Legal and Regulatory Strategies of Islamic Banking System in Malaysia: A Reflection for Nigeria

Akilu Aliyu Shinkafi 1*, Sani Yahaya 2, Ahmad Muhammad Gusau 3

1 Ph.D. Scholar, Department of Shari’ah and Economics, Academy of Islamic Studies, University of Malaya, 50603 Kuala Lumpur, Malaysia; and Principal Lecturer, Department of Islamic Studies, Zamfara State College of Education, Maru, Nigeria. Email: aliyuakilu1@gmail.com
2 Principal Lecturer, Department of Banking and Finance, Abdu Gusau Polytechnic Talata Mafara, Nigeria. Email: saniytm@yahoo.com
3 Senior Lecturer, Department of Islamic Studies, Federal University Dutsinma, Katsina Nigeria Email: amgusau@gmail.com

*Corresponding Author: Akilu Aliyu Shinkafi, Ph.D. Scholar, Department of Shari’ah and Economics, Academy of Islamic Studies, University of Malaya, 50603 Kuala Lumpur, Malaysia, and Principal Lecturer, Department of Islamic Studies, Zamfara State College of Education, Maru, Nigeria. Email: aliyuakilu1@gmail.com

Abstract

Effective strategies on the legal and regulative framework of Islamic banks are very critical to the endurance of the Islamic banking sector. In fact, legal place and regulatory structure of every industry determine the healthy standing of its stability, sustainability, and success. The major objective of this study is to explore the legal and regulatory strategies of the Islamic banking system in Malaysia and proffer it as a reflection for Nigeria. The study is qualitative in nature, it employed two instruments (document technique and interview instrument) for the data collection. Thematic and descriptive analysis were used where themes and sub-themes were depicted as they emerged from the data. The outcome of the study reveals that Malaysia has strengthened its legal strategies by promulgating several acts, legal reforms, provisions, and promulgation of certain acts of law, amendments of laws, passing bills, and enactment of new laws such as IBA, IFSA, ICMA, CBMA, Gia, GFA, Mu’amalat bench, and etcetera with the view to ensure the free hit of the legal hiccups, best practices, effective corporate governance, and proper risk management in the financial industry. The outcome of the study further show that BNM has significant influence in the regulations, supervision, and control of IBs. These roles include the formation of SAC and Shari’ah committees for IBs; establishment of Islamic financial service board IFSB, spelling effective Shari’ah governance framework SGF; services, and compliance to Shari’ah regulatory standards, and creating talents such as ISRA, INCEIF, and several others.

Keywords: Islamic Banking, Legal, Regulatory, Strategies, Malaysia, Nigeria

INTRODUCTION

The use of regulatory strategies in the areas of social science, law, health, politics and governance, economics and finance, psychology, industrial, business, and in the extent of developmental issues is not
new in the global space. Possibly, that is why Braithwaite, Coglianese, and Levi-Faur (2007) opines that regulation and governance grow into a widespread impression for the social scientist to glorify for attaining a worthy motive. The emergence of the integration of global financial markets led to the continuation of the speedy changes in the financial environment. These modifications gave the direction for the influx of risks in the modern financial system. This involves the need for regulation and oversight of the fiscal system of whatever kind to attract the investors, preserve the existing markets, and advocate the flow of economic development. Hence, achieving financial stability needs sustainable regulatory and supervisory measures that can solve the existing critical issues for the robustness and safety of the financial institutions.

In an effort to cast away the Islamic banking risk, which can touch the substance of financial industries and economic actions. The Bank Negara Malaysia shoulder the duty of reducing failures, to ensure safety, robust financial foundations and sound financial organization through the effective regulation, supervision role, and restraint of the banking and financial diligence. The major objective is to accomplish financial stability, high level of efficiency, and achieve the desired outcome intended by the Bank Negara Malaysia department of regulation and supervision. Thither is a question that this department has conducted a variety of holistic review that intended to regulate and ensure the functions of the financial policies and schemes, and sustenance for the banking sector.

Besides that, the Bank Negara Malaysia extended its exercise to playing a supervisory role, according to the provision of the concerned department with a view to ensure the functional policies, the success of the financial institutions, and transition from the conventional banking system to the dual banking system. This commitment enables the Bank Negara Malaysia to understand the emerging trends, weaknesses, and dynamic nature of the financial institutions. The supervisory function is not confined to banking supervision (supervision of Foreign Islamic Banks FIBs, Full-fledge Islamic Banks, Stand-alone investment banks, and Islamic banking subsidiaries in the domestic setting) alone. However, it rather encompasses the oversight of financial conglomerates, and Insurance and Takaful supervision.

The Malaysian Apex bank dedicated some specialized risk units (such as credit, operational, insurance, market, and technology risks) under the regulation and supervision department to provide for the influx of new risk factors, the complexity of the banking activities, and incessant modification in the finance setting. That is why the need for the financial expertise in risk assessment becomes incumbent for both individual, institutions, and the system-wide footing. However, monitoring and evaluation of departments and emerging trends of risks in the financial system prove that, these units offer an input and support to supervisory functions, policies and strategic development, and macro-prudential surveillance of risk management practices.

Therefore, the main aim of this study is to explore the legal and regulatory strategies of the Malaysian Islamic banking system and proffer it for Nigeria. The outcome of the study reveals that Malaysia has undergone several legal and regulatory reforms by promulgating several acts, provisions, and promulgation of certain acts of law, amendments of laws, passing bills, and enactment of new laws such as IBA, IFSA, ICMA, CBMA, GIA, GFA, Mu’amalat bench, and etcetera. This is with the view to ensure the free hit of the legal hiccups, best practices, effective corporate governance, and proper risk management in the financial industry.

