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Security in Islamic Finance Shariah Compliance and the New Civil Court's Approach to Dispute Resolution

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Abstract— Malaysia has a dual financial system that includes both conventional banking and Islamic banking. Over time, Islamic banking has evolved to the point where it has enticed traditional banks to offer *Shariah*-compliant products as well. However, even though conventional banks have provided *Shariah*-compliant products, the Islamic bank's obligation to provide Islamic banking services remains. The goal of this article is to look at the measures in the Islamic Financial Services Act 2013 that assure *Shariah* compliance security for Islamic banks. This paper also investigates the current approach of civil courts in resolving disputes. The qualitative research methodology was used in this paper. The phenomenology method was used in the research design. Data will be gathered from journals, statutes, and case law. The data will be analysed using the content analysis method. This paper concludes that it is a heavy duty of every Islamic bank to ensure *Shariah* compliance security, and the current civil court approach is that the Islamic banking agreement is still enforceable even if it does not comply with *Shariah* law. Islamic banking agreements that are in accordance with *Shariah* law or are not perfectly in accordance with *Shariah* law are both valid and legal.

Keywords— *Shariah Compliance, Security, Civil Court*

I. INTRODUCTION

The ultimate goal of having an Islamic bank is to ensure that all Islamic banking services comply with *Shariah* in order to uphold and maintain the moral purity of all transactions through their products, such that if funds are made for *Shariah* compliance purposes. This can be accomplished through the use of Islamic banking products and services such as the *tawarruq*, *ijarah*, *mudharabah*, *bai bithaman ajil*, *murabahah*, *musharakah*, and *istisna'* contracts. For the services and products to be labelled as *Shariah* compliant, they must be free

of *riba* (interest) and *gharar* (uncertainty), *maysir* (gambling). On top of that, Islamic finance products and services also must not have the elements of manipulation, oppression and injustices.

II. SHARIAH COMPLIANCE SECURITY AND ISLAMIC BUSINESSES

Islamic finance has been developed in many jurisdictions including Malaysia and Saudi Arabia (Mohd Zakhiri, 2012). Islamic banks primarily function as *Shariah* compliance banks that facilitate offering Islamic finance products and services. On the other hand, Islamic banking pertains to a banking system governed by *Shariah* law, which emphasizes that the principles of Islamic banking governance revolve around mutual risk and profit sharing between parties in order to promote fairness (Bank Negara Malaysia, 2021).

The connection between Islamic banks and their customers is predicated upon the foundational contract that exists between the involved parties. In contrast, within the realm of conventional banking, the association between the bank and its debtor is predominantly characterized as a debtor-creditor relationship.

In this regard, it is essential for *Shariah* compliance banks to provide Islamic banking services because it is a command from the *Quran* that Muslims keep their covenant faithfully. "Come

not near the wealth of the orphan save with that which is better until you come to strength and keep the covenant," says *Surah al-Isra*, verse 34. The covenant will undoubtedly be requested." Furthermore, the Prophet (PBUH) remarked in a *hadith* given by al- Bukhari, "Muslims are bound by their conditions." (It was reported from 'Uqbah that the Prophet (blessings and peace of Allah be upon him) said: "The condition that most deserves to be fulfilled is that which allows you to have intimacy." According to al-Bukhari (2572) and Muslim (1418). According to Abu Hurairah (may Allah be pleased with him), the Prophet of Allah (blessings and peace of Allah be upon him) remarked, "The Muslims are bound by their conditions." Abu Dawood (3594; classified as saheeh by al-Albani in Saheeh Abi Dawood) recorded it. This means that any transactions must adhere to the *Shariah* pillar (*rukn*) of contract law. As a result, Islamic banks must provide *Shariah* compliance Islamic banking services.

The *Shariah* Governance Framework (SGF) is the framework to which IFIs must adhere in Malaysia. According to Section 28(1) of Islamic Finance Services Act 2013 (hereafter referred to as IFSA 2013), Islamic banks are required to provide *Shariah*-compliant services. *Shariah* compliance, as defined in Article 28(2) IFSA 2013 and supported by Article 29(1) IFSA 2013, means that an Islamic financial institution must adhere to *Shariah* in all of its operations, business, affairs, and activities in accordance with the *Shariah* Advisory Board of Bank Negara Malaysia (SAC) and its *Sharia* standards in order to ensure that internal policies and procedures are *Shariah* compliant.

