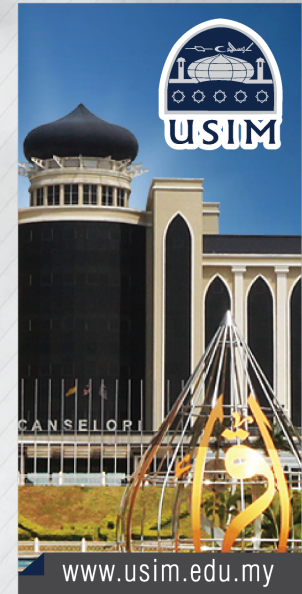


إسلامية
العلماء
البارزين



Regulatory Framework of Islamic Finance in Malaysia

MEMPELOPORI SAINS ISLAM • MEMIMPIN KEILMUAN
PIONEERING ISLAMIC SCIENCE • SPEARHEADING KNOWLEDGE

INTRODUCTION

Malaysia has a unique legal framework consisting of mixed jurisdictions and mixed legal systems namely the common law and shariah.

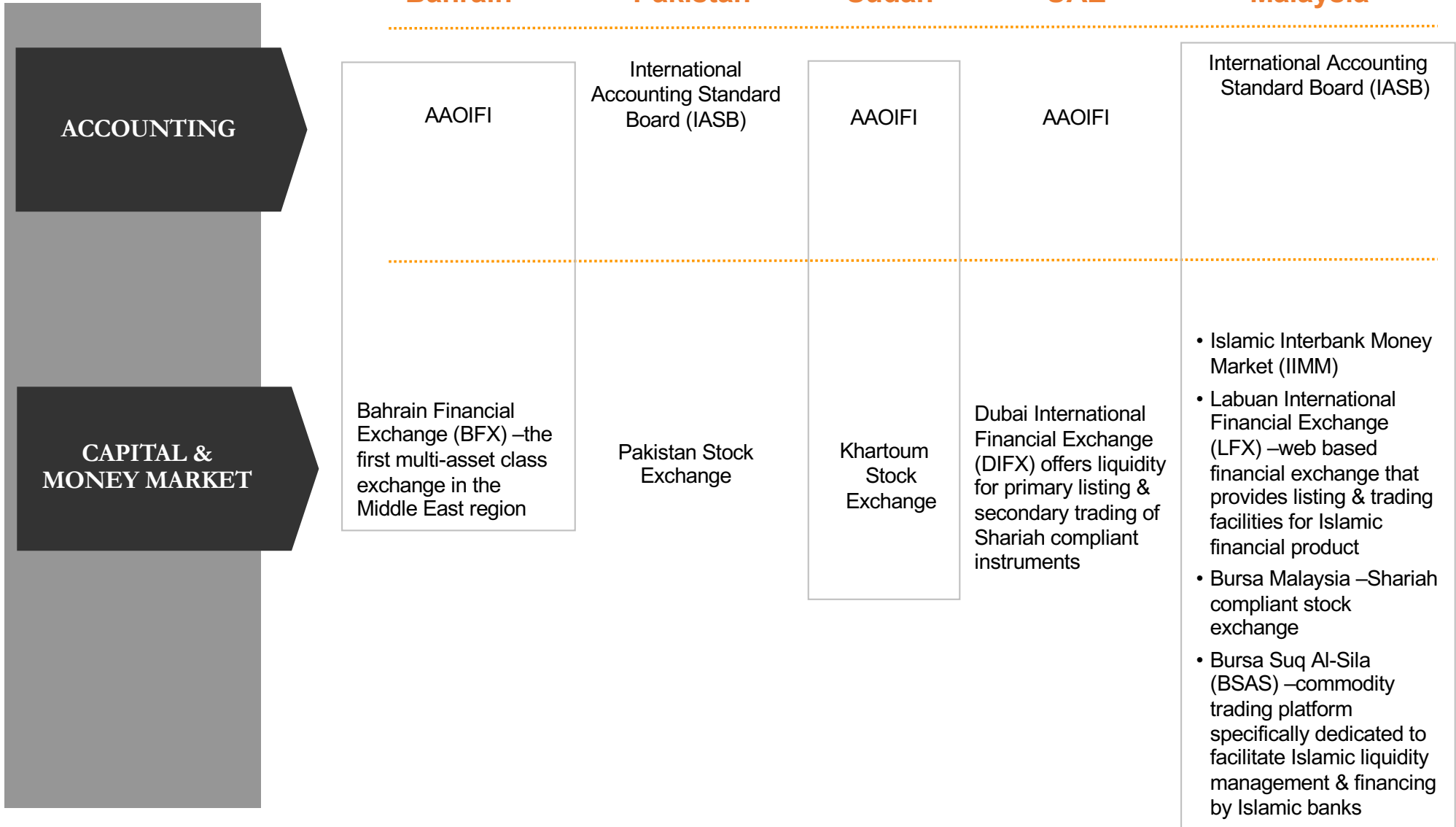


The growth and development of Islamic banking industry are supported through goods governance and its comprehensive legal frameworks. As Malaysia is one of the common law countries, it is very essential to have standard law of practice, which harmonizes both *shariah* and civil law. The integration of these two traditions is really necessary in the context of Islamic banking in Malaysia.

