

THE CONNECTION BETWEEN ROBUST LEGAL INSTRUMENTS AND THE EXCEPTIONAL PERFORMANCE OF THE ISLAMIC BANKING INDUSTRY

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Abstract

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This study investigates the pivotal role of robust legal instruments in driving the outstanding performance of Malaysia's Islamic banking industry. Our primary objective is to discern the correlation between the regulatory framework's legal strength and the industry's achievements. To achieve this, we embark on a comprehensive exploration of the historical progression of Islamic banking in Malaysia. We scrutinize the dynamics and milestones that have shaped the industry, with particular emphasis on its impressive growth. We then delve into the development of the regulatory frameworks, analyzing how the availability of strong legal instruments has contributed to the sector's triumph. This study finding the presence of robust legal instruments has been a catalyst for the ascension of Malaysia's Islamic banking industry. Coupled with accommodating regulations and responsive regulatory institutions, these legal foundations have underpinned the sector's remarkable success. This study underscores the critical importance of having sufficient legal instruments to nurture the Islamic banking industry. We recommend that governments aspiring to bolster Islamic banking's performance consider the provision of such legal frameworks. Consequently, this research carries significant implications for policymakers and industry stakeholders alike, offering insights into the essential ingredients for fostering a thriving Islamic banking sector.

Keywords: Regulatory Frameworks, Islamic Banking, Legal Instruments, Exceptional Performance, Malaysia

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1. INTRODUCTION

In the discussion on the stages of the development of Islamic banks, there is an interesting point to consider regarding the global initiatives made by various parties across the globe. Understanding the trends through which Islamic banking has

evolved is crucial. Significant changes and transformations that have occurred in the Islamic banking business during its long journey are essential aspects to consider in order to align with the overarching missions of Islamic banking. The idea itself was pioneered by Muslim scholars from the sub-continent and gained popularity in

the 1970s. The Muslim world owes a debt of gratitude to leaders and scholars from the sub-continent for their tireless efforts in propagating this idea. The inauguration of the Central Bank of Pakistan marked the establishment of an independent state of Pakistan, partly aimed at abolishing *riba* (interest) in the banking system. Since then, the battle against *riba* has been more vigorously advocated by Muslim scholars. Among the most notable figures were Khursyid Akhmad and Nejatullah Siddiqi, both of whom were Pakistani, and later, Muhammad An-Najjar from Egypt (Haron & Shanmugam, 1997). After facing numerous failures and setbacks, the Islamic banking business found its suitable model in the 1970s, thanks to the successful experiment undertaken by Muhammad An-Najjar with Mit Ghamr Local Savings Bank in Egypt (Haron & Shanmugam, 1997).

Today, approximately 50 years after the aforementioned declaration, Islamic banking has grown into a global industry with a presence spanning from Africa to America, Europe to Australia, and involving more than 80 countries. It has embraced individuals from diverse religious backgrounds, racial identities, country origins, and political affiliations (Domat, 2024). Today, it stands as a behemoth within the banking industry. Moreover, in countries that have adopted a policy of complete conversion from conventional to Islamic banks, conventional banks have even been “absorbed” by Islamic banks. In some countries with a dual banking system, the share of Islamic banking assets compared to the total assets of the banking industry continues to steadily increase.

Malaysia is among the best examples of this phenomenon, where the assets of Islamic banking account for approximately 31.5% of the entire national banking industry’s assets. While this figure is lower than Brunei’s 58%, in terms of overall value, Malaysia’s contribution to the global assets of Islamic banking ranks third, following Saudi Arabia and Iran (Islamic Financial Services Board [IFSB], 2022). In addition to this remarkable achievement, Malaysia also holds the highest ranking among all countries participating in the Islamic financial business in the Islamic Finance Development Indicator (IFDI) 2022, as reported by the Islamic Corporation for the Development of the Private Sector (ICD) and Refinitiv (ICD & Refinitiv, 2022).

The paper consists of five major sections starting with Section 1, where the purpose and objectives of the study are presented, followed by Section 2, where past research and studies related to the topic are discussed. Next, Section 3 discusses the research design and analytical methods employed in the study. Section 4 presents the findings of the research, and their interpretation followed by a discussion of the findings in light of the research purpose and objectives of the study. Finally, Section 5 summarizes the main findings of the research, their significance, and implications for future studies in the field.