The result that emerged from the study further reveals that Bank Negara Malaysia (BNM) supervision department develops, enhance, and implement certain legal and regulatory frameworks. These frameworks include the establishment of Islamic financial service board IFSB, providing avenue for Islamic financial service act IFSA to thrive, spelling Shari’ah governance framework, Mu’amalat bench and incorporation of civil courts to ensure the free hit of the legal cases, best practices, effective corporate governance, and proper risk management in the financial industry. The result further portrayed that Nigeria can reflect from the Malaysian strategies to restructure its recent and fresh system. The result of the study further projected that legal place of Islamic banking in Nigeria require revalidation as still the system has to operate under Bank and Other Financial Institutions Act BOFIA, rather than its own Islamic banking Act, IBA.
LITERATURE REVIEW

This section reviewed the literature that is related to the topic of this work. The following studies were presented:

THE LITERATURE ON LEGAL ISSUES OF ISLAMIC BANKS

According to Djojosugito (2008) understanding legal risk, laws, regulations, legal activities relating to Shari’ah, and legality of Islamic financial instruments prior to Islamic banking transactions are clear basis of information, especially for those in the Islamic banking industry without legal background or lawyer. On a similar note, Abikan (2009) considered the constitutional provisions referring the issues of legal pluralism, federal character, and religion have become pronounced, especially religion as most controversial. He appropriately examined the extent of Islamic banking accommodation by the Nigerian constitution, in the then attempt by the CBN to establish an Islamic banking system in Nigeria. Also, Aldohni (2015) considered legal and regulatory matters of Islamic banking as the major challenge to most financial and regulatory authorities.

However, Adebayo (2011) concludes that present banking laws in Nigeria need to have undergone amendment, or else the Islamic financial institutions IFIs will have to let off. He calls for the rigorous employment of professional economists, banking experts and jurists for a critical examination of the principles with a view to distinctively define Islamic financial institutions to improve the draft of framework made by the Nigerian Central Bank especially where it did not take note. On the contrary, Olayemi (2011) examined the legal foundation for the introduction of the Islamic banking product into the Nigerian banking system. The study exhibits that the introduction of the Islamic banking product into the Nigeria banking system is lawful and its benefits to the country overflow. Likewise, Alzaidi and Kazakov (2012) found that, Multi-Agent Systems (MAS) can play a critical role in Islamic banking development. It can improve the prevailing financial products in order to advocate profits, address the legal issues related to Shari’ah, and reduction of risk, support Islamic banking in commodity trading through Tawarruq financing product with the view to assist the banks, retailers, and individual participants that are in need of cash.

Additionally, Adam (2014) advises that, the Central Bank of Nigeria should develop adequate and secure legal and operational frameworks for Islamic banking system based on Maqasid al-Shari’ah. The author further suggested that the entire transactions of Islamic banks should be put in the scale of Maqasid al-Shari’ah and examine the level of harm (Madarrah) and beneficial (Maslaha) available in it before giving it the championship of ‘Shari’ah-compliant product’. On the contraries, Markom, Pitchay, Zainol, Rahim, and Merican (2013) found four different obstacles in adjudicating Islamic banks in civil courts. These obstacles involves complication of the legal documents, competency of the civil court judges, and expert evidence, the inadequacy of the existing legal framework, and explained the four tactics embraced by the civil courts in deciding the Islamic banking and finance cases. On his side, Umar A Oseni (2015) determines that, for Nigeria to draw foreign direct investment in the emerging Islamic finance market, healthy legal structure, and comprehensive dispute resolution instrument should be in place with a view to achieving the course of time. In a similar study, U. A. Oseni and Omoola (2015) explore the significance of dispute settlement and justice in commercial transactions in the modern digital economy. The study found that the sustainability of the economic system depends on the use of information and communication technology ICT in resolving the banking disputes of the Malaysian Islamic finance industry. The data further claimed that exploring the relevance of such online disputes resolution platform for Islamic finance could serve as a gateway for further subjects that will implicate design and application of such technology in the Islamic finance industry. Correspondingly, Nafees and Ayub (2016) emphasized the importance of using extraordinary talent to resolve the emerging and existing disputes between the Islamic banking and the stakeholders that could possibly destroy the business rapport.
between the parties. Lastly, U. A. Oseni and Omoola (2017) found that efficient regulation, such as advanced dispute management mechanism, and legal risks linked with banking disputes could avert reputational risks in the Islamic financial services industry. The findings further reveal that, the most influencing factors that are affecting the intention to use Online Dispute Resolution among stakeholders, particularly customers and bankers in Malaysia are ‘access to justice, the attitude of stakeholders, and resolving disputes’.

**LITERATURE ON ISLAMIC BANKING REGULATION, SUPERVISION, AND CONTROL**

On the literature regarding the regulation, control and supervision of Islamic banks, Chapra and Khan (2000) opines that International financial crisis of Islamic banks resulted in a necessary and better regulation and supervision for Islamic banks. This is to ensure more safety, stability, regulatory and Shari’ah standards for their authenticity, domestic satisfaction, and international suitability. Similarly, Ausaf (2000) distinguish the instruments of monetary control and the practices of Central banks in relation to regulation and control of Islamic banks. The author theoretically analysed the approaches of Central banks in regulating and control of Islamic banks with a consideration to ensure whether or not the Islamic banks are in the same control as applied to traditional banks.

In their study Barth, Caprio, and Levine (2004) measures the connection between explicit supervisory and regulatory practices and banking-sector development, efficiency, and delicacy using their new database on banking regulation and supervision in 107 countries. The study reveal that policies depend on rules that (1) force accurate information disclosure (2) empower private-sector corporate control of banks, and (3) foster incentives for individual agents to exercise corporate control work best to promote bank development, execution, and stability.

On the other hand, Kunhiviba (2012) presented an exclusive regulatory and governance framework of Islamic banking in Malaysia. The author highlights the Islamic Banking Act of 1983, Banking and Financial Institutions BAFIA of 1989, Central Bank of Malaysia Act 2009, and the Shari’ah Governance Framework 2011 presented by the Central Bank of Malaysia. In the same manner, Archer and Karim (2012) believe that the creation of Islamic financial service board IFSB in 2002 is mainly for directing effective supervision, regulation, and legal framework that appropriate the development of Islamic financial services industry globally. In addition to that, Grassa (2013) found that, the typical structure, functions, duties, and responsibilities of regulatory and supervisory boards differ from one country to another. He further counsels that regulatory authorities and the IFSB should enhance the Shari’ah governance system and make standard the various Shari’ah governance practices worldwide.

