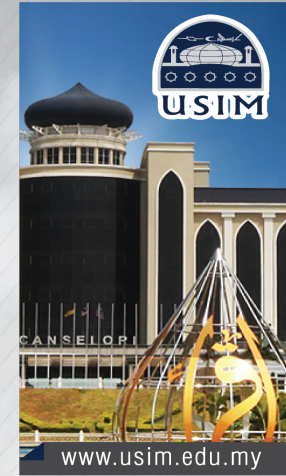


العلماء
مجلس
العلماء
مجلس



THE ISLAMIC FINANCIAL SERVICES ACT 2013

Zulkifli Hasan (Ph.D)
Faculty of Syariah and Law
University Sains Islam Malaysia

MEMPELOPORI SAINS ISLAM • MEMIMPIN KEILMUAN
PIONEERING ISLAMIC SCIENCE • SPEARHEADING KNOWLEDGE



Contents



- Introduction
- About the IFSA
- Significant Features of the IFSA
- Implications, Issues and Challenges
- Conclusion

An Overview of IF in Malaysia

- Considerable growth with 16 full-fledged IB, 12 Takaful operators and six DFI.
- Significant progress with market share increased up to 25% in 2014 (40% in 2020) of the total banking system.
- Total Islamic financing continued to grow 16.6% and represented 26.9% of total loans/financing in the banking system.
- 799 *Shari'ah*-compliant securities were listed on Bursa Malaysia, representing 87.7% of the total listed securities, with a market capitalization of RM995.7 billion or 63.7% of the total market capitalization.

Introduction

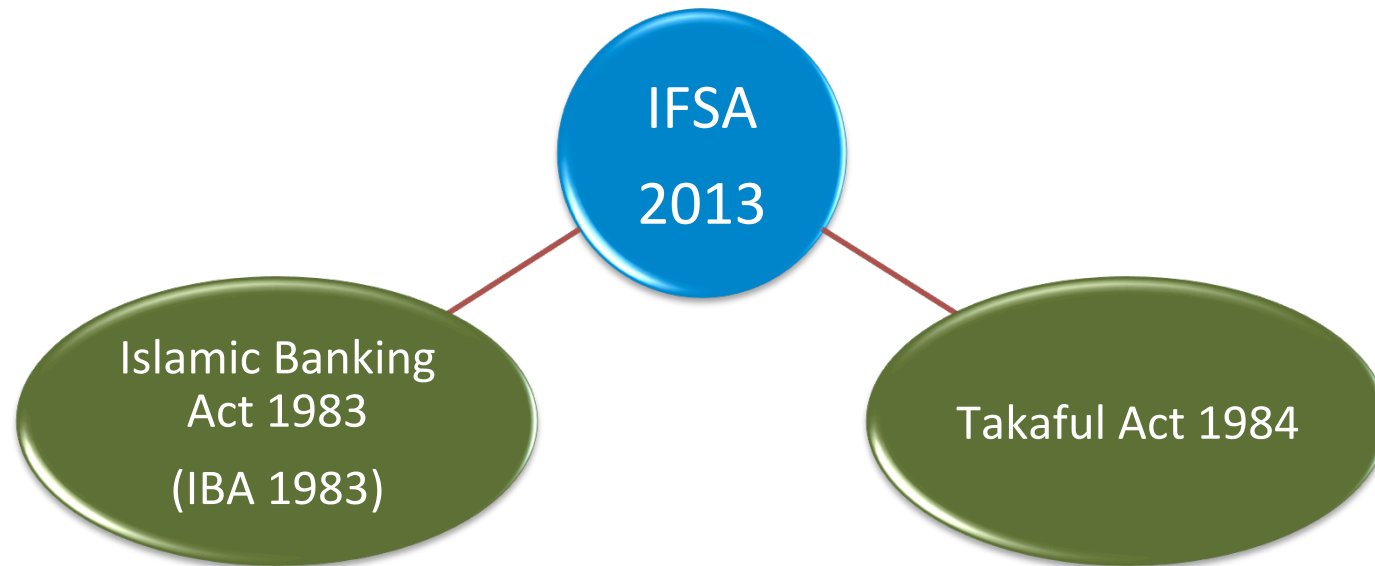
- *The existing framework of Islamic finance in various jurisdictions demonstrates diverse practices and distinct models. Malaysia as the proponent of regulatory-based approach has instituted several initiatives to promote financial stability and this include the new law, the Islamic Financial Services Act 2013.*
- *Features of this Act/ New dimensions/ Legal consequences in the aspects of demarcation between Islamic banking and its conventional counterpart, element of consumerism, interest of depositors and IAH, corporate governance, Shari'ah compliance, liabilities, judicial oversight and products and services*

