

# Shariah Law Reports

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### SUBJECT INDEX

**A CHAMPIONING THE DEVELOPMENT OF ISLAMIC BANKING LAW  
IN MALAYSIA: LEGAL ISSUES AND REMEDIES**

by

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**Abstract**

**C** *Malaysia aim to be a strong Islamic Financial Market with a well developed Islamic Banking system, an efficient legal framework with clear laws and effective legal enforcement machinery. In order to accelerate public acceptance and to inspire investor confidence towards achieving this objective, any weakness in our system must be identified and be rectified as soon as possible. This paper will discuss some identified problems and issues in our system and the possible solutions and remedies for it.*

**Introduction**

**E** Malaysia is one of the Muslim countries that is committed in not only developing Islamic banking system but also a complete Islamic financial system. The Islamic banking system in Malaysia started in 1983 when the first Islamic bank, Bank Islam Malaysia Berhad ('BIMB') commenced its operations. It was the objective of the Malaysian government to develop the Islamic banking system parallel to the conventional system. Instead of establishing many new banks, the government introduced a concept of 'Islamic window' which allows the existing conventional banks to introduce Islamic banking products to customers. The concept of Islamic window started in March 1993 when the Central Bank of Malaysia or Bank Negara Malaysia ('BNM') introduced the 'Interest-Free Banking Scheme'. Twenty one Islamic financial products were developed to cater for this scheme with only three major banks participated initially. By July of the same years, this scheme was extended to all financial institutions in Malaysia. As at end of 2000, the Islamic banking system was represented by two Islamic banks, 17 domestic commercial banks, five merchant banks and seven discount houses. There are also four foreign-owned banks providing Islamic banking products and services.

**H The Development of Islamic Banking in Malaysia: A Brief History**

**I** The modern Islamic banking practice in Malaysia has started with the experience of Lembaga Urusan dan Tabung Haji (Pilgrimage Fund) in 1969. This fund was set up for the purpose of managing pilgrimage matters and also as an alternative entity in managing Muslims investments that are Shariah compliant. Tabung Haji provides comprehensive services to the pilgrims for their pilgrimage; and also acts as an Islamic financial institution that invests the savings of would-be pilgrims in accordance with shariah, and giving

maximum return to the depositors. With such objectives in mind, its role is rather limited, as it is a non-banking institution. As such, the success of Tabung Haji provided the main impetus for establishing BIMB which represents a full fledged Islamic commercial bank in Malaysia.

In 1983, an Act of Parliament has been passed to deal specifically with Islamic banking matters. This Act is known as the Islamic Banking Act 1983 (Act 276) which came into force on 10 March 1983 that provides for the setting up, licensing and regulation of an Islamic bank in Malaysia. The introduction of the IBA marked the official introduction of Islamic banking and finance in Malaysia, whereby the first Islamic bank was established that is BIMB.

After ten years experience of BIMB as a sole Islamic bank in Malaysia, the government has taken a step forward to allow the conventional banks to exercise Islamic banking by opening Islamic windows or counters, known as 'Interest-free Banking Scheme' or 'Skim Perbankan Tanpa' Faedah (SPTF) in 1993. To make the exercise of Islamic banking windows or counters possible, an amendment was made to the existing Banking and Financial Institutions Act 1989 (BAFIA) in 1996 by inserting s 124 of the Act, allowing the conventional banks in Malaysia to operate Islamic banking and finance. Consequently, in 1998, the interest-free banking scheme (SPTF) was upgraded to Islamic Banking Scheme with the setting up of the Islamic Banking Divisions replacing the Islamic Banking Units. The division will be headed by the senior level management of the bank or financial institution. Following that, in 1999 the government then established the second Islamic bank in Malaysia known as Bank Muamalat Malaysia Berhad (BMMB). Having two full fledged Islamic banks and Islamic banking divisions in almost all commercial and merchant banks further boosted the growth of Islamic banking sector in Malaysia.

Committed to the development of Islamic banking and creating a complete Islamic financial system not only in Malaysia but also globally, the Malaysian government has also pioneered an Islamic Inter-bank Money Market in January 1994. This market was the first Islamic Money Market in the world. In the year 2000, the volume of funds traded in this market was RM301.9 billion (BNM Annual Report, 2000). In response to the growing significance of Islamic banking and financial industry, and with the purpose of promoting, disseminating and harmonizing best practices in the regulation and supervision of this industry, the Islamic Financial Services Board (IFSB) was established in 2002 with the headquarter in Kuala Lumpur, Malaysia. The IFSB serves as an association of institutions that have responsibility for the international standard for regulation and supervision of the Islamic financial services industry that is consistent with the Shariah principles. Ever since, there has not been any turning back for Islamic banking and finance generally, which has been evidenced by active practices of Islamic banking, finance and securities in Malaysia and world wide. Assuch, in 2004, the government of Malaysia has grant Islamic Banking licences to three other financial institutions, one of which is foreign bank.

