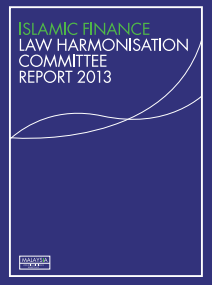
ISLAMIC FINANCE LAW HARMONISATION COMMITTEE REPORT 2013

MALAYSIA
WORLD'S ISLAMIC FINANCE MARKETPLACE

BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

LAW HARMONISATION COMMITTEE REPORT 2013



Cover:
The inter-linkages of the lines represent the harmonisation between law and Shariah

BANK NEGARA MALAYSIA
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CONTENTS

Governor's Foreword iv

Chairman's Statement vi

Introduction
- Overview Of The Legal Framework In Malaysia And Its Compatibility With Islamic Finance 2
- The Law Harmonisation Committee 6
- Executive Summary 13

Harmonisation Initiatives
- Issues Raised Where Amendments Are Recommended 17
- Issues Raised Which Do Not Necessitate Amendments 41
- Issues For Further Research 50

Moving Forward: 67
Enhancing Malaysian Law As The Law Of Choice And Malaysian Dispute Resolution Institutions As The Forum For Dispute Settlement For International Islamic Finance Transactions

Annexures
- Annexure A : Sub-Committees And Focus Groups 74
- Annexure B : Table Of Statutes, Case Law And Research Bibliography 75
- Annexure C : Glossary 78

FOREWORD BY GOVERNOR OF BANK NEGARA MALAYSIA

The publication of this inaugural report by the Law Harmonisation Committee is a culmination of the harmonisation initiatives undertaken by the Committee since its inception in July 2010 towards creation of a conducive legal system that supports the development of the Islamic finance industry. This report aims to serve as valuable reference on initiatives in harmonisation of laws in Malaysia as it is applicable to Islamic finance with the aim of enabling Islamic financial transactions to be conducted with greater legal efficiency.

The progressive development of the Islamic financial services sector in Malaysia in this recent decade has been supported by the formulation of a sound and effective legal framework rooted in the tenets of the Shariah. Certainty and enforceability of Shariah contracts would further compliment the international dimension of Islamic finance that is expected to intensify in the coming years. As cross border Islamic finance transactions in the market place gains significance, these features would enable a myriad of Islamic financial transactions with greater inter-linkages among multiple legal jurisdictions and multinational contracting parties.

Malaysia is among the privileged jurisdictions that are able to leverage on a collaborative approach in addressing this matter. The success of the Law Harmonisation Committee initiatives is a prime example where the spirit of mutual cooperation has led to the success of a common goal.

On this note, I wish to thank all those who have been involved in the publication of this report, particularly the Committee members, whose wealth of expertise and unwavering commitment have contributed to the development of legal framework for Islamic finance.

Thank you.

CHAIRMAN'S STATEMENT

Since the introduction of Islamic banking, takaful and Islamic capital market, the focus in the legal framework has been to ensure laws of Malaysia are Shariah compatible. I do not think any country had made any concerted effort to create Shariah-compatible law to support their implementation, documentation and settlement of disputes. Hence we see judgments coming from the Court of choice of parties in international Islamic financial transactions refusing to apply the Shariah even though the parties did include such a clause in the contract.

In Malaysia, we sought to solve that problem by the creation of the Shariah Advisory Council (SAC) and requiring the Court and Arbitrators to refer Shariah issues to the SAC and abide by the rulings. References are being made by the Court and the Arbitrators now. The system is working.

However, there is another area that needs to be tackled. The law that will be applied in the documentation and settlement of disputes must also be made Shariah-compatible. I voiced the need for that to be done in my following papers:

1. 28 September 2009 – "Interlink/interface between civil law system and Shariah rules and principles and effective dispute resolution mechanism" at the Islamic Financial Services Industry Legal Forum 2009.#

2. 30 July 2010 – "Interface between Shariah and civil law in Islamic finance: current problems and the way forward" at the Malaysian Law Conference 2010.#

Coincidentally, the announcement for the establishment of LHC was made three days before my last-mentioned speech. With that the Law Harmonisation Committee (LHC) came into the picture.

Unfortunately, after chairing the first meeting the work of the Committee was interrupted for six months by my hospitalisation. With support from officers from other divisions of Bank Negara Malaysia, the Securities Commission Malaysia, the Attorney General's Chambers, AIBIM, ISRA, practising lawyers and others, we started work immediately after that. This report lists, amongst other things, what the LHC had managed to do during the period of about one and a half years.

I shall not repeat the content of the report regarding what LHC has done or doing. I would only add that during the period I had also written, delivered and/or published the following speeches, lectures and articles in which I explained and publicised the works of LHC while seeking co-operation of the academia, lawyers, Shariah scholars and industry players to make their contributions:

1. 2 November 2011 – Opening remarks at visit to INCEIF and ISRA.#

2. 3 December 2011 – Speech at Universiti Sains Islam Malaysia when receiving the Hon. Degree of Doctor of Philosophy in Shariah and Judiciary.#

3. 7 December 2011 - 12th Emeritus Prof. Ahmad Ibrahim Memorial Lecture titled "Malaysia as the hub for Islamic finance: Malaysian law as the law of choice and Malaysian courts as the forum for settlement of disputes" at the International Islamic University Malaysia.#

4. 9 February 2012 – Opening remarks at Luncheon with Litigation lawyers.#

5. 6 March 2012 - Paper titled "Harmonisation of Shariah and common law in Malaysia: the way forward" at the 2nd International Seminar on Shariah and common law 2012, Universiti Sains Islam Malaysia. #

6. 10 April 2012 – Speech titled "Making our contribution to Islamic banking and Shariah at Engagement With Officers of Islamic Banking and Takaful Division, Bank Negara Malaysia.#

7. 17 May 2012 – Opening speech at a meeting with Directors of Lands and Mines, Malaysia.#

8. 21 July 2012 – Opening remarks at a meeting with representatives of the Bar Council.#

9. ISRA Research Paper No. 33/2012 titled "Enforceability of Islamic financial contracts in secular jurisdictions: Malaysian law as the law of choice and Malaysian courts as the forum for settlement of disputes" co-authored with Adnan Trakic.#

10. 20 September 2012 – Paper titled "The need for Shariah-compliant law of choice for Islamic finance transactions" at GIFF 2012.# (This paper was published in full in Business Times 9 October 2012).

11. 17 October 2012 – "Ethical dimensions in Islamic finance" at KLIFF 2012.#

12. 1 November 2012 – "Issues and challenges pertaining to the role of Shariah Advisory Council in upholding Shariah principles in Islamic banking and finance" at a Seminar organised by the Attorney General's Chambers.#

13. 31 January 2013 "Pengharmonian undang-undang sivil dan Syari'ah dalam perbankan dan kewangan Islam di Malaysia" at UKM.#

14. 19 February 2013 "Islam dan tafsiran keperlembagaan oleh mahkamah di Malaysia" at IKIM.#

I am really grateful to the Committee members who had worked as a team, looking at issues from their respective specialisation and experience. Discussions were deep and serious yet always interesting. At the end of it, without fail, a unanimous view was achieved. To everyone, it was a learning and contributing experience.

Similarly, I must record my appreciation for the sacrifices made by members on the Land Law Sub-Committee. They had worked tirelessly on complicated issues that had never been tackled before.

The Secretariat too had lived up to expectation with their research and presentation for the Committee's consideration.

I believe that this is the first time that we have managed to get the support from various agencies such as Bank Negara Malaysia, Securities Commission Malaysia, Attorney-General's Chambers, AIBIM, ISRA and Islamic finance legal practitioners through their representations in LHC. In addition, we have also initiate engagements with other relevant stakeholders such as the Ministry of Domestic Trade and Consumer Affairs, Department of Director General of Land and Mines, practising lawyers and others. I told them that they should consider themselves lucky to have the opportunity to contribute to the development of Islamic banking, takaful and Islamic capital market as well as to the harmonisation of the Shariah and the law on the land. I also told them that if we don't succeed, nobody will.

Tun Abdul Hamid Mohamad

All these speeches, lectures, papers and articles could be found on my website: www.tunabdulhamid.my

INTRODUCTION

OVERVIEW OF THE LEGAL FRAMEWORK IN MALAYSIA AND ITS COMPATIBILITY WITH ISLAMIC FINANCE

Background

One of the key pillars to the progressive development of Islamic finance in Malaysia is dedicated and enabling legislation that supports the creation of Shariah compliant financial institutions and development of innovative Islamic financial products and services offerings based on distinct Shariah tenets. Islamic Banking Act 1983 provided the much needed legal platform for the establishment of the Islamic banks and subsequent amendments led to the creation of international Islamic banks, which signifies a phased approach in developing the legal and institutional infrastructure for Islamic finance in Malaysia. Similarly, the birth of the takaful industry was supported by the enactment of Takaful Act in 1984 which enabled the creation of takaful operators and retakaful operators as well as other takaful intermediaries such as takaful brokers and takaful adjusters.

The Islamic financial system is witnessing rapid innovation with Islamic financial transactions increasing in complexity. Consumer awareness is heightened and legal certainty on the enforceability of such Islamic financial transactions becomes critical. In 2009, the Central Bank of Malaysia Act 2009 and amendments to the Capital Markets and Services Act 2007 gave statutory force to the role of the respective Shariah Advisory Councils as the highest authority to ascertain Shariah matters relating to Islamic financial business within the remit of the respective legislation. This constitutionality of mandatory referral on Shariah matters by the courts was confirmed in decided cases which were escalated to the apex court in Malaysia, paving the way towards robust judicial precedents for Islamic finance cases.

Approach to law harmonisation

The development of legal framework expands beyond regulatory law, where legal certainty through removal of legal impediments to Islamic finance developments was pursued through the Law Review Committee in 2003. Legislation concerning land, contracts, companies, taxation and court procedures were studied and reviewed in detail through five sub-committees. One of the critical achievements of this Committee which has since been emulated globally is in overcoming tax impediments on Islamic finance transactions through the adoption of a "Tax Neutrality Policy" by the government. Malaysia became a conducive jurisdiction to pioneer groundbreaking *sukuk* and Islamic financing transactions as consequential amendments were made to laws concerning income tax, stamp duty and real property gains tax to reflect this policy stance and Tax Neutrality Committee was subsequently formed among Inland Revenue Board, Ministry of Finance and Bank Negara Malaysia as the definitive platform for expeditious handling of taxation matters relating to Islamic banking and takaful.

The Malaysian Islamic finance industry has charted remarkable progress where the *sukuk* market has overtaken the bond market in terms of size and volume, Islamic banking is now 24.7% of the total banking market share compared to a mere 8.9% of the market in 2001 and the takaful industry commands 14.3% compared to 9.1%[1] in 2001. This commendable growth, uninterrupted despite the global financial crisis, is reflective of the robustness of the industry as a whole. To further sharpen the strategic focus towards internationalizing Islamic finance in Malaysia, Malaysia as an International Islamic Financial Centre (MIFC) initiative was launched in 2006.

From the legal perspective, measures to create an enabling environment for international business were pursued including liberalisation of the legal profession to enable domestic presence of law firms with expertise international Islamic finance. Capacity to handle dispute resolution was also enhanced by elevating the capability of Kuala Lumpur Regional Centre for Arbitration to handle Islamic finance arbitration.

[1] Source : Bank Negara Malaysia

The entire legal framework was also not spared so as to ensure that Malaysian law can be the law of choice for international Islamic finance transaction given its unique ability to address points of disputes concerning Shariah in the courts of law and other alternative dispute resolution mechanism. To ensure a meaningful and holistic outcome, Bank Negara Malaysia formed this committee in 2010, headed by an established authority in Islamic finance cases, YABhg. Tun Abdul Hamid Mohamad, the former Chief Justice of Malaysia (from November 2007 to October 2008), supported by accomplished member of the legal fraternity, the Attorney General's Chambers, the Securities Commission Malaysia and the International Shariah Research Academy, apart from Bank Negara Malaysia.

THE LAW HARMONISATION COMMITTEE

The establishment of the Law Harmonisation Committee and the appointment of former Chief Justice of Malaysia, YABhg.Tun Abdul Hamid bin Mohamad, who is also a member of the Shariah Advisory Council, as the Chairman was announced by Deputy Governor of the Central Bank of Malaysia, Dato' Muhammad bin Ibrahim, at the 21st Conference of Presidents of Law Associations in Asia: "Islamic Finance and Malaysia's Role", on 27 July 2010 in Kuala Lumpur.

OBJECTIVES OF ESTABLISHMENT

The underlying objectives in establishing the Law Harmonisation Committee are as follows:

- To position Malaysia as the reference law for international Islamic finance transactions;
- To achieve certainty and enforceability in the Malaysian law in regard to Islamic finance contracts; and
- For Malaysian laws to be the law of choice and Malaysian dispute resolution institutions as the forum for settlement of disputes for cross border Islamic financial transactions as part of creating a conducive legal system for Islamic finance industry.

MEMBERS OF THE LAW HARMONISATION COMMITTEE

The Committee comprises members among key government stakeholders including the Attorney-General's Chambers, the Securities Commission Malaysia as well as industry players and experienced Shariah scholars and Islamic finance legal practitioners. The Committee is supported by a full-time secretariat at Bank Negara Malaysia in collaboration with the Securities Commission Malaysia.