ABOUT THE IFSA

Background

- The Islamic Banking Act 1983, the Takaful Act 1984, the BAFIA 1989 and the Securities Commission Act 1993.
- The Central Bank of Malaysia Act 2009
- Malaysian Financial Sector Blueprint 2011-2020: to strengthen the relevant regulatory and legal framework.
- The IFSA : Consolidates the IBA and the TA and repeals both Acts. Royal Assent on 18 March 2013, gazetted on 22 March 2013 and came into effect in June 2013.
- Guidelines for IFIs: Eg. Guidelines on the Disclosure of Reports and Financial Statements of Islamic Banks and the *Shari'ah* Governance Framework.

Acts Repealed by the IFSA



IMF Country Report No 14/80

- “The regulatory and supervisory framework for the financial sector was strengthened with the coming into force of the FSA and IFSA on 30 June 2013. This ensures that laws governing the conduct and supervision of financial institutions in Malaysia continue to be relevant and effective in maintaining financial stability, supporting a sustainable, balanced and inclusive growth of the economy, as well as providing adequate protection for consumers. The laws further strengthen BNM’s supervisory and regulatory powers, including comprehensive powers to carry out consolidated supervision of financial groups and to extend the regulatory perimeter to systemically important non-bank entities that undertake financial intermediation activities”.