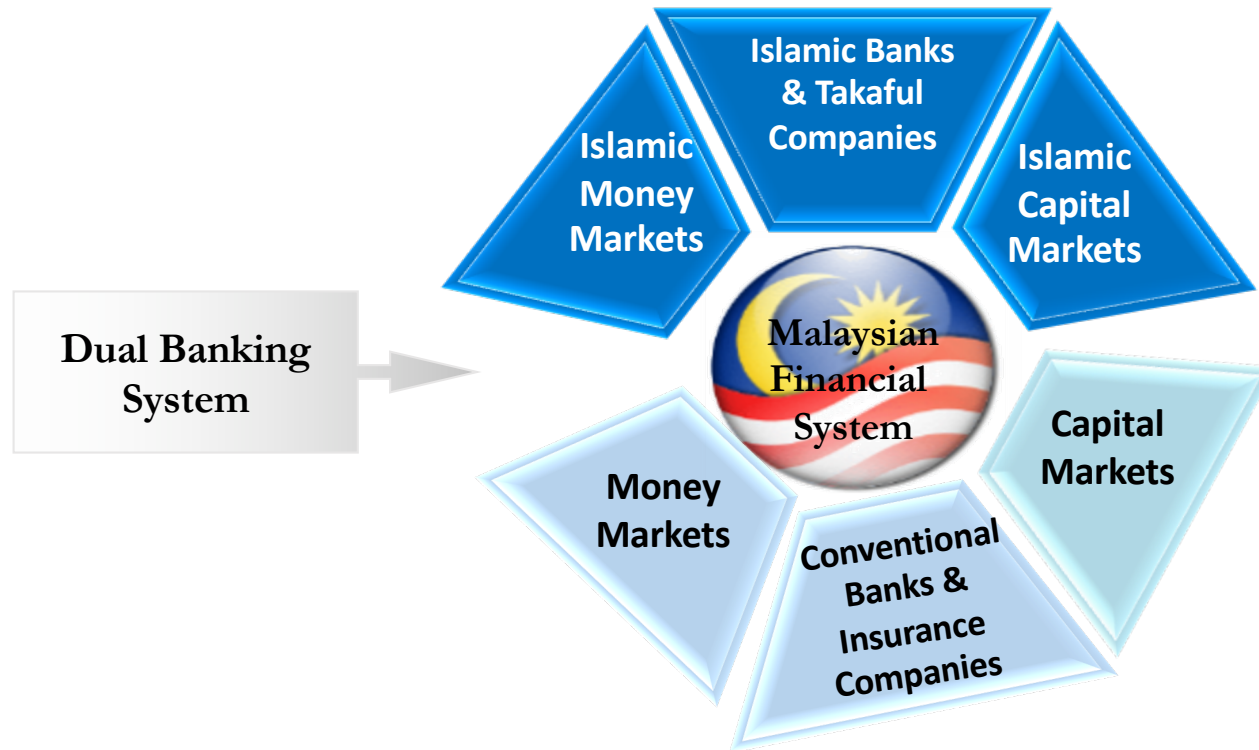
Islamic Finance in Various Jurisdictions

	Bahrain	Pakistan	Sudan	UAE	Malaysia
SYSTEM	Single	Single	Single • National aspiration to have full-fledged Islamic	Single	Dual • Existence of dual financial system is hard-coded in Central Bank of Malaysia Act 2009
LEGAL	<ul style="list-style-type: none"> • Single legislation covers both Islamic & conventional banking • Comprehensive regulatory framework for Islamic banks 	<ul style="list-style-type: none"> • Single legislation with specific provision to address Islamic banking operation 	<ul style="list-style-type: none"> • Banking Business Regulation Act 	<ul style="list-style-type: none"> • Single legislation covers both Islamic & conventional banking (Federal Law) • Takaful –specific law is introduced (2010) 	<ul style="list-style-type: none"> • Dedicated Law/ Act to address Islamic finance <ul style="list-style-type: none"> • Islamic Banking Act 1983/IFSA 2013 • Takaful Act 1984 • Government Funding Act 1983
SHARIAH GOVERNANCE STRUCTURE	<ul style="list-style-type: none"> • Shariah supervisory committee of individual Islamic banks • Shariah Board of CBB 	<ul style="list-style-type: none"> • Shariah advisor of individual Islamic banks • Shariah Board of State Bank of Pakistan 	<ul style="list-style-type: none"> • Shariah advisor of individual Islamic banks • Shariah Supervisory Board (Bank of Sudan) 	<ul style="list-style-type: none"> • Shariah committee of individual Islamic banks • Shariah supervisory (Ministry of Islamic Affairs) 	<ul style="list-style-type: none"> • Shariah advisor of individual Islamic banks • Shariah Advisory Council (SAC) of Bank Negara Malaysia

Islamic Finance in Various Jurisdictions



Malaysia's Approach



Supported by:

Robust legal & regulatory framework

Diversified players with wide-ranging products

Integrated human capital infrastructure

Professional services with familiarity on IF

Building a **comprehensive** Islamic finance system

Governance

• Legal & Regulatory

- ✓ Islamic Banking Act
- ✓ Takaful Act
- ✓ Government Funding Act
- ✓ Capital Market Services Act
- ✓ Deposit Insurance Act

• Dispute Resolution

- ✓ Judicial system – dedicated high court
- ✓ KL Regional Centre for Arbitration
- ✓ Financial Mediation Bureau

• Shariah Advisory Council

Financial Markets

• Money Market

- ✓ Islamic interbank money market
- ✓ Diverse short-term Islamic money market instruments

• Capital Market

- ✓ 55.9% of outstanding private debt are sukuk
- ✓ 87% permissible counters



Diversified Players

• Islamic Banking

- ✓ 17 Islamic banks
- ✓ 10 Islamic windows
- ✓ 6 DFIs offering Islamic banking
- ✓ 3 International Islamic Banks
- ✓ 14 International Currency Business Units

• Takaful

- ✓ 8 takaful operators
- ✓ 3 retakaful operators
- ✓ 1 International Takaful Operator
- ✓ 5 International Currency Business Units

• Fund Management

- ✓ 8 approved Islamic fund management companies
- ✓ 35 fund management companies with Islamic mandates
- ✓ 149 Islamic unit trust fund

