

An Analysis of the Islamic and Conventional Banking Regulatory Bodies and Legislation in Thailand

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Abstract

Islamic banking in Thailand is offered in the form of specialised financial institutions (SFIs) with the Islamic Bank of Thailand (iBank) as the only full-fledged Islamic bank. This research is carried out in the form of a documentary research with the purpose of examining the regulatory environment that the Islamic banking operates in and to provide solutions or recommendations to improve the current operational limitations. It was found that operating in the form of an SFI under close government monitoring and a restrictive operational structure, limits the bank's true potential, as the objective is to serve the government as its economic tool without being commercialised or maximising profit. Thus, the iBank can be taken out of the SFIs and treated as a commercial bank. An iBank-specific act and the applicable laws need to be amended to be supportive of Islamic banking's unique operational mechanisms. Furthermore, a centralised *shariah* advisory body should be constituted to provide a standard for Islamic banking in Thailand. These would facilitate the provision of Islamic banking services. Hence, competition among Islamic banking service providers will be created, and subsequently, the efficiency and growth of Islamic banking and the financial industry in Thailand will improve.

Keywords: Islamic Bank of Thailand, Islamic banking, banking regulatory bodies, banking legislation, specialised financial institutions, shariah governance

1. Introduction

Thailand is a non-Muslim country with Muslims as a minority group constituting 5% of the total population (Central Intelligence Agency, 2017). The groups of different believers in Thailand are allowed to practice their faith freely. Islamic banking and financial services in Thailand have emerged to meet the needs of Thai Muslims to conduct their financial activities in accordance with the religion of Islam, especially for the Muslims in southern Thailand. Prior to the banking service, Islamic finance in Thailand existed in the form of *zakat* and charity fund, *shariah*-based co-operatives, *hajj* savings account, and Muslim investment (Ariff, 1988). The near practices of Islamic banking are the *shariah*-based co-operatives and *hajj* savings accounts. Co-operatives have been used as a tool of trade, to increase the bargaining power through a collective group of merchants. The profits from the activities are used to provide interest-free loans and funds for needy Muslim students. On the other hand, the *hajj* savings account was first introduced by the Bangkok Metropolitan (Sri Nakorn) Bank. However, due to a lack of understanding of Islamic financial principles among both the service provider and the customers, the account offered was no different from the conventional savings account. It merely has an Islamic name.

The initial trigger to attempt an establishment of Islamic banking services came from the Indonesia-Malaysia-Thailand Growth Triangle Summit in 1994 – as a part of an economic development plan for the southern Thai area – to increase the access to Islamic permissible sources of funds for Muslim traders and entrepreneurs.

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The government has appointed the Fiscal Policy Office and the Bank of Thailand to consider the policy formation for specialised financial institutions (SFIs) or government commercial banks to offer Islamic banking services through windows and branches. Meanwhile, the Ministry of Finance has been appointed to undertake the task of forming a full-fledged Islamic bank (Bank for Agriculture and Agricultural Cooperatives, 2012; Islamic Bank of Thailand, 2010b).

The first Islamic banking services were provided by the Bangkok Metropolitan (Sri Nakorn) Bank, but the operation of the bank was terminated in 1997, as a result of the Asian financial crisis. The bank was later acquired by Siam City Bank in 2002.³ Islamic banking services were then introduced by state-owned banks, in the form of windows through the two SFIs, namely the Government Savings Bank (in 1998) and the Bank for Agriculture and Agricultural Cooperatives (in 1999) and in the form of branches by the Krung Thai Bank (in 2001) (Haron & Yamirudeng, 2003; Islamic Bank of Thailand, 2010b).

Subsequently, in 2002, the Islamic Bank of Thailand Act 2545 BE (2002 CE) was enacted, resulting in the establishment of the first and only Islamic bank in Thailand operating in the form of an SFI. Consequently, the Krung Thai *Shariah* service was acquired by the Islamic Bank of Thailand (iBank) as a policy of the Ministry of Finance (Islamic Bank of Thailand, 2010a). The iBank was setup as an SFI due to its unique features that are seen as only serving specific objectives and there have not been any banks operating under such a concept in Thailand (Rochananonda, Attaworadej, Kaluntakaphan, & Tiantitikul, 2010).

