THE NEW CENTRAL BANK OF MALAYSIA ACT 2009 (ACT 701): ENHANCING THE INTEGRITY AND ROLE OF THE SHARIAH ADVISORY COUNCIL (SAC) IN ISLAMIC FINANCE

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INTRODUCTION

Among the challenges facing the Islamic financial services industry are the development of financial services and instruments that are Shari’ah\(^1\) compliant, commercially viable, valid and enforceable, based on the prevailing governing laws. Besides, there is a need to develop experts who understand the intricacies of Islamic finance to guide the industry. Malaysia is working hard to cope with growth in Islamic finance, which has assets worth more than a trillion dollars. The first legislation enacted to facilitate the infrastructure of Islamic banking in Malaysia was the Islamic Banking Act 1983 (Act 276) IBA.

An amendment was also made to the Government Investment Act (GIA) 1983 regarding both the statutory reserves and liquidity reserve requirements, allowing them to be interest-free. The Takaful Act 1984 (‘TA’) was later on enacted to allow the licensing and operation of Islamic insurance or takāfūl companies in Malaysia. This was followed by an amendment in 1996 to Section 124 of the Banking and Financial Act (BAFIA) to allow banks licensed under the Act to introduce Islamic banking business.

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1 Malaysian institutions and authors sometimes spell the word “Shari’ah” as “Syariah”. When they do so, their spelling is maintained; otherwise the more standard English transliteration is used.
A new section was also added to IBA in 2003, Section 13A, which provides that Islamic banks seek the advice of the Shariah Advisory Council on Sharī‘ah matters relating to their banking business and requires that Islamic banks comply with that advice. 'The Shariah Advisory Council' in this section means the Shariah Advisory Council established under sub-s 16B(1) of the Central Bank of Malaysia Act 1958 (before the new Act 701 amended in 2009). This shows that the SAC has advisory powers over the Islamic banks; liaison and common understanding between the Sharī‘ah Advisory Board (SAB) of the bank and the SAC is expected.

The amendment was also intended to ensure that Islamic banks strictly adhere to Sharī‘ah requirements, as advised by the SAC. Liaison with the SAC can also facilitate a shorter time-frame for endorsing new products in Islamic Banking and Finance (IBF). The new Central Bank of Malaysia Act 2009, known as Act 701, was gazetted on the 3rd of September 2009.

The Act incorporates an explicit mandate, provides comprehensive provisions for heightened surveillance, pre-emptive actions and expanded resolution powers to facilitate the swift and orderly resolution of a financial crisis. Bank Negara Malaysia may also take appropriate intervention to avert risks that stem from unregulated entities. Anything related to Islamic finance is thoroughly discussed in Part VII of the Act. The previous Central Bank of Malaysia Act 1958 (Act 519) only discussed the Shariah Advisory Council in one section of Part II under the heading of establishment, capital and administration of the bank, whereas the new Act provides comprehensive details for the function of the Shariah Advisory Council in Part VII.

Consequently, the role of the Shariah Advisory Council in civil court has been the subject of lengthy and heated debate. Too many common law principles and interpretations based on the principle of equity were invoked in the cases decided without referring to the opinion of the SAC. The new Act aims to alleviate all the previous problems related to litigation.

This paper is divided into seven sections: first, the anomalies in reference to the Shariah Advisory Council (the SAC) prior to the amendment of Central Bank of
Malaysia Act 2009 are reviewed. Among other things, it delineates the civil courts’ jurisdiction on Islamic banking. Civil courts apply common law principles in deciding cases in *muʿāmalāt* law, and reference to the Shariah Advisory Council (the SAC) was regarded as optional and not obligatory. Second, this paper also highlights the significance of the establishment of the Shariah Advisory Council compared with the previous Act. Third, it touches on the responsibility of the Bank and Islamic financial institutions to consult the Shariah Advisory Council in any matters involving Islamic finance. Accordingly, the paper highlights the reference to the SAC for rulings by a court or arbitrator, which are binding in nature, and the *functiones officio* of the Shariah Advisory Council (the SAC). The appointment of the SAC members is discussed in detail with some elaboration on the role of the SAC as expert opinion or *al-raʾyu al-khabîr* from an Islamic perspective. The last section concludes by discussing the effects of the current amendment on the industry as a whole.

**ANOMALIES WITH REFERENCE TO THE SHARIAH ADVISORY COUNCIL (SAC) BEFORE THE AMENDMENT OF CENTRAL BANK OF MALAYSIA ACT 2009**

**I. The Legal and Judicial Framework of Islamic Finance Lies within the Conventional Civil Framework**

The issue of jurisdiction and the legal framework for Islamic finance, which has led to skirmishes between Civil and Shariah Courts, has been long debated. The debate is based on the nature of the structural law in Malaysia. The Islamic finance cases are decided in civil courts not Syariah courts. This is due to the fact that the civil courts’ jurisdiction laid down in List 1 (Federal List), of the 9th Schedule of Federal Constitution includes civil, criminal procedures, contracts, *lex mercatoria* (inclusive of banking and financial laws), arbitration, the administration of justice, etc. In contrast, the Syariah Court’s jurisdiction is laid down in Para 1 of List 11 (State List) of the 9th Schedule of the Federal Constitution. Para 1, in essence lays down the
matters under the state list, inclusive of family law, personal law, divorce, waqf, succession, and the religion of Islam, including offences against it (except what falls under the Federal Law). An amendment was made to Article 121(1A) of the Federal Constitution declaring that civil courts have no jurisdiction over matters within the jurisdiction of the Syariah courts. The amendment is to grant exclusive jurisdiction to Syariah courts in the administration of Islamic laws. In other words, article 121(1A) is the proviso to prevent conflicting jurisdictions between the civil courts and the Syariah courts. Many have argued that matters of Islamic finance fall under the text of lex mercatoria. The term “Islamic law” in Para 1, List 11 of the Ninth Schedule is subject to wide interpretation. Many commentaries on this issue proposed that the list only applies to a person professing the religion of Islam and disregarded the areas of Islamic law detailed in the same List.