Interestingly, Saidi (2014) assess the characteristics of Islamic banks that need customized regulatory measures and explored on how transparent regulations could be a pass for the Islamic banks. Moreover, Arifin, Abdullah, and Chiroma (2014) exposes that the supervision of Islamic banking system needs the support of Islamic experts through Shari’ah advisory board in Islamic financial institutions with the responsibility of fatwa and ensuring Shari’ah compliance. However, the authors added that lack of involvement of technocrats and bureaucracies; and absence of effective legal framework and enabling environment that could support the Islamic banking operation are the cause of legal injury in some Muslim countries where the Shari’ah model of banking practice is available.

Likewise, Ayedh and Echchabi (2015) found that Shari’ah compliance, and issuance of fatwas, that relates to Islamic banks are facing sensitivity of the community due to divergent Madzhab and varied Shari’ah scholars. The results further indicate that there is no uniformity in terms of Shari’ah review, operations, and set of procedures of Islamic banks, which relates to the number of staff in the Shari’ah audit department, and comprehensive banking transactions. Furthermore, Morrison (2015) shows a remarkable satisfaction on the newly introduced Islamic banking regulatory framework that relates to Shari’ah compliance and corporate governance in Oman. The author analyzed the regulatory techniques and identified the areas of possible reform contained Islamic banking regulatory framework, and attributed the success to the authority and the Central bank for dependable
Shari‘ah risk management and advancement of the Islamic banking regulatory framework. Further still, Mullah and Zaman (2015) reveals that Shari‘ah supervision boards have a positive impact on Islamic banks when they perform a supervisory role, and the impact could be negligent when they resort to an advisory role. The findings further offer support for the positive contribution of the Shari‘ah supervision boards and put emphasis on the need for effective application of regulatory mechanisms in Islamic banks.

Recently, Ali and Oseni (2017) pursuit the role of the Bank Negara Malaysia towards enhancing the legal framework for Islamic financial transactions through the formation of Islamic Financial Services Act 2013 and other related policies and regulations. Their study found that, the significance of law reforms toward strengthening the financial system is very significant especially when it relates to the issue of Shari‘ah compliance framework and consumer protection. Conversely, Faruq and Hassan (2007) express that lack of a well-defined regulatory and supervisory framework for Islamic banks could affect the smooth running of Islamic banks within the tenets of Shari‘ah. The authors further lamented the absence of an interbank Islamic money market; and lack of identical policies and strategies for Islamic and conventional banking. Besides that, the presence of a discriminatory legal reserve requirement for Islamic and conventional banking; the prevalence of a restrictive environment in the capital market, and the lack of legal provision and protection of the Central Bank to avoid the Islamic bank’s associated risks are some of the troubles facing the industry. Thus, the authors advocated that, a self-governing banking act that controls, monitors, and supervises their functions with full support should be in place to Islamic banks.

METHODOLOGY

The major objective of this study is to examine the legal and regulatory strategies of the Islamic banking system in Malaysia and drive certain reflection for Nigeria. The article intended to present Malaysia as model for Nigeria to restructure its legal and regulatory framework in Islamic banking system. The study has a real inclination for the understanding of phenomenon that relate to the legal and regulatory strategies of Islamic banking in Malaysia with the view to serve as a reflection for the Nigeria. The study is qualitative in nature, Creswell (2014) considered qualitative research as a tool for researching and interpreting the meaning individuals or groups ascribe to the social or human problem. In other words, it is dealing with the real world context or delivers a real-life view (Creswell, 2014). It helps researchers understand their environment and to clarify a phenomenon which had happened or happening (Chua, 2013). It interprets a phenomenon and social refinement (Myers, 1997). It is a field that has a concern on the intelligence collection and analysis (Hahn, 2008). It focuses on “understanding the meaning people have interpreted” that is, how people make sense of their world and the experiences they have in the world” (Merriam, 2009). Thus, to achieve the objective of this study, the authors used case studies research following the advice of (Hahn, 2008) who discoursed that in qualitative research, the researcher accepts the right to pick case studies, focus groups, grounded theory, ethnography, and phenomenology or creative mixed method to run their research intention.

The instruments employed in the process of data collection are (document and interview techniques), where purposive sampling is considered suitable for the work. Semi-Structured interview was drafted and administered to the research participants. The criteria used for the selection of participants involves professionalism and expertise, and ability and willingness of the participants to respond to the interview questions. In all, nine (9) participants from the selected categories (academician and BNM Shari‘ah experts) from five (5) universities situated in Kuala Lumpur participated in the study. However, regarding the document, the authors used both physical and online resources from the available sources of data in Malaysia. The available data gathered from the document were synthesised and analysed. The method employed for the data analysis is thematic and descriptive analysis where themes and sub-themes are depicted as they emerged from the data accordingly.
RESULTS AND FINDINGS

This section presents the results and findings of the study:

LEGAL AND REGULATORY STRATEGIES OF ISLAMIC BANKING IN MALAYSIA

The Islamic banking system in Malaysia has its own separate system of legislation and regulatory framework that is separated from the conventional banking industry. Malaysia underwent several constitutional amendments and regulatory changes to regulate and cater to the legal needs of the Islamic financial industry. Malaysia has focused on legal changes, self-regulation and measures with a view to encouraging market-based regulations (Laldin, 2008). These new measures aimed at improving the level of governance among the banking institutions and providing a holistic legal review by the Legal Review Committee set up by the BNM, which removed the legal impediment and ensured the effective purpose of Islamic banking and IFIs (Abdullahi, 2013). Thirdly, it amended the Central Bank of Malaysia Act (CBMA) that allowed the formation of the Shari’ah Advisory Council responsible for all matters related to Shari’ah, Islamic banking and Islamic financial institutions (Abdullahi, 2013; Khiyar, 2012; Laldin, 2008). The presentation and analysis below offer a summary of the data related to the inclusive legal and regulatory framework for the Islamic banking development in Malaysia.