SFIs and commercial banks are financial institutions operating under the financial system of Thailand as depository corporations serving the economic system in the roles of capital mobilisers and resource allocators, albeit in different aspects. As the names suggest, commercial banks play a part in the economic system by engendering competition by virtue of them being commercialised, while the SFIs are government-supporting tools for specific economic development policies and are not meant to be commercialised (Sirilimp, 2003).

The SFIs are government economic tools aimed at filling financial service gaps that are not fulfilled by commercial banks for less privileged consumers with specific financial needs (Sujaritkul, 2011). SFIs intend to serve the real economic sector, as each of these SFIs' economic purpose is reflected in their individual governing act. The economic groups that are served by the SFIs belong to agriculture, grassroots, small and medium-sized enterprises, real estate, and other groups such as Islamic banking. The SFIs are involved in taking deposits and giving out loans; however, not all SFIs are financial intermediaries. Some SFIs only give out loans and are non-financial intermediaries, while those providing deposit-taking services are financial intermediaries. The iBank and the SFIs offering Islamic banking windows are among the latter (Satsanguan, 2006).

2. Central Regulation of Banking in Thailand

The Bank of Thailand and the Ministry of Finance are the central regulatory bodies overseeing the operation of financial institutions in the financial system in Thailand. They work in collaboration to ensure efficiency, sustainability, safety, and soundness of the country's economic, financial, and financial institutions systems.

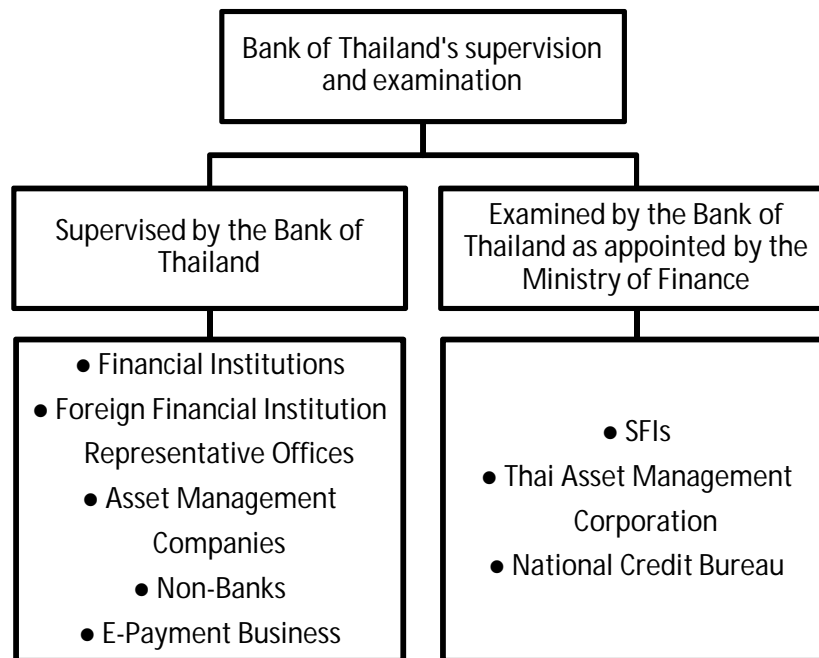
The Bank of Thailand is the central bank of the country that operates as an independent government organisation, with the role of maintaining the stability of the country's economic and financial systems through monetary policies. It plays a supervisory role with regard to financial institutions based on the following five supervision principles: (1) prudential (the international standard is complied with by the financial institutions in their consolidated supervision), (2) efficiency (enhancing the operational efficiency of financial institutions and their sectors through appropriate competition), (3) good governance (ensuring that good corporate governance is strictly followed), (4) fairness and customer protection (ensuring that consumers' rights and fair financial access and treatment are being observed), and (5) macroprudential (using regulatory tools to ensure a sound economic and financial environment) (Bank of Thailand, 2015).

Financial institutions are supervised by two authoritative groups under the Bank of Thailand, which are the Financial Institutions Policy Group (FPG) and the Supervision Group (SVG). FPG oversees the regulatory policies concerning the stability of financial institutions system and the payment system. SVG oversees and supervises financial institutions for a safe and sound financial institutions system.

³ By the power of Ministerial Regulation on Approval of Business Transfer of Bangkok Metropolitan Bank Public Company Limited to Siam City Bank Public Company Limited, 29 March 2002.