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**A Initiating the Legal and Regulatory Framework of Islamic Banking in Malaysia**

When the Malaysian government set out to introduce Islamic banking in Malaysia, it had in mind to ensure that the Islamic banking system becoming a viable banking system that meet the various needs of the Muslim business community. Thus all the necessary steps have been taken especially relating to legal framework. There are a number of remarkable and proactive steps which have been adopted by the Malaysian government to provide the legal and regulatory framework which are accommodative to the progressive development of Islamic Banking.

- B**
- C** The most significant legislations on Islamic Banking and Finance are the Islamic Banking Act 1989 (IBA); Banking and Financial Institutions Act 1989 (BAFIA); and Takaful Act 1984. However, the enforcement of Islamic banking legislation will not be possible without the central regulatory authorities that govern the operation and product development of Islamic banking and finance. The central regulatory legislations on this matter can be found in the Central Bank of Malaysia Act 1958 (CBMA) and Government Investment Act 1983 (GIA). The operations of Islamic Banking and Finance are directly related to the tax issues. To accommodate the progress of the industry the Malaysian government has also looked into the necessary amendment in the Stamp Duty Act 1949 and the Real Property Gains Tax Act 1979. This paper seeks to highlight the important and striking features of the relevant statutes that are particularly unique and connected to the Islamic banking issues.

*Islamic Banking Act 1983 (IBA)*

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- E**
- F** IBA is a unique piece of legislation. It provides for the setting up, regulations and licensing of Islamic Banks. It is a significant legislation in Islamic banking, finance and investment in Malaysia. It is the first Act of Parliament which has been enacted to deal specifically with Islamic Banking and also marked as an important development in the Malaysian legal history that Islamic Law has been given statutory force and placed on the same footing and at par with the civil law in banking matters. The first and second Islamic Bank, ie Bank Islam Malaysia Berhad and Bank Muamalat Malaysia Berhad are established under this Act.

- G**
- H** It is important to note that the IBA provides the definition of Islamic bank and Islamic banking business. Islamic banks, according to the IBA means 'any company which carries on Islamic banking business and hold a valid license'; and Islamic banking business means 'banking business whose aims and operations do not involve any element which is not approved by the religion of Islam'. The IBA also provides on the licensing of the Islamic banks, whereby the Minister will grant license upon recommendation by the Central Bank of Malaysia, as a regulatory body in Banking and Finance.
- I** The Central Bank shall, however, not recommend the grant of license and the Minister shall not grant a license, unless he is satisfied that the aims and operations of the banking business which is desired to carry on will not

involve any element which is not approved by the Religion of Islam<sup>1</sup>. Consequently, it is very essential of the Islamic banks to observe Shariah guidelines in all aspects of their operations to ensure its compliance under the IBA.

To enhance the IBA, a new section has also been added to IBA in the 2003 amendment by inserting the provision on the establishment of the Syariah Advisory Council in the Islamic banks and financial institutions to advice on shariah matters relating to the operation, product innovation and other relevant matters. This provision enables the Islamic bank to seek the advice of Syariah Advisory Council and it is mandatory for the Islamic banks to comply with the advice given.

In order to instill confident to the customer and to suit the Islamic bank with the existing conventional banking system, Islamic Banking Act also provides for the financial requirement and standard. Islamic bank has to comply with the prudential and financial requirements similar with the conventional banks for example terms which provides for the capital adequacy framework, statutory reserves, liquidity framework, statistical reporting, audited financial reports, ownership control and management and on the restriction on business.

*Banking and Financial Institutions Act 1989 (BAFIA)*

BAFIA is a statute which replaced and repealed the Banking Act 1973 and Finance Companies Act 1969. It is an Act to provide laws for the licensing and regulation of institutions carrying on banking and finance, merchant banking, discount house and money broking businesses, for the regulation carrying on certain other financial businesses and for matters incidental thereto or connected therewith. BAFIA provides for an overall and integrated supervision of the banking and financial system in Malaysia. BAFIA govern banking and finance institutions such as commercial banks, finance companies, merchant banks, discount houses, money brokers, credit and charge card companies, building societies etc. To accommodate the interest of these conventional banking institutions to do Islamic banking, an amendment has been made to s 124 of this Act to deal exclusively with conventional banks offering Islamic banking products. The main purpose of this amendment is twofold: (i) to formalize the carrying on of Islamic banking business by the licensed institutions; and (ii) to establish the Syariah Advisory Council (SAC) to advise BNM on syariah matters relating to Islamic banking and financial matters. In spite of carrying on Islamic banking businesses, these licensed institutions shall not be deemed to be Islamic banks. Their status remains conventional.

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1 Section 3(5)(a).