Supported by human capital infrastructure

INCEIF

ibfim

ISRA

Key info on current landscape

Governance

- **Legal & Regulatory**
 - Islamic Banking Act /IFSA2013
 - Takaful Act /IFSA 2013
 - Government Funding Act
 - Capital Market Services Act
- **Shariah Advisory Council**
 - Bank Negara Malaysia
 - Securities Commission
 - Labuan Financial Services Authority
- **Shariah Committees in each institutions**
- **Dispute Resolution**
 - Judicial system: dedicated high court
 - KL Regional Centre for Arbitration
 - Financial Mediation Bureau

Diversified Players

- **Banking**
 - 17 Islamic banks
 - 9 Islamic windows of conventional banks
 - 5 International Islamic banks (conduct non-RM business)
 - 17 International Currency Business Units (ICBU)
 - 6 Labuan Islamic banks
- **Takaful**
 - 11 takaful operators
 - 4 retakaful operators
 - 1 International Takaful Operator [9 ICBU]
 - 5 Labuan Retakaful companies
- **Fund Management**
 - 38 fund management companies with Islamic mandates (including 16 Islamic fund managers)

Infrastructure

- Payment, clearing & settlement system
- Principal Dealers
- Listing on Bursa with authorised exchange status

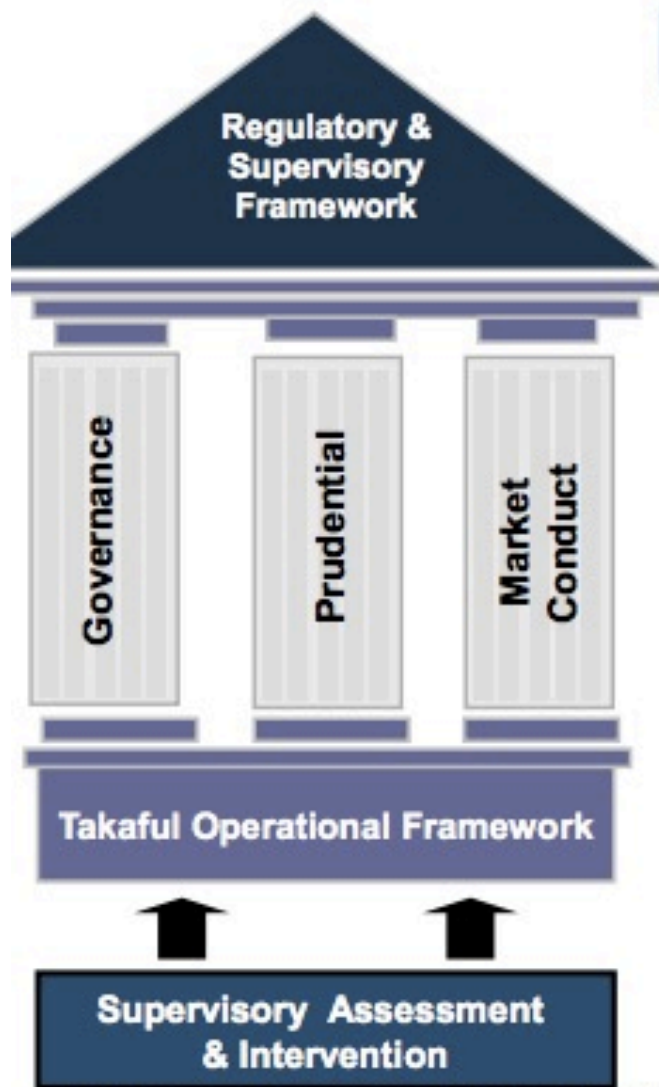
Professional Service

- Legal firm
- Accounting
- Financial Intermediaries
- Financial Advisors
- Consultancy Service

Financial Markets

- Islamic Capital Market
- Islamic Money Market
- Foreign Exchange Market
- Commodity Market
- Bursa Suq Al-Sila (commodity trading platform)

Regulatory and Supervisory Framework in Malaysia ...



Objectives

- Preserve financial stability & public confidence
- Prevent risk of contagion & systematic failure
- Ensure good market practices
- Promote high standard corporate & Shariah governance