Summary of the IFSA

18 Parts in the IFSA with 291 sections and 16 Schedules

Part I: Preliminary

Part II: Regulatory Objectives, Powers and Functions of Bank,

Part III: Authorization, Part IV: Shariah Requirements,

Part V: Payment Systems, Part VI: Prudential Requirements

Part VII: Ownership, Control and Transfer of Business

Part VIII: Financial Groups

Part IX: Business Conduct and Consumer Protection

Part X: Islamic Money Market and Islamic Foreign Exchange

Market, Part XI: Submission of document or information

Part XII: Examination, Part XIII: Directions of Compliance

Part XIV: Intervention and Remedial Action

Part XV: Other Powers of Bank, Part XVI: Enforcement and

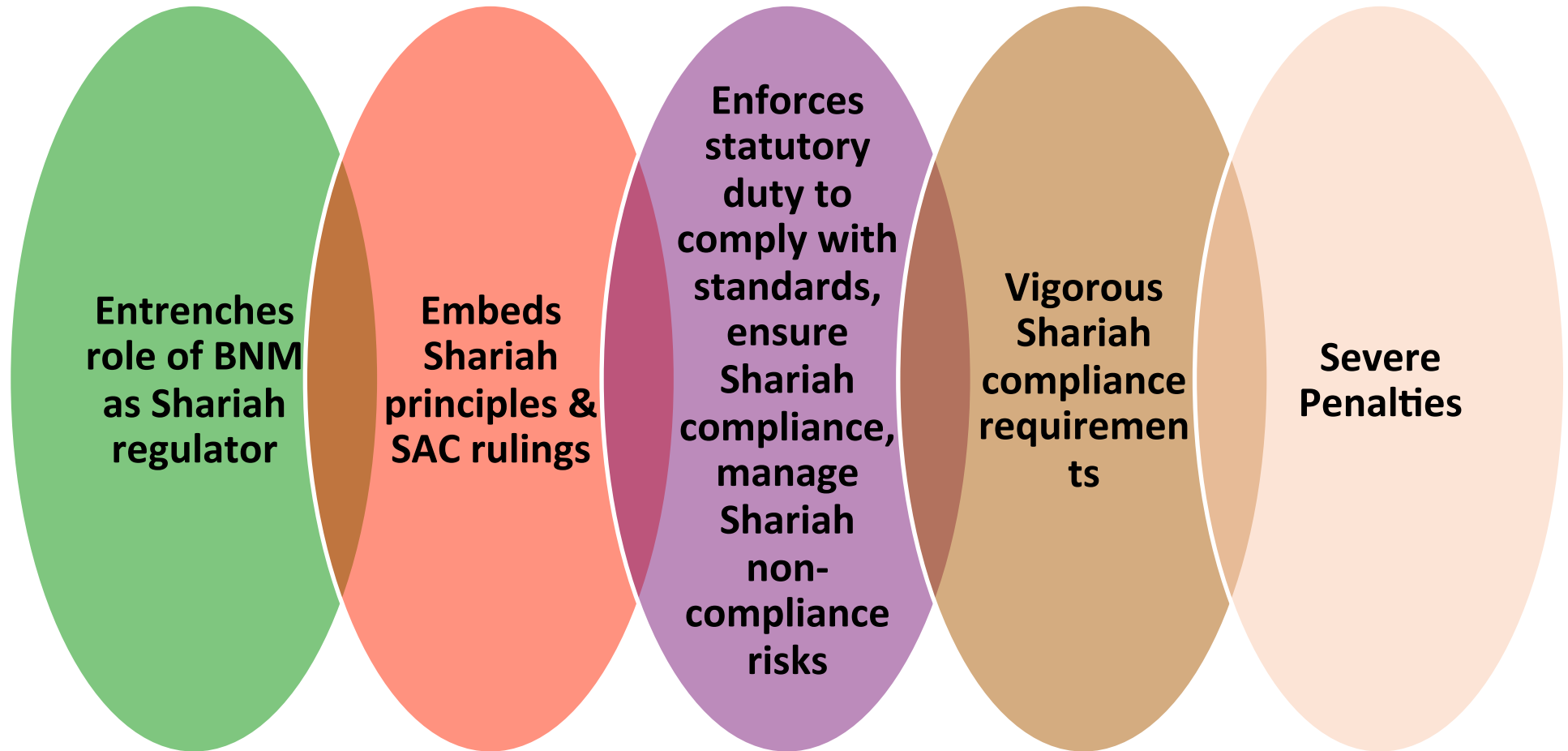
Penalties, Part XVII: General Provisions, Part XVIII: Repeal, savings and transitional

Institutions under the IFSA

- The IFSA governs all IFIs including Islamic banks, takaful operators, international Islamic banks, international takaful operators as well as operators of payment systems which the transfer of funds between Islamic bank accounts or which enables payments to be made by means of Islamic payment instruments, issuers of Islamic payment instruments, takaful brokers and Islamic financial advisor.
- The IFSA nevertheless excludes development financial institutions and cooperative societies.

Enhancement

Regulation on institutions and financial activities



Significant Features of the IFSA

Objective

- **Datuk Nor Shamsiah Mohd Yunus, Deputy Governor:**
- *The emphasis on governance framework for an end-to-end Shariah compliance.*
- *To provide a comprehensive legal framework that is fully consistent with Shariah in all aspects of regulation and supervision, from licensing to the winding up.*
- *To provide statutory foundation for a Shariah contracts-based regulatory framework that would facilitate the next level of Islamic banking business, transcending beyond financial intermediation to include real economic sector participation, complete with the consequent regulatory checks and balance.*
- *To realise further the value proposition of Islamic finance.*

Objectives

- S 6: to promote financial stability and compliance with Shariah.
- authorize the BNM as the authoritative body to ensure stability particularly to foster the safety and soundness of Islamic financial institutions, orderly functioning of the Islamic money market and the Islamic foreign exchange market as well as efficient and reliable payment Islamic payment instruments and fair, responsible and professional business conduct of Islamic financial institutions.
- The IFIs are also required to strive to protect the rights and interests of consumers of Islamic financial services and products.