MEMBERS OF THE LAW HARMONISATION COMMITTEE



YABhg. Tun Abdul Hamid bin Mohamad
Chairman of Law Harmonisation Committee

Former Chief Justice of Malaysia
Member of Shariah Advisory Council of Bank Negara Malaysia
Member of Shariah Advisory Council of Securities Commission Malaysia



Dato' Nik Norzrul Thani
Deputy Chairman of Law Harmonisation Committee

Chairman, Zaid Ibrahim & Co, Advocates and Solicitors, Kuala Lumpur



En. Bakarudin Ishak
Member

Assistant Governor, Bank Negara Malaysia



En. Mohd Radzuan Ahmad Tajuddin
Member

Deputy General Manager and Head, Development
Islamic Capital Market, Securities Commission Malaysia



Datuk Siti Zainab binti Omar
Member

Director,
Monitoring and Supervision Advisory Sector
Attorney General's Chambers
(Since July 2013)



En. Kamarolzaman Abideen
Member

Deputy Commissioner of Law Revision and Reform (Revision)
Attorney-General's Chambers
(Until June 2013)



Assoc. Prof. Dr. Mohamad Akram Laldin
Member

Executive Director
International Shariah Research Academy for Islamic Finance (ISRA)



Prof. Mohamed Ismail Shariff
Member

Mohamed Ismail & Co., Advocates and Solicitors, Kuala Lumpur



En. Badlisyah Abdul Ghani
Rotating Member

Representative from Islamic Finance industry
(Since Oct 2012)

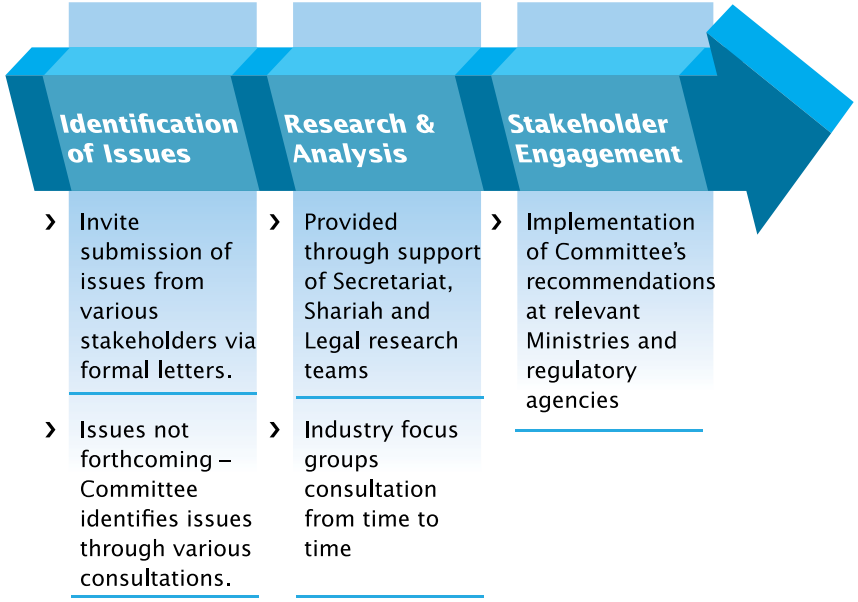


En. Rafe Haneef
Rotating Member

Representative from Islamic Finance industry
(Sept 2010-Sept 2011)

In the harmonisation initiatives undertaken by the Committee, it adopts an inclusive, consultative and focused approach in engaging all relevant stakeholders including Islamic finance practitioners, legal practitioners, researchers and academicians in identifying issues which require legislative amendments.

Law Harmonisation Committee : Consultative Approach



EXECUTIVE SUMMARY

Since the inception of the Committee, nine (9) issues have been identified, where four (4) have been recommended as requiring amendments, four (4) have been found to not require any amendments and one (1) is highlighted for further research. For easy reference, this report is set out in three (3) parts as follows:

Part A – Issues raised where amendments are recommended

	Harmonisation initiatives	Outcomes	Relevant laws	Status
1	**Legal recognition to Shariah permissibility of imposing late payment charge on judgment debts in Islamic financial cases**	Proposal incorporated in Order 42 Rule12A of the Rules of Court 2012	Procedural laws - Rules of High Court 1980 - Rules of Court 2012	Completed
2	**Improving access to financing (especially Islamic financing) involving reserve lands**	Proposal to amend relevant laws that effectively extends similar protection of financial institutions' rights to realise its security involving reservation lands was accepted-in-principle by Land Administrators Meeting on the basis that such proposal does not compromise the underlying policy rationale of reservation lands. The proposal is also subject to further technical deliberations at state level and Attorney-General's Chambers	Land laws - States' Malay Reservation Enactments - Sabah Land Ordinance - Sarawak Land Code	In progress
3	**Recognition of Islamic finance transactions under the National Land Code 1965: Legal recognition of Shariah principles to facilitate provision of Islamic finance under the National Land Code 1965**	JKPTG is in the midst of reviewing National Land Code 1965. Detailed proposals are currently being deliberated at an industry Task Force in consultation with BNM and the Committee	Land laws - National Land Code 1965	In progress
4	**Facilitating use of collateralised commodity *murabahah* in short-term Islamic financial market instruments: Clarifying requirements for registration of collateral under Companies Act 1965**	Syarikat Suruhanjaya Malaysia is in the midst of public consultation of the proposed amendments to Companies Act 1965 where this provision is included in section 353 (5) & (6)	Companies Act 1965	In progress

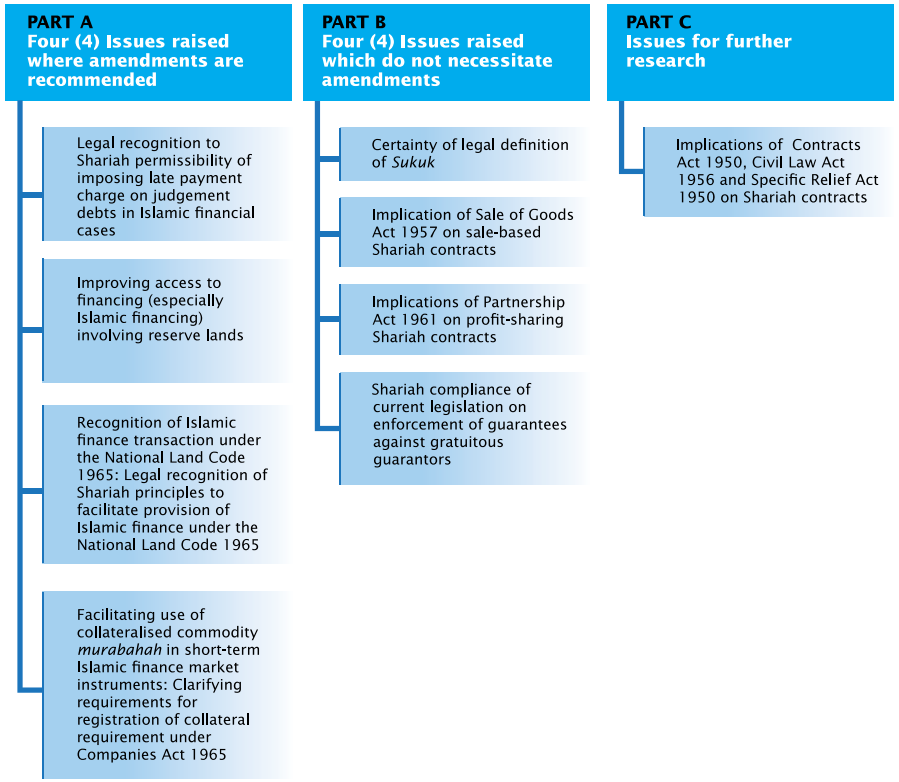
Part B – Issues raised which do not necessitate amendments

	Harmonisation initiatives	Outcomes	Relevant laws
5	**Certainty of legal definition of *sukuk***	In relation to Capital Markets and Services Act 2007, existing legal recognition and statutory framework for *sukuk* is sufficiently supported by subsidiary legislative instruments	Capital Markets and Services Act 2007
6	**Implications of Sale of Goods Act 1957 on sale-based Shariah contracts**	There is no hindrance nor legal implication	Sale of Goods Act 1957
7	**Implications of Partnership Act 1961 on profit-sharing Shariah contracts**	Partnership Act 1961 poses no hindrance	Partnership Act 1961
8	**Shariah compliance of current legislation on enforcement of guarantees against gratuitous guarantors**	Correlation of "social guarantor" concept under Bankruptcy Act 1967 where elements of enforcement of *kafalah* have been adopted	Bankruptcy Act 1967

Part C – Issues for further research

	Harmonisation initiatives	Outcomes	Relevant laws
9	**Implications of Contracts Act 1950, Civil Law Act 1956 and Specific Relief Act 1950 on Shariah contracts**	▪ Provisions of Contracts Act 1950, Civil Law Act 1956 and Specific Relief Act 1950 do not impede Islamic finance ▪ However, clarifying the legal position of "*wa'ad*" and the Shariah position of making "*wa'ad*" legally binding is pending further Shariah research	Contracts Act 1950, Civil Law Act 1956 and Specific Relief Act 1950

Harmonisation Initiatives



HARMONISATION INITIATIVES

PART A

ISSUES RAISED WHERE AMENDMENTS ARE RECOMMENDED

1. Legal recognition to Shariah permissibility of imposing late payment charge on judgment debts in Islamic financial cases

Introduction

Under the relevant court rules[2], parties are allowed to claim interest on late payment of judgment sum. Judgment creditors who are Shariah compliant institutions had refrained from claiming such interest given that it may be seen as riba', that is against Shariah.

At the time of review, imposition of interest on delay in settling judgment debts was covered under Order 42 Rule 12 of Rules of the High Court 1980 and Order 29 Rule 12 of Subordinate Court Rules 1980. The Orders read as follows:

> *Interest on judgment debts*
> *Every judgment debt shall carry interest at the rate of 4 per centum per annum or at such other rate not exceeding the rate aforesaid as the Court directs* (unless the rate has been otherwise agreed upon between the parties), such interest to be calculated from the date of judgment until the judgment is satisfied.*
>
> **in Subordinate Courts Act, the Rule reads '...as the Court shall direct...'*

This has caused a perverse incentive for judgment creditors to delay settlement of judgment sum as they will not be subject to any interest on late payment.

[2] Order 42 Rule 12 Rules of the High Court 1980 and Order 29 Rule 12 Subordinate Courts Rules 1980

Considerations

Recognising this situation, the Shariah Advisory Council of Bank Negara Malaysia had deliberated on this matter in 2005, 2006 and 2010 and ruled that Shariah compliant financial institutions may claim such sum as it is deemed as a late payment penalty charge on judgment debts based on the combination of principles of *gharamah* (penalty) and *ta'widh* (compensation) in Islamic banking and takaful cases[3]. The Shariah Advisory Council of the Securities Commission Malaysia[4] had similarly resolved the permissibility of claiming such sums as it is deemed as *ta'widh* on the late repayment of Islamic financing.

The decision of the Shariah Advisory Council of Bank Negara Malaysia[5] was communicated to the Islamic banking and takaful fraternity through a Bank Negara Malaysia guidelines[6] whilst the decision of the Securities Commission Malaysia's Shariah Advisory Council was published on 11 September 2006[7].

Recommendation

The Committee reviewed the relevant provisions to study the need for the Shariah rulings on late payment to be reflected.

[3] Resolved at its 50th meeting dated 26 May 2005, 61st meeting dated 24 August 2006 and 100th meeting dated 30 April – 1 May 2010 as per *Shariah Resolutions in Islamic finance* (2nd Edition), Bank Negara Malaysia, 2010

[4] Resolved in its 12th meeting on 14 July 1999 and 30th meeting on 8 November 2000 as per *Resolutions of the Securities Commission Shariah Advisory Council* (2nd Edition), Securities Commission Malaysia, 2006

[5] Resolved at its 50th meeting dated 26 May 2005, 61st meeting dated 24 August 2006 and 100th meeting dated 30 April – 1 May 2010 as per *Shariah Resolutions in Islamic finance* (2nd Edition), Bank Negara Malaysia, 2010

[6] Guidelines on Late Payment Charges for Islamic Financial Institutions, effective 1st January 2012 for Islamic financial institutions other than Takaful Operators

[7] *Resolutions of the Securities Commission Shariah Advisory Council* (2nd Edition), Securities Commission Malaysia, 2006

In the meantime, both Shariah Advisory Councils of Bank Negara Malaysia and the Securities Commission Malaysia jointly reaffirmed and resolved a late payment charge mechanism based on *ta'widh* and *gharamah* can be claimed on judgment sums involving Islamic banking and capital market cases[8].

Given the prevailing circumstances where not all judgment sums arising from Islamic finance related cases carry late payment penalty, the Committee recommended for this to be made transparent in the relevant rules as a new Order 42 Rule 1A of the Rules of Court 2012:

i. *Late payment charge for judgment debt may be imposed by the court from the date of the judgment until the date of settlement of the judgment debt at a rate provided by the procedures of court. The Shariah Advisory Councils (SACs) have resolved that the rate shall be determined based on the principles of ta`widh and gharamah;*

ii. *Ta`widh refers to the compensation on the actual loss. In considering the difficulty to determine the amount of actual loss and the need for standardisation in the industry, the SACs resolved that the rate of actual loss shall be determined by a third party. In the context of Islamic banking, the SACs have mandated the determination of rate of actual loss to BNM as the authority. As an applicable rate to determine actual loss, the SACs agreed to adopt the "daily overnight Islamic interbank rate" as published on the website of Islamic Inter Money Market (bnm.iimm.gov.my) fixed on the date of the judgment and calculated monthly based on daily rest basis;*

iii. *Gharamah refers to a penalty imposed as a preventive measure for late payment by debtor. In this context, gharamah refers to the difference between the amount of late payment charge and ta`widh i.e. the excess, if the amount of ta`widh is less than the amount of late payment charge. The late payment charge is as determined by the procedures of court;*

iv. *Late payment charge on judgment debt shall not be compounded;*

v. *Judgment creditor is only entitled to receive the amount of ta`widh. If the amount of ta`widh is equivalent to or more than the amount of late payment charge, then the judgment creditor may take the whole amount of the late payment charge. However, should the amount of late payment charge is more than the amount of ta`widh, the excess must be channeled to charitable body;*

vi. *The amount of late payment charge shall not exceed the outstanding principal amount[9];*

vii. *The calculation of late payment charge for judgment debt is imposed on the basic judgment sum. Basic judgment sum is the outstanding principal amount subject to ibra', if applicable and shall not include late payment charge before judgment and other related costs;*

viii. *With regard to the management of gharamah, the SACs have given the mandate to the Shariah Committee/Shariah Advisor to determine the eligible charitable bodies to receive gharamah including baitul mal. Gharamah should be channeled by the judgment creditor. Judgment creditor shall ensure that any gharamah channelled to the charitable bodies does not result in gain of any benefit howsoever and whatsoever to the judgment creditor itself; and*

[8] A joint resolution achieved on the 13th special meeting on 25 July 2011. This resolution supersedes the resolution made by the SAC of BNM in its 50th meeting dated 26 May 2005, 61st meeting dated 24 August 2006 and 100th meeting dated 30 April – 1 May 2010

[9] This term is referred to in Bank Negara Guidelines on Late Payment Charges for Islamic Financial Institutions as "outstanding balance"

ix. There is no restriction in Shariah for arbitrator to impose late payment charge as provided in the arbitration procedures or as applicable to court, subject to provisions of relevant law.

The Committee further recommends for the new sub-rule to include the following:

I. Exclusion of application of existing imposition of interest mechanism in Order 42 Rule 12 on Islamic financing cases;

II. Imposition of *ta'widh* and *gharamah* as components of late payment charge for Islamic financing cases, in which the judgment creditor will only be entitled to *ta'widh*. In the event the amount of late payment charge exceeds the rate of *ta'widh*, the balance, or *gharamah*, which serves as a deterrent from delay of payment, will be channeled to charitable organizations approved by the SAC;

III. The rate of late payment charge would follow the rate imposed by Chief Judge similar to the existing mechanism. The late payment charge will be calculated from the date of judgment until the judgment is fully satisfied; and

IV. The amount of late payment charge cannot be compounded and cannot exceed the outstanding principal amount.

Accomplishments

The proposal was approved by the Rules Committee and went in force together with the new Rules of Court on 1st August 2012. The revised Order 42 Rule 12 and the new Order 42 Rule 12A specific for Islamic financing cases reads as follows:

Order 42 Rule 12
Interest on judgment debts

Subject to rule 12A, except when it has been otherwise agreed between the parties, every judgment debt shall carry interest at such rate as the Chief Justice may from time to time determine or at such other rate not exceeding the rate aforesaid as the Court determines, such interest to be calculated from the date of judgment until the judgment is satisfied.