2. LITERATURE REVIEW

The Islamic banking industry has witnessed remarkable growth and development in Malaysia over the past few decades. The roots of Islamic

banking in Malaysia can be traced back to the early 1960s with the establishment of *Lembaga Tabung Haji* (Azahari, 2009; Kitamura, 2020; Rethel, 2020). However, it was in the 1980s that significant strides were made to promote Islamic banking as a viable alternative to conventional banking (Azman et al., 2023). The Malaysian government’s commitment to fostering the growth of Islamic finance played a pivotal role in shaping the industry. This commitment was reflected in the incorporation of Islamic finance principles into the country’s legal and regulatory framework.

One of the key drivers behind the success of Islamic banking in Malaysia has been the unwavering support of the government. Malaysia’s successive economic development plans, such as the Malaysia Plans and the Financial Sector Masterplan (FSMP), have consistently emphasized the importance of Islamic finance as a strategic component of the nation’s economic growth (Triyanta et al., 2023). These policies have included incentives for the establishment of Islamic banks, *takaful* (Islamic insurance) companies, and Islamic capital markets.

The legal framework and regulatory environment have been instrumental in nurturing the Islamic banking industry in Malaysia. The country has introduced a series of laws and regulations specifically tailored to govern Islamic finance. The Islamic Banking Act 1983 and the Takaful Act 1984 provided the legal foundation for Islamic banks and *takaful* operators (Aziz et al., 2019). Subsequent legislation, such as the Islamic Financial Services Act (IFSA) 2013 and the Financial Services Act (FSA) 2013, further refined the regulatory landscape. These laws have delineated the roles and responsibilities of various market participants, including Shariah compliance requirements, risk management standards, and corporate governance guidelines.

Shariah compliance is at the core of Islamic banking in Malaysia. The appointment of Shariah advisory boards within Islamic financial institutions ensures adherence to Islamic principles and ethical standards (Hasan et al., 2020). These boards comprise renowned Islamic scholars and jurists who provide guidance on the compatibility of financial products and transactions with Shariah principles. The strict observance of Shariah principles has enhanced the industry’s credibility and attractiveness to both Muslim and non-Muslim customers.

Malaysia’s Islamic banking sector has been characterized by continuous innovation in product offerings. The introduction of various Islamic financing structures, such as *Mudarabah*, *Murabahah*, and *Bai’ Bithaman Ajil* (BBA), has allowed Islamic banks to cater to a diverse range of customer needs (Yustiardhi et al., 2020). Furthermore, the country’s capital market has seen the issuance of Islamic bonds, or *sukuk*, which has attracted global investors seeking Shariah-compliant investment opportunities (Uluyol, 2023).

Effective dispute-resolution mechanisms have contributed to the confidence and stability of the Islamic banking industry. Malaysia has established specialized Shariah commercial courts and arbitration panels to handle Islamic finance disputes. These mechanisms ensure that conflicts are resolved in a manner consistent with Islamic

principles and within a legal framework that inspires trust among market participants (Trakic et al., 2019).

Malaysia's success in developing its Islamic banking industry has earned it international recognition. The country actively collaborates with international standard-setting bodies, such as the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and IFSB (AlAbbad et al., 2019). This collaboration facilitates the harmonization of global Islamic finance standards and enhances Malaysia's reputation as a leader in the field. The exceptional performance of the Islamic banking industry in Malaysia is the result of a multifaceted interplay of factors, including government policies, a robust legal framework, Shariah compliance, innovation, and effective dispute-resolution mechanisms.

3. RESEARCH METHOD

This study employs a comprehensive research approach that incorporates a literature review, case study analysis, and qualitative analysis of legal instruments. Each of these components contributes to a holistic understanding of the connection between robust legal frameworks and the exceptional performance of the Islamic banking industry in Malaysia. The research begins with an extensive literature review that delves into existing academic literature, government reports, and industry publications. This review encompasses studies related to Islamic banking, legal frameworks, government policies, and dispute-resolution mechanisms. The objective is to establish a foundational knowledge base and identify key concepts, trends, and theoretical frameworks relevant to the research. The core of this research involves in-depth case studies of the Islamic banking industry in Malaysia. Multiple case studies are conducted to examine specific aspects of the industry's development. These cases encompass a range of variables, including government policies, legal regulations, and the effectiveness of dispute-resolution mechanisms. The selection of cases is guided by their significance in portraying the intricate relationship between legal instruments and industry performance. A qualitative analysis is conducted to scrutinize the legal instruments governing Islamic banking in Malaysia. This analysis involves a detailed examination of relevant laws, regulations, and regulatory bodies. Qualitative data is collected through document analysis and interviews with key stakeholders, including legal experts, policymakers, and industry practitioners. The objective is to uncover the nuances of how legal instruments are designed, implemented, and enforced to support the Islamic banking sector. Data from the literature review, case studies, and qualitative analysis are synthesized to draw meaningful insights. Comparative analysis is employed to identify patterns, correlations, and causal relationships between the legal framework and the industry's performance. The analysis aims to elucidate how specific legal provisions, regulatory bodies, and government policies have contributed to the success of Islamic banking in Malaysia.