Based on this interpretation, Islamic law has no general application to other persons or legal persons such as banks and financial institutions, which cannot be construed as professing the religion of Islam. Section 2 of the IBA, however, defines an Islamic bank as any company that carries on Islamic banking business, which is defined as any operations which do not involve any elements not approved by the religion of Islam. Interestingly, the mandate written in the Memorandum of Association of a company may be construed as the basic constitutional document of that company which has to be professed or perceived by all the members of the company. If the MOA of a company stipulates that it must be Shari‘ah compliant, it must adhere to the mandate contained therein. On a proactive note, if the company runs a business which contradicts the MOA, its activities can be challenged ultra vires. Legal entity and personality created by law for a company and the acts pursuant to its incorporation must be in accordance with the AOA and the MOA. There is no issue of whether a

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3 A company is defined as a legal person, which among other features, is capable of owning property, being subject to legal rights and obligations, suing and being sued. The concept of legal entity (shakhsiyyah i‘tibāriyyah) is considered valid in Islam, based on the example of Bayt al-Māl and waqf institutions. For details on the status of legal entity in Islam, see Mahmood M. Sanusi, “The Concept of Artificial Legal Entity (Saksiyyah Ictibariyah) and Limited Liability in Islamic Law” [2009] 3 MLJ lv; [2009] 3 MLJA 65

4 Companies are regarded as being capable of engaging only in those activities set out in the object clause. Any act by a company which is not specified in its objects or incidental to their attainment is regarded as void and referred to as being ultra vires, that is, beyond the power of that company.
legal entity can profess a religion or not. It is an issue of a company acting in accord with the mandate written in its MOA and AOA. It is submitted that the right of Civil court to hear Islamic finance cases is still debatable.

However, many cases have been decided that deny Shariah courts the power to hear Islamic finance cases; for instance, in Bank Islam Malaysia Bhd v. Adnan bin Omar. In this case, the defendant argued that since BIMB ('the plaintiff') is an Islamic bank, the civil court has no jurisdiction to hear the case in view of Art. 121(1A) of the Federal Constitution. The judge, NH Chan J, overruled that objection and held that the matter was rightly brought before the civil court.

The plaintiff’s lawyer submitted that List I of the Ninth Schedule enumerates the various matters on which Parliament can enact laws. The scope of List I is very comprehensive and includes banking as well as the constitution, organization, jurisdiction and powers of all courts other than Shariah courts and native customary courts. List II in the State List provides for the constitution, organization and procedure of Shariah courts, which shall have jurisdiction only over persons professing the religion of Islam and in respect only of the matters included, excluding Islamic banking. It was further argued that since BIMB is a corporate body, therefore it does not have a religion, and as such, it is not within the jurisdiction of the Shariah courts. Accordingly, civil courts have jurisdiction to hear Islamic banking and other Islamic commercial cases.

The judge agreed, based on two principle considerations:

(a) The Shariah courts can only decide cases that fall under the State List, which excludes cases relating to commercial laws such as Islamic banking.

(b) The Shariah courts can only decide a case when all the parties are Muslims. Islamic institutions such as BIMB and Syarikat Takaful are corporate institutions created by statute and do not have a religion.

Currently, the application of English law in Malaysia is based on the provisions of Sections 3 and 5 of the Civil Law Act 1956. Section 5 of the Act provides that English
law is to be applied in matters of mercantile law or commerce. As such, the jurisdiction is certainly vested in the civil courts. In addition, Section 3 of the Act provides for the application of English law and rules of equity when there is a lacuna in the provision of any written law. Malaysia has the IBA, but as mentioned earlier, the Act is not exhaustive. Thus, any ambiguity requiring clarification and interpretation will be referred to the civil courts.

II. Civil Courts Apply Common Law Principles in Deciding Cases in Mu‘amalāt Law

Since the civil courts hear Islamic banking matters, those matters will, without doubt, be governed by the principles of English common law. This has been decisively ruled in Bank Kerjasama Rakyat Malaysia v Emcee Corporation, when the court held that:

As was mentioned at the beginning of this judgment, the facility is an Islamic facility. But that does not mean that the law applicable in this application is different from the law that is applicable if the facility were given under conventional banking. The charge is a charge under the National Land Code. The remedy available and sought is a remedy provided by the National Land Code. The procedure is provided by the Code and the Rules of the High Court 1980. The court adjudicating it is the High Court. So, it is the same law that is applicable, the same order that would be, if made, and the same principles that should be applied in deciding the application.  

The same principles followed later on in Bank Islam Malaysia Bhd v. Pasaraya Peladang Sdn Bhd. It was held that although the BBA facility was granted under Islamic principles, the laws applicable were the NLC and the Rules of the High Court 1980.  

The plaintiff in this case granted an Islamic banking facility known as Al-Bai Bithaman Ajil ('the said facility') to the defendant pursuant to a property purchase agreement and a property sale agreement ('PSA'). As security for the repayment of the said facility, the defendant charged in favour of the plaintiff ten pieces of land ('the said lands'). The charges were effected by way of two Forms 16A of the National

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5 [2003] 1 CLJ 625.
6 [2004] 7 MLJ 355
The charges were registered on 23 July, 1997. The defendant defaulted in the repayment of the instalments and a notice of demand was accordingly issued to the defendant. The defendant failed to comply with the notice of demand. Consequently, the plaintiff issued and served on the defendant the statutory notice in Form 16D of the NLC. Again, the defendant failed to pay the amount demanded. In this case, the plaintiff applied for an order to sell the said lands under s. 256 of the NLC.

The court allowed the plaintiff's application in this case and explained that Al-Bai Bithamin Ajil facility is a common Islamic banking facility involving immovable properties as collateral. It involved three separate agreements. The bank would purchase the property concerned from the chargor pursuant to the first agreement. In the second agreement, the bank would sell the property to the chargor. The third agreement was a charge given by the chargor to the bank to enable the bank to sell the property in the event of default by the chargor.

The use of the Islamic finance term for the contractual arrangement was also disregarded by the court. In Bank Islam Malaysia Bhd v Adnan bin Omar [1994] 3 CLJ 735, the court still used the word ‘loan’ when, in fact, sale and loan are two different concepts in Islam. Also, the court made no attempt to consider the view of any Shari’ah experts regarding the BBA features and framework.

