

Legal Approach To Prevention Crime In Islamic Finance in Malaysia and Iran

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This paper focuses on crime prevention in Islamic Financial Institution in Malaysia. 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 Syariah Court, Syariah 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. This paper aims to (i) to explain the concept of criminology from Islam's view; ii) to examine the background of Islamic financial criminology crime prevention in banking system in Malaysia and comparing this practices to country, Iran; (iii) to make recommendation on legal improvement to support Islamic financial system in Malaysia.

Keyword: legal system, crime, prevention and Islamic financial

Introduction

Islam has provided a complete system to organize and manage all aspects of life including economy and finance. This is to ensure financial and economic 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.

A holistic system in Islam composed of aqeedah, syariah and akhlaq provides an Islamic economy which is differ to conventional economy. Islamic financial system must be in line with Islamic economy. It is proven that conventional financial system is unable to solve current financial problems. Many shortcomings occurred such as monopoly of property and wealth in certain communities only. Contrary to that,

Islam promotes goodness in the world and hereafter. So, monopoly of wealth is against the Islamic financial system.

In the development of the global Islamic financial system, there are vacuums that need to be completed; Islamic financial crime prevention. There is a big difference between crime in conventional and Islamic financial system. The process of prevention always ends with ambiguities because most of the Islamic products is build within conventional financial framework. Therefore, a guideline with Syariah principles basis is needed to overcome this situation.

Financial Criminology from the Quran and Hadis' Perspective

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 Hadis. Generally, in Islam crime related to *mukallaf* deeds toward his creator Allah. Crime is committed when doing what has been prohibited in shariah or not doing what has been ordered in shariah to do. 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. Unfortunately, in the Qura'n and Hadis, the definition of islamic financial criminology are unclear. Usually the prohibition word is used such as *harrama*-to forbid, *la al-nahi*-prohibit verb, *naha*- to prohibit, *la al-nafi*-denial verb, *fiil al-amr*-command verb, *bathil*-wrongful deed and etc.

The basic of Islamic financial criminology 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"
[4:29]

Islam forbid 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 Surah Al-Baqarah 275, Allah said:

Allah has permitted trade and has forbidden interest

Interest or usury (riba) is a major crime in Islam. Quran explicitly prohibits interest at all levels and ways. Beside interest, other crimes noted in Quran and hadis among others are:

- (i) transactions related to alcohol, idols, gambling and etc.
- (ii) fraud
- (iii) bribery (*rishwah*)
- (iv) monopoly or hoarding (*ihtikar*)
- (v) uncertainty (*gharar*) and many more.

Malaysia: Legal historical background

Malaysia is a developing nation located strategically in the heart of South-East Asia and is one of the crossroads of the world. As recorded in history, nearly all of the worlds' major religions have substantial representation in Malaysia.

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 (Q)".

After independence, Malaysian thirteen (13) states, each enacted new rules for the administration of Islamic Law. The acts attempt to clarify the relationship of Islam with the states and the substance of Muslim Law in Malaysia. These enactments provided the constitution and powers of Muslim courts. These powers include 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.

Malaysia is a multiracial country, with Muslim a majority still adopting a limited field of Islamic Law such as those pertaining to marriage, divorce, adultery, inheritance and other social and ritual issues. Meanwhile, British Law continues to be applied in most fields of legislation and jurisprudence. 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.

Development of Islamic Banking in Malaysia

In Malaysia, Islamic banking system has been established as an alternative to existing conventional systems. The development of Islamic banking in Malaysia divided into three stages. Firstly, Bank Islam Malaysia Berhad (BIMB) was incorporated in March 1983, it is the only Islamic Bank licensed under the Islamic Banking Act; 1983. BIMB, like all banks in Malaysia, whether conventional or Islamic, are supervised by Bank Negara Malaysia (Malaysian Central Bank or BNM). The second stage is the introduction of *Skim Perbankan Tanpa Faedah* (SPTF) or Interest-free Banking Scheme (IFBS) and Islamic Banking Scheme (IBS). It allowed the existing conventional bank to offer Islamic banking window as part of their services. It was launched on 4 March 1993. In the third stage, the government has promoted Malaysia as a regional Islamic Financial Centre. Labuan has been declared as an International Offshore Financial Centre (IOFC).