Scope of IFSA

- Focus of regulation now on financial activities and not just financial institutions
- Specific provisions on consumer protection and shareholding.
- Corporate Intervention
- Consumer Shareholding
- Governance Protection
- New and enhanced powers

BNM as Financial and *Shari'ah* Regulator

Division	Provision
Division 1: <i>Shari'ah</i> Compliance	<p>S 27: Interpretation</p> <p>S 28: Duty of institution to ensure compliance with Shariah</p> <p>S 29: Power of Bank to specify standards on Shariah matters</p>
Division 2: <i>Shari'ah</i> Governance	<p>S 30: Establishment of <i>Shari'ah</i> committee</p> <p>S 31: Appointment of <i>Shari'ah</i> committee member</p> <p>S 32: Duties of <i>Shari'ah</i> committee and its members</p> <p>S 33: Cessation as member of <i>Shari'ah</i> committee</p> <p>S 34: Notice of cessation as member of <i>Shari'ah</i> committee</p> <p>S 35: Information to be provided to <i>Shari'ah</i> committee</p> <p>S 36: Qualified privilege and duty of confidentiality</p>
Division 3: Audit on Shariah compliance	<p>S 37: Appointment of person by institution to conduct audit on <i>Shari'ah</i> compliance</p> <p>S 38: Appointment of person by Bank to conduct audit on <i>Shari'ah</i> compliance</p>

Islamic v Conventional Finance

- Statutory foundation for a Shariah contracts-based regulatory framework transcending beyond financial intermediation.
- To realise further the value proposition of Islamic finance
- Eg. IFSA clearly distinguished CASA holders from an IAH.
- Investment account as an account for the purposes of investment, including for the provision of finance, on terms that there is no express or implied obligation to repay the money in full and
 - (a) with profits-sharing, or both the profits-or-losses-sharing features
 - (b) with or without any return.

IFIs

- “IFIs” means a financial institution carrying on Islamic financial business;
- **S 2 IFSA: Islamic banking business” means the business of**
- **(a) accepting Islamic deposits on current account, deposit account, savings account or other similar accounts, with or without the business of paying or collecting cheques drawn by or paid in by customers; or (b) accepting money under an investment account; and (c) provision of finance;**

(S 15 of the FSA 2013)

- Upon an application to the Bank and where the Bank has granted its written approval–
 - A licensed bank or licensed investment bank may carry on Islamic banking business
 - An approved insurance broker may carry on takaful broking business
 - An approved financial adviser may carry on Islamic financial advisory business
 - An operator of a designated payment system or approved operator of a payment system may facilitate participants engaged in Islamic financial business to transfer, clear or settle funds or securities
 - An approved issuer of a designated payment instrument may issue a designated Islamic payment instrument
- Subjected to the following provisions of the IFSA 2013 particularly
 - Parts IV (Shariah Requirements), VI (Prudential Requirements), IX (Business Conduct and Consumer Protection), X (Islamic Money Market and Islamic Foreign Exchange Market) and XIII (Directions of Compliance)
 - Any standards, notices, directions, conditions, specifications or requirements specified or made under the IFSA

Definition of ‘Depositors’

Previously under the Islamic Banking Act 1983:

- means a person who has an account at an Islamic bank, whether the account is a current account, a savings account, an investment account or any other deposit account

Now under the IFSA 2013:

- means a person entitled to the repayment of an Islamic deposit, whether the Islamic deposit was made by him or any other person
and distinguished from an “investment account holder”, as:
- “investment account” refers to an account:
 - for the purposes of investment, including for the provision of finance,
 - on terms that there is no express or implied obligation to repay the money in full and —
 - (a) with profits-sharing, or both the profits-or-losses-sharing features
 - (b) with or without any return

Definition of 'Islamic Deposit'

Previously under the Islamic Banking Act 1983:

- means a sum of money or monies worth received by or paid to any person, under which the receipt and repayment shall be in accordance with the terms of an agreement made under any Syariah principle on any basis including custody or profit sharing

Now under the IFSA 2013:

- means a sum of money accepted or paid in accordance with Shariah —
 - (a) on terms under which it will be repaid in full; or
 - (b) whereby the proceeds to be paid shall not be less than such sum of money.
- May include precious metal or precious stone, or any article or thing as may be prescribed by the Minister regardless of whether the transaction is described as a loan, a financing, an advance, an investment, a savings, a sale or a sale and repurchase or by whatever name called!