Order 42 Rule 12A
Late payment charge on judgment debts arising from financial transactions in accordance with Shariah

(1) Every judgment debt arising from financial transactions in accordance with Shariah shall carry a late payment charge calculated from the date of judgment until the judgment debt is fully satisfied at the rate provided under Order 42, rule 12 and subject to the following conditions:

(a) the Judgment creditor shall only be entitled to ta'widh as a result of late payment;

(b) the amount of late payment charge shall not exceed the outstanding principal amount; and

(c) if the amount of ta'widh is less than the amount of late payment charge, the balance shall be channelled to any charitable organisations as determined by the Shariah Advisory Council.

(2) For the purpose of this rule –

(a) "Shariah Advisory Council" means the Shariah Advisory Council established under the Central Bank of Malaysia Act 2009 [Act 701] and the Capital Markets and Services Act 2007 [Act 671]; and

(b) "ta'widh" means compensation for actual loss and shall be calculated at the rate determined by the Shariah Advisory Council."

Further refinements

Given the dynamism of the Islamic finance industry, it was observed that there is a need to further refine the late payment charges arising from takaful-related cases as the calculation of *ta'widh* (compensation for actual loss) applicable for banking-related cases is not suitable to determine actual loss borne by the takaful participants as it will vary according to respective participant's condition and takaful product involved.

This was highlighted to the Shariah Advisory Committee at the 121st meeting on 29 February 2012 where it was resolved that late payment charge may be imposed by authority for delay in settling claims for takaful benefits. The late payment charge will consist of:

i. Claimants' entitlement to receive an amount at a rate equivalent to the rate of investment yield of Participant's Risk Fund (PRF) [applicable only on the takaful benefit payable from the PRF], and

ii. Imposition of penalty charge on takaful operator which is paid from the Shareholder's Fund, where the penalty charge can be paid to the claimant or PRF. In this regard, Bank Negara Malaysia as the regulator has decided for the 1% penalty amount to be paid to the claimant.

To give effect to this new ruling that specifically caters for takaful cases, the Committee is currently finalising the following new draft provision in the Rules of Court 2012 for Rules Committee's consideration:

<u>Order 42 Rule 12b</u>
Late payment charge on judgment debt arising from a claim for takaful benefits

(1) Every judgment debt arising from a claim for takaful benefits under a takaful certificate issued by a takaful operator licensed under the Islamic Financial Services Act 2013 [Act 759] shall carry a late payment charge comprising of –

a) an amount at a rate which is equivalent to the published rate of investment yield of participants' risk fund managed by such takaful operator; and

b) an amount of one percentum per annum of the judgment debt or such other rate as may be specified under subparagraph 12(1) of Schedule 10 of the Islamic Financial Services Act 2013 [Act 759] to be paid from shareholder's fund of the takaful operator; and such amount and rates to be calculated from the date of judgment until the judgment sum is fully satisfied.

2. Improving access to financing (especially Islamic financing) involving reserve lands

Introduction

Legislation concerning reservation land of all states has been reviewed[10] with the intention to enable dealings of such lands for Islamic financial transactions.

As Shariah contracts employed to enable such transaction are trade-based activity which require some form of ownership of the underlying asset, the review was intended to ascertain the extent of which such ownership is limited by these Enactments and whether the limitations can be refined to facilitate financing involving Malay Reserve/Native/ Customary lands ["Reserve Lands"] without compromising the Enactments' objective to control alienation of the lands to non-Malays and non-Natives, where applicable

.

When feedback on the limitations found in the law was received from the Islamic banking industry[11], three areas of limitations were highlighted:

I. Limitation on effecting financier's legal interest;

II. Limitation in transfer of ownership undertaken in accordance with Shariah requirement; and

III. Limitation in enforcement.

[10] State enactments for Pahang, Perak, Negeri Sembilan, Selangor, Kelantan, Kedah, Perlis, Johor, Federal Territories and Terengganu, National Land Code (Penang and Malacca Titles) Act 1963, Sabah Land Ordinance (Cap. 68) and Sarawak Land Code (Chapter 81)

[11] Feedback received from Association of Islamic Banks Malaysia (AIBIM) on 10 February 2012 and subsequent consultation with industry was held on 24 February 2012

Identified Limitations

I. *Limitation on effecting financiers' legal interest*

Legal interests in the form of charges, caveats and liens are usually created by the financier to secure its interests in providing finance. A charge is created over land to secure repayment of any debt, and lien is created over land by the deposit of issue document of title with the lender. Caveat, on the other hand, is a unilateral act which serves as a notice to the world that the person entering caveat has a claim to an alleged interest in the land. In the case of Reserve Lands, only persons specified by the Enactments would gain the right to create such legal interests.

Creation of charges, for example, is restricted in all Enactments unless such person is gazetted by Ruler's Council or State Council in its schedule. Enactments in the states of Terengganu, Melaka, Johor, Perak, Selangor, Negeri Sembilan and Federal Territories restrict creation of caveat unless it is by Malay, Malay holding company or Malay corporate holder[12]. Lien by deposit of issue document of title, on the other hand, can only be created in Selangor, Perak, Negeri Sembilan and Pahang on behalf of any local cooperation registered under Local Cooperation Act 1948[13].

Banks are constrained with these restrictions as not all banks are gazetted in the Enactments. Banks need to obtain approval from each individual state and criteria for these banks to be gazetted vary from state to state.

[12] Section 14 of Malay Reservation Enactment Terengganu 1941, Section 108(1)(c) of National Land Code (Penang and Malacca Titles) Act 1963, Section 12 Malay Reservation Enactment Johore 1936, Section 11 Malay Reservation Enactment (FMS Cap 142) as applicable to Pahang, Perak, Selangor, Negeri Sembilan and Federal Territories

[13] Section 17 Malay Reservation Enactment (FMS Cap 142

The unclear position of the law in recognising these legal interests by way of judicial precedent further contributes to limiting financier's interest to be effectively protected. In *Badiaddin v Arab Malaysian Finance [1998] 1 MLJ 393*, the Federal Court denied the bank's status and right as a chargee in enforcing their right to obtain an order for sale of reserve land upon customer's default in the financing even though the financier is a scheduled chargee.

As a result, financiers would tend to impose stricter conditions in providing financing involving Reserve Lands.

II. *Limitation in transfer of ownership undertaken in accordance with Shariah requirement*

All Enactments restricts transfer of ownership to non-Malays or non-Natives. This is reinforced by the Federal Court in *Robert Lee v Wong Ah Yap [2007] 4 CLJ 1* where it was held that the intention of the legislature to protect identified areas of the reserve land must be observed and this includes to protect the land from being an 'empty shell' in which its contents may be enjoyed by person not intended by the legislature to do so. Equity cannot be applied to defeat specific objective of Malay Reserve Enactments.

On the other hand, in order to extend Islamic financing, there are those which employ Shariah contracts that require the financier to first own the subject matter of the transaction. This means that such types of financing will not be available to reserve lands and as such, reserve lands will be marginalised.

III. *Limitation in enforcement*

Eight state Enactments[14] restrict attachment in execution of an order by any court[15]. Execution carries the broad meaning of "enforcing or giving effect to the judgment of the court"[16]. As an order for sale has the effect of an attachment in execution of a judgment (as per *Badiaddin v. Arab Malaysian Finance [1998] 1 MLJ 393*), an order for sale in a foreclosure proceeding would therefore be in breach of the relevant state enactments.

Due to the difficulty in enforcing its rights in the court of law, the impact is such that financier would be more likely to impose stricter conditions in providing financing involving reserve lands.

Recommendation

Given the foregoing limitations and the undesirable impact on the use of reserve lands for Islamic financing, the Committee recommends allowing for institutions licensed or within the purview of Bank Negara Malaysia, the Securities Commission Malaysia and the Labuan Financial Services Authority and those using financial products under the above regulators' purview to protect their rights through the ability to realise its security so that financing can be extended to those having or intend to have reserve lands without compromising the original objective of creation of reserve lands.

To this end, the Committee proposes the following provision to be inserted in the 'definition' section of the relevant Enactments:

[14] Federal Territories, Selangor, Negeri Sembilan, Pahang, Perak, Johor, Terengganu and Perlis
[15] Section 13 Malay Reservation Enactment (FMS Cap 142), Section 14 Malay Reservation Enactment Johore 1936, Section 16 of Malay Reservation Enactment Terengganu 1941, Section 12 Malay Reservation Enactment Perlis 1935
[16] Re Overseas [1962] 3 All ER 122

(1) Notwithstanding any provision in this Enactment [or Code] or any other written law but subject to subsection (2), the restrictions of land dealings in this Enactment [or Code] shall not apply to a person carrying out a scheme of financing who is licensed or approved as the case may be by the Central Bank of Malaysia, the Securities Commission Malaysia or the Labuan Financial Services Authority.

(2) Provided always the non-application shall cease to apply upon termination of such scheme of financing referred to in subsection (1).

Accomplishments

The recommendation of the Committee was accepted-in-principle at the No.1/2012 Land Administrators' Meeting on 17 May 2012 at Jabatan Ketua Pengarah Tanah dan Galian, Kuala Lumpur. This is subject to further technical deliberation at state level and drafting refinements by the Attorney-General's Chambers.

Status

Follow-up meetings were held with the Attorney-General's Chambers and Pejabat Timbalan Ketua Pengarah Tanah dan Galian to expedite this matter. It was proposed that given the time needed for the respective amendments to State Enactments as discussed during the above meetings, the Committee recommends as an interim measure, standardization of administrative policy at States' level to enable all Islamic financial institutions to be recognised as scheduled chargee. This recommendation was tabled and agreed at the No.2/2013 meeting on 22 May 2013 in the Federal Territory Labuan.

3. Recognition of Islamic finance transactions under the National Land Code 1965: Legal recognition of Shariah principles to facilitate provision of Islamic finance under the National Land Code 1965

Introduction

The review arose from the Consultation Paper (CP) issued by Jabatan Ketua Pengarah Tanah and Galian (JKPTG) on Review of the National Land Code 1965 - *In Transforming the Legal, Administrative and Procedural Framework for Enhancement of Land Administration Delivery System in Peninsular Malaysia*[17].

It was noted that the objectives of the review are to enhance efficiency of land administration delivery system, achieve a trusted and pro-enterprise business environment and to serve as a building block for implementing an Electronic Land Administration System. The CP consists of four (4) parts with 21 issues and 31 questions. Part 1 covers proposals to create user friendly and electronically compatible statutory forms, Part 2 focused on review of regulatory framework for developing electronic land transactions whilst Part 3 is to review conceptual, procedural and technical issues in land administration, and the final part looks at capacity building in coordinating the efficiency of land administration system.

[17] The CP was issued on 1 February 2012 and is available at http://www.kptg.gov.my/en/jkptg-online/laman-berita-terkini/540-kertas-perundingan-kajian-kanun-tanah-negara-1965.html

Discussions with JKPTG confirmed that they would consider recommendations to enhance efficiency of NLC in the conduct of Islamic finance-related land dealings and as such, the Committee conducted two industry consultations[18] and formed the Land Laws Sub-committee[19], which role is dedicated to the identification of impediments which may exist in current land laws for the conduct of Islamic finance-related transactions.

The entire CP was reviewed and the Committee made the following recommendations which cover Islamic finance specific areas as well as other areas that have an impact on Islamic finance:

Issues specific to Islamic finance

The following 5 of the 21 issues raised by JKPTG in the CP were identified as relevant to Islamic finance:

i. Mode of effecting changes to recognize and harmonise National Land Code (NLC) for the purpose of Islamic finance

ii. Harmonisation of forms and terminology

iii. Recognition of beneficial ownership

iv. Facilitation of financial intermediation by foreign banks

v. Determination of amount under Order for Sale: Calculation of Rebate (*Ibra'*)

[18] Preliminary feedback was obtained from Islamic banking industry on 9 November 2011 and further consultation was made on 30 April 2012

[19] The Land Law Sub-Committee is headed by Y.M Tengku Dato' Seri Hasmuddin bin Tengku Othman and comprises of 7 other members, namely Ms. Sally Chee (representative from Bar Council), Assoc. Professor Dr. Ainul Jaria Maidin (IIUM), Professor Dr. Ashraf Md. Hashim (representative from ISRA), En. Mohd Shuhaimi Ismail (Islamic finance legal practictioner), Pn. Fadzilah Pilus (Islamic finance legal practitioner), En. Jasani Abdullah (representative from AIBIM) and En. Mohd Shukri Hj Ismail (former officer in JKPTG)

i. <u>Mode of effecting changes to recognize and harmonise NLC for the purpose of Islamic finance</u>

Issue 20 of the CP proposed for an amendment to the NLC by inserting a new Section 5E which will be procedurally reflected in Seventeenth Schedule.

Recommendation

The Committee supports the proposal and propose to reflect the following three modes of harmonising the NLC for purposes of Islamic finance in Section 5E:

(i) Address the incompatible terminologies through the interpretation section and making statutory forms more generic;

(ii) Address provisions which impede the provision of Islamic financial services via non-application of such provisions subject to certain safeguards e.g. non-application of s.433B to Islamic financing transactions; and

(iii) Address any specificities of Islamic finance which cannot be accommodated via modes (i) and (ii) through modifications reflected in the Seventeenth Schedule.

ii. <u>Harmonisation of Forms and Terminology</u>

Issue 1 of the CP highlighted statutory forms prescribed in the Schedules to the NLC may not be user-friendly, may be out-dated or may not be able to meet the requirements for electronic environment of land administration system. In this regard, JKPTG invited suggestions on specific forms that may require amendments and new forms that should be introduced.

Issue 20 stated how Islamic financial transactions can be accommodated in current land law structure through harmonising terminologies that are incompatible with Shariah and perfecting security over land pursuant to Islamic finance transactions.

Recommendations

Instead of identifying specific forms[20] and introducing new ones to accommodate Islamic financial transactions, the Committee recommends two specific measures:

(i) Terminologies which are incompatible with Shariah such as "interest" and "interest on loans" should be harmonised through the introduction of a provision in the interpretation section similar to approach taken in section 2(7) of the Income Tax Act 1967 as follows:

"Any reference in this Act to interest shall apply, mutatis mutandis, to gains or profits received and expenses incurred, in lieu of interest, in transactions conducted in accordance with the Shariah"

(ii) Insertion of a new Seventeenth Schedule to explain how Shariah compliant products and transactions involving land dealings can be safeguarded by some kind of registration on the document of title of the relevant land.