In the year 2002, the first Sovereign Global Islamic *Sukuk*, structured on the principal of *Ijarah*, amounting to USD600 million was launched. It signifies Malaysia's strong commitment in developing Islamic Banking and finance in the global front. In fact, Malaysia remains the world's leader in *Sukuk* issuance by both number and value, with 2007 trade totaling about \$25bn (2009) it represents 45.03% from total world issuance.

As a result of the successful implementation of Islamic finance in Malaysia and the market and financial intermediaries has grown rapidly including:

- Islamic Banking
- Takaful companies
- Islamic Capital Market
- Islamic Capital Equity
- International Islamic Financial Market
- Association of Islamic Banking Institutions in Malaysia (AIBIM)
- Islamic Banking and Finance Institute Malaysia (IBFIM)

These developments manifest the potential of Malaysia to become a Global Islamic Financial Centre.

Conflict Between The Jurisdiction Of The Syariah Court and Civil Court

In spite of rapid development in Islamic Finance in Malaysia, insufficient legal support occurs. The jurisdiction of the Syariah Court and Civil Court has effect the legal framework of Islamic Finance in Malaysia. Provision provided in Federal constitution, Syariah Court function to hear cases related to personal, family affairs and to those who profess Islamic religion. In addition, Syariah Court power is not vested to hear Islamic financial cases. Current practice, matters related to Islamic finance are registered and heard in Civil Court. 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 v Adnan Bin Omar** [1994] 3 CLJ 735 / [1994] MLJU 221 and the case of **Affin Bank Bhd v 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. In a nutshell, the judgment of Islamic finance is made within conventional finance framework.

There is a provision under 16B (7) of the Central Bank of Malaysia Act 1985 stated;

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

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, are powerless. In certain circumstances, disagreement of legal opinions among them could not be resolved. This is causing confusion among the finance and law practitioners as well as the public at large.

Brief background on Islamic Finance in Iran

Compare to Malaysia, Iran has taken a revolutionary approach in developing Islamic banking and financial institution. After revolution of Iran in 1979, the banking system in Iran is nationalized. The first step to Islamize all Iranian bank is by eliminating of interest or usury(riba) in banking practices. Its began with the substitution of interest by maximum service charge at maximum 4% and guaranteed minimum profit at minimum 4-8%. In order to pursuit government policy to become a full-fledge Islamic country, religious and economic authorities designated Law of Usury-Free Banking Operations in 1983 and ratified by the Council of Guardian and special representative of Imam Khomeini, to be effectively implemented on March, 1984. The law is believed to be one of the best in Islamization banking system as well as to avoid any major misconception and misunderstanding possible. Modes of Islamic financing was introduced including *qard al-hassan*, *mudharabah*, civil partnership, legal partnership,

hire-purchase, installment transactions, *muzara'ah*, *mosaqaat*, direct investment, forward deals, *jua'lah*, and debt purchase.

Following this, is to adapt intermediary practices of the banking system to Islamic rules and practices. For example, the Bank Markazi as a central bank in Iran is responsible for the formulation and implementation of the monetary and credit policies with due regard to the government policies. The investment plans and development of the bank must first obtain an approval from Islamic Consultative Council.

Unlike Malaysia, Iran practices Islamic legal system. The highest leader within the system is the Supreme Leader. According to Iran's Constitution, the Supreme Leader is responsible for the delineation and supervision of "the general policies of the Islamic Republic of Iran," which means that he sets the tone and direction of Iran's domestic and foreign policies. His sphere of power is extended through his representatives, an estimated 2,000 in numbers, selected throughout all sectors of the government and who serve as the Leader's clerical field operatives. In some respects the Supreme Leader's representatives are more powerful than the president's ministers and have the authority to intervene in any matter of state on the Supreme Leader's behalf.

The president is the second highest ranking official in Iran. Though the president has a high public profile, however, his power is in many ways are minimized by the constitution. He is responsible for setting the country's economic policies. Though he has nominal rule over the Supreme National Security Council and the Ministry of Intelligence and Security, in practice the Supreme Leader dictates all matters of foreign and domestic security.