## A Significant Amendments Made to the Law in Facilitating the Operation and Regulation of Islamic Banking

### *Central Bank of Malaysia Act 1958 (CBMA)*

- B CBMA is legislation for the regulation of the Central Bank of Malaysia which also has undergone the amendments to pave the way and to facilitate the regulation and operation of Islamic banking in Malaysia. The role of Syariah Advisory Council (SAC) plays a crucial role in determining and ensuring the shariah compliance of the Islamic banking operation and products. Thus an amendment was made to insert a new section, ie s 16B which enhance the power and integrity of the SAC. The SAC is now the
- C authority for the ascertainment of Islamic law for purpose of Islamic banking business, Islamic financial business, takaful business, Islamic development financial business, or any other business which is based on Shariah principles and is supervised and regulated by the Central Bank. Further, CBMA also provides that any court or arbitration proceedings involving shariah issues may refer to the Central Bank's directive or refer to the SAC for a ruling.
- D The ruling of SAC may be considered by the court, and binding on an arbitrator.

- E Under the CBMA, Islamic banking business has the same meaning with the one given in the IBA; whereas, Islamic financial business has been defined as financial business whose aims and operations do not involve any element which is not approved by the Shariah.

### *Stamp Duty Act 1949*

- F This Act provides for the liability of transaction instruments to stamp duty. Generally the Act provides that when there are several documents employed for a transaction, the principle documents will be subjected to the duty prescribed by the Act; whilst the other documents will be subject to the minimal stamp duty. To facilitate the Islamic banking transactions, the amendment was made to include the exemption that all instruments relating to Islamic banking transactions (such as *al-Murabahah* and *Bai Bithaman Ajil*) will be treated as one principal transaction and therefore will be subjected to one
- G ad valorem stamp duty<sup>2</sup>. In addition to the amendment, further orders were

- H <sup>2</sup> In Islamic banking transactions, especially in *al-murabahah* or *bai bithaman ajil*, there are two transactions involve, ie the selling and purchase of the asset. Where the customer made an application for financing of an asset, the bank will buy the property from the customer and then sell it back to him. Technically speaking there will be two principle documents that involve in the transactions that are: (i) Property Purchase Agreement (PPA) made between the bank and the customer whereby the bank purchases the property from the customer at an agreed price; and (ii) the Property Sale Agreement (PSA) whereby the bank sells the property to the customer at cost price plus profit margin. By the amendment of Stamp Duty Act, the PPA will be exempted from Stamp Duty.
- I The only principle document that is subject to ad valorem stamp duty is the PSA and the amount subject to stamp duty is the amount of cost price and not the total selling price (cost price plus the bank's profit margin).

issued to give equal treatment for Islamic financing documents in terms of stamp duties<sup>3</sup>.

#### *Real Property Gains Tax Act 1979*

RPGTA is an Act to provide for the imposition, assessment and collection of a tax on gains derived from the disposal of real property and matters incidental thereto. Since the Islamic banking transactions such as BBA and al-murabahah financing involve a purchase and sale transaction between the bank and the customer, legally the transaction would attract the tax on the profit gain in the 'acquisition' and 'disposal' of the assets under the RPGTA. To facilitate Islamic banking, the Act was amended in 1985 to avoid double taxation on the Islamic banking transactions, and it will be treated at par with the conventional.

#### **Further Improvements on the Legal Framework Governing Islamic Banking**

At the heart of the expansion of Islamic banking in Malaysia, emerged the need for other development of the legal and regulatory dimension to explicitly address the unique features of Islamic banking and finance. Thus, the government of Malaysia has continually looks into the possible and necessary measure towards providing a sound and stable ground for the enforcement of Islamic banking and financial system.

The government is in process of enacting new laws to support the Islamic banking for example the Bill on Islamic Hire Purchase and for the establishment of the Islamic Tribunal Panel to solve disputes pertaining to Islamic banking outside the court, following the procedures of the Code of Arbitration. Bank Negara Malaysia has also introduced the Financial Mediation Bureau as an integrated dispute resolution centre for the Financial Institution under the Bank Negara Malaysia's supervision and is expanded to include Islamic Banking. Bank Negara Malaysia has also set up a legal working committee to review the existing laws and Acts of Parliament that hinder Islamic banking and finance operations. This includes a review of the relevant statutes such as the Companies Act 1965, the National Land Code 1965, the Contract Act 1950, the Bankruptcy Act 1967 and winding up rules in order to suit the Islamic banking law and practices. There are other existing laws and regulations need to be reviewed and amended in order to ensure the effectiveness of the Islamic banking system. This needs a lot of time, effort, and expenses to remove the legal and regulatory impediments that are hindering the progress of Islamic banking and finance but the Malaysian government is very committed and has consistently taking a progressive steps towards upholding its objective of becoming a leader in the development of Islamic banking and finance.