[20] Among statutory forms identified by Islamic banking industry as requiring reforms are Forms 14A, 15A, 15B, 16A, 16D and 19D

iii. <u>Recognition of beneficial ownership</u>

Issue 20 of the CP included a proposal to expressly recognise Shariah principles such as *Murabahah*, *Musyarakah*, *Ijarah* and *Istisna'* in land dealings which include transfers, leases and charges of land. In addition, a new provision is proposed to cater for a beneficial owner under the Shariah compliant financing product known as *Bai' Bithamin Ajil* to take a charge on land as the NLC does not have any expressed provisions to cover such beneficial ownership. The institution providing financing would normally require a charge to be created in its favour to secure its position as financier of the customer's property.

Recommendation

Although current practices of creating charges is permissible from Shariah perspectives, the Committee is of the view that trust caveats would be more suitable and recommends as follows:

a. Expand the concept of trust caveat under section 332 and 333 NLC as an alternative instrument to reflect beneficial ownership as it is able to serve as a notice to the world that the caveator has an interest in the land.

b. Include the right of the caveator under such circumstances to apply for order for sale similar to s.281(2) NLC to enforce its rights upon default of the customer.

iv. Facilitation of financial intermediation by foreign banks

Issue 20 also proposed allowing licensed foreign-owned Islamic banks to be allowed to acquire land for the purposes of extending Islamic finance. This is because some Shariah principles[21] require ownership of the subject matter of the transaction before Islamic financing can be extended. Thus, sections 433A, 433B and 433E of the NLC have to be reviewed to expand the list of exemptions to either allow for Islamic financing transactions or exclude application of the restrictions to Islamic finance institutions.

If this is not addressed, foreign-owned Islamic banks will continue to face challenges in extending such Islamic financing and this could be a factor why such foreign-owned Islamic banks offer a more limited range of products.

Recommendation

Having regard to the underlying policy objectives behind such restrictions, the Committee recommends disapplication of sections 433A, 433B and 433E to Islamic financing transactions on the premise that the restriction will apply upon completion of the financing.

v. Calculation of Rebate (*Ibra'*) in determination of amount under Order for Sale

Issue 20 proposed for subsection 257(1) to have an expressed recognition of how the amount due under an Order for Sale for Islamic financing cases using the sale-based Shariah principles should be calculated and it was proposed that such amount would need to have already factored in the *ibra'* (rebate).

Recommendation

For purposes of section 257(1) of NLC, the Committee recommends the approach to be consistent with the Guidelines on *Ibra'* for Sale-based Financing by Bank Negara Malaysia[22].

Issues that has an impact on Islamic finance

Apart from the above, there are issues that relate to internal procedures and administrative matters of Land Administrators which the Committee will not provide any recommendations. Nevertheless, the Committee has the following comments and recommendations on the following issues given its impact on Islamic finance:

(a) Enhancing efficiency in land administration

The Committee supports the following proposals:

i. Issue 3 – Implementation of Single Title System

The proposed insertion of a new provision in the NLC to facilitate the creation and introduction of a single land title system to be used in the electronic land administration system to address backlog of foreclosure cases.

ii. Issue 5: One Day Title Delivery

The proposal made by JKPTG to improve speediness in issuing duly registered title by specifying the timeline for delivery, on the understanding that a phased approach is adopted to ensure that JKPTG's target can be effectively met.

[21] This includes the Shariah principles of *Murabahah* and products known as *Bai Bithamman Ajil*

[22] Islamic Banking Institutions are required to grant *ibra'* to all customers who settle their financing before the end of the financing tenure. Under the above Guidelines, *ibra'* is calculated upon settlement of the financing based on the stipulated formula.

iii. *Issue 6: Renewal Of Leasehold Tenure*
The proposed insertion of a new NLC provision to facilitate renewal of leasehold land tenure in order to enable more efficient renewal of leasehold land tenure, which would in turn enhance the effectiveness of land usage as underlying security for financing transactions

The following proposal is not supported by the Committee:

iv. *Issue 10 : Establishment of a Land Court*
The establishment of a Land Court under the NLC as a specialised forum for managing all disputes arising in the land administration and development regime is not necessary because the Committee feels that the current court system is sufficient.

(b) Enhancements to procedures to prevent fraud and forgery

i. *Issues 11 and 13 : Registrar's Power to Correct Errors and Power of Registrar in Making Inquiries*
The Committee has no objection to the proposed enhanced powers of the Registrar to correct errors and to make inquiries on incidents of fraud and forgery on the basis that such powers will be complimented with stronger and more transparent governance arrangements, in line with international best practices. This includes providing notice prior to the exercising the Registrar's power to correct errors.

ii. *Issue 12: Introduce Certificate of Correctness to Curb* Fraud and Forgery
The Committee supports the proposed introduction of Certificate of Correctness as it is has been proven useful in curbing fraud and forgery in other Torrens jurisdictions. Furthermore, it is to impose an obligation on the legal professional to be jointly responsible in verifying the identity of the persons executing instruments of dealing.

(c) Enhanced accessibility to NLC

i. *Issue 7: Position Of Overriding Statutes*
The Committee is of the view that JKPTG should consult with the Attorney-General's Chambers on the proposed for insertion of a new provision into the NLC to provide for resolving the position of overriding statutes as the matter is within their purview.

ii. *Issue 9: Defining exceptions to indefeasibility of title*
Proposals to define the terms 'fraud', 'misrepresentation', 'forgery' and 'insufficient instrument' in section 5 of the NLC may not be necessary in the Committee's view as there are sufficient sources which the courts can resort to on these terms.

iii. *Issue 15: Reversion of Provisions Prescribing for Application and issuance of strata titles from the Strata Titles Act 1985 into the Restructured NLC*
Provided the efficiency level is not adversely affected, the Committee has no objections to the proposed restructuring of the Strata Titles Act 1985 and a reversion of the provisions prescribing for application and issuance of strata titles from the Strata Titles Act 1985 into the proposed restructured NLC.

ii. *Issue 17: Streamlining the multiple options of applications for land development*
The Committee supports the proposal by JKPTG to create a single point of contact for applications for land development through the repeal of sections 204A to sections 204H;

sections 200, 202, 203, 204, 124A and the provisions relating to subdivision, partition and amalgamation in Chapters 1, 2, and 3 of Part Nine to make way for the proposed new approach, namely 'Re-establishment Of Land Boundaries-Special Provisions'.

However the Committee believes that this should be made together with necessary clarifications on consequential issues on the status of existing charges made upon completion of re-alienation (specifically, whether fresh charges need to be created and registered on new title or existing charge will be endorsed. If it is the former, then dispensation on the applicable fees should additionally be made).

(d) Enhanced consumer protection

*Issue 8: Creation of Torrens Insurance Principle for Compensation of Los*s for Innocent Proprietors

In light of rising number of fraud and forgery cases in Malaysia, the Committee believes that the move to have the Torrens Insurance Principle in Malaysia is timely as the principle provides basis for creation of an assurance fund and provisions in the NLC to compensate innocent victims for the loss suffered due to land scams or administrative errors. Furthermore, the Committee observed from countries with Torrens system like Australia and Singapore has adopted this principle as a way to provide protection to victims of administrative errors, land fraud or forgery. The Committee further recommends for the assurance fund to have in place the necessary governance and transparency and for it to be properly and professionally managed.

(e) Promote financial inclusion

Issue 19: Partitioning of Agriculture land measuring less than 2/5 hectare is Permitted But Dealing with the Partitioned portions is Restricted

The Committee supports the proposal by JKPTG to repeal subsection 205 (3) and (4) of the NLC so that agriculture land measuring less than 2/5 hectare can be partitioned and dealt with as it would unlock the commercial value of such lands including for the purpose of obtaining financing.

4. Facilitating use of collateralised commodity *murabahah* in short-term Islamic financial market instruments: Clarifying requirements for registration of collateral under Companies Act 1965

Introduction

The Islamic money market is an essential feature of the Islamic financial system as it provides Shariah compliant liquidity management for the Islamic financial institutions. The products normally have maturities ranging from overnight to up to 12 months. Repurchase arrangements are currently being done through the sale and buy-back arrangement (SBBA) which is not widely accepted. In line with product innovation, Bank Negara Malaysia has introduced collateralised *Murabahah* which essentially is a sale-based Shariah compliant product that requires the underlying commodity to be collateralised. "The *Murabahah* purchaser" will charge its securities to "the *Murabahah* seller" in order to secure the future payment of the purchase price of the underlying assets.

As Islamic financial institutions are companies, Section 108 is technically applicable if the institution acts as the *Murabahah* purchaser and a charge needs to be created and registered with the Companies Commission of Malaysia (CCM). Once the *Murabahah* is completed, a discharge of charge will be needed.

Areas of Limitation

Although, in substance, the relevant provisions do not impede the conduct of collateralized *Murabahah*, the application of the provision poses several challenges and discussions with CCM indicate that, although technically applicable, the provisions are not meant to cover such Islamic financing products.

The Committee identified three (3) specific challenges:

i. Practical impossibility of registering the creation and discharge of charge over the securities

Section 108(1)[23] of the Companies Act requires that any creation of registrable charges must be registered with the Registrar of Companies for the creditor to have its debt secured for purposes of liquidation within 30 days and a registration fee of RM300 is payable. CCM will then issue a Certificate of Charge (Form 40) within five days or receipt of the registration. Under Section 113(1), cancellation of charges will need to be registered within 14 days of the satisfaction of debt and a discharge of charge (Forms 41, 42B, 43, 43B) will be issued within five days of receipt of such registration. This will entail a fee of RM50.

This means that registration of charged securities to secure short-term collateralised *Murabahah* is practically impossible to register especially those with tenors of one month or less.

ii. Administrative costs of registration and de-registration

As stated above, the aggregate CCM fees for each collateralised *murabahah* are RM350 and such fees would not apply if it is a conventional money market instrument.

This is inconsistent with the principle of neutrality that the government adopts with regard to Islamic finance as Islamic finance transactions should not attract more fees or tax compared to conventional finance.

iii. Criminalisation of failure to register charges in Section 109[24] of Companies Act

Islamic financial institutions pledging eligible securities under short-term Collateralised *Murabahah* are under a legal duty to register charges within 30 days of its creation failing which RM1,000 penalty imposed under Section 109 Companies Act for any failure to register.

Recommendations

The Committee recommends the inclusion of a provision to exclude such transactions as follows:

[23] Section 108(1) Companies Act 1965 - Registration of Charges
Subject to this Division where a charge to which this section applies is created by a company, there shall be lodged with the Registrar for registration within thirty days after the creation of the charge a statement of the prescribed particulars, and if this section is not complied with in relation to the charge, the charge shall, so far as any security on the company's property or undertaking is thereby conferred, be void against the liquidator and any creditor of the company.

[24] Section 109(1) – Duty to register charges
(1)Documents and particulars required to be lodged for registration in accordance with section 108 may be lodged for registration by the company concerned or by any person interested in the documents, but if default is made in complying with that section the company and every officer of the company who is in default shall be guilty of an offence against this Act.
Penalty: One thousand ringgit. Default penalty.

"108. (1A) Subsection (1) shall not apply:

(a) to a charge created to secure payment or performance of a financial obligation arising from any instruments or transactions effected in the money market in such manner and to such extent as may be specified by Bank Negara Malaysia pursuant to the Financial Services Act 2013 or the Islamic Financial Services Act 2013; or

(b) if the person interested in the charge is Bank Negara Malaysia.

108. (1B) The charges under subsection 108(1A) shall be treated as if it were a charge registered under subsection (1) and shall be valid against the liquidator and any creditor of the company"

Accomplishments

CCM has agreed to the recommendation and the proposed amendment has been reflected in the exposure draft of Companies Bill which has been released for consultation on 2 July 2013. The Companies Bill is expected to be tabled in Parliament sometime this year.

HARMONISATION INITIATIVES

PART B

ISSUES RAISED WHICH DO NOT NECESSITATE AMENDMENTS

1. Certainty of legal definition of *sukuk*

Introduction

The review focused on lack of sufficient recognition accorded to *sukuk* in the current legislative framework. In its review, the Committee looked at the definition provided in the Securities Commission Act 1993 (SCA) and Capital Markets and Services Act 2007 (CMSA).

Assessment

Capital Markets and Services Act 2007
Currently, "securities" under the CMSA is defined as follow-

"securities" means—

(a) debentures, stocks or bonds issued or proposed to be issued by any government;

(b) shares in or debentures of, a body corporate or an unincorporated body; or

(c) units in a unit trust scheme or prescribed investments;

and includes any right, option or interest in respect thereof.

Section 5 of the CMSA empowers the Minister of Finance to prescribe by order, any instrument or product or class of instruments or products to be securities. In addition, section 316 of CMSA also empowers the Minister to make a prescription in respect of Islamic securities as follows:

316. Prescription by Minister in respect of Islamic securities, etc

(1) This Divis*ion applies to a person who proposes to make available, offer for subscription or purchase, or issue an invitation to subscribe for or purchase, Islamic securities.*

(2) Where the Minister has made a prescription under section 5 in respect of Islamic securities, the Minister may make such modifications in the prescription on the usage of expressions in the securities laws as may be necessary to give full effect to the principles of Shariah in respect of such Islamic securities.

(3) The Commission may specify in guidelines made under section 377 on the following:

(a) any model agreement or documentation relating to a transaction or arrangement in respect of Islamic securities;

(b) the duties and responsibilities of the different parties involved in a transaction or arrangement in respect of Islamic securities; and

(c) any other matter as may be deemed appropriate, in giving full effect to the principles of Shariah in relation to a transaction in respect of Islamic securities.

Set against this backdrop, the Minister of Finance exercised the powers as mentioned above by prescribing Islamic securities to be "securities" for purposes of the securities laws through the issuance of the Securities Commission (Prescription of Islamic Securities) Order 2004 ("the Order"). The Order had defined "Islamic securities" as -

(a) any product or instrument made available, offered for subscription or purchase, or issued pursuant to the Shariah principles of Mudharabah or Musyarakah; or

(b) any sukuk issued pursuant to any Shariah concept or principle; and

which are specified as Islamic securities under the Guidelines on the Offering of Islamic Securities ("the Guidelines") issued by the Commission.

However, the Securities Commission Malaysia has in 2012 provided further clarity by introducing a new prescription order (the 2004 order has now been repealed) relating to definition of Islamic securities known as Capital Markets and Services (Prescription of Islamic Securities) Order 2012 and created new prescription order relating to definition of Islamic capital market products, thereby further strengthening the recognition accorded to *sukuk* in the current legislative framework. 'Islamic securities' is defined therein to include '*sukuk* structured in compliance with Shariah principles'. As such, with the introduction of these orders, *sukuk* is clearly prescribed as a type of securities which is different from 'debenture'.