The conflict of general laws like Malay Reservation Land law with principles of Islamic finance is also highlighted in Dato Hj Nik Mahmud bin Daud v Bank Islam Malaysia Bhd [1996] 4 MLJ 295 (High Court). In this case, the transaction involved sale contracts; under Islamic law the transfer of land is governed by the concept of the acquisition of ownership (tamlık wa tamalluk). However, the judge referred to National Land Code 1965. Another case that followed English law principles and procedures is Tinta Press v Bank Islam Malaysia Bhd [1986] 1 MLJ 474 and; [1998] 3 MLJ 396 (Supreme Court).

In essence, the civil courts in the above cases failed to consider whether the application of the existing law and procedure would contradict the Shari’ah and affect
the validity of the documents. The cases decided also indicate that the courts find it more convenient to apply common law principles rather than refer to the Shari‘ah rules. In such situations of conflict, it seems that the rules of the civil court system will prevail. Consequently, litigants will be prevented from applying Islamic rules and principles, unless the court or judge concerned allows it, which will only happen if the Islamic rule happens to coincide with a common law principle. This is creating a limit to the growth of Islamic rules and principles in Islamic finance.

### III. Reference to the Shariah Advisory Council (the SAC) Was Regarded Optional, Not Obligatory, by the Civil Courts

Reference to the SAC or Shari‘ah ruling was held to be an abdication of the court’s judicial functions. It was held in Affin Bank v Zulkifli Abdullah (2006) 1 CLJ that since the question before the courts was the interpretation and application of the terms of the contractual documents between the parties, reference of the case to another forum for a decision would be an indefensible abdication by the court. The question was not Shari‘ah law per se but the principle of the self-sufficiency of the established courts, which would preclude the need to refer to another forum.

Reference to the Shariah Advisory Council (“the SAC”) of Bank Negara Malaysia (“BNM”) under Section 16B(8) Central Bank of Malaysia Act 1958 in Arab Malaysian Bank v Silver Concept Sdn Bhd (2006) and in a series of cases brought against Affin Bank was also disapproved as being an “abdication” of the court’s judicial functions. Also, in Taman Ihsan Jaya’s case and Arab-Malaysian Merchant Bank Bhd v Silver Concept Sdn Bhd (2008), the court decided that reference to the SAC of BNM is not necessary. On the other hand, in Ya’kup Oje’s case and Bank Kerjasama Malaysia Rakyat Bhd v PSC Naval Dockyard (2008) reference to the SAC of BNM was acknowledged as possible.

Abdul Hamid Mohamed JCA stated that the ruling of the SAC BNM is not binding on the Court in any case. It is not necessary to refer to the SAC of BNM, as such reference is discretionary, its rulings are not binding, and the issue in the particular case was not one of Shari‘ah compliance of the BBA facility but the interpretation of
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its terms, which the judges of the Civil Court would interpret on the basis of the principles of common law. The Court of Appeal, in Bank Kerjasama Rakyat Malaysia v Emcee Corporation, ruled:

Since the question before the court is the interpretation and application of the terms of the contractual documents between the parties and of the decisions of the courts, reference of this case to another forum for a decision would be an indefensible abdication by this Court of its function and duty to apply established principles to the question before it. It is not a question of Syariah law. It is the conclusion of this court, therefore, that there is no necessity to refer the question to another forum.7

The same principles were followed in the Shamil Beximco case.8 The law and principles of Shari‘ah law were ignored and the contract followed the Contracts (Applicable Law) Act 1990 s.2(1), Contracts (Applicable Law) Act 1990 Sch. 1, Civil Procedure Rules 1998 (SI 1998 3132) Part 24, and the Rome Convention on the law applicable to contractual obligations 1980. Some judges even suggested that the practice of Islamic finance today is similar to contractum trinius.9

Realization that the Islamic finance industry in Malaysia was facing various legal anomalies, as highlighted above, led to the enactment of the new Central Bank Act 2009. It incorporated several sections that recognize the roles and rulings of the Shariah Advisory Council.10 Part VII of the Act is divided into two chapters. Chapter One, consisting of Sections 51 until Section 58, elaborates the entity of the Shariah Advisory Council and its munus. Chapter Two, consisting of Sections 59 and 60,

9 The “Triple Contract” or contractus trinius is a combination of three contracts that effectively transforms a partnership into a loan. The first contract was the societas or partnership itself, in which an investor would invest his capital with a partner. Insurance had arisen in the fourteenth century in conjunction with maritime trade. The second contract was an insurance contract in which the partner insured the investor’s investment against loss: the partner would be liable for the investment should the partnership fail. The third contract was a second insurance contract, in which the investor exchanged the variable returns of the partnership for a guaranteed fixed return. Through the use of these three contracts, the investor has effectively become a lender and the partner a borrower: the investment is the principal lent in exchange for a fixed return, and the borrower is liable for the full amount of the principal in the event of default. Quoted from Usury Redux: Notes on the Scholastic Analysis of Usury by John T. Noonan & Joseph Burke, Ave Maria University, Department of Economics, Working Paper No. 0901. Retrieved from www.medievalcontract.my
discusses the powers of the Bank in issuing circulars, guidelines, etc. on Sharī‘ah matters and promoting Malaysia as an international Islamic financial centre. The following sections elaborate in detail the salient features of the new Central Bank Act 2009, particularly with respect to the practice of Islamic finance.

THE ESTABLISHMENT OF THE SHARIAH ADVISORY COUNCIL

Section 51(1) of Central Bank Act 2009 authorises Bank Negara Malaysia to establish a Shariah Advisory Council on Islamic finance, which shall be the authority for the ascertainment of Islamic law for the purposes of Islamic financial business. Section 51(2) also states that the Shariah Advisory Council may determine its own procedures. This is the same Shariah Advisory Council that was established under subsection 16B(1) of the Central Bank of Malaysia Act 1958,11 which states that Bank Negara Malaysia may establish a Shariah Advisory Council which shall be the authority for the ascertainment of Islamic law for the purpose of Islamic banking business, takāful business, Islamic financial business, Islamic development financial business, or any other business which is based on Sharī‘ah principles and is supervised and regulated by Bank Negara Malaysia.