3 The orders are the Stamp Duty (Exemption) Order 1996; the Stamp Duty (Remission) (No 4) Order 1996; the Stamp Duty (Exemption) (No 6) Order 2003; the Stamp Duty (Exemption) (No 2) Order 2004; the Stamp Duty (Exemption) (No 3) Order 2004; and the Stamp Duty (Remission) Order 2004.

**A Some Legal Issues in Islamic Banking Cases in Malaysia**

It is enlightening that the Malaysian Islamic financial system has grown from one unit bank into a large pool of players, thus signifying that Islamic banking services are now within the reach of every Malaysian, Muslims and non-Muslims alike. However, the most important development is to see the spin-offs created by the massive campaign to develop Islamic finance. From a sector considered to be on the fringe, Islamic finance has been propelled into a new era, with a clear set of objectives and missions. However, still there are some pending legal issues in the implementation and enforcement of Islamic banking and finance in Malaysia.

**C Jurisdiction of Court in Islamic Banking Cases**

Whenever there is dispute of the Islamic banking and financial issues, of course the focus will be on the legal and court system in Malaysia. In such a case, the questions on jurisdiction of courts and the laws applicable will be applicable. In Malaysia, there are two possible courts that have jurisdiction in deciding the commercial and/or Islamic commercial disputes, ie the civil court and the Syariah courts<sup>4</sup>. It would normally be presumed that cases involving Islamic commercial law dispute would go to the Syariah Court in which the qualified personnel in Islamic law is/are available and the decision will be made according to the *Shariah* principles. However, the Malaysian Federal Constitution (Paragraph 4 of List 1) provides that commercial matters come under Federal jurisdiction in which their jurisdiction belongs to the civil courts. Based on the provisions, it can be concluded that the jurisdiction over Islamic banking and finance matters rests with the civil courts; due to the fact that Islamic banking and finance matters comes under the ambit of 'mercantile law' in which the civil court has jurisdiction<sup>5</sup>. The civil court judges are bound by laws and regulations in the Civil Law Act 1956, the Court of Judicature Act 1964 and the Rules of the High Court 1980; in which no specific reference of these statutes can be found on the application of Islamic law. Pursuant to this, we may be wondering on the ability and competency of the civil court judges in deciding disputes in Islamic commercial law. To decide matters on Islamic commercial law, the judges need to acquire not only knowledge in Islamic law of transactions (*fiqh muamalat*) but also knowledge on *Shariah* in general. Being the civil court judges their knowledge in Islamic law are scarce and it would not enable them to decide Islamic matters accordingly.

**H** 4 For further explanation on the power and jurisdiction of Syariah Court in Malaysia, see Faiz Sufian Shuaib, *Powers and Jurisdiction of Syariah Courts in Malaysia*, MLJ, 2003.

5 This conclusion is further supported by the decided cases in Malaysia where the Civil Courts have heard and decided on Islamic banking and finance matters. Example of the cases are: *Tinta Press v Bank Islam Malaysia Berhad* [1986] 1 MLJ 474; *Bank Islam Malaysia Berhad v Adnan bin Omar* [1994] 3 CLJ 735; and *Dato Hj Nik Mahmud bin Daud v BIMB* [1996] 1 CLJ 576 (High Court); [1998] 3 MLJ 396 (Supreme Court).

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### Reported Islamic Banking Cases

After more than years experience in Islamic banking, it is admitted that there are not many cases on Islamic banking and finance reported in Malaysia. The observations on the reported cases on Islamic banking indicate that the courts had always based their decisions on the current banking laws without making any reference to the underlying Shariah principles that is applicable to the Islamic banking facility in dispute. Apparently, the courts did not consider whether the application of the existing civil law and procedures would have contradicted the Shariah or in anyway affect the validity of the transactions. This approach has been adopted by the judges in earlier reported cases in Islamic banking<sup>6</sup> and is still followed in the later cases. In the later case of *Bank Kerjasama Rakyat Malaysia Bhd v Emcee Corporation Sdn Bhd*<sup>7</sup> for example, the Court of Appeal held, inter alia, that even though the facility given by the appellant 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. In other words, this case indicates that Islamic banks have to work in the context of English common law principles as such law is applicable in Malaysia. Thus, the contracts have to be interpreted in line with relevant legislation and applicable law. Within the existing legal framework the decision of the civil court judges is correct, but it is not be in all cases favorable to Shariah and Islamic banking principles. In any given circumstances the courts interpretation in the decided case may give rise to anomalous decisions in term of Shariah and Islamic banking principles.