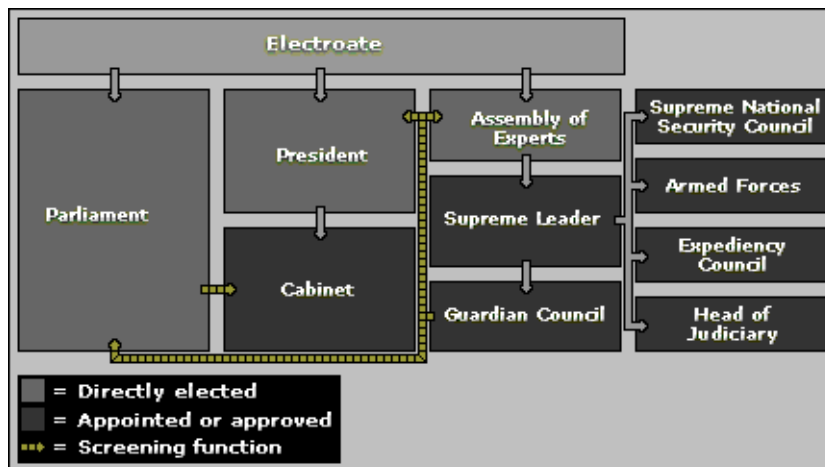
There are other advisory bodies with binding power to ensure the conformity of government policies with Islamic principles including financial system in Iran. That is the reason why Iran practice Islamic finance and discard conventional financial system. The bodies are council of guardians and expediency council. The Council of Guardians is vested with the authority to interpret the constitution and

determines if the laws passed by Parliament are in line with Shariah (Islamic law). This means that the council has effective veto power over Parliament. Expediency Council serves as an advisory body to the Supreme Leader, making it one of the most powerful governing bodies in the country

The judiciary branch of Iran's government is largely controlled by the Supreme Leader, who appoints the head of the judiciary. Iran has two courts, Public courts and special Clerical Court. Public court deals with civil and criminal cases and the Special Clerical Court functions independently of the regular judicial framework and is accountable only to the Supreme Leader. This court handles crimes allegedly committed by clerics, although it has also taken on cases involving lay people.

From the above explanation, crime prevention in Islamic financial system is done within sole system; Islamic legal framework. Corruption is at the minimum because the religious bodies are the most powerful authority in Islamic financial system in Iran to combat such practice.

Chart 1: Chart of power structure in Iran



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 Criminology 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.

The recommended improvement is to implement full-fledge Islamic legal system like country, Iran which does not segregate the legal system into Syariah 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, administrative staff with Islamic financial background to support crime prevention of Islamic finance criminology.

Comparison between Iran and Malaysia

Procedure of crime presentation in Malaysia has monitored by various SAC/SC in Central bank and commercial banks. In Iran this procedure has monitored by Central banks and Shariah Board. Malaysian government implemented dualism as legal framework, but in Iran, full-fledge Islamic laws implemented. In the issue of preventive action, Malaysian government applies the tools such as Exchange Control Act 1953 (ECA), Islamic Banking Act 1983 (IBA), Takaful Act 1984 (TA), Banking and Financial Institutions Act 1989 (BAFIA), Insurance Act 1996 (IA), Money Changing Act 1998 (MCA), Anti-Money Laundering and Anti-Terrorism Financing. In Iran, training and education (general and special), transparency in legislation, activities and procedure, and finally special institutions applied for preventive actions.

Conclusion and Recommendation

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.

In order to implement preventive measures, there should be a specific definition of the crime. In Iran the concept of economic crimes is not specific and also their component does not determined by specific laws, so there are impossible to consider any preventive measures related to crimes. Preventive measure implemented to event or behavior which it has known in its own natures and features. Lack of specific definition and concept for economic crimes could lead to collapse of preventive plans, because these plans reflect the different judgment based on people's interpretation of crimes not the reality of them. The inevitable reason behind of this event is that in silence of rules and regulations, the scales offered for preventive actions are dependent to aim of authority organizations, not dependent to aim of rules.

In conclude, although Iran use full-fledge Islamic financial system and follow unique Islamic framework but for the reason of lack of suitable rules and acts in economic crimes has inflexible role in preventive measure procedure.

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,

Syariah 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 Syariah 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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