Conclusion

In relation to the Capital Market and Services Act 2007, the Securities Commission Malaysia is of the view that the existing legal recognition and statutory framework for *sukuk* is sufficiently supported by subsidiary legislative instruments which cater for the distinct features of *sukuk*.

2. Implications of Sale of Goods Act 1957 on sale-based Shariah contracts

Introduction

The review focused on ascertaining the effect of application of the Sale of Goods Act 1957 ('SOGA') provisions to sale-based Islamic financing transactions. SOGA governs supply of goods in Peninsular Malaysia and is read together with the Contracts Act 1950 and the Consumer Protection Act 1999. SOGA may be applicable to an Islamic financial transaction when the transaction involves real trade activities.

Assessment

There are two provisions in SOGA which may not be fully compatible with principles of Shariah:

I. Section 61 'Interest by way of damages and special damages' - Reference to the right to recover interest and court's discretion to award interest.

Section 61 reads as follows:

61. Interest by way of damages and special damages.

(1) Nothing in this Act shall affect the right of the seller or the buyer to recover interest or special damages in any case where by law interest or special damages may be recoverable, or to recover the money paid where the consideration for the payment of it has failed.

(2) In the absence of a contract to the contrary, the court may award interest at such rate as it thinks fit on the amount of the price -

(a) to the seller in a suit by him for the amount of the price, from the date of the tender of the goods or from the date on which the price was payable;

(b) to the buyer in a suit by him for the refund of the price in a case of breach of the contract on the part of the seller, from the date on which the payment was made.

II. Sections 16 'Implied condition as to quality or fitness'; i.e principle of 'caveat emptor' (buyer beware) in which risks can be transferred to unsuspecting buyers of products and services.

Section 16 reads as follows:

16. Implied condition as to quality or fitness.

(1) Subject to this Act and of any other law for the time being in force, there is no implied warranty or condition as to the quality or fitness for any particular purpose of goods supplied under a contract of sale, except as follows -

(a) Where the buyer, expressly or by implication makes known to the seller the particular purpose for which the goods are required, so as to show that the buyer relies on the seller's skill or judgment, and the goods are of a description which it is in the course of the seller's business to supply (whether he is the manufacturer or producer or not) there is an implied condition that the goods shall be reasonably fit for such purpose:

Provided that, in the case of a contract for the sale of a specified article under its patent or other trade name there is no implied condition as to its fitness for any particular purpose.

(b) Where goods are bought by description from a seller who deals in goods of that description (whether he is the manufacturer or producer or not) there is an implied condition that the goods shall be of merchantable quality:

Provided that if the buyer has examined the goods, there shall be no implied condition as regards defects which such examined ought to have revealed.

(2) An implied warranty or condition as to quality or fitness for a particular purpose may be annexed by the usage of trade.

(3) An express warranty or condition does not negative a warranty or condition implied by this Act unless inconsistent therewith.

However, given that Section 62 allows parties to the transaction to opt out from the inherent provisions in SOGA, the above two provisions do not impede Islamic financial business. Section 62 reads as follows:

62. Exclusion of implied terms and conditions.

Where any right, duty or liability would arise under a contract of sale by implication of law, it may be negatived or varied by express agreement or by the course of dealing between the parties, or by usage, if the usage is such as to bind both parties to the contract.

Conclusion

SOGA does not impede Islamic financial business as it is possible to exclude the application of non-Shariah compatible provisions in an Islamic financial transaction.

3. Implications of Partnership Act 1961 on profit-sharing Shariah contracts

Introduction

The Partnership Act 1961 governs rights and duties of partners in a partnership arrangement. Partnership relationship as per the Partnership Act 1961 refers to relations subsisting between 2 to 20 persons[25] carrying on business in common with a view of profit[26]. As the Partnership Act 1961 may trigger applicability of certain Islamic finance product with equity-based structure such as *Mudarabah* and *Musyarakah*, the review is intended to ascertain the Act's applicability to Islamic Finance transaction.

Assessment

The Partnership Act 1961 is designed as a fallback for a range of different types of partnerships. Thus, the rules it imposes may not be helpful in a partnership specific circumstances and hence, section 21 of the Act allows parties to stipulate their terms of agreement. Section 21 states as follows:

> ***21. Variation by consent of terms of partnership.***
>
> *The mutual rights and duties of partners, whether ascertained by agreement or defined by this Act, may be varied by the consent of all the partners, and such consent may be either express or inferred from a course of dealing.*

[25] Section 47(2) of Partnership Act
[26] Section 3 of Partnership Act

It is common to find Islamic financing facility documents such as *Musharakah mutanaqisah* to state that the relationship between the parties should not be deemed to constitute a partnership pursuant to the Partnership Act 1961.

Conclusion

The Partnership Act 1961 does not impede Islamic finance transactions as it is possible to vary application of certain provisions in the Act by agreement or consent of the parties.

4. Shariah compliance of current legislation on enforcement of guarantees against gratuitous guarantors

Introduction[27]

The review considers two differing views of Islamic jurists on the recourse element in *kafalah* i.e the Islamic law of guarantee. The majority view of Islamic jurists (Hanbalis, Hanafis and Shafi'is) holds that the judgment creditor is allowed to take recourse after judgment debtor and guarantor simultaneously whilst the minority view of Malikis holds that judgment creditor has to first claim from the judgment debtor before attempting to obtain recourse from the guarantor. The presenter is proposing that the minority view of Malikis should be adopted in Malaysian law to alleviate unnecessary hardship placed on the guarantor in having to be simultaneously accountable to the debt like the judgment debtor.

[27] The research entitled "Classical Islamic Guarantees (*Al-Kafalah*) in Modern Banking Practices" prepared by Dr. Suhaimi bin Ab Rahman, Head of Laboratory of Halal Policy and Management, Universiti Putra Malaysia was presented at the 10th Law Harmonisation Committee meeting on 15 December 2011. The presenter has also produced two papers on the topic:
(i) The influence of classical interpretation on the Law of Guarantees in the United Arab Emirates (published in Arab Law Quarterly 22(2008) 335-358; and
(ii) Islamic Law and Modern Guarantees in Malaysia (published in International Journal of Economics and Management 1(3): 477-501 (2007)

Assessment

The recourse element in the modern Malaysian law of guarantee is provided for in Section 81 of the Contracts Act 1950. Similar to the majority view of Islamic jurists of Hanbalis, Hanafis and Shafi'is, Section 81 allows the judgment creditor to take recourse for the debt due from both judgment debtor and guarantor simultaneously. Section 81 reads as follows:

> ***81. Surety's liability.***
>
> *The liability of the surety is co-extensive with that of the principal debtor, unless it is otherwise provided by the contract.*

Although the principle of *kafalah* is comparable to the principle of modern law of guarantee, differences exist in that *kafalah* is only confined to contracts gratuitous in nature. Malikis view in holding that judgment creditor has to first claim from the judgment debtor before attempting to obtain recourse from the guarantor in *kafalah* is already recognised in Malaysian law context by way of reference to 'social guarantor' in section 2 the Bankruptcy Act 1967 and the protection provided in section 5(3). In section 2, 'social guarantor' is defined as a person who, not for the purpose of making profit, provides guarantees on the following:

(i) a guarantee for a loan, scholarship or grant for educational or research purposes;

(ii) a guarantee for a hire-purchase transaction of a vehicle for personal or non-business use;

(iii) a guarantee for a housing loan transaction solely for personal dwelling.

Section 5(3) prevents a petitioning creditor to commence any bankruptcy action against a social guarantor unless he proves to the satisfaction of the court that he has exhausted all avenues to recover debts owed to him by the debtor.

The Committee further considers the possible extension of similar treatment beyond social guarantors and agreed that is not preferred as it would increase the cost of financing since the principal debtors will be required to furnish additional security when banks are not able to get direct recourse from guarantors.

Conclusion

As the current Bankruptcy Act 1967 has sufficiently addressed the concern on adopting jurists' minority views on Islamic law of guarantee, no further enhancement to the law is needed.

HARMONISATION INITIATIVES

PART C

ISSUES FOR FURTHER RESEARCH

1. Implications of Contracts Act 1950, Civil Law Act 1956 and Specific Relief Act 1950 on Shariah contracts

Introduction

Like most laws of general application in Malaysia, the Contracts Act 1950, the Specific Relief Act 1950 and the Civil Law Act 1956 ("the Acts") came into force in Malaysia prior to the introduction of Islamic finance. Thus, the review undertaken by the Law Harmonisation Committee firstly seeks to ascertain the compatibility of the legislation with Islamic financial transactions. Secondly, it seeks to identify and address legal aspects of Shariah contracts in Islamic financial transactions which were not addressed in the Acts or any other Acts.

For purposes of the review, the Committee consulted the banking, takaful as well as capital market sector to obtain their feedback[28]. To this end, the Committee issued a series of questions to assist the Committee in its review of the Acts. From the response received from the industry, seven (7) key issues had been identified by the Committee for its discussion.

Assessment

Contracts Act 1950

(i) Recognition of Shariah contracts made without consideration

The application of Shariah concepts in Islamic financial transactions which on its face, do not meet the essential ingredients of a contract raises the question whether there is a need to accord legal recognition to such concepts under the Contracts Act 1950. This issue is particularly relevant given the prevalent use of instruments such as purchase undertaking in Islamic financial transactions using the concept of a unilateral promise (*wa'd*). The absence of a requirement for consideration in such purchase undertaking causes legal uncertainty as to whether such instruments are legally binding on parties to a transaction. However, a Shariah assessment on the enforceability and binding nature of such instruments is required before a legal assessment of such Shariah contracts can take place. In this, the Committee accepted the recommendation by the Secretariat for the Shariah assessment on *wa'd*, *wa'dan* and *muwa'adah* to take place prior before any substantive amendments to the Act is made.

(ii) Obligation of person receiving advantage under void agreement

Section 66 of the Contracts Act 1950 is a restitutionary provision which requires a person who has received an advantage under a void agreement or a contract that becomes void to restore the original amount received to the other person. It has been argued in the case of *Arab Malaysian Finance v Taman Ihsan Jaya and Ors (Koperasi Seri Kota Bukit Cherakah Sdn Bhd) [2008] 5 MLJ 681* that in the event of a dispute, financiers carrying out Islamic financial transactions are only entitled to the principal financing amount and are not entitled to any of the profit margin agreed with customers. This decision inevitably left financiers carrying out Islamic finance transactions in a worse off position than its conventional counterparts. While the decision in the above case has been overruled by a later Court of Appeal[29] decision, the position under Shariah has to be clarified to ascertain the consequences of a void or imperfect Islamic financial transaction.

[28] Industry feedback was obtained by 13 June 2012

[29] Bank Islam Malaysia Berhad v Lim Kok Hoe and Anor [2009] 6 MLJ 839

(iii) Consistency of provisions on bailment of pledges with Shariah concept of Ar-Rahn

Specific provisions in the Contracts Act 1950 codify the common law position on pledges. As the concept of pledge in the Act has been equated to the English definition thereof[30], this raises the concern on the compatibility of such provisions with the concept of *Ar-Rahn*. While there have been no instances in which this issue has been tested in the courts of law, there is a need to ascertain the position in this matter vis-à-vis Islamic financial transactions using the Shariah concept of *Ar-Rahn*. The Committee was guided by the response provided by the Secretariat to the Shariah Advisory Council which expressed the view that the provision on bailment of pledges is generally consistent with the Shariah concept of *Ar-Rahn*.

Civil Law Act 1956

(i) Inconsistency of common law and equity principles in English law with Shariah principles

Section 3 of the Act provides for the application of the English common law and rules of equity while section 5 of Act stipulates that in the absence of any written law, commercial matters shall be governed by English law. It has been highlighted that the broad scope of these provisions could lead to a potential conflict in respect of the application of the provisions to financial transactions which use Shariah principles as its basis. This issue reflects a similar conflict faced by the English court in a case where Shariah law and the laws of England are used together as the governing law in an Islamic financial transaction[31]. In the domestic arena, the absence of judicial precedent which specifically addresses this matter may cause legal uncertainty as to the application of Shariah principles in relation to commercial transactions such as Islamic financial transactions.

However, critical analyses of judicial precedent[32] dealing with the interpretation of the provisions reveal that they are not applied automatically but are subject to specific requirements. In *Nepline Sdn Bhd. v Jones Lang Wooton [1995] 1 CLJ 865, Abdul Hamid bin Mohamed J (as he then was), in referring to section 3 of the Act held that:*

"In my view, the approach that the Court should take is first to determine whethere there is any written law in force in Malaysia. If there is, the Court need not look anywhere else. If there is none, then the Court should determine what is the common law of, and the rules of equity as administered in, England on 7 April 1956. Having done that the Court should consider whether 'local circumstances' and 'local inhabitants' permit its application, as such. If it is 'permissible' the Court should apply it. If not, I am of the view that, the Court is free to reject it totally or adopt any part which is 'permissible', with or without qualification. Where the Court rejects it totally or in part, then there being no written law in force in Malaysia, the Court is free to formulate Malaysia's own common law. In so doing, the Court is at liberty to look at any source of law, local or otherwise, be it common law of, or the rules of equity as administered in England after 7 April 1956, principles of common law in other countries, Islamic law of common application or common customs of the people of Malaysia. Under the provision of s. 3 of the Act, I think, that it is the way the Malaysian common law should develop".

[30] Jin Seng Hong Sdn Bhd v Khiing Sie Khuo [1988] 3 MLJ 101
[31] Beximco Pharmaceuticals Ltd and Ors v Shamil Bank of Bahrain [2004] EWCA Civ 19
[32] Nepline Sdn Bhd v Jones Lang Wooton [1995] 1 CLJ 865; Jasa Keramat Sdn Bhd v Monatech (M) Sdn Bhd [2001] 4 CLJ 549

This view was reaffirmed in the later Court of Appeal decision of *Jasa Keramat Sdn Bhd v Monatech (M) Sdn Bhd [2001] 4 CLJ 549*.

The guiding principle to be drawn from the court decisions thus appears to be that the provisions of this Act are applicable only in so far as the circumstances of the State of Malaysia and its respective inhabitants permit. Furthermore, even if it is 'permissible' to apply such principles they may still be subject to such qualifications as local circumstances render necessary. More importantly, if the English common law or rules of equity are not permissible, the court should refer to other sources of law, including principles of Islamic law.

In resolving this issue, the Committee was presented with two (2) recommendations: firstly to recognize the application of Islamic law in section 3 and 5 of the Act. It was envisaged that such recognition would provide greater clarity to the application of Islamic law in commercial transactions and complement the role of the Shariah Advisory Councils established under the Central Bank of Malaysia Act 2009 and the the Capital Markets and Services Act 2007.