4. RESULTS AND DISCUSSION

4.1. The emergence of Islamic banking industry in Malaysia

The Islamic banking and finance industry in Malaysia commenced its journey in 1963 with the establishment of *Lembaga Tabung Haji*. The inception of this idea took place in December 1959 when it was proposed to the Federal Government of then Malaya. Subsequently, in 1963, the Prospective Hajj Pilgrims Savings Corporation was established under Law No. 34 of 1962, and it was placed under the supervision of the Ministry of Rural Development. This corporation made history by opening counters to collect deposits from prospective Hajj pilgrims in the country. It aimed to instil the practice of savings from an early age among Malaysian Muslims within a Shariah-compliant organization that strictly avoided prohibited elements like *riba*, preparing them financially for their Hajj pilgrimage. The remarkable achievements of *Lembaga Tabung Haji* garnered numerous suggestions to the Government of Malaysia regarding the establishment of a full-fledged Islamic bank. As a result, a series of meetings and conferences were convened, eventually leading to the formation of a national council in 1981. This council comprised 20 experts in the field who were tasked with studying the concept of establishing Islamic financial institutions in Malaysia (Akram Laldin, 2008).

The impetus to initiate Islamic banking activities in Malaysia originated from the Muslim community. In 1980, the government received a call from the Bumiputra Congress to commence Islamic banking operations. Then, in 1981, a comprehensive study was conducted by the National Steering Committee to assess the feasibility of establishing a new Islamic bank in Malaysia. The primary role of this committee was to furnish the government with in-depth research and analysis of various legal aspects (Hassan et al., 2016).

The outcome of this study was favourable, paving the way for the establishment of Malaysia's first full-fledged Islamic bank, named Bank Islam Malaysia Berhad. It is widely believed that the inception of Bank Islam Malaysia marked the initial step in the construction of the Islamic financial system in Malaysia. Among the Islamic banking products introduced by Bank Islam were *Mudarabah*, *Murabahah*, *Bai' Bithaman Ajil*, and *Qard Hasan*. Bank Islam demonstrated its viability as a banking institution, expanding its operations through 80% of its branches within a decade. Furthermore, in 1992, the bank was listed on the main board of the Kuala Lumpur Stock Exchange (Hassan et al., 2016).

4.2. Robust regulatory framework

In addition to taking the initial steps to respond to the call for Islamic banking, the Malaysian government introduced the Islamic Banking Act of 1983. A year later, in 1984, the Takaful Act was enacted, which pertained to insurance companies compliant with Islamic principles. Following these

developments, Malaysia's Islamic financial system operated in parallel with the conventional system. Islamic banks were regulated by the Islamic Banking Act of 1983, while *takaful* companies were governed by the *Takaful* Act of 1984. On the other hand, conventional banks and insurance companies were subject to the Banking and Financial Institutions Act (BAFIA) 1989 and the Insurance Act 1963, respectively (Hassan et al., 2016). As previously mentioned, Malaysia's Islamic financial system has operated in tandem with the conventional system, known as the dual-banking system. This dual-banking system in Malaysia offers two primary advantages. Firstly, it results in a wider range of Islamic financial products being available, and secondly, the Islamic banking products within this dual system tend to exhibit a higher level of sophistication. This is because the dual-banking system allows Islamic banks to adapt to innovations in the conventional banking system, compelling them to create comparable products that adhere to Shariah principles.