The Specialised Financial Institutions' Supervision and Examination Department under SVG supervises and assesses SFIs, ensuring their compliance with the regulations of the Bank of Thailand. The financial institutions under such supervision are those under the Financial Institution Business Act 2551 BE (2008 CE) and the Declaration of Revolutionary Council No. 58 2515 BE (1972 CE), as shown in the figure below.

Figure 1. Financial business under the Bank of Thailand's supervision and examination (adapted from Bank of Thailand, 2008).



As illustrated in the figure above, there are two groups of financial institutions that are supervised: one is directly under the supervision of the Bank of Thailand, and the other is under the examination of the Bank of Thailand as appointed by the Ministry of Finance. It can be noticed here that the commercial banks are directly supervised by the Bank of Thailand while the SFIs are supervised by the Ministry of Finance through the Bank of Thailand, as each SFI act – as a governmental economic tool – serves different economic purposes.

Concurrently, the role of the Ministry of Finance is to oversee the financial and treasury-related activities of the country as well as oversee the development of state enterprises and government assets to ensure the sustainability, soundness, and efficiency of the economic system through the management of the organisations under its responsibility.

The groups of the organisations under the responsibility of the Ministry of Finance comprise government agencies, state enterprises, and public organisations. SFIs and government commercial banks are situated under state enterprises. Under the organisations of the Ministry of Finance, there are sub-divisions that are directly related to the financial institutions and SFIs. The department that works in collaboration with the Bank of Thailand and the organisations-in-charge in this regard is the Bureau of Financial Policy and Financial Institutions (under the Fiscal Policy Office, which is a government agency). Its responsibility involves monitoring financial institutions, particularly the SFIs, as well as participating in the process of policy formulation of the financial system and the financial institutions system (Fiscal Policy Office).

Therefore, the Ministry of Finance oversees an overall policy supervision of the SFIs, and the Bank of Thailand is appointed as the supervisor of the SFIs reporting to the Ministry of Finance. The tasks of Bank of Thailand, with respect to its supervision of the SFIs, include the formulation of supervision measures, supervision, monitoring, examination, and provision of solutions to problems.

3. Banking Legislation

Islamic banking in Thailand is operating as a minor part of conventional banking, under a conventional-plus financial system (ISRA, 2013). Conventional banks (commercial banks in this case) are governed by the Financial Institution Business Act 2551 BE (2008 CE) and the Bank of Thailand Notification No. 20/2551 BE (2008 CE) on the Permission for Commercial Banks to Undertake *Shariah* Banking Services Business. Meanwhile, the Islamic bank (the iBank in this case) is governed by the Islamic Bank of Thailand Act 2545 BE (2002 CE), which is a specific act drawn for the iBank and not to be implemented for Islamic banks in general. The governing legislation has been compared and analysed to comprehend the regulatory environment of the commercial banks and Islamic banks in Thailand. The evaluation is as follows.

The nature of the financial institutions

Commercial banks, by definition, are financial institutions operating as public limited companies with the license to undertake commercial banking business. On the other hand, the SFIs are state financial institutions operating as juristic persons under specific individual acts. The definitions reflect the two distinct objectives of the two types of financial institutions, namely, the objective of the commercial banks that are aimed at commercialisation and the optimisation of profit making, whereas the iBank is neither aimed at being commercialised nor at maximising profit but at serving a specific purpose as a governmental economic tool.

Supervision

Commercial banks are directly under the supervision of the Bank of Thailand. Meanwhile, the iBank is supervised and examined by the Bank of Thailand, as appointed by the Ministry of Finance as a consequence of it being an SFI, and hence, it acts as an economic tool for the government, which has led to government interference and restrictions in operation. In addition to this, commercial banks are to report their financial statements to the Bank of Thailand and the iBank is to report its financial statements to the Ministry of Finance. The assessment of the banks' operation may be performed, as deemed fit, with regard to the Bank of Thailand's power to appoint officers for commercial banks and the Ministry of Finance's power to appoint officers for the iBank. The issue of transparency arises in the cases where there is significant governmental interference in the iBank's activities – what if the Ministry of Finance does not perform any operational assessment?