Based on the above definition, a question may arise whether the ruling of the SAC of Bank Negara binds the SAC of the Securities Commission? The Securities Commission is a statutory body set up under the Securities Commission Act 1993. The impetus for establishing the SAC has been to ensure that Sharī‘ah principles are obeyed and observed. Section 58 states that when a ruling given by a Sharī‘ah body or committee constituted in Malaysia by an Islamic financial institution differs from the ruling given by the Shariah Advisory Council, the ruling of the Shariah Advisory Council shall prevail. But again, does the mandate given under section 16B(1) include the Islamic capital market? The answer is no. Even though section 16B(1) includes Islamic financial business, the Islamic capital market is governed by the Security Commission.

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11 Section 100(j) CBA 2009 states that any directive, notice or circular issued, or any act or thing done by the Bank in relation to Islamic financial business, or any ruling made by the Syariah Advisory Council established under section 16B of the repealed Act before the coming into operation of this Act shall be deemed to have been validly issued, done or made under this Act and shall continue to remain in full force and effect in relation to the person to whom it applied until amended or replaced.
Commission Act 1993. Should any dispute arise, the expert call shall be from the SAC of the Securities Commission and not from Bank Negara. This is due to the fact that the ruling from the SAC of BNM is not binding upon the SAC of the Securities Commission. However, so far there has been little disagreement between the two in rulings pertaining to either Islamic finance or Islamic capital market. This is due to the fact that most of the SAC members from BNM also sit as the SAC members for the Securities Commission.  

Section 53(1) states that the Yang di-Pertuan Agong may, on the advice of the Minister, after consultation with the Bank, appoint as members of the Shariah Advisory Council persons who are qualified in the Sharī‘ah or who have knowledge or experience in the Sharī‘ah and in banking, finance, law or such other related disciplines. The current amendment has recognised the level of the SAC to be at parity with that of a civil judge, since the appointment process is the same. The appointment mechanism provides a significant platform for uplifting the standard of the SAC to the standard of Civil Court judges while at the same time distinguishing it from them. As compared to the previous ACT 519, appointment to the SAC is done by the Minister on the recommendation of the Bank, from amongst persons having knowledge or experience or both in the Sharī‘ah. Note that the appointment is not the sole discretionary power of the YDPA. The words “on the advice” of the Minister and “consultation with the bank” mean the decision is ultimately that of the Minister in charge. For example, in the case of Dato’ Anwar Ibrahim v PP [2000] 2 CLJ 570, it was held that when the Yang Di Pertuan Agong consults the Conference of Rulers, he does not seek its consent; he merely consults. When the Conference of Rulers gives its advice, opinion or views, the YDPA is clearly not bound to accept it. Legally, the Prime Minister can insist that the appointment be proceeded with. 

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13 Refer to Article 122B of the Federal Constitution: “The Chief Justice of the Federal Court, the President of the Court of Appeal and the Chief Judges of the High Court…shall be appointed by the Yang Di Pertuan Agong, acting on the advice of the Prime Minister, after consulting the Conference of Rulers.” For further detail refer to Abdul Aziz Bari “The Appointment of Superior Court Judges” (2000) 8 HUMILJ 211.
14 Refer to Section 16B(2), Central Banking Act 1958.
15 P. 571-572.
THE BANK AND ISLAMIC FINANCIAL INSTITUTIONS ARE TO CONSULT THE SHARIAH ADVISORY COUNCIL

Section 55(2) states that any Islamic financial institution in respect of its Islamic financial business, may\(^\text{16}\) (a) refer for a ruling, or (b) seek the advice, of the Shariah Advisory Council on the operations of its business in order to ascertain that it does not involve any element which is inconsistent with the Shari‘ah.

Section 55(1) states that the Bank shall consult the Shariah Advisory Council on any matter—

(a) relating to Islamic financial business; and (b) for the purpose of carrying out its functions or conducting its business or affairs under this Act or any other written law in accordance with the Shari‘ah, which requires the ascertainment of Islamic law by the Shariah Advisory Council.

(2) Any Islamic financial institution in respect of its Islamic financial business may

(a) refer for a ruling; or (b) seek the advice, of the Shariah Advisory Council on the operations of its business in order to ascertain that it does not involve any element which is inconsistent with the Shari‘ah.

The word ‘consult’ in section 55(1) means to refer a matter for advice, opinion or views. Black’s Law Dictionary defines ‘consultation’ inter alia as “the act of asking the advice or opinion of someone”. To consult does not mean to consent. If we refer to the Federal Constitution, it uses the words ‘consent’ and ‘consult’ separately and not interchangeably.

\(^\text{16}\) The word “may” is used in order to highlight the function of SAC members at each IFI level. The IFI Shariah Advisory Committee may refer to a decision of BNM’s SAC should they so choose. This is due to the fact that the practice of each bank may differ from one country to another. The international bank or local bank may adopt certain rulings which may be contrary to the practice in Malaysia. For example, bay‘ al-‘inah is not allowed in GCC countries but Malaysia allows it.
REFERENCE TO THE SAC FOR A RULING BY A COURT OR ARBITRATOR

Arbitration is referral of a dispute to one or more impartial persons for final and binding determination. Private and confidential, it is designed for quick, practical, and economical settlements. Parties can exercise additional control over the arbitration process by adding specific provisions to their contracts’ arbitration clauses or, when a dispute arises, through the modification of certain aspects of the arbitration rules to suit a particular dispute. Stipulations may be made regarding confidentiality of proprietary information used, evidence, locale, number of arbitrators, and issues subject to arbitration, for example. The parties may also provide for expedited arbitration procedures, including a time limit for rendering an award, if they anticipate a need for hearings to be scheduled on short notice.

The new Section 56(1) states that in any proceedings relating to Islamic financial business before any court or arbitrator if any question arises concerning a Shari’ah matter, the court or the arbitrator, as the case may be, shall (a) take into consideration any published rulings of the Shariah Advisory Council;\(^{17}\) or (b) refer such question to the Shariah Advisory Council for its ruling. Section 56(1) makes it compulsory for the courts to refer to any established rulings should there any disputes pertaining to Shari’ah issues. And Section 56(1)(b) makes it compulsory for the court to refer to the decision of the SAC as expert evidence in court under Section 45 Evidence Act 1950, should there a need to refer to any non-established rulings pertaining to the practice. As noted above, the wording in Section 55(1) states “shall consult”. Arguably, the word “consult” indicates a non-binding option,\(^{18}\) however Section 56(1) makes it compulsory and binding upon the Bank.