In 1993, the Central Bank of Malaysia launched an interest-free banking scheme, also known as *skim perbankan tanpa faedah* (SPTF). This scheme successfully attracted the participation of the three largest commercial banks in Malaysia: Malayan Banking Berhad (Maybank), Bank Bumiputera Malaysia, and United Malayan Banking Berhad Corporation (Yakcop, 2003). The Central Bank saw this as an opportunity to promote Islamic banking on a broader scale by permitting conventional banks licensed under BAFIA to offer Islamic banking services using their existing infrastructure (Yakcop, 2003). Subsequently, this scheme was upgraded to the Islamic banking scheme or *skim perbankan Islam* in 1998. Under this enhanced Islamic windows scheme, all banking institutions with Islamic windows were mandated to elevate their Islamic banking units and establish Islamic banking divisions, overseen by senior-level management officers.

The establishment of Bank Muamalat Malaysia Berhad (BMMB) in 1999 as the second full-fledged Islamic bank signifies the expanding landscape of the Malaysian Islamic banking industry. This bank was formed through a merger between Bank Bumiputera Malaysia Berhad (BBMB) and Bank of Commerce Berhad (BOCB) (Razad, 2003). A significant amendment to BAFIA, marked by the insertion of Section 124, permitted conventional banks to engage in Islamic banking or Islamic financial activities alongside their existing licensed operations. This change paved the way for numerous licensed conventional banks under BAFIA to transition their operations into full-fledged Islamic banks as subsidiaries (Hassan et al., 2016).

The Malaysian Islamic banking and finance sector achieved another milestone with the enactment of the Islamic IFSA 2013 and the FSA 2013. These acts were introduced to accommodate the industry's rapid growth and provide comprehensive regulatory frameworks for Islamic banking, expanding the scope of banking regulations in the country (Lee & Oseni, 2015). The introduction of FSA 2013 repealed the BAFIA 1989, Insurance Act 1996, Payment Systems Act 2003, and Exchange Control Act 1953 (Section 271 of FSA 2013). Conversely, IFSA 2013

repealed the Islamic Banking Act 1983 and *Takaful* Act 1984 (Section 282 of IFSA 2013).

The legal framework for the Islamic banking industry in Malaysia comprises three types of legislation: 1) enabling laws, 2) transactional laws, and 3) guidelines on Islamic banking. The table below illustrates the types of legislation applicable to Islamic banking in Malaysia.

Table 1. The legislations for Islamic banking in Malaysia (extracted)

<i>Enabling laws</i>	<i>Transactions laws</i>
<ul style="list-style-type: none"> - Central Bank of Malaysia Act 2009; - Islamic Financial Services Act 2013; - Financial Services Act 2013; - Government Funding Act 1983; - Development of Financial Institution Act 2002; - Securities Commission (Amendment) Act 2015; - Capital Market and Financial Services (Amendment) Act 2015. 	<ul style="list-style-type: none"> - Contracts Act 1950; - Hire Purchase (Amendment) Act 2010; - Real Property Gains Tax 1976; - Stamp Duty Act 1949; - National Land Code 1960; - Anti-Money Laundering, Anti-Terrorism Financing and Proceeds of Unlawful Activities Act 2001; - Rules of Court 2012.

Source: Bank Negara Malaysia (n.d.).

Regarding guidelines, it is the nature of the banking business that constantly faces challenges due to rapid innovations in the business and changing economic conditions. Bank Negara Malaysia, as the central bank responsible for the well-being of Islamic banking, appears to be very responsive in issuing various guidelines as compulsory instruments to support the Islamic banking business.

4.3. Strong regulatory authorities

An adequate regulatory system shall benefit the Islamic banking industry. A sufficient and robust regulatory system will increase the effectiveness of the Islamic banking system, help maintain the financial stability of the industry, standardize policies and guidelines for Islamic banks, regulate and monitor the industry's performance, and mitigate any negative impacts from the fluctuating financial market. Regarding the regulatory authorities for the Islamic banking industry in Malaysia, there are three categories: 1) private regulatory authorities, 2) self-regulated bodies, and 3) international standard-setting bodies.

The Central Bank of Malaysia, the Securities Commission Malaysia (SC), and the Labuan Financial Services Authority (Labuan FSA) are the private regulatory authorities for the Islamic banking system in Malaysia. Regarding the Central Bank of Malaysia, it is a statutory body governed by the Central Bank of Malaysia Act (CBMA) 2009. The bank was established and began its operations on 26 January 1959. The general functions of the Central Bank of Malaysia include acting as the regulator and supervisor of Islamic banks, international Islamic banks, *takaful* and *retakaful* operators, international *takaful* operators, and serving as a Shariah Advisory Council (SAC) for Islamic banking and *takaful*.

