

Enhancing the effectiveness of legal Infrastructure: A Study on Legal Issues and other challenges of Islamic Banking and Finance in Malaysia

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One of the strategies in the Financial Sector Master plan of Malaysia is to set the country as a global Islamic financial hub by 2010. Malaysian banking industry is expected to constitute 20 percent of overall global banking and insurance market in terms of assets, financing and deposits. To achieve the Islamic financial hub status internationally, issues and challenges faced by the Islamic financial institutions should be highlighted and gives serious attention. In becoming global financial hub, domestic financial institutions need to enhance their capacity and capability so that they will be able to compete with global players in the industry in terms of product offerings and innovations, corporate governance and human capital. Does the legal infrastructure i.e. statutes is effective in supporting Islamic banking and finance in Malaysia?. Thus, the objective of this paper is to discuss legal infrastructure issue on Islamic banking in Malaysia such as legislation, civil court jurisdiction and also lack of expertise to hear Islamic Banking cases in the courts and also to see the possibility to enhance its effectiveness as a legal infrastructure and at the same time to promote Islamic banking as a mechanism to increase the economic value of the country. The methodology used relies on referring to the statutes and cases which has been decided by Malaysian court pertaining to Islamic banking and finance issue. Other than that, the paper find out the possible solution and recommendation in solving and minimising the issues and challenges face by Islamic Banking and finance institution in relation to the effectiveness of legal infrastructure.

Keywords: Islamic Banking Law, Regulation, Legal issues, Court Jurisdiction, Malaysian Law.

1.0 Introduction

An effective legal infrastructure is essential for the development of any type of sector in any country, especially in the Islamic finance sector which is currently enjoying a renaissance. The asset and liability structure of Islamic banks is unique. The risks exposed to each stakeholder of Islamic banks are also unique. The main concern is the fact that such unique structure may require a different type of regulation and supervision.

Islamic banks perform their operations in accordance with the rules and regulations of their domicile. They also comply with *Shariah* regulations as much as possible. Islamic banks

are expected to provide acceptable returns, safe banking environment and *Shariah* compliant instruments to customers. Although Islamic banks may claim full compliance with *Shariah*, regulation and supervision should be enforced in line with customer expectations. However, a uniform regulatory and legal framework supportive of an Islamic financial system has not yet been developed.

Islamic banking has come out with the various products in accordance with *Shariah*, which is clean from any uncertainty. The transaction of the Islamic Banking products nowadays is very efficient, in fact, it involve certain procedures to make sure the transaction is safe and attain its quality. There is certain documentation involved in operating the products of Islamic Banking. The products have their own step to be followed, agreements to be made, conditions to be fulfilled and to make sure transaction is done successfully without any problems.

2.0 Current Legal Infrastructure

As the truth of facts, there are two specific provisions governing Islamic Banking in Malaysia. One is the Islamic Banking Act 1983 (IBA) which exclusively governs Islamic banking in Malaysia and the other is Banking and Financial Institutions Act 1989 (BAFIA) which regulates conventional banks and Islamic Banking Divisions (IBDs). The natures of these laws are somewhat different as the IBA has been enacted to cope with the matters of Islamic Banking whereas BAFIA has been enacted to govern conventional banking. Therefore, the provision in BAFIA itself specifically provides that “the Act shall not apply to Islamic Banks.”¹ As such, one can loosely say that the IBA, as the name implies, is an Islamic statute while BAFIA is conventional or civil statute to govern their respective banks. The nature of dual banking system; a fully fledged Islamic banking system operating on a parallel basis with a sophisticated conventional banking system is unique.²

Thus, there are several legislations which have been referred to in the conduct of Islamic banking business i.e. Takaful Act 1984, Companies Act 1965, Securities Commission Act, Stamp Duty Act 1949, National Land Code, the Contracts Act 1950, Real Property Gains Tax Act 1967, Hire Purchase Act 1967, Sale of Goods Act 1957 and Development Financial Institutions Act 2002.

Despite of the existence of several referred provisions pertaining to the Islamic banking matters, there is still an unsolved major issue regarding the issue of jurisdiction of the court in determining the case involving Islamic banking and Takaful matters; whether it is the jurisdiction of the *Shariah* or civil court. This is certainly an issue of great importance and urgency as cases involving Islamic Banking are largely still awaiting decisions and settlements in courts.