Legal Reform (Amendments, Acts, and Provisions)

In Malaysia, separate legislation governs the Islamic and conventional financial bodies and Malaysian Islamic banks conform to types of laws:

1. Positive laws that are promulgated by the monetary authority (BNM) to safeguard the interest of the public;
2. Islamic law that is based on religious foundations

The Islamic banks are governed by the Islamic Banking Act of 1983 based on Shari’ah principles, which was passed by the parliament and came into force on 7 April 1983. Section 3(1) licensing issue and section 13a was inserted to impose the guidance of the Shari’ah Advisory Council (SAC) on certain Shari’ah issues that relate to financial questions (Abdullahi, 2013; Khiyar, 2012; Markom et al., 2013; Ruzian, 2009). Islamic banks are also mandated under the Islamic Banking Act (IBA) 1983 to form a Shari’ah Advisory Committee (SAC), where section 3(5)b of the IBA provides that the BNM shall not recommend the grant of a license and the minister shall not grant the license unless he is satisfied (Abdullahi, 2013; Al-Nasser & Joriah, 2013). This result from the available document confirmed by one of the interview participants as in the following statements:

Here in Malaysia, there are many amendments. These are done for the betterment of Islamic banking and finance, from the Islamic Banking Act (IBA) to the Islamic Financial Services Act (IFSA). Several laws were changed, and many acts of the law were promulgated and provisions are made to support the goodness of the Islamic financing system (PT: 2).

Similarly, another participant noted:

From time to time, we ask the government to improve our existing legal framework, to provide more comprehensive and practical solutions, to make the things to work and we do have sometimes, legal hiccups, which are referred to the courts to interpret and resolve the dispute between the clients’ banks. The Malaysian legal framework is basically under the Central Bank. The Central Bank is the last resort. We also have our court system. We also have the Sharia courts, both working together. So far, we do not have any issues, and our legal experts are helpful. Most of this legal expertise comes from our faculty of law who are specifically teaching Shari’ah and legal knowledge. By training as a legal person, I know law defines our legal verdict to provide a solution to legal disputes between parties (PT: 1).

The Conventional banks and Islamic Banking Scheme (IBS) are governed by the Bank and Financial Institutions Act of BAFIA of 1989, section 124 (7)a, which repealed and replaced the Malaysian Company

In the same way, in 2007 the Central Bank of Malaysia Act (CBMA) 1958 was amended with the insertion of section 16b of the CBMA that provided the establishment of the SAC. There were also amendments to other existing laws that provided better opportunities for the Islamic banking customers such as the amended Stamp Act of 1949 and that of the Real Property Gains Tax Act (RGPTA) of 1976 (Abdullahi, 2013); and (Ruzian, 2009). Other acts and provisions included the enactment of Government Investment Act (GIA) of 1983, the provision of the Takaful Act (Islamic Insurance Act) of 1984, and the provision of the Securities Commission Act of 1993. The Development Financial Institution Act (DFIA) of 2002 appointed Shari’ah bodies on their own enterprises, which fell under neither the Bank and Financial Institutions Act (BAFIA) nor the Islamic Banking Act (IBA). For instance, the Bank Rakyat Act (BRA) of 1978 governed the Bank Kerjasama Rakyat Malaysia Berhad (KRMB). The other banks include SME Bank, Agro Bank, Bank Simpanan Nasional and Export-Import Bank of Malaysia Berhad (Mustafa & Shakir A. Solarin, 2014).

These banks were given a mandate and supported to operate Islamic banking services by section 129 (1) of the DFIA 2002, which provides equal right and independence for both DFIA and IBA to operate the Islamic Banking activities. Likewise, there is the Capital Market and Services Act (CMSA) of 2007, and section 16b (1) and section 53 of the Central Bank of Malaysia Act (CBMA) of 2009 (Abdullahi, 2013; Khiyar, 2012; Ruzian, 2009).

The result from the available documents and responses of the respondents confirm that Malaysia has undergone several amendments for the betterment of Islamic banking and finance. Following the Islamic Banking Act (IBA), the Islamic Financial Services Act (IFSA) was passed three decades later. The result shows that numerous laws were changed or modified, several acts of the law were promulgated, and provisions were made available to support the Islamic financing system. The result further indicates that, from time to time, the government decided to improve the existing legal framework to provide more comprehensive and practical solutions to arising needs. The data exposes that the legal framework of Islamic banks in Malaysia is guided by the Central Bank, the regular court system, and the Shari’ah courts working collaboratively with help of legal experts who are mostly faculty of law and Shari’ah experts. This helps a lot in providing a legal solution to legal disputes matters.

**Mu’amalat Bench (Special Court of Law)**

An infrastructure was established and dedicated to adjudicate all cases in the commercial division of the ‘Mu’amalat Bench’ (Special Court) of the High Court Kuala Lumpur. The Chief Judge of Malaysia issued a directive (Practice Direction’ No. 1 of 2003) that all Islamic banking and finance cases were to be registered at the Mu’amalat Bench of the High Court for exclusive jurisdiction and hearing and determining of cases (Abdullahi, 2013; Bösch, 2012; Kunhibava, 2015). One of the participants confirmed this development as follows:

> And the same is done in the court system itself, where the court system is offered to have the Mu’amalat bench, in which there is also the amendment to the Central Bank of Malaysia Act in 2009. This means that before the judge can give any decision, they must refer to the opinion of the Shari’ah Advisory Council (SAC) at the Bank Negara Malaysia Berhad (BNM) or Central Bank Malaysia (CBM). It is compulsory for the judge to follow any direction and advice given by the Shari’ah Advisory Council (SAC) at the Central Bank of Malaysia (PT: 2).

The study reveals that Malaysia established a legal infrastructure, which was dedicated to the High Court to adjudicate all cases in the commercial division under the special court of the Mu’amalat Bench in Kuala Lumpur. There was also an amendment to the Central Bank of Malaysia Act in 2009 for the purpose of resolving all Islamic banking and finance cases according to the principles of Islamic law.
PROVISION OF REGULATORY INFRASTRUCTURE

To ensure the developments and success of the Islamic banking industry, Bank Negara Malaysia (BNM) was entrusted with developing the regulation, supervision, control, and legal framework, which led to the emergence of other regulatory institutions. The Central Bank of Malaysia established the Shari’ah Advisory Council (SAC) to regulate any arising Shari’ah issues. Other regulatory institutions recorded in the available documents include the Islamic Financial Service Board (IFSB), the Malaysian Accounting Standards Board (MASB), and the Deposit Insurance Scheme in Malaysia, (DISM) (Kunhibava, 2015; Ruzian, 2009).