### Ambiguous Provisions of Law

The existing unfriendly legislative framework and ambiguous provisions of law may also hamper efficiency of Islamic banking transactions. In relation to Islamic banking, the IBA, being the main legislation on Islamic banking does not provide a clear definition of Islamic 'banking business'. Section 2 of the IBA provides that Islamic banking business is 'the Islamic banking business which does not approved by the religion of Islam'. The provision does not provide a clear guideline on what is the 'banking business' means. By comparison, the BAFIA provides a definition of banking business which says that the banking business means 'the business of: (i) receiving deposits; (ii) paying and collecting checks; (iii) provisions of finance'. Further, the provision is also vague on the position of Islamic legal schools (*madhhabs*) in the general term of 'religion of Islam' embedded in that provision. It is well noted that Islamic law consists of a few legal schools which have their

6 The first reported case in Islamic banking is *Tinta Press v Bank Islam Malaysia Berhad* in 1986. This approach has been followed even in the landmark cases in *Adnan bin Omar and Dato' Nik Mahmud*. Even in the later case of *Arab Malaysian Merchant Bank Bhd v Silver Concept* [2005] 5 MLJ 210. All the above cases seemed to put customers in a tight jacket.

7 [2003] 2 MLJ 408.

A own views on certain issues<sup>8</sup>. In such cases where the views are not unanimous it may be difficult to say whether an act involves any element, which is not approved by Islam. No one can say that one opinion is correct and others are not. It is more a question of choice. And there is no indication as to what *madhhab* to be followed. As a result, in the event of differences in opinion on the law applicable, there is no direction in the Act as to the law of which madhhabs is to be applied.

B There is another conflict in the provisions in the IBA and BAFIA. For example in Bank and Financial Institutions Act 1989 ('BAFIA') provide for the bank duty for secrecy, Section 99(1)(a) of the BAFIA made it mandatory for the bank to have written instruction from the client before an information can be disclose<sup>9</sup>. However the Islamic Banking Act, s 34(3)(a) which also provide for the bank's duties of secrecy does not state for the requirement of a written instructions by the client; and further, both Acts provide different punishment for breach the duty of secrecy<sup>10</sup>. In practice, the court has choice to decide and give the correct meaning of a particular issue which will later be the path / direction for our Islamic banking system. Given the circumstances, different decisions may be concluded as the terms and provisions of both of the Act are different.

#### Awareness of Islamic Banking and Finance

E Another challenge facing by the Islamic banking and finance is lack of public awareness of the concepts, products and operation of Islamic banking and finance available in the market today. Although they are aware of the existence of Shariah compliant banking and finance system but the quality of knowledge and information is superficial. There are hardly any literatures and references of Islamic banking and finance and Islamic capital market that are directed at the layman explaining on the Islamic banking and finance, basic contracts, rationale, Shariah principles involved in the Islamic financial processes. Even within the industry, the quality of this information is questionable. The regulators, lawyers and practitioners are not well verse in the requirements of Shariah compliant products. Thus they need to be informed, updated, educated and trained in these aspects so that they really understand the processes involved, believe and confident with the systems and consequently they are able explain the system to the public satisfactorily.

H <sup>8</sup> For example the principles of Bai Bithaman Ajil which is now modified for the purposes of financing rather than trading, has been an issue, where different fatwa issued with regard to its legality in syariah.

H <sup>9</sup> See *Tan Lay Soon v Kam Mah Theatre Sdn Bhd (Malayan United Finance Bhd, Intervener)* [1992] 2 MLJ 434. Under common law as per the decided case of *Sunderland v Barcloys Bank Ltd* (1983) 5 LDAB 163 the teleconversation between a customer to a bank via a telephone to give permission to the bank to disclose her information is consider a good instruction thus bank's duty for secrecy is lifted.

I <sup>10</sup> The IBA provides for three years imprisonment and/or penalty RM40,000, which is lesser in amount as compare to BAFIA, which provide for the punishment of three years imprisonment and/or RM3,000,000.

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Asimple analogy is that if the Muslims are unaware about the Shariah practices and rationale behind it, they cannot fully utilize and exploit it.

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As for the judges deciding Islamic banking cases, they may find difficulty in finding the references of reported cases, past judgments and reports on Islamic law and Islamic banking cases. The Islamic law cannot be readily or easily 'found' in the law reports or standard works to which the judges and lawyers trained in the common law system are used to. Problem would arise as to where to find the law? There is no ready access to the law as what the conventional banking have. Judges and counsel have to find, propound and apply Islamic banking, however our Islamic banking law still developing and need to be enhance. There is only a few cases has been reported pertaining to the Islamic Banking cases, on the other hand there is still no decided case as yet to be the most helpful precedent and guidelines.

### Documentations of IBF products

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Being the main evidence of the contract, the documentation embodies the terms of the contract. The issues in documentation flow from the various issues relating to the legal framework. These include compliance with the requirements of Syariah as well as the existing legislation such as the Contract Act 1965 and the National Land Code as well as the common law. An examination of one of the main Islamic contracts in Islamic banking such as the deferred sale contracts (BBA) illustrates the challenges in documenting Islamic banking transactions. Lack of understanding of the basic concepts of Islamic banking transactions and Shariah principles are reflected in the documentations drafted for Islamic banking purposes. More often than not, the documents do not really reflect the true concept and principle of the Islamic banking product. The drafters made mistakes by converting the conventional documents to become the Islamic contract thus it cause issue of incorrect terminology, and the contract does not reflect the true operational process of the financing<sup>11</sup>. It is important that the drafters take an extra caution tin the drafting of Islamic banking documents to ensure the validity of the Islamic financing contract is incorporated correctly otherwise it may render the financing document invalid<sup>12</sup>.