I. A Question of the Inherent Power of the Judiciary

Bank Negara should be given commended for their efforts to ensure the Islamic finance fraternity is upgraded. The newly amended Act seems to remedy some of the

\(^{17}\) Interview with Dr Akram Mohd Laldin, Executive Director of ISRA, 19 Oct., 2009, 10:58 AM.
\(^{18}\) See fn. 17.
current problems faced by industry players. Hopefully, the civil courts will proffer no excuses to continue delivering their equity-based interpretations without referring the disputes to the SAC, but one may ponder to what extent the ruling can survive in the civil courts? The Federal Constitution provides for separation of powers between the executive (Article 39) the legislature (Art 44) and the judiciary (Art 121). In Sugumar Balakrishnan [1976] 2MLJ 262, the Court of Appeal considered the relationship between the organs of government. Gopal Sri Ram JCA observed:

*The Federal Constitution has entrusted to an independent judiciary the task of interpreting the supreme law and indeed all laws enacted by the legislative arm of the government. Hence, it is to the court that citizens must turn to enforce their rights...the judicial power was vested impliedly [sic] in the judiciary as discussed in Liyanage v The Queen [1967] 1 AC 259. In other words it is important to ensure that powers of the judiciary are not usurped by the legislature or the executive. This would maintain the separation of powers which aims to prevent concentration of powers that may increase the likelihood of abuse of powers. Rule 137 of the Rules of the Federal Court clearly gives inherent power to the court to hear any application or make any order as may be necessary to prevent injustice. The Federal Court also has the inherent jurisdiction under the common law to deal with cases with a view to preventing injustices in limited circumstances. This is in line with Section 3(1)(a) of the Civil Law Act 1956, which was promulgated in accordance with Cl.(c) of Art. 121(2) of the Constitution which confers the Federal Court “such other jurisdiction as may be conferred by or under federal law.” Can the Civil court judge be forced to refer and adhere to decisions made by the SAC? What would be the consequences if the court still refuses to be bound by the SAC’s decisions? Is there a need to also amend other existing laws unfriendly to Islamic law? For instance, Section 5 Civil Law Act 1956 states “in the absence of any written law, the law generally applicable to commercial matters and any matters incidental thereto is the English Law.” This should be amended with the additional words “not including Islamic finance and any trading under Islamic finance,” and it should be incorporated under Section 2 of the IBA 1983. As mentioned by Hamid Sultan Abu Backer JC, there is a common notion in Malaysia that it is in the hands of Islamic jurists and/or Sharī’ah advisory boards to be the sole arbiter to determine whether a Sharī’ah financial instrument is Sharī’ah compliant. In the case of Shamil

19 See for further detail, MGG Pillai v Tan Sri Dato’ Vincent Tan Chee Yioun [2002] 2 MLJ 673, FC.
Bank Bahrain v. Beximo Pharmaceuticals Limited & Ors [2003] EWHC 2118, it was stated in no uncertain terms that there is no opinion of any person, body or jurist which binds a court in deciding a Shari’ah issue. It was further reiterated that the court is the supreme body under the Federal Constitution to decide what is right or wrong in a given circumstance. The Federal Constitution does not permit the court to abdicate its role by submitting to decisions of lesser bodies or tribunals such as Shari’ah supervisory boards or fatwás or any purported legislation, rules.

The judge went on to state:

_Having said that, courts will at all times listen receptively to the views and opinions expressed by these bodies, but the final decision maker under the Federal Constitution is none other than the courts. In essence, whether a contract or Islamic product, based on murabaha or bay al inah or mudarabah etc., principle is valid must be decided by the courts. As long as it does not breach the Qur’anic prohibition of riba or gharar etc., the courts will have no hesitation in upholding the same. It all depends on the terms of the contract and not the concept per se, because, the court is concerned with the terms and not the concept._

_The proper procedure in law to challenge the legality of a contract, is by filing an originating process and seeking relief as set out in the Specific Relief Act 1950. That does not mean that the court has no power or jurisdiction to consider such issues if properly raised and argued in a foreclosure proceeding, as was done in Taman Ihsan’s case._

The judge further mentioned that there is certain legislation that may be followed by the Civil Court and other legislation that they are bound to follow, like Rules of the High Court 1980 on Order 83(3) as regard the rules on interest, besides Civil Law Act 1956.

**FUNCTIONS OFFICIO OF THE SHARIAH ADVISORY COUNCIL**

*(THE SAC)*

Section 73(1) states that the Bank may, in giving effect to its objects, carrying out its functions or conducting its business or affairs under this Act or any other written law, put in place such arrangements or take such measures as may be approved by the

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Shariah Advisory Council to ensure that such functions, business or affairs are in accordance with the Sharī‘ah. Section 52 describes the functions of the Shariah Advisory Council, identifying the following functions:

(a) To ascertain the Islamic law on any financial matter and issue a ruling upon reference made to it in accordance with the relevant part of the Act;

(b) To advise the Bank on any Sharī‘ah issue relating to Islamic financial business, the activities or transactions of the Bank;

(c) To provide advice to any Islamic financial institution or any other person as may be provided under any written law; and

(d) Such other functions as may be determined by the Bank.²¹

Section 16B(4) of the previous Act 519 had left it to the Bank to determine the function of the SAC and did not specifically outline its tasks, as has been done in the current Act.

However, in order to properly analyse the SAC’s function, it is also vital to refer to the BNM/GPS.²² It identifies the main duties and responsibilities of the Sharī‘ah Committee as follows:

(a) To advise the Board on Sharī‘ah matters in its business operation

   The Sharī‘ah Committee shall advise the Board on Sharī‘ah matters in order to ensure that the business operations of Islamic financial institutions comply with Sharī‘ah principles at all times.

(b) To endorse Sharī‘ah Compliance Manuals

   The Islamic financial institution shall have a Sharī‘ah Compliance Manual. The Manual must specify the manner in which a submission or request for

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²¹ Sec 52(2). For the purposes of this Part, “ruling” means any ruling made by the Syariah Advisory Council for the ascertainment of Islamic law for the purposes of Islamic financial business.

²² These guidelines are applicable at the level of both the BNM’s SAC and the IFI’s SAC.
advice be made to the Shari’ah Committee, the conduct of the Shari’ah Committee's meeting and the manner of compliance.