A second recommendation was to maintain the existing provisions with no amendments as the issue at hand could be resolved by leveraging on available judicial precedent. The Committee expressed a preference for the second recommendation as the existing case law already provided clear guidance in the application of the provisions in the context of Islamic finance

(ii) Discretion of court to award pre-judgment interest

Unlike Order 42 Rules 12 and 12A of the Rules of Court 2012 which only govern post-judgment interest and late payment charges respectively, section 11 of the Act grants the courts discretionary powers to award pre-judgment interest in disputes. Case law[33] suggests that the court's discretion in granting pre-judgment interest is to be exercised only where a party has been kept out of the money which ought to have been paid to him. In cognizance of this general rule, it has been argued that such discretion could also be exercised in disputes relating to Islamic financial transactions with or without the relevant party claiming for such. As a matter of practice, the industry has included "waiver of interest" clauses in its financing agreements to observe the Shariah requirement on prohibition of riba. In these, the provision of the Act raises two sub issues:-

(a) Whether the powers of the court is limited to granting pre-judgment interest only or whether it is extended to granting "pre-judgment compensation";

(b) Whether the existing practice by the industry of including a waiver of interest clause in financing agreements could be challenged.

The question on whether parties to an Islamic financial transaction are entitled to the equivalent of pre-judgment interest i.e. money a party has been kept out from the date he ought to have been paid is a Shariah issue to be determined. In this, the recommendation made to the Committee was to table the issue to the Shariah Advisory Council of Bank Negara Malaysia and the Securities Commission Malaysia for its ruling on pre-judgment interest.

In its deliberations, the Committee noted that the courts' discretion under section 11 of the Act is rarely exercised in the context of financial transactions as the consequences for breach of obligations under a financial transaction (e.g. delayed repayment) are generally

[33] Lee Guan Par v Hotel Universal Sdn Bhd [2005] 4 MLJ 589

provided for in the agreements entered into by parties. It was also observed by the Committee that the provision was generally exercised in disputes relating to personal injury cases. Upon further consultation with the industry, it was found that there is no current practical example of circumstances under which the courts discretion under section 11 of the Act has been exercised in relation to Islamic financial transactions.

(iii) Assignment of rights by a takaful participant and purpose of assignment

Another provision in the Act which requires clarity in its application to Islamic financial products is section 4 (3) of the Act which deals with the effect of assigning debt or legal chose in action. The issue presented to the Committee was twofold from the Shariah perspective:

(a) Can a takaful participant invoke an assignment pursuant to section 4 (3) of the Act to transfer the rights and benefits under a takaful certificate from a participant to an assignee?

(b) Must the purpose of the assignment be Shariah compliant?

In making its decision, the Committee was guided by the response by the Secretariat of the Shariah Advisory Council of Bank Negara Malaysia as follows:

(a) In accordance with the SAC decision at its 114th meeting, a takaful participant may assign the takaful certificate to another person without having to obtain the consent of the nominee or beneficiary as the takaful certificate is considered as the participant's asset during his lifetime.

(b) There are no SAC decisions on whether the purpose of an assignment must be Shariah compliant. The Secretariat was of the view that since the takaful certificate is the participant's asset, there should not be any impediment for him to transact in accordance with his preference.

The Committee was also informed that the issue has also been addressed in the Islamic Financial Services Act tabled in end 2012. Having considered the analysis, the Committee accepted the recommendation not to amend section 4(3) of the Act.

(iv) Effect of nomination on hibah

In its consultation with the industry, it was highlighted that there is a lack of clarity on whether section 23 of the Act which deals with moneys under a policy of assurance is equally applicable to takaful participants. Section 23 (1) of the Act stipulates that monies payable to a beneficiary under a policy of assurance shall create a trust in favour of the beneficiary and shall not form part of the estate of the insured. In this, the Shariah issue raised was whether the same principle was applicable to takaful participant. It is observed that this was unlikely given that the language of the provision was specific to the insurance policy holder. Furthermore, the Act itself was passed prior to the introduction of the Takaful Act 1984.

In determining the appropriate legal treatment for the issue, the Committee took note that the issue has also been addressed through the Islamic Financial Services Act and decided that no amendments to the Act itself was necessary.

Specific Relief Act 1950

In its consultation with the industry, there was no substantive issue raised in relation to the Specific Relief Act 1950.

Conclusion

In cognizance of the issues and recommendations made to it, the Committee decided that no amendments were required to be made to the above Acts as the issues related thereto were either sufficiently addressed through judicial precedent or will otherwise be addressed in other Acts.

Moving Forward :

ENHANCING MALAYSIAN LAW AS THE LAW OF CHOICE AND MALAYSIAN DISPUTE RESOLUTION INSTITUTIONS AS THE FORUM FOR DISPUTE SETTLEMENT FOR INTERNATIONAL ISLAMIC FINANCE TRANSACTIONS

Enhancing Malaysian law as the law of choice and Malaysian dispute resolution institutions as the forum for dispute settlement for international Islamic finance transactions

In fostering a credible, efficient and conducive legal framework to support a competitive, dynamic and evolving Islamic financial system, it is imperative that references on evolution of the Malaysian legal system is developed. This inaugural Law Harmonisation Committee Report presents the first in upcoming series of references on initiatives to enhance existing Malaysian law and legal framework.

The current phase of the Law Harmonisation Committee's initiatives and efforts are focused on recommendations to overcome remaining legal impediments which may still exist to the efficient conduct of Islamic finance in Malaysia as well as creating the awareness of the work of the Committee.

One of the Committee's recommendations to amend the courts rules with regard to interest on judgment debt in Islamic finance cases has since been implemented[34]. Other recommendations are currently being studied by relevant stakeholder government department, ministries and agencies where implementation is expected to follow suit[35].

The Chairman of the Committee has been instrumental in generating interest of the legal fraternity and legal academicians, particularly in clarifying the rationale behind compulsory reference by the courts to the Shariah Advisory Committee at Bank Negara Malaysia and the Securities Commission Malaysia as well as the use of the civil instead of the Shariah courts to hear Islamic finance disputes. The relevant speech[36] was cited verbatim as the ratio decidendi in an Islamic banking Court of Appeal judgment[37].

[34] Order 42 Rule 12A, Rules of Court 2012 which came into force on 1 August 2012
[35] Please refer to pages 8 and 9 on detailed recommendations that are currently under review
[36] Chairman's speech delivered at the 12th Emeritus Prof. Ahmad Ibrahim Memorial Lecture on 7th December 2011 (see Annexure B)
[37] RHB Bank Bhd v Mohd Alias Ibrahim (unreported)

The Law Harmonisation Committee recommends the following five key developing factors:

Firstly, Malaysian law should evolve towards **providing for legal certainty of Shariah contracts enforcement** as the future of Islamic finance depends on its agility and innovativeness in developing new products.

Integral to the above, the Committee's **second recommendation** is for the **Malaysian legal system to be responsive to implement legislative changes** to allow for consistent and continuous enforcement of Shariah contracts.

As the regulatory infrastructure for Islamic finance in Malaysia cut across various agencies-jurisdictional spheres, the **third** recommendation is for **inter-agency collaborations** similar to that of the Law Harmonisation Committee be encouraged to enable sustainable integration and natural progression of Malaysia's leadership in driving growth and innovation in the industry.

Fourthly, true to reflect Malaysia's long-held conviction that sustainable growth of Islamic finance could not be achieved without adequate attention to the development of intellectual resources, the existing intellectual development at this end should emphasise towards **producing highly qualified legal talent and commercially experienced judiciary**.

Undeniably, as Islamic finance activities venture beyond domestic boundaries, the development of facilitative legal framework for cross-border transactions is of great importance. As part of the support towards positioning Malaysian legal system in the eyes of the world, the Committee's **final recommendation** is to create a **supportive and reputable dispute resolution environment** to instill public and international community's confidence to demonstrate that

Malaysia could be the best available platform for adjudication and dispute settlement.

Next phase

In the next phase and concomitant with the recommendations above, the Law Harmonisation Committee will intensify efforts on the following aspects:

First, the Committee will participate in an initiative to enhance legal certainty of Shariah contracts enforcement

With the coming into force of the Islamic Financial Services Act 2013, Shariah compliance and governance will be given more prominence and emphasis. Standards on commonly used Shariah contracts in Islamic finance will be issued where such standards will have legal force[38]. To complement these standards, clear and practical guidance will be provided through operational standards that will include appropriate legal treatment for the features of each Shariah contract. This initiative may entail further review by the Committee of relevant laws in Malaysia, including laws covered in this Report, to ensure effective enforceability of the Shariah contracts

The Law Harmonisation Committee will form part of the ecosystem to validate appropriateness of the legal treatment.

Secondly, in producing highly qualified legal talent and commercially experienced judiciary and thirdly, in creating a supportive and reputable dispute resolution environment equipped to handle cross-border disputes, the Law Harmonisation Committee will be assessing sufficiency of available mechanisms to resolve Islamic finance-related disputes, the preparedness of the legal fraternity in handling Islamic finance matters and the adequacy of appropriate legal training and education.

Towards ensuring a meaningful and holistic outcome of positioning Malaysian law as the law of choice for international Islamic finance transactions and Malaysian legal system as the choice jurisdiction for Islamic finance dispute resolution, the Committee continues to welcome contribution of views and opinions by submission to the following:

Secretariat
Law Harmonisation Committee
c/o Financial Infrastructure Development
Islamic Banking and Takaful Department
6B, Bank Negara Malaysia
Jalan Dato' Onn, 50480 Kuala Lumpur

lhcsecretariat@bnm.gov.my

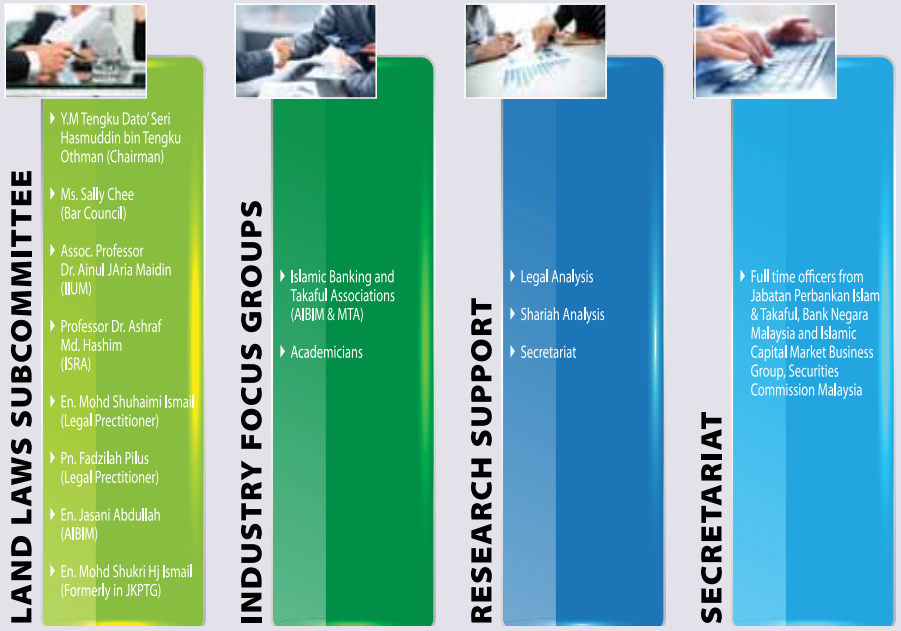
Tel : 03-2698 8044 ext 8915 or 7694
Fax : 03-26903724

[38] Section 29 of Islamic Financial Services Act 2013

ANNEXURES

ANNEXURE A :
Sub-Committees, Focus Groups, Research Support And Secretariat

The Committee appreciates the dedication and expertise of the sub-committee, focus groups and secretariat for their contribution to the Committee's work.



ANNEXURE B :
Table Of Statutes, Case Law And Research Bibliography

PART (A) : ISSUES RAISED WHERE AMENDMENTS ARE RECOMMENDED	
1	Legal recognition to Shariah permissibility of imposing late payment charge on judgment debts in Islamic financial cases <u>Statutes</u> a) Rules of the High Court 1980 b) Rules of Court 2012 <u>Shariah Resolutions</u> a) Bank Negara Malaysia's Shariah Resolutions in Islamic Finance (2nd Edition) b) Resolutions of the Securities Commission Shariah Advisory Council (2nd Edition)
2	Improving access to financing (especially Islamic financing) involving reserve lands <u>Statutes</u> a) Malay Reservation Enactment Kelantan 1930 b) Malay Reservation Enactment Kedah 1931 c) Malay Reservation Enactment Perlis 1935 d) Malay Reservation Enactment Johor 1936 e) Malay Reservation Enactment Terengganu 1941 f) Malay Reservation Enactment (FMS Cap 142) (as applicable to Pahang, Perak, Selangor, Negeri Sembilan, Federal Territories) g) National Land Code (Penang and Malacca Titles) Act 1963 h) Sabah Land Ordinance (Cap. 68) i) Sarawak Land Code (Chapter 81) <u>Case Law</u> a) Badiaddin v Arab Malaysian Finance [1998] 1 MLJ 393 b) Robert Lee v Wong Ah Yap [2007] 4 CLJ 1

3	Recognition of Islamic finance transaction under the National Land Code 1965: Legal recognition of Shariah principles to facilitate provision of Islamic finance under the National Land Code 1965 Statutes a) National Land Code 1965 b) Strata Titles Act 1985
4	Facilitating use of collateralised commodity *Murabahah* in short-term Islamic financial market instruments: Clarifying requirements for registration of collateral under Companies Act 1965 Statutes a) Companies Act 1965

PART (B) : ISSUES RAISED WHICH DO NOT NECESSITATE AMENDMENTS	
1	Certainty of legal definition of *sukuk* Statutes a) Companies Act 1965 b) Securities Commission Act 1993 c) Capital Markets and Services Act 2007 Guidelines a) Islamic Securities Guidelines (*Sukuk* Guidelines) 2011
2	Implication of Sale of Goods Act 1957 on sale-based Shariah contracts Statutes a) Sale of Goods Act 1957 b) Contracts Act 1950 c) Consumer Protection Act 1999
3	Implications of Partnership Act 1961 on profit-sharing Shariah contracts Statute a) Partnership Act 1961

4	Shariah compliance of current legislation on enforcement of guarantees against gratuitous guarantors Statute a) Bankruptcy Act 1967 Articles a) Suhaimi Ab Rahman, *The influence of classical interpretation on the Law of Guarantees in the United Arab Emirates*, Arab Law Quarterly 22(2008) 335-358 b) Suhaimi Ab Rahman, *Islamic Law and Modern Guarantees in Malaysia*, International Journal of Economics and Management 1(3): 477-501 (2007)

PART (C) : ISSUES FOR FURTHER RESEARCH	
1	Implication of Contracts Act 1950, Civil Law Act 1956 and Specific Relief Act 1950 on Shariah contracts Statutes a) Contracts Act 1950 b) Specific Relief Act 1950 c) Civil Law Act 1956 d) Rules of Court 2012 e) Takaful Act 1984 f) Islamic Financial Services Act 2013 Case Law a) Arab Malaysian Finance v Taman Ihsan Jaya and Ors (Koperasi Seri Kota Bukit Cherakah Sdn Bhd) [2008] 5 MLJ 681 b) Bank Islam Malaysia Berhad v Lim Kok Hoe and Anor [2009] 6 MLJ 839 c) Jin Seng Hong Sdn Bhd v Khiing Sie Khuo [1988] 3 MLJ 101 d) Beximco Pharmaceuticals Ltd and Ors v Shamil Bank of Bahrain [2004] EWCA Civ 19 e) Nepline Sdn Bhd v Jones Long Wooton [1995] 1 CLJ 865 f) Jasa Keramat Sdn Bhd v Monatech (M) Sdn Bhd [2001] 4 CLJ 549

SPEECH / LECTURE	
1	'Malaysia as an Islamic finance hub: Malaysian law as the law of reference and Malaysian courts as the forum for settlement of disputes' by Tun Abdul Hamid Mohamad (Former Chief Justice of Malaysia)) - delivered at 12th Emeritus Prof. Ahmad Ibrahim Memorial Lecture on 7th December 2011

12TH EMERITUS PROF. AHMAD IBRAHIM MEMORIAL LECTURE

Wednesday 7th December 2011

MALAYSIA AS AN ISLAMIC FINANCE HUB:
MALAYSIAN LAW AS THE LAW OF REFERENCE AND MALAYSIAN COURTS AS THE FORUM FOR SETTLEMENT OF DISPUTES

By

Tun Abdul Hamid Mohamad
(Former Chief Justice of Malaysia)

I thank the International Islamic University Malaysia for inviting me to deliver this lecture.