Similarly, the data gathered from the responses of the participants confirm the above data gathered from the available literature that Malaysia provided the legal and regulatory framework, which led to the enactment of several acts, provisions, and amendments of certain acts of law. This enabled the establishment of Islamic finance and banking in Malaysia such as the Islamic Banking Act (IBA) of 1983, the Islamic Finance Service Act (IFSA) of 2013, and the Capital Market Services Act (CMSA). On the regulatory issues, the available data from the responses of the participants indicate that the Malaysian government supports Islamic finance through the Central Bank of Malaysia, the Security Commission Malaysia, and the Malaysian Ministry of Finance. On the legal and regulatory strategies of Islamic finance and banking in Malaysia, one of the participants noted that:

The Islamic financial banking system in Malaysia is growing gradually and we have been strengthening our position systematically with policy prescriptions when the need arises. The government through the Central Bank comes up with the proper legislation. Last time there is the Islamic Banking Act 1983 including the Islamic Finance Service Act (IFSA) 2013, which has been legislated, and it is exclusively meant to govern Islamic banking and financial activities. Recently, we have also come up with many guidelines in terms of the policy directions from the Malaysian government, especially from the Central Bank. So far, we are recording huge achievements and we are not only in the banking sector alone. Our major restraint is from the Islamic capital market. We have many agencies that are stationed in Kuala Lumpur, for example, the Islamic Finance Services Board, to strengthen Islamic banking and finance in Malaysia (PT: 1).

Another participant acknowledged:

Actually, ah ..., we can also see that there is a development in terms of the laws, the main laws itself. For example, the Islamic Financial Services Act 2013 repelled the Islamic Banking Act (IBA) back in 1983. Therefore, it shows that the government is supportive in realizing the banking system in Malaysia. And, as I’ve mentioned earlier, very recently the BNM introduced the value-based intermediation concept for the Islamic banks to realise that substance of the Islamic banking in realising the Maqasid-al-Shari’ah of Islamic banking and finance (PT: 2).

Other participants looked at its overall development from the perspective of initiatives, talents, and incentives. In this respect, one participant shared that:

Probably, we look at initiatives in terms of regulating the Shari’ah committee, you know. They established the Shari’ah Governance Framework, they have established ISRA and many other institutions. This is to cope and produce a main power and talents in the area of Islamic finance, then perhaps the talent point of view, and then look at the tax incentive point of view, and then probably look at the regulations point of view. They have a board initiative to come up with the Islamic Finance Service Act, IFSB, Shari’ah Regulatory Framework, and then what else there is. I will probably say to sum up the whole thing, they have the valid excuse and framework to develop Islamic banking in Malaysia, and I can easily say that, without our government support, I do not think that Islamic banking will have the successful ground as it is now (PT: 3).

In addition to that, another participant shared that:

Yes, of course, the Central Bank of Malaysia is also having the supervision power over the Islamic banking and financial institutions in Malaysia. For example, BNM has provided the Shari’ah governance...
framework, which has been put in place, and the Islamic Financial and Services Act to substitute, because previously, under the Islamic Banking Act of 1983, there is no such Shari’ah governance. In terms of the protection of customers, it has been upgraded in the IFSA as well. This is because there is no provision about the customers in the Islamic Banking Act of 1983. Therefore, I believe that the government has done a lot because it involves not only the Central Bank but also the core system in Malaysia. I mean the judiciary system in Malaysia, the entire government agency to ensure that the Islamic regulation for Islamic finance is in line with their growth and development (PT: 2).

Another participant reported that:

This is the first challenging task of the regulatory bodies, especially at this stage, when you talk of the banks is under the central bank in Malaysia. In this regard, the Central Bank of Malaysia has its own regulations, in fact, there are always regulations. They have the Shari’ah principles. There is the supervision of the policies implemented in an Islamic bank. Of course, it is not there for the experience, it should come into, in making the rulings. When they want to make any rulings, so is also under the Central Bank. Therefore, the Central Bank has taken to using the Shari’ah Supervisory Board, which comes to ensure the Shari’ah position on some of the products. However, ultimately in case of any court case, the decision made by the ruling judge will be there and will be held on. So, I will say that along the way, this start to be reflected, this is because each conventional bank has their own Shari’ah supervisory committee. However, banks are being supervised and regulated by the Central Bank in terms of ensuring financial stability (PT: 4).

One participant gave a detailed picture of the Malaysian approach to regulate the Islamic financial and banking system. Below are some of the statements:

Concerning the Malaysian approach, when the first government realised that there is a need to have an Islamic banking system in Malaysia, initially, they set up a task force committee under the Ministry of Finance. The committee is to look into the roadmap to establish Islamic finance in terms of moving the mega analytical framework that will have the way for Islamic finance and other strategies that they need to put in place to have a very sound and robust Islamic finance. ... Therefore, before the establishment of the first Islamic bank here in Malaysia in 1983, there are certain strategies. After the enactment of the Islamic Banking Act in 1983, then the bank came under operation. However, apart from the act that established Islamic financial institutions, there is also an amendment in some suggestion from the task force committee to look into a certain area. For example, in the statutory requirement in the Ministry of Finance, I do not want to go into that, but the Central Bank established a committee called ‘Harmonization Committee’. This committee’s role is to be looking at the existing laws and Shari’ah concept. Whenever there is any contrary or conflict between Shari’ah and the existing law, they will look into that and propose some amendment in order to pave a way in operating the Shari’ah concept into existing law. That is why the Central Bank Malaysia Act 2009 was established. They have in the establishment a separate section to establish the Shari’ah Advisory Council who has the authority and final say when it comes to Shari’ah issues in Islamic finance. Here in Malaysia, whenever there are any issues relating to Islamic banking and Takaful, they have to refer to the resolution of this body including the cost of adjudication. Therefore, the Central Bank makes it clear that the committee should also refer as far as Islamic banking is a concern. They refer to the verdicts or resolutions of Shari’ah Advisory Council. The Central Bank also provides certain provisions to facilitate the existence of Islamic banking (PT: 6).