(c) To endorse and validate relevant documentations

To ensure that the products of the Islamic financial institutions comply with Shari’ah principles in all aspects, the Shari’ah Committee must endorse the following:

i) the terms and conditions contained in the proposal form, contract, agreement or other legal documentation used in executing the transactions; and

ii) the product manual, marketing advertisements, sales illustrations and brochures used to describe the product.

(d) To assist related parties with advice on Shari’ah matters upon request

The related parties of the Islamic financial institution, such as its legal counsel, auditor or consultant, may seek advice on Shari’ah matters from the Shari’ah Committee. The Shari’ah Committee is expected to provide assistance to them so that compliance with Shari’ah principles can be completely assured.

(e) To advise on matters to be referred to the SAC

The Shari’ah Committee must advise the Islamic financial institution to consult the SAC on any Shari’ah matters which have not been resolved or endorsed by the SAC.

(f) To provide written Shari’ah opinion

The Shari’ah Committee is required to record any opinion given. In particular, the Committee shall prepare written Shari’ah opinions in the following circumstances:

i) where the Islamic financial institution make reference to the SAC for advice; or
ii) where the Islamic financial institution submits applications to Bank Negara Malaysia for new product approval in accordance with guidelines on product approval issued by Bank Negara Malaysia.

(g) To assist the SAC upon referral to it for advice

The Sharī‘ah Committee must explain the Sharī‘ah issues involved and the recommendations for a decision. It must be supported by relevant Sharī‘ah jurisprudential literature from the established sources. The Sharī‘ah Committee is also expected to assist the SAC on any matters referred by a Islamic financial institution. Upon obtaining any advice from the SAC, the Sharī‘ah Committee shall ensure that all the SAC’s decisions are properly implemented by the Islamic financial institution.

The guidelines provided seem to be more comprehensive. The products and issues forwarded to the SAC or Sharī‘ah Advisory Committee at the IFI level will be approved as they are presented. The committee will not go beyond their theoretical explanations.23

THE APPOINTMENT OF MEMBERS TO THE SHARIAH ADVISORY COUNCIL

Section 53(1) states that the Yang di-Pertuan Agong may, on the advice of the Minister, after consultation with the Bank, appoint members of the Shariah Advisory Council from among persons who are qualified in the Sharī‘ah or who have knowledge or experience in the Sharī‘ah and in banking, finance, law or such other related disciplines.

The section clearly mentions the requirement of understanding the intricacies of Sharī‘ah, finance law and banking in particular. Expertise in the combination of these four niche areas needs to be developed since it seems most Sharī‘ah scholars are still “green” in banking and finance and vice versa. These requirements are vital in order

23 Interview with Dr Mohamad Akram Laldin, Exec. Director of ISRA, Friday, 6 Nov., 2009, 5 PM, ISRA.
to avoid future disputes over interpretation of Shari‘ah principles and law. A member of a Shari‘ah Committee shall be an individual. A company, institution or body shall not constitute a Shari‘ah Committee for the purpose of these Guidelines. The proposed member of the Shari‘ah Committee shall at least either have qualification or possess necessary knowledge, expertise or experience in the following areas:

(a) Islamic jurisprudence (uṣūl al-fiqh); or

(b) Islamic transaction/commercial law (fiqh al-mu‘āmalât).

It should however be noted that paper qualification on the above subjects will not be mandatory as long as the candidate has the necessary expertise or experience in the above areas.²⁴

The members of the Shari‘ah Committee shall be persons of acceptable reputation, character and integrity. Bank Negara Malaysia reserves the right to disqualify any member who fails to meet the requirements. In particular, any member may be disqualified due to any of the following breaches of corporate governance:

(a) he has acted in a manner which may cast doubt on his fitness to hold the position of a Shari‘ah Committee member;

(b) he has failed to attend 75 per cent of meetings scheduled for the Shari‘ah Committee in a year without reasonable excuse;

(c) he has been declared bankrupt, or a petition under bankruptcy laws has been filed against him;

(d) he has been found guilty for any serious criminal offence, or any other offence punishable with imprisonment of one year or more; or

(e) he is subject to any order of detention, supervision, restricted residence or banishment.

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²⁴ BNM/GPS No. 12.
“Upon the discovery of information that would make any member of a Shari‘ah Committee subject to any ground for disqualification or otherwise make the member unfit to hold such appointment as provided in these Guidelines and/or in the letter of approval from Bank Negara Malaysia, the Islamic financial institution shall terminate the appointment of the Shari‘ah member.”

I. The SAC and Conflict of Interest

Section 100(f) states that notwithstanding the repeal of the Central Bank of Malaysia Act 1958 under Section 99, the Shariah Advisory Council established and its members appointed under the repealed Act shall be deemed to be established and appointed, as the case may be, under or in accordance with this Act. Section 53(2) further states that if a judge of the High Court, the Court of Appeal or the Federal Court, or a judge of the Syariah Appeal Court of any State or Federal Territory, is to be appointed under subsection (1), such appointment shall not be made except—

(a) in the case of a judge of the High Court, the Court of Appeal or the Federal Court, after consultation by the Bank with the Chief Justice; and

(b) in the case of a judge of the Syariah Appeal Court of any State or Federal Territory, after consultation by the Bank with the Chief Syariah Judge of the respective State or Federal Territory, as the case may be.

Section 53(3) states that “a member of the Shariah Advisory Council appointed under subsection (1) shall hold office on such terms and conditions as may be provided in their respective letters of appointment, and shall be eligible for reappointment.” The question that needs to be pondered is whether the SAC member can hold another advisory position at another Islamic financial institution or international Islamic financial organisation? Should there be a limit or should the issue of conflict of interest at least be raised? There is a report of one Shari‘ah scholar holding an

25 BNM/GPS No 17.
advisory post for 100 companies and bodies. The CBA amended in 2003 (repealed by Act 710, 2009) provides for the establishment of the National Syariah Advisory Council (SAC) at the BNM. The amended CBA also provides that no member of the SAC can be a member of any Shari‘ah body, or act as a Shari‘ah consultant or Shari‘ah advisor with any banking institution or other financial institution. Section 100(j) CBA 2009.