2.1 Statutory Incompetency

¹ Section 124(6) of Banking and Financial Institution Act 1989.

² Norhashimah Mohd Yasin. 2009. *Islamic Banking in Malaysia: Legal Hiccups and Suggested Remedies*. Journal IIUM. Kuala Lumpur: IIUM's Publisher .Vol. 9. p 4.

An analysis of the provisions in the IBA shows that the Act is regulatory in nature and does not provide for the substantive law for Islamic banking. There have not been specific thoughts of meeting the requirements and expectation of the *Shariah* since the clauses used are mainly derived from the conventional banking practices and the existing banking laws. Moreover, the main legislative for Islamic banking in Malaysia is actually based on civil laws and falls within the jurisdiction of the civil courts. The evidence that the IBA is regulatory in nature can be seen in the arrangement of the section itself. Part 1 of the act is on preliminary part which contain short title, commencement, application and interpretation³. Part II of the act mainly provide a provision on licensing of Islamic Banks⁴. Furthermore, Part III of the act regulates the financial requirement and duties of Islamic Banks⁵. Part IV of the act provide the provision on ownership, control and management of Islamic Banks⁶. Part V of the act provide the provision for restriction on business⁷. While part VA provide provision on international Islamic banking business⁸. Part VI of the act provide the powers of supervision and control over Islamic banks⁹. Part VII is provisions on miscellaneous¹⁰ and part VIII is on consequential amendment¹¹. One of the example to be highlighted here is part V of the Act. Eventhough it provides the provisions for restriction on business but it is regulatory in nature and nothing to do with *Shariah*¹² principle. To make it more reliable, it is suggested if this part can be amended by adding an additional provision on restriction of business according to the *Shariah*, and the statute will be much more better in term of procedural and substantive law.

There are also ambiguities in this Act. For example, it does not define what is the meaning and scope of banking business, however in BAFIA, it defines the meaning and the scope of banking business¹³. Both statutes have the same objective but different subject matter where as IBA is to regulate Islamic bank and BAFIA is gazetted to regulate conventional bank¹⁴. Due to this reason, IBA need the definition of banking business which is in accordance with *Syara'*.

Another concern regarding IBA, the term “Religion of Islam” has not been defined clearly. This may give rise to ambiguity as to the position of the Islamic legal schools in the

³ Section 1 and 2 of Islamic Banking Act 1983.

⁴ Section 3-13A of Islamic Banking Act 1983.

⁵ Section 14-20 of Islamic Banking Act 1983.

⁶ Section 21-23 of Islamic Banking Act 1983.

⁷ Section 24-30 of Islamic Banking Act 1983.

⁸ Section 30A-30E of Islamic Banking Act 1983.

⁹ Section 31-43 of Islamic Banking Act 1983.

¹⁰ Section 44-56 of Islamic Banking Act 1983.

¹¹ Section 57-60 of Islamic Banking Act 1983.

¹² Under Part V of Islamic Banking Act 1983, there are 8 provisions which are regulatory in nature which are the provisions for restriction on payment of dividends and grant of advances and loans (Section 24), Prohibition of loans, etc., to directors, officers and employees (Section 25), Restriction on grant of loan, advance or credit facility under section 24 (4) (Section 26), restriction on credit to single customer (Section 27), control of credit limits (Section 27A), Disclosure of interests by directors (Section 28), Limitation on credit facility for purpose of financing the purchase or holding of shares (Section 29) and Proof of compliance with sections 24, 25, 26, 27 and 29.

¹³ Section 2 Banking and Financial Institution Act 1989.

¹⁴ Section 3 Islamic Banking Act provide that Islamic banking business to be transacted only by a licensed Islamic bank and Section 4 of Banking and Financial Institution Act 1989 provide that banking, finance company, merchant banking, discount house and money-broking businesses to be carried on only under license.

interpretation of the catch-all phrase “approved by the Religion of Islam” used in IBA¹⁵. If we look at the positive side, it is actually good for the invention and development of Islamic banking products. *Mu’amalah* or Islamic transaction is something different from *Ibadah* and without restrict its position to any school of Islamic thought, it will open to the *ijtihad* of *Shariah* Advisory Council to make a decision based on any Islamic School of thought with a justification¹⁶. It is very important for the growth of Islamic banking itself because the issue in banking is changing rapidly and there are a lot of product been invented and bunch of issues every year. Thus, *Shariah* Advisory Council play a very important role to take care of catch-all phrase “approved by the Religion of Islam” which used in IBA¹⁷.