Furthermore, as seen in the case of *Maybank Islamic Bhd v M-1- Builders Sdn Bhd* (2015) 4 CLJ 526, Islamic banks are required to provide *Shariah* compliance services. The facts are that the appellant granted the first respondent a *Murabahah* Overdraft Facility (MOD facility) on July 31st, 2003, with the second respondent as a guarantor for RM 3 million. The facility was made available on the basis of the *murabahah* financing principle.

In both the High Court and the Court of Appeal, the appellant raised the issue of illegality. Asmabi Mohamad J explored the idea of *murabahah* in the High Court, which states that the asset must already exist and be possessed by the seller before the sale can take place.

the sale can take place. As a result, Asmabi Mohamad J ruled that the transactions violated the *murabahah* concept because they did not involve a sale of the plaintiff's asset but rather a buy back of the first defendant's asset. The MOD facility was declared null and void because the contract did not comply with the fundamental tenet of *murabahah*.

In the nutshell, Islamic bank is required to provide Islamic banking services because it is vital for it to carry out *Shariah* compliance services as commanded in *al-Quran* and *al-hadith*. Furthermore, it is also supported by the provision under sections 28 and 29 of IFSA 2013, and the decision held in the case of *Maybank Islamic Bhd v M-1- Builders Sdn Bhd* (2015) for Islamic bank to provide *Shariah* compliance products and services.

This is also supported by Section 28 of the IFSA 2013, which states that the Islamic financial institution must provide *Shariah* compliance services. In addition, Islamic financial institution also needs to follow any ruling issued by the *Shariah* Advisory Council and *Shariah* parameters issued by BNM as to ensure that the Islamic banking business is *Shariah* compliant. In the event, it triggers the issue of *Shariah* non-compliance, the Islamic banks need to take rectification measures within 30 days and informed BNM the same.

According to Trakic and Tajuddin (2016) in their book "*Islamic Banking & Finance: Principles, Instruments, and Operations*," Islamic banks are also classified as public companies under the Companies Act of 2016, allowing them to engage in trading activities such as asset purchase and sale. As a company, this means that Islamic banks have articles of association (AOA) that outline their principle of producing *Shariah*-compliant products. Failure to comply will render the bank's activities null and void.

In addition, the SAC is being established and given authority to supervise Islamic financial institutions and provide *Shariah* resolutions that is binding on all Islamic banks to ensure there is no conflict of interest, as stated by Markom and Ismail(n.d.) in the article "*Development of Islamic banking laws in Malaysia*.". The SAC is also referred to not only by Islamic financial institutions, but also by courts and arbitrators in resolving *Shariah* disputes for the products provided by Islamic banks by virtue of Section 56 and 57 of the Central Bank Act 2009.

¹⁴ In the matter of *CIMB Islamic Bank Bhd v LCL Corporation Bhd & Anor* [2012] 7 CLJ ¹⁹, the plaintiff bank gave the first defendant a term-financing facility under the BBA facility. The first defendant has defaulted on the repayment, and the plaintiff has served a notice of demand, but no action has been taken. Later, the plaintiff sought summary judgement in order to recover the repayment and *ta'widh*.

The first defendant, on the other hand, claimed that the BBA facility was void and null, and that there was an error in the *ta'widh* calculation. In his judgement, the Zawawi Salleh Judge referred to the SAC's resolution and found that the BBA facility was lawful, although the amount of *ta'widh* had to be adjusted.

III. CURRENT CIVIL COURT APPROACH ²⁴ IN RESOLVING ISLAMIC BANKING DISPUTES IN CIVIL COURT

Malaysia applies a dual system in banking, they are conventional and Islamic, so it is by law a contract that violates *shariah* principles will be void (Muhammad Hafiz Mohd Shukri, 2020). So most Muslim scholars would argue that it would be a sin if an invalid contract occurred including the parties who entered into it. (Zuhayli, 2002).

It is strongly advised that Civil Court judges consult to the SAC to ensure ⁴ the security of Sharia-compliant contracts. In the matter of *Bank Kerjasama Rakyat Malaysia Berhad vs. Bramton Holding Sdn Bhd* (2015) 4 CLJ 635, the judge noted that funding that is not sharia-compliant must not be decided without consulting the SAC. ⁴ SAC's main role is to enforce the law, as demonstrated in the case of *Mohd Alias bin Ibrahim v. RHB Bank & Anor* [2011] 3 MLJ. Although Article 56(2) and Article 57(3) of the Central Bank of 2009 appear to bind the court or arbitrator, the main rule is that the court decides. The main task of the SAC is to ensure sharia law and the power to determine lies with the courts to decide. So, this causes the unconstitutionality of the 2009 Central Bank Law, especially articles 56(2) and 57(3).