The Central Bank, serving as the SAC, holds the highest authority for Shariah matters in Islamic banking and *takaful*. The primary objective of

the Central Bank is to promote monetary stability and financial stability conducive to the sustainable growth of the Malaysian economy, as outlined in the Central Bank of Malaysia Act 2009, Section 5(1). On the other hand, the SC was established on March 1, 1993, in accordance with the Securities Commission Act 1993. The SC operates as a self-funding statutory body with investigative and enforcement powers, and it reports to the Minister of Finance, with its accounts being tabled in Parliament annually (SC, n.d.-a). Labuan FSA, established on February 15, 1996 under the Labuan Financial Services Authority Act 1996, is also a statutory body with responsibilities related to the development and administration of the Labuan International Business and Financial Centre (Labuan IBFC).

There are also three self-regulated bodies governing the Islamic banking system in Malaysia: 1) the Malaysian Takaful Association (MTA), 2) the Association of Islamic Banking Institutions Malaysia (AIBIM), and 3) the Association of Shariah Advisors in Islamic Finance (ASAS). The MTA was established under the Malaysian Societies Act 1966 in November 2002. MTA operates as a statutory association, and in accordance with the Takaful Act 1984, all *takaful* operators in Malaysia are required to be members of MTA before commencing their operations. MTA's affairs are managed by a Secretariat responsible for implementing and overseeing the execution of initiatives and directives set forth by the management committee.

The AIBIM was established in 1996 under the name "Association of Interest-Free Banking Institutions Malaysia". AIBIM currently has 27 member banks, including 12 domestic banks, 5 development financial institutions, and 10 locally incorporated foreign banks operating in Malaysia. The primary purpose of AIBIM is to provide advice and assistance to its members in the development of Islamic banking and finance at local, regional, and global levels. Additionally, AIBIM aims to promote a sound Islamic banking system and practices in Malaysia (AIBIM, n.d.). On the other hand, the ASAS was founded on April 12, 2011. ASAS gained national recognition as part of the agenda outlined in the Financial Sector Blueprint (2011-2020) under Agenda 3.2: Internationalization of Islamic finance (ASAS, n.d.). ASAS's objectives include promoting and maintaining a high level of professionalism with standards of competence and conduct for Shariah advisory services in Islamic finance, fostering and preserving public confidence and trust in Islamic finance and Shariah products and services, as well as promoting and facilitating professional development and education in Islamic finance (ASAS, n.d.).

In addition to being supervised by the Central Bank of Malaysia, Islamic banks in Malaysia are also subject to certain rules and regulations set forth by international standard-setting bodies. However, it's important to note that the rules introduced by these international standard-setting bodies hold a persuasive rather than binding status, as the SAC of the Central Bank is recognized as the highest authority regarding Shariah matters in Malaysia. There are four prominent international standard-setting bodies in this context: 1) the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI, n.d.),

2) the IFSB, 3) the International Islamic Financial Market (IIFM, n.d.), and 4) the Basel Committee on Banking Supervision (BCBS) (Bank for International Settlements [BIS], n.d.).

One of the most notable among these standard-setting bodies is the IFSB, which is headquartered in Kuala Lumpur. The fact that this body is located in Kuala Lumpur may enhance the global perception of the government's strong commitment to supporting the industry's development. IFSB was officially established on November 3, 2002, and began its operations on March 10, 2003. It serves as an international standard-setting body for regulatory and supervisory agencies with a vested interest in ensuring the soundness and stability of the Islamic financial services industry. IFSB also promotes the development of a prudent and transparent Islamic financial services industry by introducing new standards or adapting existing international standards consistent with Shariah principles, recommending them for adoption. To date, IFSB has issued twenty-seven standards, guiding principles, and technical notes for the Islamic financial services industry accordingly.

4.4. Dispute resolution mechanisms: Sufficiency in legal apparatuses and modes of resolution

The development of business transactions has always been closely linked to the methods used to settle disputes. Transactions, particularly those outlined in contracts, involve the allocation of rights and obligations. Contracts are governed by fundamental principles, and consent is one of the principles that must be safeguarded to ensure the high quality of transactions. In this context, the process of dispute settlement must be well-defined within the regulatory framework. The absence of such provisions can create hesitation among parties involved in business transactions, as it introduces uncertainty into the dispute resolution process. In the context of Islamic banking in Malaysia, dispute settlement typically involves a litigation process, namely, resorting to the court system, rather than non-litigation methods such as alternative dispute resolution.