Eventhough some people argue, this may give rise to ambiguity as to the position of the Islamic legal schools, it is already been mitigated by the existence of a *Shariah* Advisory Council (SAC) for the Islamic bank as required by the IBA, essentially to safeguard and ensure *Shariah* compliance. The general rule to be observed in Islamic Banking Finance (IBF) is ensuring that there is no contravention of any *Shariah* principles in the transactions. For example, all transactions must be free from the elements of usury, dubiousness and gambling. A new section was also added to the IBA in the 2003 amendment which is s 13A. It provides:

- (1) An Islamic bank may seek the advice of the *Shariah* Advisory Council on *Shariah* matters relating to its banking business and the Islamic bank shall comply with the advice of the *Shariah* Advisory Council.
- (2) In this section, “*Shariah* Advisory Council” means the *Shariah* Advisory Council established under subsection 16B(1) of the Central Bank of Malaysia Act 1958.

This amendment enables Islamic banks to seek the advice of the *Shariah* Advisory Council (SAC) of BNM, and it is mandatory for the Islamic banks to comply with the advice given by the SAC pursuant to such request. This indicates that the SAC has advisory powers over the Islamic banks, where liaison and common understanding between the SAB and SAC are expected. This will also ensure that *Shariah* compliance is always strictly observed and adhered to by the Islamic bank with the advice of the SAC.

The liaison with the SAC can also facilitate a shorter time frame in endorsing any new products in Islamic Banking and finance. Nonetheless, nothing in the IBA provides for a minimum qualification of lawyers who are involved in Islamic banking documentation and litigation. There is no specific requirement that lawyers dealing with Islamic banking transactions should have the relevant qualifications in drafting the documents. Generally, this lack of necessary knowledge of the *Shariah* and Islamic law could lead to mistakes in drafting

¹⁵ Norhashimah Mohd Yasin. 2009. *Islamic Banking in Malaysia: Legal Hiccups and Suggested Remedies*. Journal IIUM. Kuala Lumpur: IIUM’s Publisher .Vol. 9. pp. 10.

¹⁶ Interview with Dr. Abdul Halim El-Muhammady, former member of *Shariah* Advisory Council of Central Bank of Malaysia and member of *Shariah* Advisory Council of Bank Muamalat on 1st November 2011.

¹⁷ Ibid.

and also risks on the legality of the documents, especially for non-compliance with the *Shariah* principles.¹⁸

Another issue raised is that s. 3(1) of the IBA 1983 states that “Islamic banking business shall not be transacted in Malaysia except by a company which is in possession of a licence in writing from the Minister authorising it to do so”. So, it appears only an Islamic bank can do Islamic banking business. This is, in fact, not so.

One more issue to be pondered is on s. 55 of the IBA. It reads as follows:

“An Islamic bank which is incorporated under the Companies Act 1965 shall be sub to the provisions of that Act as well as the provisions of this Act, save that where there is any conflict or inconsistency between the provisions of that Act and the provisions of this Act the provisions of this Act shall prevail.”

The Legislature has in Section 55 limited its scope to cover only the Companies Act, in other situations where there are conflicts between Islamic law, and other Acts or laws or even principles of common law, Islamic law is not necessarily to prevail. How to resolve this issue? There are two consideration that may be taken into account as follows:

- (i) whether the court apply the legal maxim of *expressio unios alterius*? which means the express mention of one thing implies the exclusion of another. So, there is possibility that in Islamic Banking Act, it prevail over others act although it just expressly mention about Companies Act.
- (ii) By looking at the provision of Islamic Banking of Pakistan which stated that, “the provision of this ordinance shall have effect notwithstanding anything contained in the Companies Act 1913, or any other law for the time being in force”¹⁹

If comparison being made with the provision of section 55 of Islamic Banking Act 1983, the law in Pakistan expressly stated about others act and not confined to Companies Act only. Therefore, in Pakistan the IBA prevail over other acts include Companies Act. However, in Malaysia, there is no such words about prevail any acts except only the Companies Act in IBA. Thus, IBA just prevail over Companies Act. This situation needs to be immediately rectified.