Activities of the banks

The main distinction between commercial banks and the iBank is the interest (*riba*)-related activities. Wherever these constitute the main business of commercial banks, they are prohibited in the iBank's business. The iBank is not to involve in any interest-related activities or any activity that contradicts the Islamic law. Nevertheless, it is permissible for the iBank to perform commercial banking activities that comply with the Islamic law. There are also other activities that are otherwise made permissible for the iBank due to its unique nature. These activities include deposit taking for investment, *zakat* account management, acting as an agent or representative for selling and purchasing or exchanging movable and immovable assets, and acting as an agent or representative in providing loans or capital investment. To respond to the customers' needs and allow for expansion of the business, additional business activities have been granted permission, namely the payment processing representation, credit card service, and the issuing of *sukuk*. However, the last two activities have not been made available yet. Nonetheless, since the operational mechanism of the iBank is different from that of commercial banks, the applicable laws, such as the land code act and taxation law, may not be fully supportive and hence, these may put the iBank at a disadvantage.

Shareholding of the iBank

The iBank, being a state enterprise, has the Ministry of Finance as its biggest shareholder. Being an SFI (as a government economic tool) brings operational inefficiency to the bank, as the bank's business policy is meant to serve the government's purpose rather than that of the bank's.

Number of shareholders and directors

Commercial banks are permitted to have up to 49% of non-Thai shareholders, while the iBank is allowed up to 33% of the same.

This is likely since the iBank is an SFI and hence, it follows the government's strategy in controlling its financial and economic tools. However, limiting the number of foreign shareholders can restrict the flow of overseas capital for developing and expanding the iBank.

The permissible proportion of non-Thai directors of commercial banks is 50%, while it is 33% for the iBank. This could be a disadvantage to the iBank as the number of Thai experts in Islamic banking and finance is limited. The iBank can benefit from having experienced experts from countries with more developed Islamic banking and finance markets to increase the opportunities for product innovation and market expansion.

As for the iBank, it is not permissible for a person to own more than 15% of its shares, unless the individual in question is part of a state enterprise or a juristic person operating under a specific act. The Government Savings Bank owns almost 40% of the shares as, by virtue of being an SFI, it is both a state enterprise and a juristic person. This indicates the presence of more indirect governmental power and interference over the bank's activities.

Shareholding of other financial institutions

Commercial banks and the iBank are not allowed to hold shares of other financial institutions for the purpose of financial stability control on a general basis. However, the Government Savings Bank and the Krung Thai Bank are permitted to hold shares of the iBank as per the Ministerial Regulation on Shareholding of the Islamic Bank of Thailand 2547 BE (2004 CE), because they are state enterprises. Hence, it leaves room for more government interference. Nevertheless, if the iBank were to be allowed to hold the shares of other banks, the issue of involving in interest (*riba*)-related activities could be raised.

Board of Directors

The requirements for the Board of Directors for commercial banks and the iBank are contrary to each other. For the iBank, the Board of Directors must include representatives from the Ministry of Finance and the Bank of Thailand, whereas, for commercial banks, the directors and managers must not be political officials or officers of the Bank of Thailand. As an SFI, the iBank needs to be under the supervision of the government and hence, the requirement mentioned above. As for commercial banks, though these institutions operate under the eye of the authority, they should not be interfered with as it could affect the operation of the financial system as a whole.

With the structure of the Board of Directors so outlined and with the characteristics of an SFI, the iBank's policy is meant to serve the goals of the government rather than the bank's true potential. Also, the iBank can benefit more by employing experts who are specialised in administering a bank instead of having representatives from the Bank of Thailand and the Ministry of Finance.

Commercial banks undertaking *shariah* banking services business

The Bank of Thailand Notification No. 20/2551 BE (2008 CE) on the Permission for Commercial Banks to Undertake *Shariah* Banking Services Business, in addition to the Financial Institution Business Act 2551 BE (2008 CE) is to enable the flexibility of commercial banks to meet the needs of the customers in the form of Islamic banking windows service. It allows for Thai and non-Thai commercial banks to apply for permit, based on the banks' readiness to do so and in terms of their management and human resources, provided they meet the requirements of assets and securities. In providing these services, the banks must treat the Islamic banking windows as if they are other equally juristic persons and these windows must be operated in accordance with the Islamic principles. There must be no co-mingling of funds between the conventional banking services business and the *shariah* banking services business. This clause for the separation of funds also pertains to the start-up capital, assets, liabilities, obligations, and the accounting system. The banks must also appoint at least one *shariah* advisor for the operation of the Islamic banking windows. The banks are also required to seek approval from the Bank of Thailand before the implementation of any new products that have not been previously granted. This requires the commercial banks to operate business activities that are completely different from what are conventionally provided, as their activities must comply with the Islamic law that emphasises trade and profit (and loss) and risk-sharing principles. Consequently, *shariah* banking services have not been offered by any commercial banks so far. Venturing into a new dimension of business may not be worth the risk, as the procedure involved in providing the required services costs the banks additional funds and time.