A further question may arise regarding the reasons for appointing the civil court to settle disputes related to Islamic banking contracts in Malaysia, as opposed to the Shariah court. This designation is based on the consideration and argument that Islamic banking business shares similarities with general business activities and, therefore, should fall under the jurisdiction of the civil court. In contrast, the Shariah court is more focused on family law matters and certain aspects of criminal offences, leading to a lack of expertise among its judges in handling business cases. Different countries may adopt varying policies in this matter, with some arguing that Islamic banking transactions fall under the *muamalah* area and, therefore, should be handled by the Shariah or religious court. In its initial stages, Malaysia established a specific desk or division within the civil court to handle disputes related to Islamic banking transactions (Hasshan, 2017). This clearly indicates that sufficient infrastructure and organizational structure have been developed to

provide a more effective solution to the issue of dispute settlement.

The English judicial hierarchy forms the basis for the Malaysian court system, with the Federal Court being the highest court in the country. Malaysia's court system is classified into two categories: 1) subordinate courts and 2) superior courts. In terms of the litigation process, it involves one party suing or making a claim related to a dispute or disagreement in court. Islamic banking disputes often raise the question of which court should hear the dispute, considering that Malaysia has two types of courts: 1) the civil court and 2) the Shariah court. Since Islamic banking matters are governed by Islamic law and principles, it is commonly believed that such disputes should fall under the jurisdiction of the Shariah court. However, Paragraph 1 of List II of the Ninth Schedule of the Federal Constitution specifies that Shariah courts have jurisdiction only over matters listed in List II, which is the State List. List II of the Federal Constitution grants Shariah courts authority over Muslim personal matters, such as marriage, divorces, wills, and succession. The term "Islamic law" in Paragraph 1, List II of the Ninth Schedule is limited to individuals professing the religion of Islam and does not include institutions or companies like banks and financial institutions that do not fall under the category of individuals professing the religion of Islam (Hassan et al., 2016).

On the other hand, according to List I of the Ninth Schedule of the Federal Constitution, civil courts have jurisdiction over all matters, including civil and criminal procedures, contracts, mercantile laws, and arbitration. Consequently, banking and financial matters fall under the scope of mercantile laws, which include banking and financial laws. Therefore, any disputes related to Islamic banking and finance matters should be heard in civil courts, where judges are guided by laws and regulations that do not reference the application of Islamic law. This situation has led to significant confusion within the Islamic banking industry.

Realizing the legal constraints faced by the Islamic banking and finance industry, a Shariah commercial court was established based on the recommendations made in the FSMP (2001-2010). The Shariah commercial court is responsible for hearing and addressing legal issues related to Islamic financial business and *takaful* in Malaysia. In 2003, a positive step was taken by the former Chief Judge of Malaya, Dato' Haidar Bin Mohamed Noor, who issued Arahan Amalan No. 1/2003 — Pendaftaran Kes-Kes Muamalat di Mahkamah. Effective from March 1, 2003, all Islamic financial or transaction cases were required to be registered with special classification codes. The specialized Muamalat Court officially commenced its operations in February 2009. Structurally, the Muamalat Court is part of the commercial division of the Kuala Lumpur High Court and is designated to hear all cases related to Islamic financial business (Hasshan, 2016).

In response to the market demand for more flexible options for settling disputes in the field of Islamic finance, alternative dispute resolution mechanisms, including arbitration and mediation, have been initiated alongside the litigation process. Today, there are two mechanisms available for resolving Islamic banking disputes in Malaysia:

1) litigation and 2) alternative dispute resolution (Hikmany & Oseni, 2016). Disputes are an inevitable part of human relationships and have been widely practised across different generations. Parties involved in a dispute may choose to refer their case to an arbitration centre. The Kuala Lumpur Regional Centre for Arbitration (KLRC) is the main body responsible for supervising and managing the arbitration process in Malaysia. Established under the auspices of the Asian-African Legal Consultative Organization (AALCO) in 1978, KLRC provides institutional support and a convenient venue for domestic and international arbitrations. In 2007, KLRC introduced the Rules for Arbitration of Kuala Lumpur Regional Centre for Arbitration (Islamic Banking and Financial Services) to encourage the use of arbitration for disputes arising from Islamic financial services. According to Rule 1, paragraph 3, "*these rules shall be applicable for the purposes of arbitrating any commercial contract, business arrangement, or transaction based on Shariah principles*" (p. 1). Currently, there are 23 panellists for Islamic banking arbitration, and the latest rules for Islamic banking disputes are the KLRC-i Arbitration Rules (revised 2013).