In the case of disputes arising between an Islamic financial institution and its clients, they will have to refer the matter to the civil or common law courts that have jurisdiction to hear the litigation. This may result in decisions that may not comply with the *Shariah* rules. This problem is further exacerbated by the non-existence of any substantive law on Islamic financial services and banking practices in such countries. In short, although the transactions entered by the parties may be *Shariah* compliant in the first place, but upon enforcement of the contracts, the court may make orders and decisions that may sideline the Islamic legal principles

Moreover, in the event that there are conflicts and inconsistencies between the provisions of the special laws on Islamic financial services and those of the general laws of the country,

¹⁸ <http://islamicbanking-malaysia.com>

¹⁹ Section 42 of the Modaraba Companies and Modaraba (Flotation and Control) Ordinance, 1980.

there is no clear-cut position as to which law would prevail over the other like *takaful*, *sukuk* and others. These problems have been aptly illustrated in a number of cases that had gone to the civil courts of the country to resolve disputes arising between the parties.

The main problem that still remains, however, is the perceived uncertainty of the substantive Islamic rules and laws applicable to the Islamic financial transactions. This is mainly due to the uncodified nature of Islamic law on financial transactions in these countries. In the absence of substantive laws in the forms of codes and legislations, decisions and rulings are dependent very much on individual court rulings based on the judge's reading of the Islamic legal literature and opinions on the issues raised. Given the fact that most of the previous court decisions were not systematically reported, plus the non-binding nature of judicial precedents, future court decisions and judgments can be quite unpredictable. This can cause some trepidation on parties from other jurisdictions who are not familiar with the working of law and judicial process in the countries concerned. Hence, they may not choose to be governed by these countries' laws in their cross-border transactions; and may instead choose to be governed by civil or common law jurisdictions as evident in most cross-border Islamic financial transactions.²⁰

3.0 Jurisdiction of the Court in Islamic Finance

Generally, the term “jurisdiction” can be defined as the power of a court to hear and decide a case or make a certain order.²¹ While, “Islamic Banking” means banking business whose aims and operations do not involve any element which is not approved by the Religion of Islam.²² The term “banking business” itself is not defined and the IBA does not stipulate how that term is to be understood in the context of Islamic banking. Although Islamic law has long been regarded as being part of the law of the land, for the first time in the legal history of the country, Islamic law was given statutory force and placed on a footing on par with the civil law in banking matters.²³

3.1 Islamic Banking but Civil Court Jurisdiction.

Islamic banking in Malaysian is within civil court jurisdiction²⁴. There have been a number of cases heard in the Malaysian courts involving Islamic banking matters. Islamic law in Malaysia is only applicable in a very limited sphere: family law and “religious offences”. Islamic law is provided for under the State list and therefore is under the administration of each state.²⁵ Subsequently, there was an amendment to Article 121 of the Federal Constitution (FC) in 1988 which restrains the Civil Courts from having jurisdiction to hear cases where Islamic law is

²⁰ Dr Engku Rabiah Adawiah bt Engku Ali. *Constraints and Opportunities in Harmonisation of Civil Law and Shariah in the Islamic Financial Services Industry*. [2008] 4 MLJA 1.

²¹ Elizabeth A. Martin. 2006. *Oxford Dictionary of Law*. 6th edition. Oxford University Press: New York. p. 298

²² Section 2(1) of Islamic Banking Act 1983.

²³ Mohamed Ismail Shariff. *The Development of Islamic Banking Law in Malaysia*. [1998] 1 MLJA 145.

²⁴ Norhashimah Mohd Yasin. 2009. *Islamic Banking in Malaysia: Legal Hiccups and Suggested Remedies*. Journal IIUM. Kuala Lumpur: IIUM's Publisher .Vol. 9. pp. 5-7.