Conflict of interest is defined as allowing one’s private interest to come in conflict with one’s duties and using one’s position for personal advantage. Cross-reference is made to the BNM/GPS 1 Guidelines on the Governance of Shari‘ah Committees for Islamic Financial Institutions. Guideline No. 19(1) mentions that the members of the Shari‘ah Committee are subject to the following restrictions:

(a) In line with Section 16B(6) of the Central Bank of Malaysia Act 1958, an Islamic financial institution is not allowed to appoint any member of the SAC to serve in its Shari‘ah Committee; and

(b) To avoid conflict of interest and for reasons of confidentiality within the industry, an Islamic financial institution shall not appoint any member of a Shari‘ah Committee of another Islamic financial institution in the same industry.

For this purpose, Islamic financial institutions which are regulated under the IBA, BAFIA and DFIA are classified as of the "Islamic banking industry", whilst Islamic financial institutions that are regulated under the TA are classified as of the “takāful industry”. Every Islamic financial institution is required to establish a Shari‘ah Committee. In the case of a BAFIA IBS bank, it may establish one Shari‘ah Committee for the banking group. However, if a takāful operator is part of that group, the takāful operator must establish its own separate Shari‘ah Committee, due to the legal requirement under the TA. Memberships in other categories of industry are excluded from the restriction. This section needs to be refined in detail to avoid potential problems. Furthermore, clarification is required whether this restriction applies merely to local organisations or to international organisations as well.

26 The CBA amended in 2003 (repealed by Act 710, 2009) provides for the establishment of the National Syariah Advisory Council (SAC) at the BNM. The amended CBA also provides that no member of the SAC can be a member of any Shari‘ah body, or act as a Shari‘ah consultant or Shari‘ah advisor with any banking institution or other financial institution. Section 100(j) CBA 2009.
27 For details refer to Allied Capital Sdn Bhd v Mohamamed Latiff bin Shah Mohd and Anor Application [2001]2 MLJ 305, FC.
30 Guideline no 7, BNM/GPS 1.
The Islamic financial institution must provide necessary assistance to the Sharī’ah Committee. The Sharī’ah Committee must be given access to relevant records, transactions, manuals or other relevant information, as required by them to perform their duties. For this purpose, the Sharī’ah Committee members are granted exemptions from the secrecy provisions under the respective legislations.31 It is interesting to note the trend in banking practice to outsource functions.32 Information about the customers may leak. Data stored in computers may be hacked for personal use or to gain other information. The 1924 case of Tournier v National Provincial and Union Bank of England sets out four areas where a bank can legally disclose information about its customer. These principles still hold good today and are:

i. where the bank is compelled by law to disclose the information

ii. if the bank has a public duty to disclose the information

iii. if the bank’s own interests require disclosure; and

iv. where the customer has agreed to the information being disclosed.

The bank’s main duty to its customers is to observe confidentiality, to advise, not to profit at the customers’ expense, and to exercise reasonable skill and care in servicing their customers in fulfilment of their direct contractual obligations. The function of the SAC at the BNM or IFI level is on a consultation basis. They are not even considered as officers of the Bank. Their role and function is outsourced by the bank. The information may leak to some extent. On a precautionary note, if the banks owe certain fiduciary duties and standards of care to the customers, can the same apply analogically to the SAC members?

31 Refer to BNM/GPS 1 21(e).
32 Andrew Teoh in a presentation on Banks and Customer Relationship, at the Bar Council, 6 Nov., 2009.
II. Implied Protection from Any Liability in Law?

Section 86(1) states that

without prejudice to Section 88, and except for the purpose of the performance of his duties or the carrying out of his functions or when lawfully required to do so by any court or under any law, no person who is or has been director, officer, or employee of the Bank or member of the Shariah Advisory Council or any committee appointed under this Act shall disclose to any person any information relating to the business or affairs of the Bank or of a financial institution or of a customer of the Bank or of a financial institution which he has acquired in the performance of his duties or the carrying out of his functions.

Section 86(2) states that any person who fails to comply with subsection (1) commits an offence and shall, on conviction, be liable to a fine not exceeding three million ringgits or imprisonment for a term not exceeding three years or both. The SAC members are required to maintain secrecy, but at the same time, there is no limitation on one of them being appointed as a Shari'ah advisor of other institutions. Is this section implying that the Shariah Advisory Council as also liable for misconduct such as failure to exercise due diligence and not acting in bona fide and good faith?

Sheikh Esam Ishaq has suggested that there should be a limit to the number of

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88. (1) Where the Bank in the course of the exercise of any of its powers, or the discharge of any of its duties, or the performance of any of its functions, under this Act, or under any law enforced by the Bank referred to in the Second Schedule or other written law, suspects that any person has committed any offence under this Act, or any of the Acts referred to in the Second Schedule, or any other written law, it shall be lawful for the Bank to give information of such commission to a police officer in charge of a police station or to any other police officer, or to convey any or all information in relation to such offence to any financial institution or other person affected by such offence, or to any authority or person having power to investigate under, or enforce, the provision of the law under which the offence is suspected by the Bank to have been committed.

(2) Subsection (1) shall have full force and effect, notwithstanding anything inconsistent with, or contrary to it, in the Act or any law enforced by the Bank referred to in the Second Schedule or in any other written law.

87. (1) No action, suit, prosecution or other proceeding shall lie or be brought, instituted, or maintained in any court or before any other authority against—
(a) any officer or employee of the Bank;
(b) any person lawfully acting on behalf of the Bank, or on behalf of any such officer or employee, in his capacity as a person acting on such behalf; or
(c) any person appointed pursuant to this Act,

for or on account of, or in respect of, any act done or statement made or omitted to be done or made, or purporting to be done or made, in pursuance or in execution of, or intended pursuance or execution of, this Act, any order in writing, direction, instruction, notice or other thing issued under this Act:

Provided that such act or such statement was done or made, or was omitted to be done or made, in good faith.