Shariah governance

Shariah governance in Thailand takes place at an institutional level and is centralised as the iBank and the commercial banks (which offer *shariah* banking services) are required to appoint *shariah* advisors within the organisations. The duty of the *Shariah* Advisory Council, in accordance with the Islamic Bank of Thailand Act 2545 BE (2002 CE) and the Bank of Thailand Notification No. 19/2559 BE (2016 CE) on the Rules of Supervision of Specialised Financial Institutions Operating Islamic Banking and Finance Business, is to give advice, recommendations, suggestions, and reports on matters concerning the operation of the bank in relation to Islamic principles to ensure that there are no violations of Islamic law. For Islamic banks, having *shariah* advisors (as opposed to commercial banks) may lead the banks to incur additional procedures and costs; however, it is essential for minimising the *shariah* non-compliance risk, which may not only cost the banks financially but may also affect the banks' reputation and goodwill.

The *shariah* advisors should be experts with knowledge of and experience in Islamic law, as well as in Islamic and modern banking, finance, and economics or other related areas that are beneficial to the bank. Possessing this quality will enhance consumers' trust in the bank and its operation.

The role of the *Shariah* Advisory Council, in conformity with the policies of corporate governance and in accordance with the Islamic principles, is vital to the bank not just for the operation of the bank, but also for the maintenance of its image and reputation. This is because the transparency and the sincerity of the council impact the consumers' trust and confidence in the bank.

4. Findings

Commercial banks are directly under the supervision of the Bank of Thailand, while the SFIs are under the supervision of the Bank of Thailand (as appointed by the Ministry of Finance). The Bank of Thailand oversees the SFIs, as authorised by the Ministry of Finance, and reports their workings to the Ministry. The tasks of operational policy supervision and the supervision as shareholders remain with the Ministry of Finance.

The problem is not with the regulatory structure itself, as commercial banks should operate independently of the government's influence, and the SFIs, as governmental economic tools, should operate under the government's close attention. The problem is with the iBank being cast in the form of an SFI and hence being put under such an authority structure in which it is not treated as a commercial bank. This places limitations on the operation of the iBank.

The salient features of iBank as an SFI, which restrict it from achieving its full operational potential, can be addressed with the following suggestions for the iBank:

- a. Being under the two authorities, the Bank of Thailand and the Ministry of Finance
- b. Having the Ministry of Finance as its policy supervisor
- c. The Ministry of Finance being the biggest shareholder
- d. Having a Board of Directors consisting of representatives from the Bank of Thailand and the Ministry of Finance
- e. There being a limited number of non-Thai shareholders and directors
- f. Being in the form of a juristic person
- g. Being a state enterprise
- h. Having a specific governing act

Being an SFI, the iBank must go through a longer process when requesting approval; it must first get approval from the Bank of Thailand for the Bank of Thailand to recommend it to the Ministry of Finance, which in turn will grant the final approval. This prolonged process affects the bank's operational efficiency. Being an SFI puts the iBank directly under the policy influence of the government and the Ministry of Finance, as it must serve its function as their economic tool. Thus, the policy that is imposed on the bank is one that serves the operation of the government rather than the achievement of the bank's full operational potential. The flexibility in the operation and management of the bank is also limited. An SFI has an objective in providing the services that are not efficiently available in the financial system, and each SFI serves a specific purpose. It does not aim to be commercialised or to maximise its profit. Hence, its operation is reflected in the form of a juristic person and not as a public limited company like commercial banks.

Furthermore, instead of having representatives from the Bank of Thailand and the Ministry of Finance in the Board of Directors, the bank could use personnel who are experts in running different aspects of the bank so as to achieve its full potential. Also, limiting the number of non-Thai shareholders and directors does not only restrict the flow of capital from overseas in terms of shareholding but also limits the number of experts in Islamic banking and finance from more experienced and developed markets in other countries joining the bank, thus limiting new innovations and ideas in the bank. Furthermore, being a state enterprise often results in operational inefficiency. As a result, being an SFI limits the potential performance, growth, and expansion of the bank.