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11 For example common negligent done by the practitioner in drafting the Bai Bithaman Ajil (BBA) Agreements, the term 'lending' is not right for trading transaction as the proper term is 'financing'. The term 'repayment' was incorrect because the payment is not to pay back the loan but as payment of the financiers sale price. The term 'interest' is totally wrong as it is prohibited in Islam and the correct terminology to be use for surplus is either profit or fees.
- 12 A simple example of this issue is the sequence of parties in asset purchase agreement where customer as seller and the bank as buyer. There have been instances where the sequence of parties are not correct. In Asset purchase agreement, the sequence of parties must always be that the first party being a customer as the seller of the asset and the bank as the buyer of the asset. While for the asset sale agreement, the sequence of parties must always be that the first party being the bank as the seller of the asset and the customer as the buyer of the asset. The sequence of signing also must be done correctly in order that the transaction is completed in a correct ways.

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A The products and the documents involving Islamic banking have to accord and comply with both civil law and Islamic law. It has to be valid in Islam and enforceable in civil court. Thus it is the duty of the practitioners to ensure the proper and effective legal documentation that are reflective of the intention of the contracting parties, while at the same time, maintaining the observation of the applicable syariah principle. The documents and products in Islamic banking still need to be modified and improved upon as there is still lacking of the Islamic spirits and there is still lacuna in the documents and the products which need to be fill in order to suit with the existing procedure, and practices. As the application and use of Islamic Law in the commercial transaction become more pervasive, the necessity for new types of documents will be felt, and these must be devised. Great ingenuity and far sightedness will be needed in the creation of such documents. The legal practitioner also has a duty to ensure that the documents comply with the Syariah and civil law. Thus legal practitioners must be extra cautious and careful in advising the bank.

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#### D Remedies and the Way Forward

##### *The Courts*

E As mentioned earlier, the proponent of Islamic banking has a bit of reservation on the fact that it is the civil court which decides Islamic banking cases in Malaysia. Looking on the other perspective, there is an advantage of having the Islamic banking cases been heard in civil court due to the fact that the civil courts system are more systematic and established and civil court judges are more familiar with commercial and banking laws; thus this will maintain the integrity of our judiciary system and instill confidants on public at large that their right is protected by the Malaysian Law. The other advantages of having the dual system of law is that the system of court structure and court procedure would be incorporated and integrated with both civil and Islamic law system thus our Malaysian court will be able to handle all types of cases including Islamic banking and transaction Law. That is unique and will serve as a model for other countries to follow.

G More than that, with the establishment of the Muamalat Court which is a special Islamic bench court or division for litigation cases involving Islamic banking and finance increases the smooth implementation of Islamic banking and Islamic commercial transaction. Judges sitting on the Muamalat Court will hear only cases involving Islamic banking and finance, thus it allows specialisation in that particular bench and this make things easier for the judges and the lawyer. It also can ensure speedier disposal of cases and saving the court time while a special procedure which suit Islamic law can be apply systematically and in consistent manner. The great advantage of having this Muamalat Court would be as reference court for other judges to seek advise and a decision on particular points of Islamic banking law<sup>13</sup>.

I <sup>13</sup> Currently in Kuala Lumpur High Court, Islamic Banking has been fixed to be heard at the special court of the commercial division that is Dagang 4 which is headed by a selected judges, registrar and selected staff. At first it is headed by Dato' Wan Azman, later it has been replaced by Dato' Abdul Malik bin Ishak and currently it is headed by Dato' Abdul Wahab Patail.

The establishment of this Court was made possible by virtue of the Practice Directions No 1/2003<sup>14</sup> which stated for the establishment of the special court at the High Court Commercial Division which is call as the Muamalat Court<sup>15</sup>.

### *The Prevailing Law*

Some writer was in a view that the legislation is necessary to give the Islamic Law its rightful place with regard to Islamic law and Islamic banking transactions. It ought to be declared in express and clear terms that in matters pertaining to Muslims and Islamic law, the prevailing law should always be Islamic law. This proposal is called off pursuant to the existing legislation of Civil Law Act 1950 which provides that in the case where there is lacuna in our law or the existing law is not sufficient, the reference should be made to the English law. There was a strong call by late Professor Ahmad Ibrahim<sup>16</sup> for the amendment of that provision; in order to pave the way for the application of Islamic law in Malaysia. The proposal was made considering the fact that Islamic law has long been regarded as being part of the law of the land in Malaysia<sup>17</sup>. On the other hand, Tun Hamid Omar<sup>18</sup> opposed the suggestion saying that the amendment will only led to uncertainty, difficulties and havoc. The Malaysian Law is still developing and there is a lot of lacuna. By having the Civil Law Act judge has discretion whether to follow the common law or to use equity in deciding a case. By applying the equity principle, the Islamic Law can also be referred to.