The Role of Regulatory Bodies in Malaysia

The BNM played a pivotal role in shaping the Malaysian Islamic financing industry, especially in the area of regulation, control, supervision, and legal framework of Islamic banking and finance. The Malaysian government played a role toward improving the existing legal framework, providing a Shari’ah governance framework, and providing more comprehensive and practical solutions to address the legal hiccups through the courts to interpret and resolve existing disputes. The Central Bank of Malaysia played
a key role in providing a legal framework, regulations, control, and supervision of Islamic banks. Another important role is providing the court system, Shari’ah courts and legal experts, who support the system.

Consequently, the overall regulation, supervision, control of the Islamic financing industry and Shari’ah matters are through the SAC at BNM. The Central Bank of Malaysia extended its effort in providing the Shari’ah governance framework and later on Shari’ah standards that ensure uniformity and harmonisation of Shari’ah interpretations. There is also the formation of SAC and the establishment of a Shari’ah committee for each bank in order to resolve any arising issues and provide guidelines on their governance. Thus, one of the important issues worthy of consideration for the development of the Islamic banking system in Malaysia is the starring role of the regulatory bodies in building an effective legal and regulatory framework. In this regard, one of the participants stated that:

From time to time, we ask the government to improve our existing legal framework, to provide more comprehensive and practical solutions to make things work, and we do have sometimes legal hiccups, which are referred to the courts to interpret and resolve the dispute between the clients’ banks. The Malaysian legal framework is basically under the Central Bank. The Central Bank is the last resort. We also have our court system. We also have the Shari’ah courts, both working together. So far, we do not have any issues. Our legal experts are helpful. Most of this legal expertise comes from our Faculty of Law who are specifically teaching Shari’ah and legal knowledge. By training as a legal person, I know law defines our legal verdict to provide a solution to legal disputes between parties (PT: 1)

In December 2004, BNM provided the first guidelines on the governance of Shari’ah committees that spelt out the functions of the Shari’ah bodies of the Islamic financial institutions. In 2010, a new version of the Shari’ah Governance Framework for Islamic Financial Institutions superseded the previous guidelines to restructure the system and meet the expectations of the stakeholders and Islamic financial institutions pertaining to Shari’ah compliance (Abdullahi, 2013).

The structure of the Shari’ah governance model for IFIs of 2010 spelt out the roles, scope, duties, and responsibilities of the internal Shari’ah committees in advising the respective Islamic financial institutions on Shari’ah issues. This governance framework further set out the procedure, rules, and regulations in the establishment of Shari’ah committees for Islamic banks and IBS banks (Abdullahi, 2013; Akhtar, 2005). Concerning the legal and regulatory issues, one of the participants noted:

Ammh, I believe that financial regulatory bodies in Malaysia are very supportive because from time to time, we have seen that there are a lot of laws, which are enacted to accommodate the growth and development of Islamic banking. We can say that there is the tax being the stamp duty. The banks had to pay the double tax in the early period, but now that has been amended. Meaning that, we treated the Islamic banking system as similar to the conventional banking system in which only one time of payment for the stamp duty. There are also a lot of... what you call it... ah ..., an amendment has been done to the betterment of Islamic banking and finance, from the Islamic Banking Act to the Islamic Financial Services Act. And the same also has happened in the court system itself, where the court system has been offered to have the Mu’amalat Bench, in which there is also the amendment to the Central Bank Act in 2009. This means that before the judge can give any decision, they must refer to the opinion of the Shari’ah Advisory Council at the Bank Negara Malaysia Berhad or Central Bank Malaysia. This is compulsory for the judge to follow, any direction and advice given by the Shari’ah Advisory Council and the Central Bank of Malaysia (PT: 2).

One of the participants offered a clear picture of the role of regulatory institutions such as the Shari’ah standard, the Shari’ah governance framework, and the role of Shari’ah committees:

Before the Shari’ah standard, there is what we call the Shari’ah governance framework, which specified the role of Shari’ah committee of each bank, and Takaful. It also gives a mandate to the management of banking and Takaful industry. All necessary information and documents must be transferred to the Shari’ah committee when necessary. This is to ensure that the Shari’ah committee knows the operations of banks before they give a fatwa. Therefore, this means that the ruling they give is much of a comprehensive assessment of the scenario. That is why it is the work of the management. Therefore, the Shari’ah governance framework is to guide the industry and ensure hand-to-hand Shari’ah
compliance. The framework specified that the bank should also have a Shari’ah department in order to bridge the gap, or sometimes the Shari’ah committee will say something, the management will say something else. So, these Shari’ah units in the banks, they will do Shari’ah review on the operations of the day-to-day operations and business services of the bank. We report potential Shari’ah non-compliance to the Shari’ah committee if there is any. So, in the end, it will be the highest affair of the Shari’ah committee or day-to-day activities of the committee. Therefore, there are things that the regulatory body does and their strategies in their regulations to ensure that Islamic banking system here in Malaysia is moving towards the right directions (PT: 6).

The data that emerged from the available document and responses of the interview reveals that the Malaysian Islamic banking industry progressed through the support enjoyed from the regulatory bodies, especially the BNM. The Central Bank of Malaysia was assigned with the code of practice, supervision, control, and legal framework of financial institutions, which led to the emergence of other regulatory institutions. The data shows that the Central Bank of Malaysia recognised the Shari’ah Advisory Council (SAC) to regulate any arising Shari’ah issues. On the other hand, the study reveals that other regulatory institutions that guide the functions of Islamic banks in Malaysia include the Islamic Financial Service Board (IFSB), the Malaysian Accounting Standards Board (MASB), and the Deposit Insurance Scheme in Malaysia (DISM). Therefore, these regulatory institutions have contributed a lot in reshaping the strategic focus of Islamic finance and banking industry.

The responses of the participants above show that the regulatory institutions played a pivotal role in shaping the Islamic finance industry. This includes BNM with its overall regulation, supervision, and control of the Islamic financing industry, and Shari’ah matters as guided by the SAC, and Shari’ah committees in other banks as guided by the SAC at BNM. In addition, there was the Shari’ah governance framework and later the Shari’ah standard to ensure uniformity and harmonisation of Shari’ah interpretations. There was also the formation of the Islamic Financial Services Board (IFSB) and the establishment of Shari’ah committees for banks.