However, there are differences between the validity of agreements that are in accordance with *shariah* law and those that are not. The question would be whether an Islamic

agreement that did not perfectly follow *Shariah* would be enforceable with the help of civil laws. The answer to this question is affirmative. This is basically in the interface between Section 24 of Contract Act 1950 and Section 28 ³ of IFSA 2013. *Bai' Bithaman Ajil (BBA)* agreement stated by *Tan Sri Abdul Khalid Ibrahim vs Bank Islam Malaysia Bhd & Others* (2010) 4 CLJ 388 can still be enforced even though the plaintiff demands *rahn*. It is because the court is of the opinion that in Islamic teachings it is important to uphold the rules for fulfilling contractual obligations because the parties never intended the contract to become *rahn*. It is worth noting that the plaintiff in this case claimed that the defendant's BBA agreement was unenforceable because it violated Section 24(e) of the Contracts Act of 1950.

In this regard, the latest decision ³ from the Court of Appeal on the matter, as well as section 281 of the Islamic Financial Services Act 2013 (IFSA 2013), will be analysed to verify the legality and validation of Islamic banking agreements that are not *Shariah*-compliant.

Section 281 of IFSA 2013 states that an agreement entered into in violation of IFSA 2013 is ¹⁵ id, with the exception that it does not affect any person's liability for any administrative, civil, or criminal actions brought as a result of the breach. This means that even if there is a breach of the contract, the Islamic banking agreement will still be enforceable under civil law. Furthermore, even if the Islamic banking agreement is non-*Shariah* compliant, it will still be liable.

¹³ Section 281 has a substantial impact, as stated by the Court of Appeal in the recent case *Maybank Islamic Berhad v Golden Base Construction (Bhd & 2 Ors, 2021)*. Golden Base Construction Sdn Bhd secured an RM 50 million Islamic *murabahah* finance loan from Maybank in this case. Golden Base purchases *Shariah*-compliant commodities such as *murabahah* Asset on delay ¹⁸ payment conditions from Maybank after requesting for *murabahah* Asset at a purchase price equivalent to the loan amount.

The deal contained two guarantors, but both Golden Base and the guarantors failed to make payments on time. Maybank filed legal action against them, and in response, *Golden Base* and the guarantors claimed in their defense and counterclaim that the financing agreement is null and void because it violates *Shariah* principles. One of the pivotal points of contention revolved around whether the *murabahah* transaction ²² referred to the *Shariah* guidelines and parameters set forth by Bank Negara Malaysia. Based on the decision of the Court of Appeal, it was declared non-compliance with sharia regulations, this did not cause the financing facility contract to be invalid, so that this provision caused Maybank to win. And this decision also has support from applicable case law and also Article 281 IFSA 2013.

Furthermore, in this case, the Court of Appeal concluded that *murabahah* contract remained in accordance with Malaysian contract law; Contract Law of 1950, which replaced *Shariah* contract principles.

In the nutshell, the current approach of the court is that would not refer to SAC if the court decided there is no *Shariah* issue at hand. The contract is still valid and enforceable by virtue of Section 281 of IFSA 2013 so long there is no vitiating factor under Section 24 of Contract Act 1950

IV. CONCLUSION AND SUGGESTION

The obligation lies with Islamic banks to ensure that their entire operations and products are *Shariah* compliant. It is important to note, before the products being traded in the market, the products were already be endorsed as *Shariah* compliant and it remains as such until be challenged at Civil Court, to contrary.

The civil court's approach in Maybank Islamic Berhad vs Golden Base Construction Sdn Bhd & 2 Ors is that sharia banking agreements can still be enforced even though they do not comply with *Shariah* law. Islamic banking agreements that are in accordance with *Shariah* law or are not perfectly in accordance with *Shariah* law are both valid and legal. Thus, even if Islamic banking respects and follows civil laws, the Islamic banking agreement will still be enforceable as long as it does not affect any person's liability for any administrative, civil, or criminal actions resulting from the breach of the agreement.

According to the Rome Convention on the Law Applicable to Contractual Obligations 1980, Islamic financial contract issues must be resolved in accordance with *Shariah*. As such, it is highly recommended that the court

consult with the *Shariah Advisory Council* on *Shariah* issues before issuing a decision. Their decision is correct if they follow *Shariah* rules and principles in deciding Islamic finance disputes.

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