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Sharī’ah Boards any single advisor can sit on and has proposed that Sharī’ah advisories must be regulated.\textsuperscript{35}

Is Section 87 trying to protect the SAC members from the repercussions of negligence? As long as they are acting in good faith, are they immune from any negligence suit? Should this be a standard of the SAC? Shouldn’t they fulfil a certain standard of care? Shouldn’t it be read in the best interest of the SAC, Bank Negara and the industry? For example, the current practice merely looks at the standard agreement and the structure of products without due diligence over the assets involved.\textsuperscript{36} For instance, in asset-based sukūk the transferability of the assets used to back the sukūk issuance is not investigated in detail.\textsuperscript{37} The main argument in sukūk issuance is the legal ownership of the products. The issue of whether or not in the issuance of the sukūk the creditor is a secured creditor is not addressed.\textsuperscript{38}

Cross-reference is made to Section 52(1) of the function of the SAC “...to ascertain the Islamic law on any financial matter and issue a ruling...” Argal, should bona fide or acting in good faith be determined on the basis of the best interest of the practice? If, for example, products approved appear to be non-Sharī’ah compliant, but it is claimed that the determination was made in good faith, does this mean that liability is successfully repudiated?\textsuperscript{39}

\textsuperscript{35} Islamic Banker, June 2009.
\textsuperscript{36} The disparity between the ‘ideal’ and the ‘reality’ of sukūk was highlighted by AAOIFI in February 2008, when it published six principles regarding sukūk structures and initially noted that around 85% of existing sukūk were not in compliance with these principles. Subsequently, many sources attributed the market decline to these statements. In reality, the decline in sukūk market volume in 2008 was probably due more to prevailing global credit market conditions (it was a very difficult time to raise funds, whether conventional or Islamic) rather than to any direct reaction to the AAOIFI statements. See Moody’s Investors’ Service, 6 May, 2009.
\textsuperscript{37} ISRA roundtable discussion with Rafe Haneef, 14 Oct., 2009.
\textsuperscript{38} Interview with industry experts at ISRA, 19 Oct., 2009.
\textsuperscript{39} In relation to Section 59(3) it is compulsory for institutions to follow guidelines as to Sharī’ah rulings and any person who fails to comply with any circulars, guidelines or notices issued by the Bank under subsection (1) commits an offence and shall, on conviction, be liable to a fine not exceeding three million ringgit.
THE SAC AS EXPERT OPINION (AL-RA’YU AL-KHABĪR) FROM AN ISLAMIC PERSPECTIVE

Expert opinion also known as al-ra’yu al-khabīr, is the opinion or the evidence or the testimony given by someone who is skilful in a field or issue. The Arabic word khabīr can be either an adjective, meaning ‘familiar, experienced, knowing’, or a noun, meaning ‘specialist or expert’. It comes from the root word khabara which means ‘to try, examine, to know well, thoroughly’. The court may use the opinion of a skilled person to assist in determining disputes.

“[Prophet], all the messengers We sent before you were simply men to whom We had given the Revelation: you [people] can ask those who have knowledge if you don’t know.”

It is a procedure whereby a dispute, perhaps of a technical nature, is to be resolved by an expert, nominated or identifiable, whose decision is to be final and binding on the parties, and who need not follow the rules of arbitration or litigation. In principle, the determination of an expert is binding, and as such, it has contractual effect between the parties. Alternatively, by party agreement, the determination may have effect as a recommendation to the parties.

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Refer to Ibn al-Qayyim, al-Turuq al-Hukmiyyah, Maṭba’at al-Madani, Egypt, 1977, p. 188. Refer also to Ahmad Fathi al-Bahansi, Nuzariyyat al-Ithbār, Egypt, 1962, p. 179.


Refer to http://www.resolveit.co.uk/EDheader.htm
THE EFFECTS OF THE CURRENT AMENDMENT

Section 57 highlights that any ruling made by the Shariah Advisory Council pursuant to a reference made under this Part shall be binding on the Islamic financial institutions under Section 55 and the court or arbitrator making a reference under Section 56. Section 58 states that where the ruling given by a Sharî‘ah body or committee constituted in Malaysia by an Islamic financial institution is different from the ruling given by the Shariah Advisory Council, the ruling of the Shariah Advisory Council shall prevail. Section 59(2) states that an Islamic financial institution shall comply with any written circulars, guidelines or notices issued by the Bank under subsection (1) and within such time as may be set out in the circulars, guidelines or notices. Section 59(3) states that any person who fails to comply with any circulars, guidelines or notices issued by the Bank under subsection (1) commits an offence and shall, on conviction, be liable to a fine not exceeding three million ringgit.

I. The Binding Nature of the Rulings on Sharî‘ah Interpretation from the Shariah Advisory Council within the Islamic Finance Fraternity

An interesting issue to ponder is whether the court is obliged to follow any rulings made by any Sharî‘ah Advisory Council in international cases which involves litigants from GCC and other Western, or even Asian, countries. The absence of standardisation of a framework to assist the market may lead to uncertainty in the practice. At the end of the day, the court may revert to the norms of international trade which disregard Sharî‘ah principles and values. For example, if the issue of bay‘ al-‘înah is decided to be valid in the Malaysian milieu while the practice is held to be invalid in the GCC, which ruling should be referred to by the court?43

43 According to Dr Akram, there is an urgent need for the market to sit and thoroughly discuss the issues in order to harmonize the practice across the globe. Interview conducted on 19 Oct., 2009, at 12:11 PM.
CONCLUSION

This paper highlights the significant role of the Shariah Advisory Council in the trajectory of Islamic finance in the context of institutional/legal impediments to its development which led to the new provisions of the 2009 Act. It also ponders some potential landmines in the future. The new Central Banking Act 2009 was enacted to replace the Central Banking Act 1958 (ACT 519) and augments the status of the Council as the main point of reference for the Central Bank, courts of law, arbitrators and Islamic financial institutions with regard to legal issues that arise in Islamic finance. Since the SAC is the highest authority in the industry, there is a need to inculcate certain values and ethics in its practice. This paper foresees some possible predicaments that may hinder the significant role of the SAC. The history of cases has enlightened us on the inherent judicial power of the civil courts. I did not set out to detail all the examples of interference by civil courts in applying alien interpretations to Sharī‘ah issues from their dockets; a highlight should suffice to serve as a caution. In response to the above, our legal and regulatory framework should be more resilient and facilitative. A comprehensive review of the related Act in Islamic finance is imperative. There are a few other laws in the pipeline which have yet to be tested in the courts. As emphasised, a cogent and well argued set of laws needs to be formulated to obviate reliance on the conventional legal framework. If this is delayed, the guidance of the Sharī‘ah will fail to be realized in the financial realm.
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