### *Role of lawyers, judges and academicians*

Islamic Banking Act does not provide for a minimum requirement of lawyers dealing with Islamic Banking. Thus, the question may arise that do judges and lawyers have adequate knowledge and of the shariah and Islamic law principles relating to commercial and transactions? A simple respond to that question is that they must be equipped with adequate knowledge to assist them in interpreting and applying the principles of Islamic Law; and to decide the Islamic Banking cases.

14 Practice Directions issued by the Chief Justice Dato' Haidar bin Mohamed Nor, Practice Directions No 1/2003 (p 610), Malaysian Court Practice, MLJ 2004.

15 Currently there is only one specific Muamalat Court has been established that is the Dagang 4 of the Kuala Lumpur High Court, however the other court is still not implementing it yet. This is may be due to very limited cases involving the Islamic Bank has been filed in court thus, the need to have a special court in other state is still not practical. As can be seen, the cases involving default payment by the Islamic Bank's customer is lesser in compared to the conventional bank and there is very limited cases where the Islamic banking case been challenge in court.

16 *Malaysian Law News*, January 1991, p 58.

17 This is evidenced in the decision of court in *Ramah v Laton* [1927] 6 FMSLR 128 (CA) where it was held that 'Muslim law is the law of the land and the local law is a matter of which the court must take judicial notice. The court must propound the law and it is not competent for the court to allow evidence to be led as to what is the local law.'

18 Chief Judge, *Law News Magazine* 1990, p 20.

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A In Malaysia there is an institution that provides training for judges and court's staff, ie ILKAP (Institut Latihan dan Kehakiman Malaysia). This institution can play its role in upgrading the knowledge and information of lawyers and courts' staff on the issues pertaining to Islamic banking and finance. The Bar Council of Malaysia can also play the role by promoting the members to enhance their knowledge on Islamic banking. The immediate step is by providing necessary facilities for research, organizing seminars, workshops and training on the relevant matters.

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B While for a practitioner, there must be personal effort to improve their knowledge and qualification on the areas relating to Islamic banking and finance. There are many courses held by the higher education institutions on for Islamic Banking; thus it is up for the person whether they wish to take the opportunity to enhance their knowledge or not. While during the chambering period and even during their practice life, the master, the pupil, the boss and the advocates and solicitors must put their joint effort to strive for the latest information, current development, extra knowledge and training by attending seminars, reading, excess to the internet and by being alert to the latest decided cases, court direction and circulars issued.

C

C The education institutions also have to take proactive steps at producing students of better qualification and skills needed for the contemporary practitioners. This can be done by designing the courses that provide the skills and expertise needed. The courses should also enlighten the students on the Syariah laws and the court procedure. The university can hold a seminar and lecture to attract the practitioner, judges, bankers and the pupil at large. While it is an urgent needs for more articles, books and journals on Islamic banking by the academician be published, as the academician nature of works and their high qualification giving them the opportunity to have ample time and capabilities to do researches, reading, discussing and writing. The reading materials and the researches done by the academician will be the precious contribution to the Banking Industry and to the public at large.

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*Role of expert (scholar) in court proceeding*

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G It is the understanding of the most practitioners in Malaysia, that in case of Islamic law, no expert evidence as to what the law is can be given. This is because Islamic law is regarded as part of the law of the land<sup>19</sup> and the judge would have to expound and apply it as he himself finds it and by submissions made by counsel appearing before him. Given the fact, some of the counsels are reluctant to apply to the judge for the expert witness to explain and assist them in cases relating to Islamic law. However, that is not the wise step to be taken by the judges and counsels when the case in trial is Islamic banking cases. The fact that Islamic banking matters is complex as it needs understanding of not only banking products but also Islamic commercial law and Shariah

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I <sup>19</sup> As per *Ramah v Laton* [1927] 6 FMSLR 128 (CA), in this case it was held that "Muslim law is the law of the land and the local law is a matter of which the court must take judicial notice. The court must propound the law and it is not competent for the court to allow evidence to be led as to what is the local law."

in general. It is wise for the counsel and the judges to call an expert to assist the court in deciding matters involving Islamic law<sup>20</sup>, when they are not able to do so.

Observation on the decided cases in Islamic banking in Malaysia however does not show the courts practice of inviting the experts to resolve complicated issues on Islamic banking. Hence, it is proposed that the Malaysian courts should take into consideration the attitude of English Court of Appeal in the case *Shamil Bank of Bahrain v Beximco Pharmaceuticals Ltd & Ors*<sup>21</sup> where the English Court was willing to consider the Shariah principles and obtained evidence from the Shariah experts before making its decision.