Islamic banking adopts a different operational mechanism from conventional commercial banks. It operates based on the risk- and profit- and loss-sharing principle and must not be involved in any interest-related activities. The currently applicable laws may not be as supportive as they should be with regard to this, thus making it difficult for Islamic banking to be on par with the conventional one.

Furthermore, *shariah* governance is not centralised, as it is at an institutional level. The principles of corporate governance, in accordance with the Islamic principles stated in the Bank of Thailand Notification No. 19/2559 BE (2016 CE) on the Rules of Supervision of Specialised Financial Institutions Operating Islamic Banking and Finance Business, are only enforced in the case of the iBank. This could create ambiguity among the consumers when different institutions offer their products and services based on different analogies and could subsequently affect the consumers' trust in Islamic banking and finance.

Although the Bank of Thailand Notification No. 20/2551 BE (2008 CE) on the Permission for Commercial Banks to Undertake *Shariah* Banking Services Business allows for commercial banks to offer Islamic banking services in the form of windows, no commercial bank has yet to provide such services. As this requires commercial banks to venture into an entirely different area of business operation, they may not find it to be worth the risk. As a result, competition among Islamic banking services providers is absent with no Islamic banking windows available from commercial banks, the iBank being the only full-fledged Islamic bank, and the Government Savings Bank and the Bank for Agriculture and Agricultural Cooperatives offering Islamic banking products and services in conformity with each bank's specific purpose as an SFI. Hence, the growth and expansion of the Islamic banking market in Thailand are limited. Subsequently, the consumers' options are limited to the less-efficient services.

To solve this problem, the iBank must not be treated as an SFI, i.e. it must operate in the same form as commercial banks. The Islamic Bank of Thailand Act 2545 BE (2002 CE) should be made a general act that can be extended to any Islamic bank and should not be just a specific act for a particular bank. The necessary amendments may be made with respect to the applicable Islamic banking laws, such as taxation law and land code acts, for Islamic banking services to be able to perform at their full potential and at par with their conventional counterparts. There should also be a push towards having a centralised *shariah* advisory body for standardised resolutions and the *shariah* governance to be cemented. Achieving these two aspects would encourage the commercial banks to provide *shariah* banking services, as it would facilitate their provision of such services.

5. Conclusion

Islamic banking in Thailand, though operating under the same financial system as conventional banking, is restricted by the regulatory environment that it is operating in. Instead of being able to perform freely as Islamic commercial banks would, their operation is bound to the form of SFIs due to their unique features that are seen to only serve a specific purpose.

The SFIs are meant to serve as economic tools of the government; hence, profit maximisation and commercialisation are not the aim. Therefore, their operation is limited to the operational structure and supervisory authorities that are designed for a close monitoring of such institutions. However, being under such authorities could leave room for government interference.

Although there are a few Islamic banking services providers, the iBank is without direct competitors in the same category (Islamic banking). The other two Islamic banking windows services providers are to comply with each of their own specific objectives in serving as SFIs.

Operating as an SFI results in operational inflexibility and inefficiency, which affects the full business potential of the bank. Consequently, the iBank should be transformed from an SFI into an Islamic commercial bank. The act that is drawn specifically for the iBank should be generalised. The bank would be able to operate more freely and efficiently as it would then be able to operate based on objectives that are meant to serve the bank's goal as a business.

To create competition among Islamic banking services providers, the current operational environment could be enhanced to encourage the provision of such services. Despite the permission for commercial banks to provide *shariah* banking services, no services have yet been offered by the banks. The applicable laws should be amended to enable the Islamic banking services providers to be at par with their conventional counterparts. There should also be a centralised *shariah* advisory body for standardised resolutions and *shariah* governance. As Islamic banking services are being provided in a country where Muslims are not the majority, it should be presented unambiguously. This improvement would facilitate the current and potential Islamic banking services providers in providing the services.

Once Islamic banking services are made more readily available because of these supportive changes, competition will be created among the Islamic banking providers. The competition will encourage operational efficiency as well as innovations in products and services. Consequently, the growth and expansion of the Islamic banking market will be assured. The consumers will benefit from such an improvement. Moreover, this will become a supporting factor for people from the ASEAN Economic Community (AEC) and other countries to do business in Thailand. Hence, the expansion of the Islamic banking market will help to expand the economy of the country in the long run.

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