Mediation is a flexible process that involves a neutral person actively assisting disputants in reaching a negotiated agreement for resolving a dispute or difference (Hollingdale, 2015). It is a cooperative and collaborative process where the parties involved maintain control over the outcome. Mediation is voluntary, confidential, and the resulting agreement is not binding on the parties unless they agree to it. This makes mediation a contextual alternative to litigation that doesn't compromise either side's litigation strategy or reveal sensitive information. In Malaysia, particularly in Islamic banking and *takaful* matters, mediation is overseen by the Ombudsman for Financial Services (OFS), formerly known as the Financial Mediation Bureau (FMB). The FMB was created through the merger of the Banking Mediation Bureau and Insurance Mediation Bureau in January 2005 (Zain & Ali, 2016; Khan & Zakaria, 2017; Oseni & Ahmad, 2015). However, starting from October 1, 2016, mediation in Islamic banking and *takaful* disputes falls under the purview of the OFS and is no longer under the FMB. OFS accepts all types of complaints or disputes that fall within its jurisdiction, subject to the terms of reference (Hassan et al., 2016; Mohd Zain et al., 2022; Ilias et al., 2021).

In addition to the existing channels for resolving disputes in Islamic banking, the Securities Industry Dispute Resolution Centre (SIDREC) has been established to address issues and disputes related to monetary claims made by individual investors against capital market intermediaries who are members of SIDREC (SC, n.d.-b). Currently, all capital market intermediaries, including corporations holding licenses under the Capital Markets and Services Act 2007 to deal in securities and futures and engage in fund management, are members of SIDREC. This list of SIDREC members also includes banks, brokers, fund management companies, unit trust management companies, and Private Retirement Schemes (PRS) providers and distributors (Ali et al., 2015; Dahlan et al., 2021; Nakagawa, 2019).

5. CONCLUSION

In conclusion, this paper describes the development and evolution of Islamic banking in Malaysia, as well as the crucial role of legal regulations in supporting its growth. There are three main points that can be summarized from the above discussion and are relevant for future research, along with some research limitations that need to be considered. Firstly, the significant role of the government in promoting and supporting the growth of Islamic banking in Malaysia is evident. The Malaysian government has adopted clear policies to promote Islamic banking as a key component of the country's economic growth. Future research can further investigate the impact of these policies and to what extent they have succeeded in driving the growth of Islamic banking. Secondly, the legal framework supporting Islamic banking in Malaysia plays a central role in shaping an environment that is supportive and sustainable for Islamic banking businesses. This includes the creation of laws, regulations, and relevant regulatory bodies. An important aspect of future research is to evaluate the extent to which this legal framework can provide adequate protection and encourage the development of Islamic banking businesses. Thirdly, efforts to improve dispute-resolution mechanisms have become an integral part of the development of Islamic banking in Malaysia. This includes

the establishment of specialized courts (civil courts) to handle Islamic banking disputes and the formation of arbitration panels. Future research can investigate the effectiveness of these dispute resolution mechanisms in ensuring legal certainty for parties involved in Islamic banking transactions.

In the context of future research, it is important to consider the limitations of this study. One limitation is the limited focus on the development of Islamic banking in Malaysia. Further in-depth research can be conducted to understand the development of Islamic banking in other countries and cross-country comparisons. Furthermore, although the importance of the legal framework in supporting Islamic banking has been discussed, further research can delve deeper into the specific impact of certain legal regulations on the growth of Islamic banking. This can help government and regulatory bodies design more effective policies. In conclusion, the development of Islamic banking in Malaysia serves as clear evidence that factors such as government support, a sound legal framework, and effective dispute resolution mechanisms are crucial for the growth of this industry. Future research should continue to explore these elements in greater detail. By fully understanding the role of the legal framework and government policies, we can better plan steps to support the growth of Islamic banking and the broader Islamic financial industry.

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