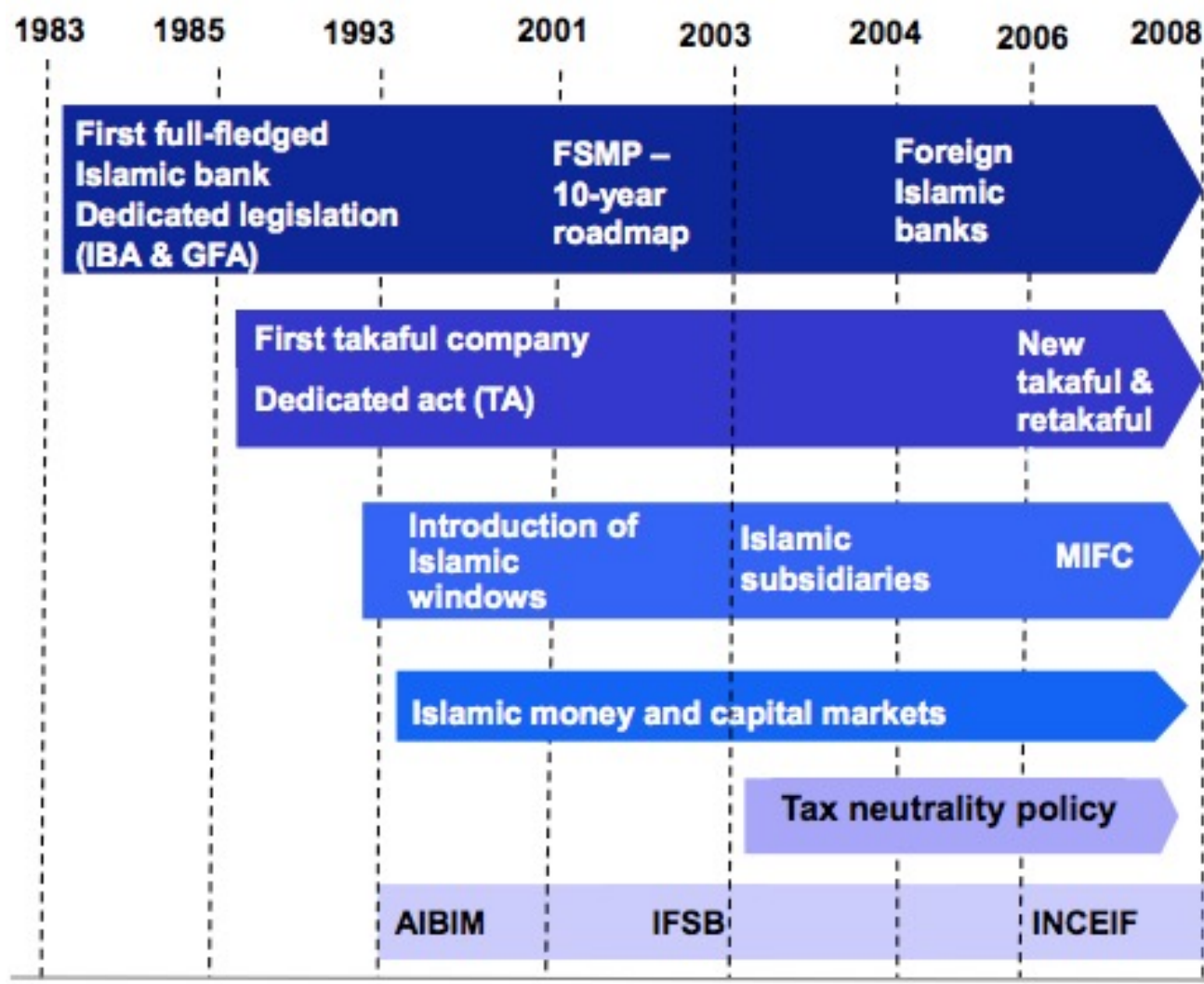
Pragmatic approach to regulation

- Leveraging on established field of conventional system
- Separate rules to address takaful industry peculiarities
 - Shariah-compliant in all aspects of the takaful operation
 - Balance between interests of shareholders & participants
 - Separation of funds between shareholders & takaful fund
- Efficient and forward looking supervision under Risk-Based Supervisory Framework

Regulatory framework for insurance broadly applicable... but requires adaptation to be more takaful-attuned

Legal framework being strengthened by Islamic Financial Services Act to enable more comprehensive regulation and supervision of the takaful industry

Flexible and facilitative policy is imperative...

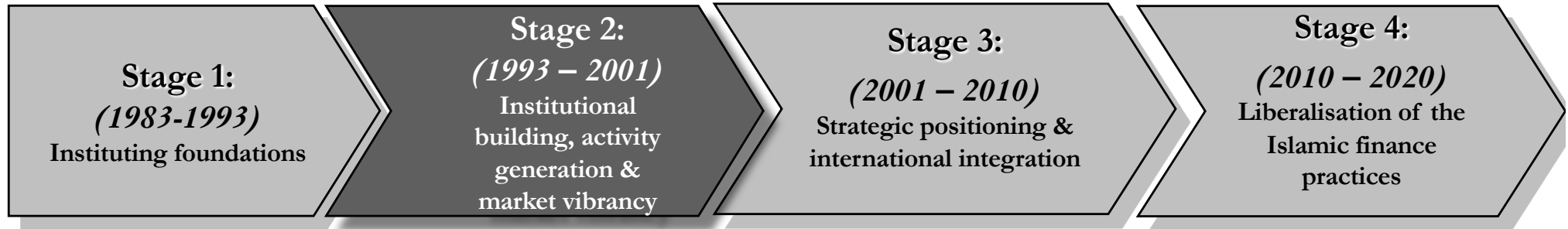


- Regulation should evolve over time with changes in the structure / architecture landscape of economy
- Diversity of institutional structure
 - ✓ full-fledged Islamic banks
 - ✓ Islamic windows
 - ✓ Islamic subsidiaries
 - ✓ International Islamic Banks
- Robust financial markets
 - ✓ money & capital market, Government Funding Act (GFA)
- Tax neutrality principles
 - ✓ equal treatment vis-à-vis conventional banking – creation of "level playing field"
 - ✓ exempt additional instruments & transactions executed to fulfill Shariah requirement, from additional stamp duty & tax payment

...regulation has to be effective and efficient

* IBA – Islamic Banking Act; GFA – Government Funding Act; TA – Takaful Act; MIFC – Malaysia Islamic Financial Centre; ISRA - International Shariah Research Academy for Islamic Finance; IFSB – Islamic Financial Services Board; AIBIM – Association of Islamic Banking Institutions in Malaysia

Pragmatic development of legal framework to governs specificities of Islamic finance



Enactment of dedicated **Legislative** acts for Islamic banking, **amendments to allow** takaful & Shariah compliant government **Islamic banking windows** funding

- Islamic Banking Act 1983 (IBA)
- Government Funding Act 1983 (GFA)
- Takaful Act 1984 (TA)

Banking and Financial Institutions Act 1989 (BAFIA)

Several measures to ensure legal framework are accommodative of Islamic finance

- Central Bank of Malaysia Act 2009
- Capital Market Services Act 2007 (CMSA)
- Development Financial Institutions Act 2002 (DFIA)
- Dispute Resolution
- Tax Neutrality Framework
- Law Review Committee
- Law Harmonisation Committee

Islamic Financial Services Act

VBI

Increasing emphasis to streamline with International Standards...

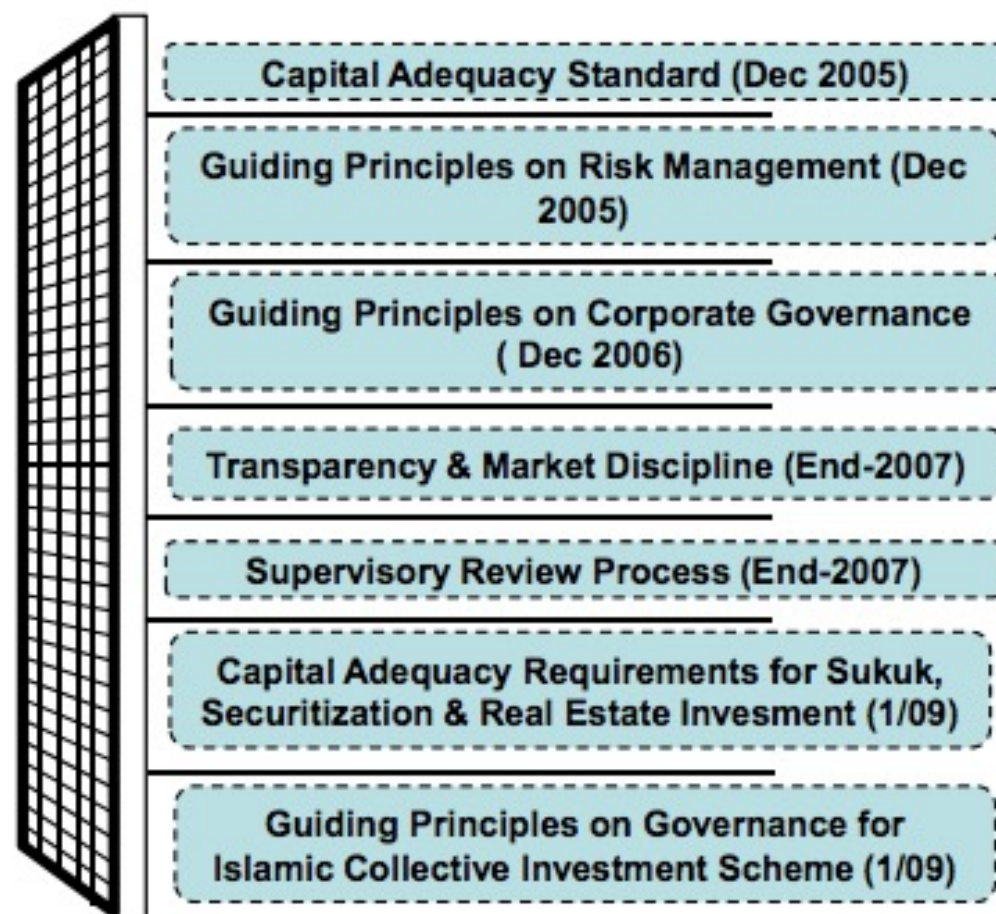
DOMESTIC REGULATION

- Formulation of separate guidelines to reflect distinct features of Islamic finance
- Instill financial stability, market discipline and public confidence



INTERNATIONAL BEST PRACTICES

- IFSB made significant progress in formulating standards to address issue regulatory framework for Islamic financial institutions



Why are international standards important?... Regulatory convergence

Note: BNM Guidelines can be downloaded at www.bnm.gov.my

* IFSB- Islamic Financial Services Board.

Future development & initiatives under Financial Sector Blueprint

1 Regulatory & supervisory regime

- Enactment of a comprehensive legislative framework for the conventional & Islamic financial systems respectively

3 Increase the diversity of players

- Issue new takaful licenses to institutions with specialised expertise
- Encourage international players to establish retakaful operations
- Promote greater involvement of takaful brokers

5 Talent development

- Promote standards & accreditation of Islamic finance programmes
- Introduce dedicated training programmes for Shariah graduates

2 Strengthen Shariah governance framework

- Establish a single legislated body as the apex authority on Shariah matters
- Strengthen International Shariah Research Academy for Islamic Finance to become a premier international research agency

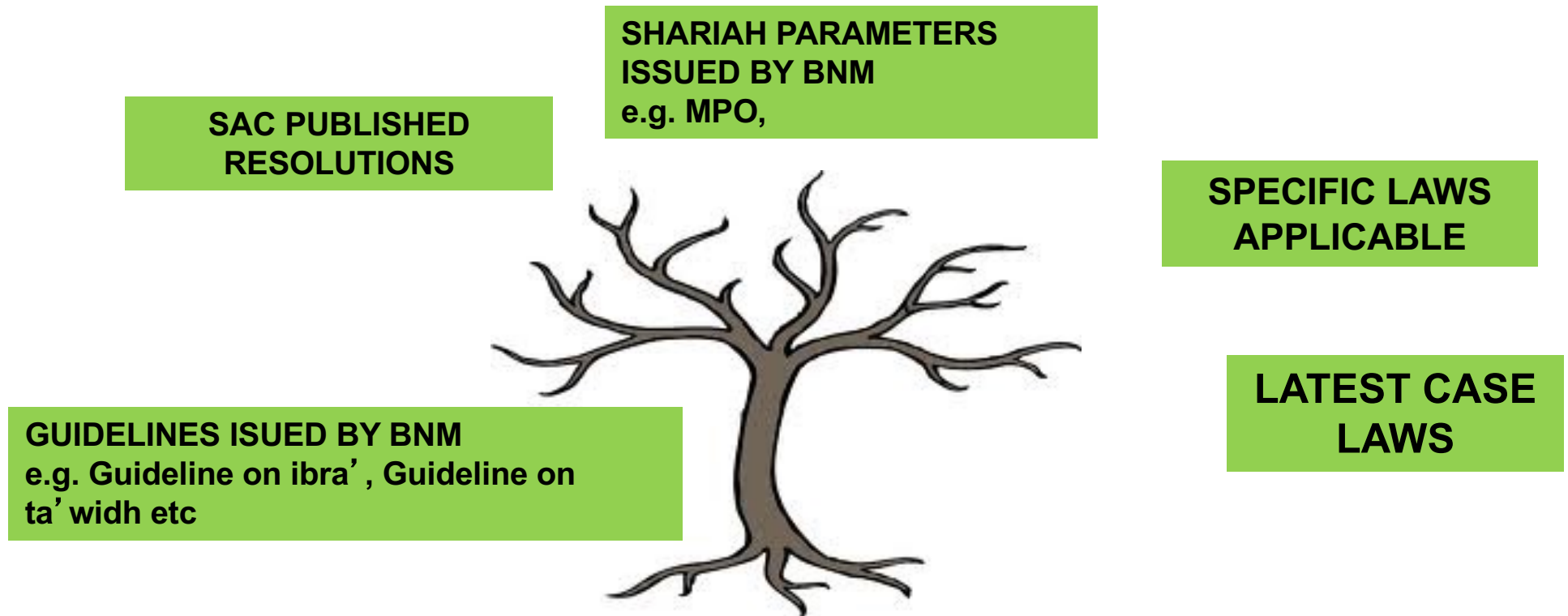
4 Increase market efficiency

- Facilitate the development of standard retakaful documentation

6 Wide range of products & services

- A regulatory framework that facilitates the offering of affordable microtakaful

Compliance Framework



Regulators

BNM

Securities Commission

LOFSA

BNM

- 1) To promote monetary stability and a sound financial structure
- 2) To influence the credit situation to the advantage of the federation
- implementing all the regulations concerned with these matters as laid by the law, as well as issuing policies and directives to further the implementation of these regulations.
- Where and when certain of the regulations have become inadequate or new or additional regulations become necessary, it is also the Central Bank's responsibility to initiate the formulation of such changes.

Securities Commission SCA 1993



(a) to advise the Minister on all matters relating to securities and futures industries;



(b) to regulate all matters relating to securities and futures contracts;



(c) to ensure that the provisions of the securities laws are complied with;



(d) to regulate the take-overs and mergers of companies;



(e) to regulate all matters relating to unit trust schemes;



(f) to be responsible for supervising and monitoring the activities of any exchange holding company, exchange, clearing house and central depository;

Labuan FSA LOFSA Act 1996

- Section 3(2) spells out the objectives of the Authority are-(a) to promote and develop Labuan as a centre for offshore financial services; (b) to develop national objectives, policies and priorities for the orderly development and administration of offshore financial services in Labuan, and to make recommendations to the Minister
- Offshore Banking Act 1990 (OBA)
- Offshore Insurance Act 1990 (OIA)
- Labuan Offshore Securities Industry Act (LOSIA)
- Labuan Offshore Financial Services Authority Act 1996
- Labuan Offshore Business Activity Tax Act 1990

BNM

Section 5 CBA

(a) to formulate and conduct monetary policy in Malaysia

(b) to issue currency in Malaysia;

(c) to regulate and supervise financial institutions which are subject to the laws enforced by the Bank;

(d) to provide oversight over money and foreign exchange markets;

(e) to exercise oversight over payment systems;

(f) to promote a sound, progressive and inclusive financial system;

(g) to hold and manage the foreign reserves of Malaysia;

(h) to promote an exchange rate regime consistent with the fundamentals of the economy; and

(i) to act as financial adviser, banker and financial agent of the Government.

Section 16B CBA 1958

- (1) states that Bank Negara Malaysia may establish a Shariah Advisory Council, which shall be the authority for the ascertainment of Islamic law for the purposes of Islamic banking business, takaful business, Islamic financial business, Islamic development financial business, or any other business which is based on Shariah principles and is supervised and regulated by the Bank.
- Section 16B (7) states that Bank Negara Malaysia shall consult the Shariah Advisory Council on Shariah matters relating to Islamic banking business, Takaful business, Islamic financial business, Islamic development financial business, or any other business which is based on Shariah principles and is supervised and regulated by Bank Negara Malaysia, and may issue written directives in relation to those businesses in accordance with the advice of the Shariah Advisory Council.
- Section 16B (8) states that where in any proceedings relating to Islamic banking business, Takaful business, Islamic financial business, Islamic development financial business, or any other business which is based on Shariah principles and is supervised and regulated by Bank Negara Malaysia before any court or arbitrator any question arises concerning a Shariah matter, the court or the arbitrator, as the case may be, may take into consideration any written directives issued by Bank Negara Malaysia as provided in sub-section (7); or refer such question to the Shariah Advisory Council for its ruling.
- Section 16B (9) states that any ruling made by the Shariah Advisory Council pursuant to a reference made shall, for the purposes of the proceedings in respect of which the reference was made if the reference was made by a court, be taken into consideration by the court in arriving at its decision; and if the reference was made by an arbitrator, be binding on the arbitrator.
- Section 16B (11) states that any request for consultation or reference for a ruling of the Shariah Advisory Council under the Act or any other law shall be submitted to the secretariat.
- Section 16B (10) states that the Bank Negara Malaysia may establish a secretariat and such other committees as it considers necessary to assist the Shariah Advisory Council in the performance of its functions and may appoint any of the officers of the Bank or any other person to be a member of the secretariat or any of such committees.



Establishment of Shariah Advisory Council

51. (1) The Bank may establish a Shariah Advisory Council on Islamic Finance which shall be the authority for the ascertainment of Islamic law for the purposes of Islamic financial business.

(2) The Shariah Advisory Council may determine its own procedures.