The Role of the Central Bank of Malaysia

The data from the responses of the respondents reveals that the Central Bank of Malaysia has the power to spell out the roles, scope, duties, and responsibilities of the Islamic finance system. It also ensures regulation, control, and effective supervision. In the following interview statement, one of the participants explained:

*The legislative and the executive are supposed to provide the law, but the enforcement comes from the Central Bank of Malaysia. The Central Bank of Malaysia has the full authority to exercise their power in any issue. They have the power to cancel the license of those banks, implement punitive measures, put fines, and penalize them for violation. Therefore, the Central Bank, as the regulatory agency, has full authority to exercise power to stop anything that the commercial banks and other agencies are doing wrong. We also have a strong legal framework that regulates the security market. We do have also the legal framework in the form of the Takaful Risk Management area. The Takaful is still struggling whereas the banking, finance, and Islamic wealth management, capital market are well taken care of (PT: 1).*

Similarly, another participant regards the Central Bank of Malaysia as supportive enough to accommodate the growth and development of Islamic banking in Malaysia. Thus, the Central Bank of Malaysia knows how to supervise the Islamic financial institutions:

*Yeah, of course, the Central Bank of Malaysia also has the supervision power over the Islamic banking and financial institutions in Malaysia. For example, we have the Shari’ah Governance Framework, which has been put in place, and the Islamic Financial and Services Act to substitute, because previously, under the Islamic Banking Act of 1983 there is no such Shari’ah governance framework. In terms of the protection of customers, it is upgraded in the IFSA as well. This is because there is no provision about the customers in the Islamic Banking Act of 1983. Therefore, I believe that the government has done a lot because it involves not only the Central Bank but also the core system in Malaysia. I mean the judiciary*
system in Malaysia, the entire government agency to ensure that the Islamic regulations for Islamic finance are in line with their growth and development (PT: 8).

One of the participants showed satisfaction and considered the role the Central Bank of Malaysia plays as extraordinary, especially in the evolution of Islamic financing products, in the following words:

> I think the Central Bank of Malaysia has been very correct, and our policy from an investment account to investment account platform in the tradition of Islam. Then, you can also see that over the side the evolution of the contracts of Bay al-Inah to Tawarruq, and many files have taken place within the last 20-30 years. In addition, we cannot discount our policy and the role the regulatory bodies and leadership play in terms of all the manner of this product. So, our policy to the establishment of all these regulatory bodies started from the Central Bank. Then look at the other institutions that the Central Bank has created like the Islamic Financial Service Board (PT: 3).

Likewise, another participant acknowledged that there is sufficient and effective control and supervision exercised by the Bank Negara Malaysia:

> Certainly, Islamic financing institutions have to follow all finance guidelines. From time-to-time, contact audit of Islamic banking, to make sure they comply with the entire regulatory framework. In addition, there is control and supervision by the Bank Negara Malaysia. Within each Islamic bank, they have their own structure. They also have their audit, the internal audit division or department, or other computer division. Islamic banks also have their own regulatory principles separate from each other, separate Shari’ah committees, separate from conventional bank regulatory structure, and more (PT: 5).

Another participant explained that:

> Definitely, when you talk of the banks; it is under the Central Bank in Malaysia. Ahhh..., in this Central Bank, there are always regulations. They have Shari’ah principles and there is supervision of the policies implemented in an Islamic bank. Of course, it is not there for the experience, it should come in to make rulings. When they want to make any rulings, that is also under the Central Bank. So, having this quite a number of times makes people question. Therefore, the Central Bank has taken to using the Shari’ah Supervisory Board, which comes to ensure the Shari’ah position on some of the products. However, ultimately, in case of any court case, the decision made by the ruling judge will be there and will be held on. Therefore, I will say that along the way, this started to be reflected. This is because each conventional bank has their own Shari’ah supervisory committee. However, banks are being supervised and regulated by the Central Bank in terms of ensuring financial stability (PT: 4).

Similarly, another participant noted the role of the Central Bank in terms of regulations, control, initiatives, and legal issues as follows:

> The role of the regulatory body has actually aided the system. For example, in the Central Bank Act 2009, in order to pave a way for the success of Islamic banking system, one of the amendments they made was to establish a board that will be the best choice for Shari’ah when it comes to Islamic banking and finance in Malaysia. It is a duty of the Central Bank management to refer any matter of Shari’ah or legal matters to the board. This is to ensure the regulations and Shari’ah compliance for Islamic banks here in Malaysia. Apart from the Central Bank, here in Malaysia based on their initiatives, they included an Islamic Finance Service Act. The Central Bank may issue from time to time a Shari’ah standard that will guide the operations of the banks. So, this is the Shari’ah standard on Musharakah, Mudarabah, Istsinsah, Hawalah, Wadiah, Hibah, Qard al-Hasan, and Wakalah. Hence, these are some initiatives of the Central Bank here in Malaysia. This is with the view to ensure that the Islamic bank is moving toward the standard. Before the Shari’ah standard, there is what we call the Shari’ah governance framework, which specified the role of the Shari’ah committee of each bank and Takaful (PT: 6).

Another participant believed that Malaysia to be very well-regulated in terms of finance, and banking:

> Malaysia is very highly regulated in terms of finance, and banking. The regulator regulates Takaful. They put properly in the legal system the position of Shari’ah, which is a very good thing that they have done. I do not think there is any other country that has done that. There is a bold statement in our legal document, the position of the Shari’ah Advisory Council. Their resolution is regarded as a rule, Qanun
From the above responses of the participants, the result that emerged from the data reveals that the Central Bank of Malaysia has the strong power in spelling out the roles, scope, duties, and responsibilities of the Islamic finance system. It also has the responsibility to ensures regulation, control, and effective supervision. In addition to that, the Central Bank of Malaysia has provided and endorsed other regulatory bodies such as SAC, Shari‘ah standards, the Shari‘ah governance framework, IFSB, and other related Islamic financial regulatory bodies. This is to ensure that the Islamic banks are moving in the right direction. The Shari‘ah governance framework details the function of the Shari‘ah committee of each bank, and the Central Bank of Malaysia is definitely the key to all the existing successes. The power of the Central Bank of Malaysia to control the Islamic finance industry through regulation, control, and effective supervision is the reason for confidence, foreign investment, and financial stability.