Looking back, last year, today, I was lying on my back on the hospital bed, unable to turn to the left or right, being fed through the nose, had to be lifted in order to sit, unable to speak because of loss of voice and so on. Today, one year later, I am standing here and delivering this lecture. What can I say, except *Alhamdulillah* and thank you for your prayers?

I have chosen this topic because this is what I have been entrusted to do two months before my hospitalisation, this is what I am doing now and this is what I would like to spend my "injury time" doing and I hope to score the winning goal before the final whistle blows.

I know that this lecture is in memory of Emeritus Professor Ahmad Ibrahim and not about him. However, let me share with you an incident that had happened between the two of us.

When I was in my third year at the Law Faculty of the University of Singapore, Ahmad Ibrahim, then the Attorney General of Singapore, became my lecturer, teaching revenue law. You know that tax law is a very technical and boring subject. The judgments, especially of the English Courts, were lengthy. To make it worse, at every lecture, he would give us at least twenty judgments to read.

About fifteen years later, I met him at a function in Kuala Lumpur. He asked me, "Where are you now?" I replied, "I am now a Senior Federal Counsel at the Department of Inland Revenue." "Good," he said. Then I said, "But Prof, I am sorry that, in spite of you, I still don't understand tax law." He smiled and replied, "Don't worry. I don't understand it myself". That statement says a lot about the man, especially how humble he was.

For the sake of brevity, in this lecture I am using the term "Islamic finance" to cover Islamic banking, Islamic capital market and *takaful*.

Before proceeding any further, I would like to make one point. I am not an academician. So, this is not going to be an academic lecture. It is about work, the work that should be done by all of us. After all, Emeritus Prof. Ahmad Ibrahim is remembered not so much for what he taught but for what he did. What he taught could be found in the books but what he did in spear-heading the drafting of the Enactments and Laws now used in the Shari'ah Courts in this country, is his legacy.

The birth of Islamic finance in its modern form is associated with the need of pious Muslims who want to avoid committing a sin in their financial transactions. However, over the last few decades it has grown beyond anybody's imagination. Today, the industry, with over 600 financial institutions in 75 countries, is worth approximately USD1 trillion worldwide and is expected to grow to USD1.6 trillion in 2012.[1]

In Malaysia, Islamic finance began as an industry in 1983 with the enactment of Islamic Banking Act 1983 and followed one year later by the Takaful Act 1984, both of which form the foundations of Islamic finance industry in Malaysia that we see it today. These Acts paved the way for the licensing of the first Islamic bank and *takaful* operator. Subsequently, in 1993, the Securities Commission Malaysia was established. The development of Islamic capital market was one of the Commission's developmental agenda.

[1] "JEF 2011 Debates The Future Needs of Islamic Finance", Global Islamic Finance Magazine (2011).

From just one bank and one *takaful* operator back then, Malaysia now has 16 Islamic banks, five (5) International Islamic banks and 11 *takaful* operators with another takaful operator underway. In addition, there are 16 licensed Islamic fund management companies licensed under the Capital Market and Services Act 2007.

As at June 2011, the Islamic banking assets have grown to almost RM393 billion accounting for 21.6% of the total banking assets of the country. Deposits stand at RM296.8 billion or 22.79% of the total deposits in the country. Islamic financing amounts to RM240.6 billion or 23.8% of total financing in Malaysia.[2]

As for *takaful*, the industry assets amounts to RM16.3 billion or 8.66 % of *takaful* and insurance total assets. Market penetration has increased to 12.1%.

In the area of Islamic capital market, Malaysia is the largest *sukuk* market in the world with USD112.3 billion or 62% of outstanding global *sukuk* as of the second quarter of 2011.[3]

As of June 2011, 89% of the securities listed on Bursa Malaysia were Shari'ah compliant and there are 160 approved Islamic unit trust funds currently in the market.[4]

In terms of product offerings, Malaysia offers a comprehensive range of Islamic financial products, from a plain wadiah savings account for the man on the street, to more complex financing structures for multi-national companies such as Islamic structured products and *sukuk*. There are also ranges of family and general *takaful* products as well as investment products such as Islamic real estate investment trust.

[2] Bank Negara Malaysia.
[3] Total outstanding global sukuk as of 2nd quarter of 2011 was USD179 billion – Bloomberg/ MIFC Promotions Unit, Bank Negara Malaysia.
[4] Malaysian ICM, 2nd Quarter 2011,Vol 6 No. 2 (Quarterly Bulletin of Malaysia Islamic Capital Market by Securities Commission Malaysia.)

Malaysia has attracted international institutions to set-up their operations here. Al-Rajhi, Kuwait Finance House, Qatar Islamic Bank, HSBC Amanah, Standard Chartered Saadiq and Deutsche Bank are among the well-known international institutions that have set-up their Islamic banking business in Malaysia. Renowned international fund managers like Franklin Templeton, Amundi, Nomura and BNP Paribas have also established their Islamic fund management companies in Kuala Lumpur.

In the *takaful* industry, leading international companies such as Prudential, American International Assurance, Friends Provident Group UK and Great Eastern Life Assurance Limited have taken steps by partnering with local institutions to establish their *takaful* operations in Malaysia.

The Government, together with Bank Negara Malaysia and Securities Commission Malaysia are also facilitating the development of Islamic finance. One of PEMANDU's Entry Point Project under the Financial Services is to *"position Malaysia as the indisputable global hub for Islamic finance"* and to create approximately 12,000 jobs under the sector.

Malaysia currently hosts two leading international Islamic financial organisations, namely the Islamic Financial Services Board (IFSB), a standard setting organisation, and the International Islamic Liquidity Management Corporation (IILMC), a corporation established to facilitate global Islamic financial institutions in managing its financial liquidity.

To support the growth of the industry, it is essential to have human capital development. Towards this end, substantial resources have been spent by Malaysia to develop talents for the Islamic financial industry. The biggest commitment by Bank Negara Malaysia is the establishment of the International Center for Education in Islamic Finance (INCEIF). INCEIF, a university recognised by the Ministry of Higher Learning, has the objective of developing talent not only for Malaysia's Islamic finance industry but also globally. It now has *"approximately 2,000 students from over 75 countries."*[5]

[5] Handbook on the visit by Tun Abdul Hamid Mohamad to INCEIF on 2 November 2011.

In addition, International Shari'ah Research Academy for Islamic Finance (ISRA) is spearheading the global research initiatives for Islamic finance. The effort by Bank Negara Malaysia is complemented by the effort of the Securities Commission of Malaysia through its training arm, the Securities Industry Development Corporation, to undertake programs catering for the development of talent for the Islamic capital market. These initiatives are to complement the already existing efforts by leading universities such as International Islamic University Malaysia in developing the much needed talents for the industry. Malaysia's focus is not limited to developing the business aspect of the industry but its human capital developments as well.

In the words of Tan Sri Zeti Akhtar Aziz, the Governor of Bank Negara, Malaysia *"is currently supplying world class talent for the fast-growing Islamic finance".* [6]

In addition, to borrow the words of Dato' Muhammad Ibrahim, the Deputy Governor of Bank Negara. *"..... the market has been supported by a robust regulatory and supervisory framework, reinforced by the legal and Shari'ah framework."* [7]

The Global Islamic Finance Report (GIFR 2011), in the chapter on The Malaysian Model under the heading *"Strength and Advantages of the Malaysian Model"* at page 165 to 166 has this to say:

> *"The strength and advantages of the Malaysian model are numerous and deserve an analysis on their own. However, in summary, amongst the obvious advantages of the Malaysian model are the following:*
>
> *(i) Sound and clear Sharia-compliance and governance framework;*

[6] Malaysian National News Agency (BERNAMA), 15 October 2011 – 3rd Convocation of INCEIF.

[7] Dato' Muhammad Ibrahim, Deputy Governor, Bank Negara Malaysia, Luncheon Address 21st Conference of Presidents of Law Associations in Asia:"Islamic Finance and Malaysia's Role" 27 July 2010.Kuala Lumpur Convention Centre

(ii) Tax accommodations;

(iii) Certainly and predictability of dispute resolution outcomes;

(iv) Talent enrichment and thought leadership infrastructures;

(v) Depth and width of its capital market;

(vi) Deposit insurance protection."

We have also taken measures to ensure that our products comply strictly with Shari'ah requirements. New products are only issued with the approval of either the Shari'ah Advisory Council (SAC) of Bank Negara or of the Securities Commission, respectively, the two highest authorities on Shari'ah issues in Islamic finance in the country. Besides, every Islamic financial institution and takaful company is required to have its own Shari'ah committee whose members have to be approved by the SAC of the Central Bank.

Since November 2009, we have gone further by making it compulsory for the court and the arbitrators to refer Shari'ah issues arising before them to the respective SACs and that the rulings of the SACs are binding on them.

Why do we do that?

Having been a Judge in all the courts in the country, from the Magistrate's Court to the Federal Court and the Special Court as well as in the Shari'ah Court of Appeal, over a period of nearly forty years and also sitting in the Shari'ah Advisory Council of Bank Negara since 2004 and of the Securities Commission since 2006, I can see clearly the advantages of giving the SACs the power to decide on Shari'ah issues in Islamic finance. So, whatever happens to the fate of SACs, I am not repentant for suggesting that Shari'ah issues on Islamic finance arising in court be referred to the SACs. The advantages are:

(i) It enables a product to be thoroughly screened to spot the Shari'ah issues, if any. This is the most difficult part. The SACs have a Secretariat each manned by officers who, not only have Shari'ah background but are exposed to Islamic finance. (From my own observation, the Shari'ah officers at Bank Negara and the Securities Commission are among the best in the country, if not the best, for the job.) The officers in the Secretariats are assisted by their colleagues from other departments, Islamic or conventional, when the need arises. Other institutions under Bank Negara, like ISRA and INCEIF are also there to assist. The Secretariats have access to the industry. The officers are in a position to call on the people in the industry for consultation and feedback. Bank Negara and the Securities Commission have regulatory and supervisory powers over the banking institutions, insurance companies, takaful operators and capital market institutions under their respective jurisdictions. Bank Negara and the Securities Commission are in a position to ensure that the rulings are complied with. No other religious department, religious council or fatwa committee has all such power and expertise. With such expertise and facilities, the Secretariats are able to present very comprehensive papers for consideration of the respective SACs. Whenever there is a common issue, the two SACs hold a joint meeting.

(ii) Having the SACs at national level enables speedy ruling on an issue. The Secretariat has to prepare and present the case for deliberation and ruling to one council only. Otherwise, it would have to do it, at least fourteen times, at fourteen different Fatwa Committees. That would take time and the rulings may differ from one state to another. (This is not taking into account the issue of jurisdiction).

(iii) It promotes consistency of rulings on Shari'ah issues. Imagine putting those issues to be determined by fourteen Fatwa Committees, fourteen Shari'ah Courts of Appeals or leaving them to the respective Shari'ah Committees of the financial institution. We are concerned about uncertainty in contracts, but uncertainty in Shari'ah rulings is even worse.

Why not the civil courts?

Civil courts do not have the expertise to decide Shari'ah issues. Indeed from my observation, we have reached a stage now that even an ulama' or a Mufti alone is not in a position to make a proper ruling on a Shari'ah issue in Islamic finance anymore. In their case, it is not for the lack of knowledge of the Shari'ah or Islamic jurisprudence, but it is due to the difficulty to understand the complexity of the products. Judges, sitting alone or even in three's are in no better position. They lack the knowledge of the Shari'ah and Islamic jurisprudence.

In the case of common law, civil court judges are in a position to look for the law. They may even find that the submissions of both counsels are wrong. But, they are unable to do the same in the case of a Shari'ah issue. In the end, they would just listen to the submissions of the two opposing, partisan and, with respect, equally "un-learned" lawyers, and choose which submission to accept.

Do you want Shari'ah issues to be decided that way? What more, where both the lawyers and the judges are not even Muslims! Can you accept their rulings which would bind everybody, institution, government, corporation or individual alike?

Some may say that the court will be assisted by expert witnesses. Let me tell you this. In my forty years experience in and around the court, I have not come across an expert witness (I am speaking generally) who gives evidence detrimental to the party calling him as witness. Otherwise he would not be called by the party and pay him for it. It is as simple as that. So, they too are partisan.

Why not the Shari'ah courts?

Shari'ah courts do not have jurisdiction over finance, banking and insurance, nor over limited companies and banks, they not being *"persons professing the religion of Islam"*. Companies law, bankruptcy law, contracts law, land law and a host of other laws relevant and applicable to Islamic finance are outside the jurisdictions of Shari'ah courts. Neither Shari'ah judges nor Shari'ah lawyers, unless they are also members of the Bar, have expertise in those laws.

Legal documents are in English and common law lawyers who draft those documents could not appear in the Shari'ah courts. The law is in English. The witness, local and more so foreigners, give evidence in English.

There are fourteen Shari'ah Courts of Appeals as against one Federal Court. That could lead to inconsistency in the rulings on a particular issue.

Shari'ah issue is a very rare issue in court. In 2009 the Mua'malat Division of the High Court in Kuala Lumpur alone disposed of 940 cases as against 691 registered in that year. In 2010, 1270 cases were disposed of as against 1260 registered. Up to September 2011, 1033 cases were disposed of as against 1020 registered. (First, please note that the courts are disposing more cases than registered during the year, cutting down the old backlog). So far only one Shari'ah issue has been referred to the SAC of Bank Negara Malaysia i.e. this year. Those thousands of other cases had been decided on issues of land law, law of contract, companies law and others in which the Shari'ah courts have no jurisdiction on and Shari'ah judges do not have the expertise in. Shari'ah courts do not even have rules to cover those actions.