²⁵ Schedule 9, list II of Federal Constitution.

applicable and such jurisdiction is now vested in the Court.²⁶ Previously, the *Shariah* Courts and Civil Courts exercised concurrent jurisdiction on certain matters involving Islamic law. With the inclusion of Clause (1A) in Article 121 of FC, it was argued that the jurisdictions of the Civil Courts on matters involving Islamic law had been taken away. In addition, the subject matter that is being dealt with in the civil courts in Islamic *Shariah* financing cases is financing and not Islam.²⁷

Based on the provisions in the FC above, it can be concluded that the jurisdiction over Islamic banking and finance matters rests with the jurisdiction of civil courts. This is due to the fact that banking and finance matters are within List I (Federal List) of the Ninth Schedule on mercantile law. Although the term “Islamic law” in Paragraph 1, List II of Ninth Schedule is wide, its application is limited to persons professing the religion of Islam. Thus, it has no general application to other persons and legal persons, such as banks and financial institutions, who cannot be construed to be professing the religion of Islam. Furthermore, the legislations on Islamic banking and finance are all federal legislations that are subject to the civil courts' jurisdictions. There has not been any state legislation on Islamic banking and finance matters. The judgment of the Supreme Court in *Mohamed Habibullah bin Mahmood v Faridah Dato' Talib*²⁸ has ruled that the *Shariah* Court can only decide matters falling under its jurisdiction, as such the amendment to Article 121 of the Constitution does not take away the jurisdiction of the High Court in matters when they fall under the Federal list. Such matters include banking and finance.

Obviously, there are a number of leading cases that were decided in Civil Courts (High Court). The issue on the jurisdiction of civil courts to hear Islamic banking matters in Malaysia, and the possible conflicts that might ensue, had actually been heard and decided upon in the case of *Bank Islam Malaysia Berhad (BIMB) v Adnan Bin Omar*²⁹. In this case, the defendant argued that since BIMB is an Islamic Bank, the Civil Court had no jurisdiction to hear the case in view of Article 121 (1A) of the Federal Constitution. The judge, N.H. Chan overruled that objection and submitted that the matter was rightly brought before the Civil Court. It was submitted that List 1 of the Ninth Schedule enumerates the various matter in which Parliament can enact laws. The scope is very comprehensive which includes banking and the constitution, organization, jurisdiction and powers of all courts other than *Shariah* Courts and native customary courts. While, List II in the State List provides for the constitution, organization and procedure of *Shariah* Courts, which shall have jurisdiction only over person professing the religion of Islam and only in respect of any of the matters included which exclude banking. It was further held that since BIMB is a corporate body, it does not have a religion and therefore is not within the jurisdiction of the *Shariah* Court.

²⁶ Ahmad Ibrahim. *The Amendment to Article 121 of the Federal Constitution: Its Effects on Administration of Islamic Law*. [1989] 2 MLJ xvii.

²⁷ Fakihah Azahari. *Islamic Banking: Perspectives on Recent Cases Development*. [2009] 1 MLJA 91.

²⁸ [1993] 1 CLJ 264.

²⁹ [1994] 3 CLJ 735.

In another case relating to *Al-Bai Bithamanil Ajil* (BBA) transaction that was illustrated by the case of *Dato' Hj Nik Mahmud bin Daud v Bank Islam Malaysia Bhd*³⁰, it highlighted that there is no provision in the law at present that could be called in aid specifically to protect the validity of an Islamic banking transaction. Meanwhile, in the case of *Bank Kerjasama Rakyat Malaysia Berhad v Emcee Corporation Sdn. Bhd*³¹, the Court of Appeal decided that even though the facility given to the respondent was an Islamic Banking facility, it did not mean that the law applicable was different from the law applicable if the facility was given under conventional banking. Similarly, the case of *Tinta Press Sdn. Bhd. v Bank Islam Malaysia Berhad*³² where as in this case, the dispute was dealt with by the civil courts on the principles applicable to the common law of leasing even though the case is in relation to *ijarah* transaction.