Functions of Shariah Advisory Council

52 (1) The Shariah Advisory Council shall have the following functions:

(a) to ascertain the Islamic law on any financial matter and issue a ruling upon reference made to it in accordance with this Part;

(b) to advise the Bank on any Shariah issue relating to Islamic financial business, the activities or transactions of the Bank;

(c) to provide advice to any Islamic financial institution or any other person as may be provided under any written law; and

(d) such other functions as may be determined by the Bank.

(2) For the purposes of this Part, “ruling” means any ruling made by the Shariah Advisory Council for the ascertainment of Islamic law for the purposes of Islamic financial business.

Sec. 56 of the CBA 2009

Section 56. Reference to Shariah Advisory Council for ruling from court or arbitrator.

(1) Where in any proceedings relating to Islamic financial business before any court or arbitrator **any question arises concerning a Shariah matter**, the court or the arbitrator, as the case may be, shall—

- (a) take into consideration any **published rulings of the Shariah Advisory Council**; or
- (b) refer such question to the **Shariah Advisory Council** for its ruling.

(2) Any request for advice or a ruling of the Shariah Advisory Council under this Act or any other law shall be submitted to the secretariat.

Effect of
Shariah
Rulings S57
CBA 2009

S 57. Any ruling made by the Shariah Advisory Council pursuant to a reference made under this Part shall be binding on the Islamic financial institutions under section 55 and the court or arbitrator making a reference under section 56.

Shariah Advisory Council ruling prevails

- **58.** Where the ruling given by a Shariah body or committee constituted in Malaysia by an Islamic financial institution is different from the ruling given by the Shariah Advisory Council, the ruling of the Shariah Advisory Council shall prevail.

CBA 1958 v CBA 2009

subject	CBMA 1958	CBMA 2009	Effect
Shariah Advisory Council ruling prevails	-	The ruling of the Shariah Advisory Council shall prevail.	It ensures harmonization of Shariah views in the country in the Islamic financial business regulated by Bank Negara Malaysia.
Islamic Financial Institutions to consult	In this regard, there is no equivalent provision found in CBMA 1958.	Any Islamic financial institution in respect of its Islamic financial business, may— (a) refer for a ruling; or (b) seek advice, of the Shariah Advisory Council on the operations of its business in order to ascertain that it does not involve an element which is inconsistent with the Shariah.	The implication of this new provision is that it ensures the authoritative role of Shariah Advisory Council.
Term of Appointment	CBMA 1958 is silent on the term of appointment.	A member of the Shariah Advisory Council appointed shall hold office on such terms and conditions as may be provided in their respective letters of appointment and shall be eligible for appointment.	The implication of this new provision is the formal appointment of Shariah Advisory Council members.
Restrictions on Members	Unless the Bank otherwise approves in writing, no member of the Shariah Advisory Council shall become a member of any Shariah advisory body of, or act as a Shariah consultant or Shariah advisor of, or assume any position or office to such effect for, or occupy any office or employment whether remunerated or not with, any banking institution or other financial institution.	There is no provision found equivalent in this regard found in CBMA 2009.	It could be understood that this part could be covered under the provision where it is stated that a member of the Shariah Advisory Council appointed shall hold office on such terms and conditions as may be provided in their respective letters of appointment, and shall be eligible for reappointment.

Statutory Legislations

Islamic Banking and
Takaful- Central Bank of
Malaysia Act 2009 and
IFSA 2013

Islamic Capital Market-
Securities Commission Act
1993 and Capital Market
and Services Act 2007.

Dispute Resolution

Multi-tier dispute resolution system

Court system

Dedicated High Court judge
to adjudicate Islamic finance cases

- Precedents for Islamic finance cases
- Competent pool of judges

Arbitration mechanism

Kuala Lumpur Regional Centre for
Arbitration

- Special rules
- Speed & confidentiality

Mediation Mechanism

Financial Mediation Bureau as
alternative dispute resolution
mechanism

- Scope of
jurisdiction
- Fast & low cost
dispute
settlement

... effective legal infrastructure instills public confidence

Court Jurisdiction

List 1 (Federal List), of the 9th Schedule of Federal Constitution includes civil, criminal procedures, contracts, *lex mercatoria* (inclusive of banking and financial laws), arbitration, the administration of justice, etc.

Para 1 of List 11 (State List) of the 9th Schedule of the Federal Constitution. Matters under the state list, inclusive of family law, personal law, divorce, waqf, succession, and the religion of Islam, including offences against it (except what falls under the Federal Law).

Bank Kerjasama Rakyat Malaysia v Emcee Corporation (2003) 2 MLJ 408;

The appellant granted the respondent a facility under the Islamic banking principle of BBA. Both parties executed two agreements on the same date.

Under the first agreement, the respondent sold 22 pieces of land to the appellant for RM20Million.

The second agreement, the appellant sold to the respondent the same properties upon deferred payment terms for 36 monthly installments. As security for the repayment of the sale price under the second agreement, the respondent charged to the appellant 15 pieces of the land under the NLC.

COA



- *“The law was mentioned at the beginning of this judgment the facility is an Islamic banking facility but that does not mean that the law applicable in this application is different from the law that is applicable if the facility were given under the conventional banking”.*
- The charge was a charge under the National Land Code. The remedy available and sought was a remedy provided by the Code. The procedure was provided by the National Land Code and the Rules of the High Court 1980.

Co-Ordination With Judicial Body

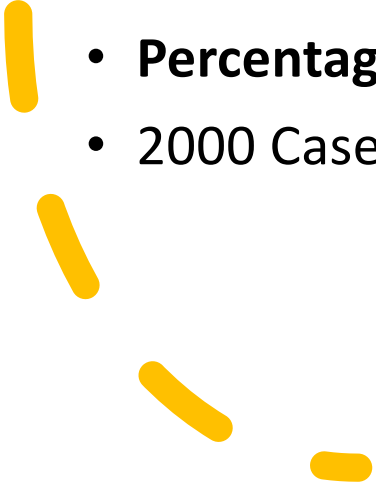
Lack of scholars with the right combination of knowledge of Islamic law, modern finance and technical English to serve on the *Shariah* committees of institutions based around the Gulf and beyond.