Lastly, Reciprocal Enforcement of Judgments Act 1958[8] does not extend to judgments of the Shari'ah courts.

So, do not think that by transferring the jurisdiction to the Shari'ah courts, even if possible, everything would be fine.

Actually, what we have done had received very favourable report from other countries. I will only quote two passages. The first is from the book *"The Art of Islamic Banking and Finance" by Yahia Abdul Rahman at page 79:*

> *"This approach (the Malaysian approach - added) saves a lot of confusion and conflicts within different Shari'aa Boards. The involvement of the Central Bank adds credence and weight to the rulings. In addition, because the Shari'aa Board is operated and supervised by the Central Bank, there is no potential for conflict of interest, because the individual banks are not paying their own hand-picked scholars for their services."*

The second is from GIFR Report 2011, at page 165:

> *"The existence of a structured and powerful National Supervisory Advisory Council (NSAC) (SAC – my addition) was originally intended to ensure clarity in terms of fiqh muamalat practices, but today it also has the power of final arbiter on Shari'a issues in any IBF dispute. By having legal authority, there will be coherence and assurance of validity of pronouncements by Shari'a scholars. In most other jurisdictions, the status of Shari'a pronouncements for IBF contracts remains vague and ambiguous when it comes to enforcement under the law."*

I am reminded of the Hadith narrated by Abu Hurairah in which the Prophet (p.b.u.h.), inter alia, said, *"When the power or authority comes in the hands of unfit persons, then wait for the Hour (doomsday.)"*[9]. That Hadith shows how serious the matter is.

Producing the highest standard of Shari'ah compliant products is not the end of the matter. It is equally important that the implementation and the settlement of disputes, if they arise later, be done in a Shari'ah compliant environment. Our laws, in so far as they are applicable to Islamic finance, should be Shari'ah compliant. Towards this end, some work had been done by the Law Review Committee established by Bank Negara in 2003 but that was insofar as removing any impediments that may exist in the law then.

But, that is not all. We are, in fact, going one step further: we want to give legal effect to Shari'ah principles which are applied in the practices, services and products of Islamic finance in the market. A good example is *wa'ad*. This is to ensure legal certainty of those principles.

On 27th July last year (2010) Bank Negara announced the establishment of the Law Harmonisation Committee (LHC) and I have been entrusted to chair it. The Committee consists of representatives from Bank Negara, Securities Commission, Attorney General's Chambers, practicing lawyers, ISRA and the Association of Islamic Banking Institutions Malaysia (AIBIM). It is supported by a full-time Secretariat at Bank Negara.

The objectives are:

1. To create a conducive legal system that facilitates and supports the development of Islamic finance industry;

2. To achieve certainty and enforceability in the Malaysian laws in regard to Islamic finance contracts;

[8] First enacted in 1958 (Ordinance No. 65 of 1958) and revised in 1972 (Act 99 w.e.f.15December 1972.)

[9] Book No.3 Hadith No 56 Sahih Bukhari www.searchtruth.com/SearchHadith.ph

3. To position Malaysia as the reference law for international Islamic finance transactions; and

4. For Malaysian laws to be the law of choice and the forum for settlement of disputes for cross border Islamic financial transactions.

From the beginning, the Committee adopts a practical approach and works within the system. We would identify the laws or provisions that are not consistent with the Shari'ah or which are not conducive to Islamic finance, ascertain the Shari'ah position, draft the Shari'ah alternative and send it to the relevant authorities for legislation. We would not debate about the Federal and State jurisdictions or Civil and Shari'ah Court jurisdictions. We would accept the constitutional provisions as they are. If there are legal or Shari'ah issues, we would refer, respectively, to the Attorney General's Chambers for advice or to the relevant SACs for rulings.

In identifying the Shari'ah non-compliant provisions we adopted the approach: *any law that is not un-Islamic is Islamic*. In case you are shocked by that statement, please remember that, that was exactly what Emeritus Professor Ahmad Ibrahim did when he and his team were drafting the procedural laws for the Shari'ah Courts.

We have, so far, identified a number of issues, including *wa'ad* and *ibra'* and a number of provisions that need to be harmonised and are working on them. We have also formed a Land Laws Sub-Committee to look at the land laws. The Committee has identified a number of areas e.g. regarding charges, liens and others and is working on them.

The question that keeps coming to my mind is this:

"Are these the only areas where our laws are not Shari'ah compliant or that need be addressed to facilitate the development of Islamic finance in Malaysia?"

Since there are many academicians in this hall, I would like to take this opportunity to appeal to all of you that if, in the course of your research or teaching, you had come across any area in our law applicable to Islamic finance which are not Shari'ah compliant or which are not conducive to the development of Islamic finance, please let us have them, preferably with the Shari'ah position and your recommendation. We will even invite you to present your findings and suggestions at our meeting.

Between all of you, you must have done centuries of research. I am sure that you have come across something that would be useful to us. Let us have them. Let us put the results of your research to practical use. To me, to do a research without putting the findings to practical use is like conceiving without delivering.

If we succeed in this project, I am sure that we will put Malaysia in a very favorable position in our quest to make Malaysia the hub for Islamic finance. Investors will know that not only our products are Shari'ah compliant but the laws applicable to them after the issuance and in the settlement of disputes, are also Shari'ah compliant.

There is another area that needs to be focused if we really want to make Malaysia a holistic hub for Islamic finance i.e. the area of settlement of disputes. In this respect we will have to focus on the lawyers, the Judges, the court and the arbitrators.

In our system, indeed in any system in the world now, lawyers play a very important role in finance, conventional or Islamic. They are the ones who advise the financial institutions when issuing a product, they are the ones who advise the customers on the legal aspects of the product, they are the ones who draw up the contracts, they are the ones who advise

the parties when there is a dispute, they are the ones who appear in court when there is a case, they are the ones who make the submissions on the facts and the law for the Judge to decide, in reality, trying to persuade the Judge to decide in their clients' favor. So, they have to know Islamic finance to be able to do all those things. Otherwise they would be misleading everybody who seeks their advice, including the court that hears the case.

However, even here, I think, we have an advantage. Most of our lawyers who specialise in Islamic finance, are Muslims. The faith factor is there. Secondly, we have many institutions of higher learning which offer courses in Islamic finance, full-time or part-time. The lawyers may enroll themselves in such institutions. In fact, many have done so. This argument could be extended to Judges and arbitrators.

We now come to the courts. First, our court system is based on the common law system. Let me remind you that we have adopted the same system for our Shari'ah courts. The system has the advantage of oral and documentary evidence, oral and written submissions by counsels, full written and reasoned judgments instead of mere orders. All these lead to transparency and reduce the incidence of corruption. What is important is that the judgments and the reasons thereto are open to scrutiny by everybody, forever. Next, following the common law system, the courts abide by the doctrine of precedent which leads to consistency and certainty of the law. In this respect, we have an edge over countries with Muslim majority population which practise the continental system. In this regard, another point in our favour is that our lawyers and judges speak English, proceedings in the superior courts (where these cases go) are in English and judgments are written in English, the language of modern mua'malat, in practice, if I may say so, with respect to Arabic.

Our courts now stand among the best in the world in terms of speedy disposal, after a fair trial. In the Mua'malat Division of the High Court in Kuala Lumpur (where most of the Islamic finance cases go), for writ actions, most of the cases that go for trial, are disposed of within six months. For summary judgment and Originating Summons, it is three months. The World Bank in its Progress Report entitled *"Malaysia: Court Backlog and Delay Reduction System"* published in August this year has given a very favorable report on the achievement of the Malaysian Judiciary in its reform to reduce backlog and delays in court. What is left is for our lawyers and Judges, at least some of them, to specialize in Islamic finance. That would put them ahead of their counterparts in other common law countries.

A word about arbitration. Most of what I have said about the court applies to arbitrators. This is what GIFR Report says:

> *".....the Kuala Lumpur Regional Centre for Arbitration (KLRCA) provides a convenient alternative resolution platform by having a specific rule to govern disputes including IBF matters. The Rules for Arbitration (Islamic Banking and Financial Services) 2007 was specially drafted and introduced to provide a customised platform and mechanism for the resolution of disputes in the Islamic financial services sector."*

I agree, in theory. But, let us look at the reality. In September 2009, when preparing my paper for the Islamic Financial Services Industry Legal Forum 2009, I checked with KLRCA to find out how many cases had been registered and heard since the making of the Rules. The answer was: NONE. I gave the reasons why it was so in that paper. While preparing this lecture I checked again. The answer is: ONE. I think the reasons that I gave in 2009 are still valid. However, a beginning has been made. It is interesting to note that in that case a Shari'ah issue was referred to the SAC of Bank Negara Malaysia, it was duly answered and effect was given to it. Another first. At least we have seen the system working.

I will end my discussion of this part by quoting from GIFR Report 2011 again, at page 167:

> *"It is observed that all these while English law has been the preferred law of reference for international Islamic finance transactions, therefore the objective of the Committee is arguably very ambitious. Considering that English law has a long tradition of being the reference law for international contracts and English courts command enormous respect in the international arena for its impartiality and independence there are many reasons for people to be skeptical. However, if we consider that Malaysia is simply offering a value proposition whereby parties to an international Islamic finance contracts are comfortable that:*
>
> - *The jurisdiction is neutral to all parties to the contract;*
>
> - *The Malaysian law offers absolute certainty and predictability with regard to Shariah issues as the NSAC if* the final arbiter on *such matter – which no other jurisdiction can offer;*
>
> - *The Malaysian courts and arbitration are competent in dealing with disputes arising from IBF contracts, and then there is no reason to reject the possibility of making Malaysian law as the reference law for IBF contracts."*

So, even foreigners sitting in London writing the report think that it is possible for Malaysian law to be the law of reference for international Islamic finance contracts. It is up to us to make it happen and that is what we should do, together.

Let us now try to reassess our position.

First, Malaysia, in the eyes of the world, is an Islamic country. Internationally, it is seen as model Islamic country. It is only natural for Malaysia to want to be the hub for Islamic finance.

Second, Malaysia is already the leader in Islamic finance.

Third, no other Government in this world has done more than the Malaysian Government in developing and for the development of Islamic finance.

Fourth, we already have a pool of Shari'ah scholars who have specialised in Islamic finance. Some of our Shari'ah scholars are sitting in Shari'ah Committees all over the world. We also have people in their thirties (to me, the right age), who are proficient in both Arabic and English who are also trained in law and Shari'ah. They are our potentials.

Fifth, we have the Shari'ah Advisory Council of Bank Negara Malaysia (SAC, BNM) and the Shari'ah Advisory Council of the Securities Commission (SAC, SC) at national level, to make Shari'ah rulings on Islamic finance. Hopefully, the two could be merged into one in the near future.

Sixth, we already have the common law and the common law system in place and working comparatively well.

Seventh, Malaysian lawyers and Judges speak English, our laws and judgments of our superior courts are in English.

Eighth, our courts and arbitrators are efficient, competent and independent. Remember that the cases are pure civil cases based on contract involving companies and individuals. There is no politic in it. Negative perception should not be an issue unless there are Malaysians who go around the world condemning our courts and arbitrators for ulterior motives. In terms of knowledge in Islamic finance, our Judges, Arbitrators and lawyers, taken as a whole, are at par with their

counterparts in other countries, if not better.

Ninth, we have the infrastructure. Our court rooms are among the best in the world, our transportation and communication are good, our streets and hotels are free from suicide bombing (so far), our cost of living is comparatively cheap and we have summer throughout the year. All these factors are conducive to foreign lawyers coming to do litigation here.

So, I think we have the right ingredients to be the holistic hub for Islamic finance. But we must have confidence in ourselves, our system and our country. We must think positively. We should think of the bigger gains to share, in this present life itself, if Malaysia succeeds in this aspiration. We should work to build and not to destroy Malaysia's position in Islamic finance, for a short term gain.

We are honoring Emeritus Professor Ahmad Ibrahim by being here today. Let us continue to honor him by continuing the work that he had done. Let us think beyond our own State and national borders because the opportunity is borderless. And, let us not be *"an ummah of lost opportunity"*, to borrow the words of Sheikh Nizam Yaqubi.

Thank you.

ANNEXURE C :
Glossary

TERMS	EXPLANATION
Alienation	To dispose state land in perpetuity or for a term of years in consideration of the payment of rent in accordance with provisions of National Land Code 1965
Ar-Rahn	Pledge/charge
Beneficial Ownership	A person who enjoys the benefits of land ownership even though the land title is in another's name
Caveat	A type of land transaction recognised in Malaysian land law system giving any person claiming an unregistered interest in land an opportunity to prevent his interest from being unjustly overridden by a subsequently created adverse registered interest in respect of the same land
Charge	A type of security transaction recognised in Malaysian land law system which amounts to an interest in land once duly registered
Chose in Action	A right to personal things of which the owner does not have the possession, but merely a right of legal action for their possession
Dealings	Transactions undertaken between individuals or bodies, whether public or private, effected with respect to alienated land but does not include caveat or prohibitory order
Debenture	An instrument acknowledging debts of a company
Gharamah	Fine/penalty
Ibra'	Rebate/waiver of partial or total claim against certain right or debt
Ijarah	Lease or service contract that involves benefit/usufruct of certain asset or work for an agreed payment or commission within an agreed period
Istisna'	Sale contract by way of order for certain product with certain specifications and certain mode of delivery and payment (either in cash or deferred)

Judgment Debt	The amount of money in a court judgment award to the winning party, which is owed to the winner by the losing party
Kafalah	Guarantee
Lien	A type of land transaction recognised in Malaysian land law system created upon the entry of a lien-holder's caveat at land office by a person or body with whom the issue of document of title has been deposited as security for a loan
Mudarabah	Profit sharing contract
Murabahah	Sale contract with a disclosure of the asset cost price and profit margin to the buyer
Musyarakah	Profit and loss sharing contract
Musyarakah Mutanaqisah	A contract of partnership that allows one (or more) partner(s) to give a right to gradually own his share of the asset to the remaining partners based on agreed terms
Mutatis mutandis	Things are generally the same, but to be altered, when necessary
Muwa'adah	Binding promise of both parties
Order for Sale	An order made by court or land office for property to be sold
Scheduled Chargee	List of persons/body recognised in states reserve land enactments allowed to create charge over reserve lands as security for a loan
Specific Performance	Implies an order compelling a party to perform some act or do something that is required under the contract
Sukuk	Islamic securities/bonds
Ta'widh	Compensation
Torrens System	A system of land title registration, adopted originally in Australia and later in some other countries including Malaysia
Wa'd	Promise
Wa'dan	Two way unilateral promise

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