3.2 Competency and Attitude of the Civil Courts to Hear Islamic Financing Cases.

Islamic principles are mandatorily applied with regards to the nature and operations of the Islamic banking, and for this purpose, there are specific rules and regulations supervised by the *Shariah* Advisory panel of banks and financier and the National *Shariah* Advisory Council under the Central Bank to ensure that any banks which operates Islamic Banking Scheme (IBS) is obliged to follow the Islamic principles. Hence, in the conduct of Islamic banking cases, the civil courts would be guided by the published *Shariah* resolutions made by the *Shariah* Advisory Council of Bank Negara Malaysia and the *Shariah* Committee of Islamic financial Institutions to shed light on *Shariah* issues presented to the court. The *Shariah* Resolutions are applicable to all Islamic financial institutions regulated and supervised by Bank Negara Malaysia and are part of the BAFIA rules and regulations.³³

The decisions in previous cases on Islamic Banking issues had properly considered the principles of just and equity as the primary consideration and fundamental principle of *Shariah* that shall not be compromised. In the cases of *Affin Bank Bhd v Zulkifli Abdullah*³⁴ and *Malayan Banking Bhd v Marilyn Ho Siok Lin*,³⁵ the judgments had rightly attempted to act within the parameters of justice and equity to attain a just result and to ensure that excess profit is not made in the name of Islamic principles.

However, many observations reveal that the civil courts are reluctant to refer to the *Shariah* Advisory Council when dealing with *Shariah* matters arising from the Islamic banking and finance and it is not surprising when in several occasions, the decisions made are contrary to the *Shariah* principles. In the case of *Arab Malaysian Merchant Bank Bhd v. Silver Concept Sdn Bhd*³⁶, it is clearly noted that in the civil court, not every presiding judge is a Muslim and even, if so, may not be sufficiently equipped to deal with matters, which *ulama'* take years to comprehend. The presiding judge further acknowledged that the *Shariah* Advisory Body appears to have rather wide scope of referral and not merely confined to issue of whether the matter at

³⁰[1998] 3 MLJ 396.

³¹[2003] 1 CLJ 625.

³²[1987] 1 CLJ 474.

³³section 126 of the BAFIA and section 53 of the IBA.

³⁴[2006] 3 MLJ 67.

³⁵[2006] 7 MLJ 249.

³⁶[2006] 8CLJ 9.

hand involves any element which is not approved by the Religion of Islam.³⁷ However, the judge was of the view that the final say must rest with the presiding judge as stated in section 16B (9) (a) of the Act.

Therefore, the Kuala Lumpur High Court in the case of *Tahan Steel Corporation Sdn Bhd v. Bank Islam Malaysia Bhd*³⁸ ruled that the ruling of the *Shariah* Advisory Council was not sought after in that case because the parties knew that the whole banking transaction in the present case was Islamic in nature.

Hence, the newly passed Central Bank of Malaysia Act 2009 which came into force on 3rd September 2009 is intended to ratify the above situation and it is done by granting the authority to the Central Bank of Malaysia for the establishment of the *Shariah* Advisory Council as the highest and sole authority to be referred by the civil courts in dealing with Islamic banking and finance cases in Malaysia.³⁹

4.0 Other Issues and Challenges

4.1 Corporate Governance.

To ensure the efficiency of the financial institutions, a safe, sound and stable financial system needs to be developed. This is to ensure survival in the economic instability and financial insecurity from within and outside the system. To have a stable financial system in the institutions there must be robust financial institutions, strong regulations and reliable infrastructure. Corporate governance in the Islamic financial system is necessary to reinforce sound regulations and supervision. It also contributes towards maintaining market confidence, strengthening transparency and accountability.⁴⁰

Thus the emphasis need to be value oriented and promote fairness and justice with respect to all stakeholders of the banking institutions. Islamic corporate governance serves through its underlying principles of the economic well being of *ummah*, universal brotherhood, justice and accountability in all levels of management, especially the board of directors.

4.2 Human Capital.

Lack of adequately trained human resource in the models and tools of Islamic finance is also one of the main issues in the Islamic financial system in Malaysia.⁴¹ Most of the Islamic financial institutions have generally recruiting bankers and financial professionals from the conventional institutions. Their recruitments is merely based on their industrial experience in banking system and operation and is not based on their expertise in the Islamic areas is very

³⁷ section 16B of the Central Bank of Malaysia Act 1958.

³⁸ [2004] 6 CLJ 25.

³⁹ Surianom Miskam. 2010. *Reference to the Shariah Advisory Council in Islamic Banking and Finance Cases: The Effect of the Central Bank of Malaysia Act 2009*. Proceeding ICBER 2010. p 2-4.

⁴⁰ *Ibid.* p. 21.