The Role of the Shari‘ah Advisory Council (SAC)

The Shari‘ah Advisory Council was established by BNM in 1997 with the objectives of i) advising BNM on matters related to operation IBs, IFIs and Takaful; ii) coordinating Shari‘ah matters related to operation IBs, IFIs, and Takaful; and iii) analysing and evaluating Shari‘ah compliance of new products or schemes submitted by banking institutions and Takaful operators. Its functions and commitments make it necessary that it is empowered with the sole authority on Islamic banks, Islamic financial institutions, and Takaful and reference body and advisor for BNM on Shari‘ah matters (Abdullahi, 2013). The council has agreed on several matters and issued a number of resolutions such as i) allowing the banks to impose penalty charges on unpaid debts; ii) not restricting female and non-Muslim solicitors to act as signatories in all financial documents, and iii) second- and third-party charge are accepted as security (Abdullahi, 2013). The Shari‘ah Advisory Council has the responsibility of validating new emerging financing products to ascertain their suitability with Shari‘ah principles. It oversees of the Shari‘ah bodies of Islamic banks and IBS with a view to avoid divergent Shari‘ah interpretation and ensure the effectiveness of the Shari‘ah compliance (Akhtar, 2005; Ruzian, 2009).

REFLECTION FOR NIGERIA

Thus, from the above outcome, Nigeria can learn how to revise its current legal and regulatory procedures, legal reforms amendments, and provision of new acts of law for the Islamic banking system to flourish in the country. Nigeria can learn to provide special courts similar to the Mu‘amalat Bench in Malaysia that can handle any court dispute in relation to Islamic banking. Malaysia replaced the Islamic Banking Act of 1983 with the Islamic Financial Services Act (IFSA 2013). Subsequently, several amendments and changes were made gradually. For example, Malaysia revised the Shari‘ah Regulatory Framework of 2011 and introduced the Shari‘ah Governance Framework. Legal and regulatory philosophies were formulated to suit the operational run of IFIs in accordance with basic principles of Islamic law. In this respect, Malaysia resorted to two approaches that encompass compliance with Shari‘ah international standards and developed a separate regulatory framework to address the exclusive features of Islamic banking.

In the first place, Malaysia complies with the current Shari‘ah international regulatory standards. This concerns the Islamic banks and conventional banks operating Islamic banking schemes that observe parallel international standards, supervisory principles, risk management standards, corporate governance standards, financial disclosure, and customer policy. Similarly, these institutions are subject to monitoring, evaluation, supervision, and surveillance by the BNM. Malaysia employed these policies in an efficient manner according to the needs of these institutions without contradicting the principles of Islamic law. Thus, Nigeria can emulate this idea by providing more regulatory infrastructures that can ensure the necessary level of supervision and extra regulatory needs.
In addition to that, Malaysia has introduced the Islamic banking scheme within the conventional banking setting. However, the Islamic banking division of the conventional banking system was granted the right to operate independently. These strategies by the BNM provide interaction for economies of scale and take advantage of cost efficiency. These measures serve as a firewall that ensures strict adherence to Shari’ah principles (Abdullahi, 2013). Even though Nigeria allowed two conventional banks (Stanbic IBTC and Bank PHB) to introduce Islamic banking within a period of five years, it is time to allow other conventional banks to operate the Islamic banking window and observe an efficient and minimum Islamic banking fund based on separate clearing account. This depends on CBN policies, infrastructure and needs a well-structured system that can provide effective separation of the payment system and separate accounting disclosure. Moreover, Nigeria needs to consider the Malaysian approach as a roadmap by increasing the number of players from the conventional banks and incorporate foreign banks. This will open the door for more employment opportunities to Nigerian young graduates, increase economic growth and development, and promote savings and investments. Lastly, Nigeria can also learn from the Malaysian confidence in Islamic banking and finance. Malaysia has confidence in what they are doing, that is why they became the best in the world, and there is no dispute about it. This is achieved because of the concerted efforts by the government, regulators, experts, legislators, courts, and the public.

CONCLUSION

The motive behind the conduct of this study was to discover the legal and regulatory strategies/policies of the Malaysian Islamic banking system by which Nigeria can reflect and re-echo its system. The available document and literature establish that, the Malaysian legal and regulatory framework of Islamic banking system is mainly dominated by the BNM through various developments, implementations, and establishments. The Malaysian apex bank incorporated several Shari’ah experts, legal experts, business experts, and academic experts from various institutions to contribute to the legal and regulatory issues of the system. This is because; legal and regulatory framework of the financial system has the ability to determines the effectiveness of the banking system, financial stability and attract foreign and domestic investment. It also ensures the healthy growth of the system. Henceforth, the result of the study reveals that Malaysia has undergone several legal changes and shaping the legal and regulatory design to suit the need of the system by making several provisions and legislation on the legal issues, which led to the accomplishment of Islamic banking business in Malaysia. The outcome that emerged from the document reveals that the BNM supervision department develops, enhance, and implement certain legal and regulatory framework. These involve establishment of Islamic financial service board IFSB, providing avenue for Islamic financial service act IFSA to thrive, spelling Shari’ah governance framework, Mu’amalat bench and incorporation of civil courts to guarantee the free success of the legal cases, ensure best practices and effective corporate governance, and proper risk management in the financial industry. The outcome of the study from the interviews further depicted that Nigeria can reflect from the Malaysian strategies/policies to streamline its recent system. In addition to that, the result of the study that emerged from the reactions of the participants further projected that legal place of Islamic banking in Nigeria requires resuscitation, because the system is currently operating under BOFIA rather than its own Islamic banking Act IBA. The restriction of this article is limited to legal and regulatory strategies of the Malaysian Islamic banking system with the view to serve as a reflection for Nigerian context. Several strategies other than legal and regulatory issues can be employed as a future direction in connection with an Islamic banking system in Malaysia or any other experienced country in such areas like risk factors, awareness, and religiosity issues.
Reference:


