

Framework to Prevent Islamic Financial Crime in Malaysia

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Abstract: Current practice indicates that due to historical background which separate Islamic and Civil law, crime prevention within Islamic financial criminology framework is obscured. Conflicts of power exist among authoritative bodies; Civil and Shari'ah Court, Shari'ah Advisory Boards, National and State Fatwa Councils shows insufficient legal system to support the growth Islamic Financial Institutions in Malaysia. As a result, Islamic financial crime prevention is done within the scope of conventional framework. Therefore, this paper aims to study the prevention method taken by Malaysia. This research suggests that the best approach for now is to harmonize between civil court and sharia court. Better understanding from both courts will provide a comprehensive framework to prevent Islamic financial crime in Malaysia.

Key words: Islamic Financial Crime • Conventional Framework • Prevention • Malaysia • Sharia

INTRODUCTION

Malaysia which known as Malay Land during Malay Malacca Sultanate was an Islamic country which implements full-fledge Islamic system including law, economy, politics and etc. Then after invasion of British, the concept of dual system was introduced. The introduction of Civil (English) Law, conventional economy, secular education and etc which is not an Islamic based as well as separation of power between Sultan, ruler of Malay Land and residence as appointed from British officer.

Ahmad Ibrahim stated that:

"In the period of British occupation, the place of the Islamic Law as the basic law of the country was affected by the introduction of the English Law. The result was the administration of the Islamic Law was confined to matters of family law and certain offences against religion. The legislation provided for administration of the Islamic Law by the Kathis [Qadis]" [1].

After independence, Malaysia is known as a multiracial country, with Muslim a majority still adopting a limited field of Islamic Law including the solemnization and registration of marriages and divorce, the custody of children, the administration of *Baitul-mal*, *waqf*, *zakah* and also *zakah al-fitr* and the administration of mosque[1]. Meanwhile, British Law continues to be applied in most fields of legislation and jurisprudence including economy and finance. Consequently, the power of jurisdiction and the status of Muslim Courts are still very much lower than the common-laws of the British legal system [2].

Furthermore, the jurisdiction of the Shari'ah Court and Civil Court has effect the prevention of Islamic Financial crime in Malaysia. Provision provided in Federal constitution, Shari'ah Court function to hear cases related to personal, family affairs and to those who profess Islamic religion according its jurisdiction which falls under Para 1 of List 11(State List) of the 9th Schedule of the Federal Constitution. In addition, Shari'ah Court power is not vested to hear Islamic financial cases [3].

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Current practice, matters related to Islamic finance are registered and heard in Civil Court. This due to its jurisdiction which laid down in List 1 (Federal List), of the 9th Schedule of Federal Constitution includes civil, criminal procedures, contracts, *lex mercatoria* (inclusive of banking and financial laws), arbitration, etc.[3]. Therefore crime prevention for Islamic finance is done within conventional framework.

Problems arise because the concept of Islamic finance and conventional system is different. Islam has provided a complete system composed of Aqeedah, Shari'ah and Akhlaq to organize and manage all aspects of life including finance. This is to ensure financial activity will remain within the scope of the tenets of God which is based on guidelines set forth in the Qur'an and Hadis. There will be no separation between mind and revelation in Islam. They will hold, or centered on direct revelation. Any separation or isolation between the two aspects cannot be accepted by Islam [4]. Likewise, the definition of crime in Islamic finance is also contradicts to conventional. In Islam, crime has been described explicitly in the Quran and Hadis. For example the practice of usury (*riba*) is prohibited but it is practiced widely in conventional system. This leads to conflicts among economic players as well as law practitioners to prevent crime in Islamic finance [5].

Financial Crime from the Quran and Hadis' Perspective:

There is no specific definition for financial crime in conventional economy and it usually referred as white-collar crime and fraud. Federal Bureau of Justice Statistics (Dictionary of Criminal Justice Data Terminology) has defined it as non-violent crime for financial gain utilizing deception and committed by anyone having special technical and professional knowledge of business and government, irrespective of the person's occupation [6]. Generally, white-collar is considered as non-violent but in long term, this crime will have a traumatic impact on business and community. The component of white-collar crime is deceitful, intentional, breaches trust, involves losses, may be concealed and may be an appearance of outward responsibility. Some of the crimes include consumer fraud, credit card fraud, kickbacks, bid rigging, inventory theft, theft of cash, basic company fraud, travel and entertainment claims, check fraud, identity fraud and etc [6].

In Western law, the offender will be punished in accordance with the public law which is the civil law in accordance to the country. Normally, the offenders will be punished by imprisonment or paying the fine. While from

the viewpoint of Islam, the criminal offenses comprise violation of rights of Allah and human. It is divided into three parts, namely; (i) Crimes against life in absolute terms such as murder, (ii), Crimes against life- not absolute to body parts, such as hitting, (iii) Crime which does not involve the life of one party instead it involves the other party such as abortion of the foetus. From the aspect of sentencing, Islam divides crimes into three parts, which are *hudud*, *qisas* and *ta'zir*. There is no owned provision of financial crimes related to Islam. Fundamentally, Islamic financial crimes fall under three criminal division based on the type of crime committed. The major crimes are theft and robbery and the punishments have been explained clearly in the Quran:

“As to the thief, Male or female, cut off his or her hands: a punishment by way of example, from Allah, for their crime: and Allah is Exalted in power.”
[al-Maidah 5:38]

“The punishment of those who wage war against Allah and His Messenger and strive with might and main for mischief through the land is: execution, or crucifixion, or the cutting off of hands and feet from opposite sides, or exile from the land: that is their disgrace in this world and a heavy punishment is theirs in the Hereafter;”
[al-Maidah 5:33]

Two crimes mentioned above are considered major crimes and the punishments should not be seen as conservative. At present, both crimes occurred in a variety of approaches and more complex ways, especially when it involves technology and modern financial system. However, if it meets the perfect conditions of stealing and robbing, they are still placed under the category of *hudud*. Rasulullah SAW stated:

“Anyone who had wronged but not to the extent to receive hudud are those who did wrong” [7].

It means that if the conditions of *hudud* are not reached, the punishment of *ta'zir* will be given. Other crimes in Islamic finance such as gambling, bribery, *riba*, consuming properties that are unlawful (*haram*) and others that are put under the category of *ta'zir* punishment as mentioned in the Quran and Sunnah without mentioning the punishments. Thus, the punishments are quite flexible and are not fixed. It is based on the courtesy of the ruler on its local compatibility.

So, there is a vast different between the definition of criminology in Islamic finance and conventional finance. In Islam, criminology has been described explicitly in the Quran and Hadith. Generally, crime is a type of wrongdoing done by a mukalaf toward his creator (Allah). Crime is committed upon doing what has been prohibited in *shari'ah* or not doing what has been ordered by the *shari'ah*. In Islamic finance, crime is defined as doing what has been prohibited in Islamic financial transaction. The practice of usury (*riba*) on modes of Islamic financial transaction is one of the examples. The basic of Islamic financial crime is prescribed in the following verse:

"O you who believe! Eat not up your property among yourselves in vanities: but let there be amongst you traffic and trade by mutual good-will: Nor kill (or destroy) yourselves: for verily ALLAH hath been to you Most Merciful" [al-Nisa'4:29]

Islam forbids us from taking or consuming property in vanity except in business or transactions with mutual consent. The focus in this issue is business with mutual consent. Detailed interpretation of vanity (*bathil*) is clearly prescribed in the following Quranic verse:
In, Allah said:

"Allah has permitted trade and has forbidden interest" [al-Baqarah 2:275]

In a nutshell, interest or usury (*riba*) is a major sin in Islam. Quran explicitly prohibits interest at all levels and ways. Beside interest, other crimes noted in Quran and Hadith are transactions related to alcohol, idols, gambling and etc., fraud, bribery (*rishwah*), monopoly or hoarding (*ihhtikar*), uncertainty (*gharar*) and many more.

Islamic Financial Activities: In Malaysia, Islamic financial system was built after the strengthening of the conventional financial system by the British in Malaysia. Until now, the Islamic financial system is just a small entity and its position as the only alternative system. In 2020, Malaysia targets to balance the ratio between both financial systems. Thus, the progress towards handling monetary crime is also in accordance with the policy that held by respective countries. To understand the development of the prevention method, the process in Islamic finance activities in Malaysia and should be understood. Generally there are three main levels; (i) Policy making, (ii) System development and technical approach, (iii) Implementation.

Policy Making: In Malaysia, Islamic banking and finance laws and regulations are first passed by the parliament and thereafter by responsible authoritative bodies. There are three main regulators which standardize as well as supervise different sectors in Islamic finance; Bank Negara Malaysia, Security Commission Malaysia and Labuan Offshore. Each of them is bound to different acts and powers as shown below in figure 1.

There are some acts related to Islamic banking and finance that are divided into two categories, primary and secondary acts. Primary acts are those that are passed to monitor Islamic banking and finance operations, such as Islamic Banking Act (IBA) 1983, National Bank Act 1958, Government Investment Act 1983, Takaful Act 1984, the banking and financial institutions Act 1989 and the Securities Commission Act 1993. The secondary acts are those that included amendments in several existing acts and regulations related to IBS. The secondary acts are the contract act 1950, Companies act 1965, the National Land Code 1965, the Hire Purchase Act 1967, the Income Tax Act 1967, the Bankruptcy Act 1967, Anti-money laundering Act 2001 and so on [8].

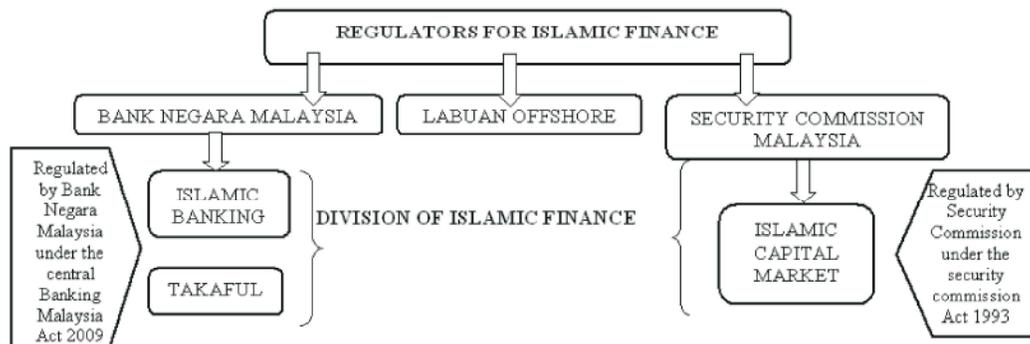


Fig. 1: Regulators of Islamic Finance

System Development and Technical Approach: Two most important bodies involved in the process and technical development are Bank Negara and Security Commission. Bank Negara Malaysia regulates the Islamic financial system operation as the main body which supervises all Malaysian banking and finance systems. In order to monitor and supervise Islamic banks, Bank Negara Malaysia focuses on 2 vital components which are a centralized *Shari'ah* Advisory Body at the Bank [9] and an internal *Shari'ah* Committee formed in each respective financial institution. Security Commission also has established *Shari'ah* Advisory Council which was given the mandate to ensure that the running of the Islamic Capital Market (ICM) complies with the *Shari'ah*. Its scope of jurisdiction is to advise the Security Commission on all matters related to the comprehensive development of the Islamic Capital Market and as a reference centre for Islamic Capital Market related issues.

Implementation: Each bank and financial institution in Malaysia should appoint their own panel of advisors called *Shari'ah* Committee. Their role in general is to ensure the *Shari'ah* compliance of the operations and activities of the Islamic financial institution. They have to follow guideline provided by Bank Negara [10]. Bank Negara has designed *Shari'ah* Governance Framework to make sure that all products and activities are in line with the principal of *Shari'ah*. However, other than Bank Negara Malaysia, other consultative bodies such as National and State Fatwa Councils has given some impact in implementing Islamic finance and banking product in Malaysia.

Conflict and Issues: In spite of rapid development in Islamic Finance in Malaysia, insufficient legal support occurs. Since Islamic finance case heard in Civil Court, it is undeniable that the case will governed by the principles of English Common Law [5]. Thereupon, the judgments on Islamic financial matters are incompatible to Islamic principles. This could be seen that, the concept of *Bay' Bithaman' Ajil* (BBA) was misinterpreted as a loan in the cases of Bank Islam Malaysia Berhad versus Adnan Bin Omar [1994] 3 CLJ 735 / [1994] MLJU 221 and the case of Affin Bank Bhd versus Zulkifli Abdullah [2006] 1 CLJ

438. Islam prohibits excess payment to the loan as it is usury (*riba*), while the BBA contract is allowed as it is an agreed profit margin [11].

Moreover, the underlying framework of Islamic financial institutions still retains its conventional structure either from the viewpoint of the system, products designation, acquisition of profits, or the financial institutions and banking philosophy itself. The proof can be seen clearly through the distribution of Islamic finance cases that are heard in the High Court of Kuala Lumpur. The data below shows that the issue of Islamic banking products is a major concern. Most cases heard are related to *Bai' Bithaman Ajil* that cover 90% of the whole cases that are heard. There are two aspects that need to be addressed; the facts of the case and the settlement of cases [12].

The facts of the case shows that there are two legal issues that arise; contracts of Islamic banking products must comply with the provisions of the civil law and should also be in line with the principles of Islamic *Shari'ah*. Those needs are difficult to achieve because it requires deep understanding of Islamic finance as well as conventional finance from either judges and practitioners.

It follows that, to improve the situation, Bank Negara Malaysia was authorized to establish a Shariah Advisory Council. Its function is to ascertain Islamic Law for the purposes of Islamic financial business [p10]. Provision under 16B (7) of the Central Bank of Malaysia Act 1985 stated that;

Relating issues must consult Shari'ah Advisory Council (SAC) under Bank Negara Malaysia on Shari'ah matters relating to Islamic Banking business, Takaful business, Islamic Financial Business, Islamic Development Financial Business or any other business which is based on Shari'ah principles [13].

However, the authoritative power is not clearly stated. Besides SAC of Bank Negara, Malaysia also has other advisory boards such as SAC of Securities Commission (SC), National Fatwa Council and State Fatwa Council. The National Fatwa or States Fatwa Councils, which should have the most authoritative voice,

Table 1: Muamalat Cases Registered In High Court KL 2003-2009. (Commenced By Writ Summons)

Product / Year	2003	2004	2005	2006	2007	2008	2009	TOTAL
Total files	186	291	478	507	554	490	679	3185
Total viewed	152	265	433	475	515	461	633	2934

are powerless. In certain circumstances, disagreement of legal opinions among them could not be resolved [14]. This is causing confusion among the finance and law practitioners as well as the public at large. The inconsistency of the fatwas' caused confusion among the banks and financial institutions as well as publics. For example, an inconsistency fatwa related to Amanah Saham Bumiputra and a tobacco company complicates the bank and the financial institution to decide whether to invest in the company or not to invest [14].

Legal Infrastructure to Support Islamic Financial

System: Practices adopted on Islamic financial crime prevention in Malaysia, need improvement to support our Islamic financial legal system. An Islamic Financial Crime guideline needs to be developed as a reference to support the system. Today's practice, the concept of Islamic criminology is a mix between Islamic financial and conventional framework. Adding to that, the Islamic financial criminology's jurisdiction is place under the jurisdiction of Civil court which lack human capital expertise in Islamic financial system [15].

The recommended improvement is to implement full-fledge Islamic legal system which does not segregate the legal system into Shariah and Civil court. Indeed, major change such as amending of provisions in federal constitution seems impossible. Thus, the next best approach is to give a clear authority among the existing bodies in Malaysia; Court, Advisory bodies and Fatwa councils. Supposedly, role of fatwa councils is to determine legal opinion and advisory bodies is to ascertain the consensus legal opinion made by fatwa councils. In the meantime, civil court needs to upgrade human capital expertise in Islamic financial system. For instance, equipped judges, lawyers, admin staff with Islamic financial background to support crime prevention of Islamic finance crime [1].

CONCLUSION

Conceptually, the process of crime prevention in Islamic banking in Malaysia is under the jurisdiction of civil court. Conflicts arise when judgment of Islamic banking cases were trial within the conventional banking framework which lead to injustice and disagreement with the Islamic principles. The limited role of SAC of Bank Negara as an advisor will not affect the power of Civil Court. In the meantime, there are other advisory board exist such as the SAC of Securities Commission, *Majlis Fatwa Kebangsaan* and *Majlis Fatwa Negeri-Negeri* but with no authoritative power to ensure Islamic banking

implementation in accordance with Islamic principles. At times, there occurs conflicting of *fatwa* (legal opinion) among SACs. Consequently, this will create confusion within the financial and banking practitioners and publics at large. The study recommended that the Malaysia National Fatwa Council to be the highest authority to determine Islamic financial cases. Other advisory bodies and Civil court judges to obey and ascertain National Fatwa Council's view. Theoretically, Shari'ah Court is more compatible to hear Islamic cases, however, due to the Malaysian law historical background less power has been vested to the Court. Thus, the next alternative is to harmonize the roles and responsibilities of Civil Court and Shari'ah Court. On the other hand, in order to minimize conflicts a clear empowerment of the existing authoritative bodies, need to be addressed and consequently, implementation will be in line with Islamic principles.

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