⁴¹ Norhaziah Nawai, Wan Rasyidah Wan Nawang. 2007. *Readings in Islamic Financial Services*. KUIM: Negeri Sembilan. p. 22

crucial since these people will become the people with credibility to explain and create awareness on Islamic financing among the society. Islamic financial system needs bankers and financial experts to effectively market, educate as well as advise the public on the Islamic financial products and services.

The Islamic institutions are currently facing a shortage of trained personnel who can analyze and manage portfolios as well as develop innovative products according to Islamic financial principles. Only a limited number of Islamic institutions can afford to train their staffs and deploy resources in product development. The personnel with the right blends between knowledge in finance and the understanding of *Shariah* are scarce.⁴² Hence Islamic financial institutions should work together particularly with the higher learning institutions to produce expertise. The collaboration effort between the financial institutions and universities in Islamic economic and financial service area will prepare the industry with suitable workforce for the Islamic banking business.

4.3 Shortage of Expertise.

The relevant issue nowadays is the lack of expertise in Islamic Banking area. Islamic-finance experts estimate that the sector is growing by about 15 percent a year⁴³. However, the rapid rate of growth in the sector has Islamic bankers worried that the industry is not keeping up with demand. That is because only a handful of Islamic scholars who are specialists in *Shariah*, or Islamic law, hold sway over Islamic finance, and evidence is growing that their expertise is rapidly being stretched too thin. Some *Shariah* experts say it may take more than a decade to train more scholars, but even the most optimistic ones do not expect a new generation of scholars for at least five years⁴⁴. The lack of scholars does not mean the industry is paralyzed, but it slows down development. This matter may lead to non-standard practices in respect of different contracts in different jurisdictions.

Different adoption of *Shariah* rules sometimes results in differences in financial reporting, auditing, and accounting treatments by Islamic banks.⁴⁵ For example, some *Shariah* scholars considered the terms of a *Mudharabah* or *Istina'* contract to be binding on the buyer, others argue that the buyer has the option to decline even after placing an order and paying the commitment fee. While each practice is acceptable by different schools of thought, the bank risk is higher in non-binding cases and it may lead to potential litigation problems in case of unsettled transaction. This also contributes into the problem of pending cases in the court.

4.4 Implementation of the concept into practice in Islamic Banking.

⁴² *Ibid*

⁴³ Mohammed Abbas. 2008. *Shortages of Scholars Troubles Islamic Banking*. The New York Times. [www. http://www.nytimes.com/2008/01/22/business/worldbusiness/22iht-bank.4.9412578.html](http://www.nytimes.com/2008/01/22/business/worldbusiness/22iht-bank.4.9412578.html). Retrieved on 9.7.2011.

⁴⁴ *Ibid*.

⁴⁵ Zamir Iqbal, Abbas Mirakhor. 2007. *An Introduction to Islamic Finance Theory and Practice*. John Wiley & Sons (Asia) Pte Ltd. p. 245

Basically, there are no problems in implementation the concept into practice in Islamic Banking nowadays. Many countries in the world have to apply the Islamic Banking system especially in Europe. Many sectors rely on the Islamic Banking in order to gain the profit and these kinds of products of Islamic Banking were applicable to all level of people. For instance, the products based on the Islamic Banking are suitable for Muslim or non-Muslim.

Islamic Banking in the modern world, generally aims to promote and develop the application of Islamic principles, law and traditions to transactions of financial, banking and related business affairs. It is also to promote investment companies to engage in such business activities that are acceptable and consistent within the *Shariah* precept. The main principles of Islamic banking are the prohibitions of interest (*usury*) in all transactions, the undertaking business and trade activities must be on the basis of fair and legitimate profit and the prohibitions of monopoly and hoarding. By doing so, Islamic banks will safeguard the Islamic communities and societies from activities that are forbidden in Islam.⁴⁶

As emphasis in earlier definition of Islamic banking system, Islamic Banks do not deal with loans except for benevolent loan or *Qardh Hassan*. Instead, they introduce *Musharakah* (Partnership), *Al-Bai Bithaman Ajil* (deferred payment sale as a result from trading activity) and *Mudharabah* (Profit Sharing of gain and losses), which make the investments of the Islamic Banks depend on the usefulness and feasibility to the project in which the money is invested. This is a contrast with traditional banks using the conventional system that loans out money for interest, without regard as to the usage to which the money will be put, because the bank knows that the client is able to repay the loan.