BNM with a cooperation of judicial body has agreed to set up a special High Court in the Commercial Division known as the Muamalah bench.

According to Practice Direction No.1/2003, paragraph 2, all cases under the code 22A filed in the High Court of Malaya will be registered and heard in the High Court Commercial Division 4 and this special high Court will only hear cases on Islamic banking.



Islamic Finance Litigation

- The implementation of muamalat bench shows a positive result on the increasing numbers of settled cases. From the statistic, it shows that more than 75% out of 656 cases has been settled by the court from year 2003 to 2005.
 - **Cases Registered from 1.3.2003 – 1.12.2005=656**
 - **Settled Cases from 1.3.2003-1.12.2005=497**
 - **Balance of Cases up to 1.12.2005=388**
 - **Percentage of Settled Cases from 1.3.2003 – 1.12.2005=75.7%**
 - 2000 Cases 2010-2011
- 

Which Court has jurisdiction to hear Islamic banking and finance cases?

MOHD ALIAS IBRAHIM

v

RHB BANK BHD & ANOR

[2011] 4 CLJ 654

[2011] 3 MLJ 26

Bai Bithaman Ajil Facility ('BBA facility') and cash line facility based on Bai' Inah principle.



Federal List

Islamic banking was put under Federal List since it refers to commercial dealings although it actually falls under the purview of Islamic law.

It is the parliament to pass any law governing the Islamic financial institutions.

The disputes will be heard in the Civil court due to Schedule Nine, List 2 of the Federal Constitution.

Refer Bank Islam Malaysia Bhd v. Adnan bin Omar.

*BANK ISLAM
MALAYSIA
BHD V LIM
KOK HOE &
ANOR AND
OTHER
APPEALS
[2009] 6 CLJ
22*

- The High Court judge questioned the validity and enforceability of the BBA contracts on two main grounds, namely that he found the BBA contracts to be more onerous than the conventional loan and that he found that the BBA contract practised in this country was not acceptable by all the four mazhabs in Islam. He thereby concluded that the BBA contracts were contrary to the basic principles of Islam.
- Held
- A BBA contract was a sale agreement whereas a conventional loan agreement was a money lending transaction. As such, the profit in a BBA contract is different from the interest arising in a conventional loan transaction.
- s 2 of the Act does not mean banking business whose aims and operations are approved by all the four mazhabs.

Court of Appeal

- “Similarly, the law applicable to BBA contracts is no different from the law applicable to loan given under the conventional banking. The law is the law of contract and the same principle should be applied in deciding these cases. Thus, if the contract is not vitiated by any vitiating factor recognised in law such as fraud, coercion, undue influence, etc. the court has a duty to defend, protect and uphold the sanctity of the contract entered into between the parties.”



Constitutional Issue on S56 and 57 of the CBA 2009

MOHD ALIAS IBRAHIM V RHB BANK BHD & ANOR [2011] 4 CLJ 654

Whether the impugned provisions were worded to the effect that they usurped the judicial power of the court to decide the ultimate issues in dispute between the parties by transferring such power onto another body, which in this case was the SAC?

Whether by imposing a duty on the court to refer any Shariah banking matter to the SAC and making the decision of the SAC binding on the court the litigants were deprived of any chance to be heard?

Held: S 52 of the Act provides that the SAC was established as an authority for the ascertainment of Islamic law for the purposes of Islamic banking business, takaful business and Islamic financial business. Thus, if the court referred any question under s 56(1)(b) of the Act to the SAC, the latter was required to merely make an ascertainment and not a determination of the Islamic laws related to the question. The sole purpose of establishing the SAC was to create a specialised committee in the field of Islamic banking to ascertain speedily the Islamic law on a financial matter. As such there was no reason for the court to reject the function of the SAC in ascertaining which Islamic law was to be applied by the civil courts in deciding a matter.

JRI RESOURCES SDN BHD v. KUWAIT FINANCE HOUSE (MALAYSIA) BERHAD; PRESIDENT OF ASSOCIATION OF ISLAMIC BANKING INSTITUTIONS MALAYSIA & ANOR (INTERVENERS) [2019] 3 MLRA 87

- Whether ss 56 and 57 of the CBA 2009, had the legal effect of encroaching on the judicial power of the courts, hence, were unconstitutional having contravened Part IX of the FC.
- **HC:** The respondent's claim at the High Court premised on the applicant's failure to make payment of the amount outstanding to the respondent under various Islamic Facilities Agreements granted, was allowed.
- **COA:** Allowed the applicant's appeal and directed that the question relating to the Shariah compliance of clause 2.8 of the facilities agreements granted by the respondent to the applicant be referred to the SAC. The SAC decided that the said clause was Shariah compliant. Dissatisfied, the applicant filed the present application for reference.

Federal Court

- RICHARD MALANJUM, CJ AHMAD MAAROP, PCA ZAHARAH IBRAHIM, CJM DAVID WONG DAK WAH, CJSS RAMLY HAJI ALI, FCJ AZAHAR MOHAMED, FCJ ALIZATUL KHAIR OSMAN KHAIRUDDIN, FCJ MOHD. ZAWAWI SALLEH, FCJ IDRUS HARUN, JCA
- Dismissing the application and holding that ss 56 and 57 of the 2009 Act were not in breach of the FC and unconstitutional.
- The ascertainment of Islamic laws for the purposes of Islamic financial business was a function or power delegated by the legislative branch to the judicial branch and the SAC.