#### *Role of Syariah Advisory Council*

One of the requirements of an Islamic bank is to have an in-house syariah advisory body 'to advise the bank on the operation of its banking business. What would be the position if the advise of these two bodies on the same issue differ? As both are established under statute, which one should prevail? In Malaysia there is a Syariah Advisory Board of each institutions which will discuss, advised and endorsed each principles, products, documents and issues relates to Islamic Banking. Fatwa by one Syariah Advisory Board may not be binding on another Syariah Advisory Board. However, all the Syariah Advisory Board of the banks and financial institutions have to seek for the approval from Syariah Advisory Council of the Bank Negara. Thus, there will be no differences in opinion or conflict in fatwa made by the board. The Syariah Advisory Council of the Bank Negara will approve the fatwa made by the Syariah Advisory Board of the bank. This is to ensure the uniformity of fatwa issued and for the standard of banking practices in Malaysia. The existence of the Shariah Advisory Council at the Central Bank is needed as a mechanism for to have check and balance as well as maintaining the integrity and confidence of the public toward the fatwa and advised issued by Shariah Advisory bodies. It is proposed that there must be some machinery set up to ensure that both the advisory bodies at the banks level and the Central Syariah Advisory Council of the Bank Negara Malaysia consult each other and agree on the advice to be rendered on any issue of Islamic law. This will ensure the uniformity and standard Islamic banking practices.

20 Order 92 of the Rules of High Court 1980 allows judges to use his discretion whether to allow the expert witness or not. The Court has the inherent powers to make any order as may be necessary to prevent injustice or to prevent an abuse of the process of court. This can also apply in cases that the judge can decide to allow expert witness in order to reach a conclusive evidence and in order to have the best reason for the decision.

21 (2004) EWCA CIV 19; [2004] All ER (D) 280 (Jan). It was decided in that case that since the judge was not expert in Islamic Banking, the parties should call the expert as witness in assisting judge to understand the case better. And it is the obiter dicta of the judge that it is better to refer to the law which govern and regulates the parties rather than to follow the law of the land which is different from what the contract is meant or intended for.

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A Another issue related to the role of Shariah Advisory Council is their involvement in product development of Islamic banking. A survey of the available literature on the Malaysian Islamic Banking and business indicates that the SAC is not presently involved in product development<sup>22</sup>. The main task of the SAC is to guide the financial institutions to adhere strictly to Islamic principles. The SAC, being the external syariah auditor, is the party responsible to certify this compliance because other parties are not able to do such task. The confidence of the public as well as the shareholders depends very much on the credibility of a particular SAC, and to the end, it has never been assigned with the duty of product innovation. Most financial institutions would prefer to present their product to SAC just to get endorsement for syariah compliant. In this deliberation, the SAC may endorse the product as it is, or it may suggest some other changes, or alternatively to made a new contract altogether. However the burden to convert the new contract into a workable product still lies with the management of the bank. Therefore the SAC's involvement has never been at the initial stage, but rather it normally comes at the end of the process essentially for the sake of endorsement.

D However, it is envisaged that with the inherent sophistication and complexity of new product, the Sac would play an integral part in product development and innovation in future.

**Conclusion**

E The Islamic banking law is still developing and need to be enhanced. Up to present, there is no decided case as yet to be the good precedent and guidelines. The Islamic banking law need times, as time goes, the changing circumstances will change the existing Islamic banking industries, thus the Islamic banking law will be develop accordingly. More cases to be decide, and more issue to be solved. The Banking Industries need more learned people in this area and more references , books and articles need to e publish for easy references and in order to instill better understanding and confident on the Islamic banking. Judges need to be trained as well as the counsel on the Islamic banking law and practices. The judges and the counsel involve with the Islamic banking case must be conversant with the Islamic law in order that a systematic and proper development and application of Islamic law can be achieved.

H The law, the court and the banking system must keep up to date as the development of the Islamic banking and Islamic transaction. Thus an action must be taken to meet the demand. In other words, the existing legal system must be fully empowered to run abreast with those developments. That requires resolute and swift action in several areas on the part of government legislation.

I In order to enhance the syariah compliance, concerted effort by all the regulator, syariah advisors, banker, lawyer, shareholder, auditors and public

22 Mohd Daud Bakar, *Product Innovation in Islamic Business and Banking: The Role of a Shariah Advisor*, IKIM 2003.



towards a global syariah standard. Collective action on central basis must be done rather than by individual bank to enhance the syariah training of the practitioners, industry players and the regulators as well as to enhance the syariah expert's exposure to current commercial realities and knowledge, including legal terminologies and jargons in the documents. On top of that, the professional Syariah screening and auditing are essential as an Islamic bank requires Syariah screening and approval for its products and activities.

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