It may be concluded that, Islamic banking essentially is based on certain theoretical concepts and features before they are translated into practical operations. This process of translating the concepts and features into practice that creates challenges to the banks as they need to try to blend their traditional roles as financiers in trading activities, leasing activities and fee-based services.⁴⁷

5.0 Suggestions and conclusion

The possible solution and recommendation in solving and minimising the issues and challenges face by Islamic Banking and finance institution in relation to the effectiveness of legal infrastructure are very important to be identified.

5.1 Suggestions

There are numbers of the legal issues in Islamic banking and Takaful besides the conflict of jurisdiction between *Shariah* court and Civil Courts. Some flexible proposal must be taken into considerations which are the law applicable to Islamic banking has to be made certain and

⁴⁶ Nabil A. Saleh. *Unlawful Gain and Legitimate Profit in Islamic Law: Riba, Gharar and Islamic Banking*. JKAU: *Islamic Economy*. Vol.3. pp 115-124.

⁴⁷ Ahmad Lutfi Abdull Mutalip. 2008. *Practical Legal Issues in Islamic Banking*. Azmi & Associates. p2.

guidelines on the law applicable should be made clear. The legislatures must ensure that there are suitable amendments in various provisions of the relevant Acts to ensure that *Shariah* banking activities are truly implemented within the spirit and intent of the Holy Quran and to ensure that *Shariah* banking activities are principally aimed at creating a socio-economic balance within the spirit of *Shariah*.

Another suggestion is the provisions in Islamic Banking Act shall be review and reformulated to suit the requirement of Islam. Besides, there are also possible solutions regarding to these issues which are establishment of *Shariah* Governance Systems, competent, high-caliber Islamic Finance Professionals and management teams with the required expertise, well-informed individual and corporate consumers, and knowledgeable about Islamic banking and takaful. In advance, the availability of *Shariah* compliant products and modern technology solutions was designed to support Islamic finance.

Amendments to the Acts relating to Islamic financial system, such as Central Bank Act 2009, Bank and Financial Institution Act 1989, by inserting a provision should be allocated to not have to depend on or only minimal reliance on the law of other statutes to operate. Other measures can be taken is the formulation of Islamic law such as contract law, sale or companies that are inherent in Islamic *Muamalat* to replace the Contracts Act 1950, the Hire Purchase Act 1956 and Companies Act 1965. It is also the right time to regulate a statutes which are comply with Islamic Financial system. Malaysia need to have Islamic Hire Purchase Act, Islamic Contract Act and also Islamic Companies Act in order to ensure that the practices are in accordance with *Syara'*.

Amendments to Section 3 and Section 5 (1) Civil Law Act 1956 which provides that the court may adopt the English law in the absence of legal provision in question or the issue of banks and banking. Amendments can be made either by (i) eliminate the act, or (ii) introduce Islamic law as a reference the court, especially cases involving the issue of *Shariah*, or (iii) exempt the user of English law in cases concerning the financial and banking Islam.

5.2 Conclusion

It is a paradox to be remarked when one said that Islamic banking and finance matters are governed by the civil courts instead of *Shariah* courts, but that is the truth of the fact. One must analyze the issue thoroughly and must not merely be confused by the terms Islamic and conventional. Pertaining to the issue of the jurisdiction, the law has been there, but the compatibility of the law has long been in question.

Islamic banking has proved vital potential as a competitive and better substitute against conventional banking system in many countries of the world. This can be seen in our current situation where Islamic banking system being accepted in various countries and approved throughout the world about its effectiveness. It is said to be a better substitute for current conventional system.

With the implementation of Islamic norms in banking system, it changed our daily system on how we operates and manage our financial matters. It get rid all cumbersome, burdensome and sometime doubtful forms of financing as being provided under conventional system. As opposed to conventional system, Islamic banking system offer a clean and efficient interest-free banking.

One of the key factors in maintaining the sustainable growth of Islamic finance industry locally or globally is an effective legal infrastructure in order to provide an effective adjudication forum for legal redresses arising from dispute revolving around Islamic financial transaction. It is also one of the critical elements in stilling and maintaining the public confidence in the system. Most importantly, the effective legal infrastructure should be able to appreciate the underlying principles of Islamic financial contract in eliminating *riba* and propogating social justice in the society.

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