration Framework

Contents	Themes	Framework
ABIF should aim to facilitate cross-border banking relationships between ASEAN member states by removing regulatory and operational barriers through bilateral agreements (Handayani & Abubakar, 2018b)	Bilateral (Islamic) Banking Agreement Enhancement	
Adherence to standardized banking practices is essential for banks to expand their operations internationally (Karim et al., 2024)	(Islamic) Banking Regulation Harmonization	
The Sustainable Growth Rate (SGR) model provides a useful framework for evaluating the performance of bank		

integration within the ASEAN region (Isnurhadi et al., 2022)		ASEAN Islamic Banking Integration Framework
Tailored Islamic regulatory frameworks (risk-sharing, transparency, and ethical behavior) are essential for Islamic banking (Chaudhry et al., 2024)		
Islamic banks should prioritize the development of Shariah-compliant products that align with customers' religious beliefs and values, while also considering their evolving needs and preferences (Abror et al., 2019)	Islamic Product and Service Innovation Orientation	
Governments and regulatory bodies need to create policies that foster the growth of Islamic finance (Hosen & Muhari, 2018)		
The development of innovative financial products and services , powered by advanced technologies, is essential for the future of banking (Rusydiana & As-Salafiyah, 2021)		
Islamic banks face challenges in meeting QAB criteria, including product innovation (Harrieti, 2018)		
Mergers can help Islamic banks expand their market share and increase revenue (Ahdizia et al., 2018)	Qualified ASEAN (Islamic) Banks (QAIBs)	
Mergers and acquisitions can provide Islamic banks with opportunities to achieve economies of scale (Hosen & Muhari, 2018)		
Mergers and acquisitions can be employed as strategic tools to enhance the growth and profitability of banks (Suryasnia et al., 2016)		

Source: Thematic Analysis by Authors

Despite its potential, the framework's implementation faces significant challenges. Firstly, there is a shortage of qualified Islamic banking and finance professionals, particularly in Sharia compliance, risk management, and product development. Secondly, technological disparities among ASEAN countries can create operational bottlenecks. Finally, differences in the level of development of Islamic finance markets across ASEAN countries can result in uneven playing fields. These factors are crucial considerations for government and regulators in the development of practical policies to implement the framework

CONCLUSION

The integration of Islamic banking is essential because Islamic banking offers a diversified financial system, reducing reliance on conventional banking, Shariah-compliant principles can promote risk-sharing and prudent financial practices, and Islamic banking can reach underserved segments of the population, particularly those who may be excluded from traditional banking systems. Integration can expand the market for Islamic financial instruments, making it more liquid and stimulating innovation in Sharia-compliant products and services to better serve developing customer preferences.

While the potential benefits of Islamic banking integration are significant, several challenges must be solved, including harmonizing diverse regulatory frameworks that can be complex, ensuring consistent and robust Shariah governance across different jurisdictions, building a skilled workforce with expertise in Islamic finance, and leveraging technology to enhance efficiency and reach a wider customer base. ASEAN's current approach to policy coordination and standardization in banking demonstrates a careful balancing act. Member states maintain control over their domestic banking regulations, but adjustments can be made through negotiations and informal agreements, like the bilateral arrangements and less-defined standardization methods currently used. A regional financial supervisory authority to oversee integration would likely fail because member states are unwilling to relinquish control of their domestic financial systems to a regional body. Furthermore, ASEAN's reliance on "soft law" prevents it from compelling members to do so.

The success of Islamic banking integration in ASEAN depends on strong political will, coordinated policy efforts, and a shared vision among member states. Although the ASEAN Banking Integration Framework (ABIF) has been established, additional frameworks are necessary to address the specific challenges and opportunities of Islamic banking integration, particularly in areas such as Shariah governance, product standardization, and regulatory harmonization.

The scarcity of empirical research directly addressing regional Islamic banking integration limited the scope and depth of this study's analysis. For future studies, a few areas to close the gap such as conducting in-depth studies examining the regulatory frameworks on the Islamic banking cross-border bilateral agreements and the innovation of cross-border Islamic banking, can be addressed. By continuing to explore these areas, a deeper understanding of the potential in Islamic banking integration at the regional level should be gained.

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