Definition of 'return'

- in relation to the definitions of “financing facility”, “investment account” and “Islamic deposit”, and “Islamic securities” as defined in subsection 224(1), includes any form of rental, profit, dividend or benefit, and any fee or gift, payable or to be given.

Hibah in Islamic Deposit

- Shariah Parameter on Hibah BNM;
- S 16.1 The hibah contract may be arranged together with the qard contract whereby the borrower at his own discretion, may give hibah, either in monetary or non-monetary form, to the lender provided that it is not a pre-condition at the time of entering into the qard contract and provided that such practice does not become a customary practice (`urf).
- S 16.2 Pursuant to paragraph 16.1, the practice of giving hibah is considered customary if the hibah is given to a majority of the borrower's lenders.
- S 16.3 The borrower in the qard contract shall not undertake to give hibah to the lender.

Corporate Governance

- The IFSA expects greater responsibility to IFIs
- Responsibilities: S 29: every institution, its director, chief executive officer, senior officer or member of a *Shari'ah* committee
- *Offence: S 28(6):* failure to comply with the standards is an offence under the Act.
- Duty of Care: IFIs cannot simply rely on their professional advisors or experts. The IFIs must ensure that they have taken reasonable measures
- Potential exposure to board or directors, management, officers and even *Shari'ah* committee members with heavy penalties including imprisonment.

Functions and duties of board of directors (Section 65 of the IFSA 2013)

includes: (f) **have due regard to any decision of the Shariah committee** on any Shariah issue relating to the carrying on of business, affairs or activities of the institution.

(3) In carrying out its functions or duties under this Division—

(a) the board of directors of an institution shall **have regard to the interests of, as the case may be, depositors, investment account holders** and takaful participants of the institution or participants

*Khiudin bin Mohd & Anor v Bursa Malaysia Securities
Bhd and another Application [2012] MLJU 445*

- Rohana Yusof J held that reliance to advisor is no longer a good defense. She said: *“A CEO and a director have duties to exercise care and diligence in the exercise of their functions in the company. Relying on the expert did not per se discharge directors from their duties. Reasonable steps must be taken which requires each individual to take up upon themselves the responsibilities which commensurate their roles in relation to reading and understanding the financial statement. Complexities and volume cannot be an excuse.”*

Shariah Governance Framework

- 2.1 The board is ultimately **ACCOUNTABLE & RESPONSIBLE** on the overall Shariah governance framework & Shariah compliance of the IFI, by putting in place the appropriate mechanism to discharge the aforementioned responsibilities.
- The board is also expected to perform diligent oversight over the effective functioning of the IFI's Shariah governance framework

Additional issues for Boards

- BOD to have due regard to interest of depositors, investment account holders and and policy holders
- Compare with previous duty to only act in the best interest of shareholders
- Potential conflict of interest between majority shareholder and depositors or policy Holders.

Additional Duties of BOD

- Higher and wider standards expected of boards of companies under FSA
- Ultimate responsibility moved to Board of Directors
- Consumerism invades the Board of Directors:
- Duty to act in best interests of company
- Duty to act in best interests of third party consumer
- Duty to prevent breaches

Consumerism

- Shall have due regard to the interest of depositors, IAH and takaful participants.
- S 6 (b): IFIs are required to strive to protect the rights and interests of consumers of Islamic financial services and products.
- The BOD has the duties to act in the best interests of the IFIs and to act in the best interests of customers.
- Takaful: Establishment and maintenance of takaful fund, takaful funds to be separate from shareholders' fund, requirements relating to takaful funds, shareholders' fund, withdrawal from takaful funds and deficiency of takaful funds).

Statutory Duty

- **In general, the IFSA imposes two statutory duties.**
- **Compliance: (1) aims, operations, business, affairs and activities. (2) Internal policies and procedures. (3) To carry out an audit on Shariah compliance.**
Responsibilities: The BOD, CEO, Senior Officer and Shariah Committee.
- **Reporting duty: IFIs are required to immediately notify the BNM and its SC of any non-Shariah compliant activities and immediately cease from carrying on such business, affair or activity. Within 30 days, to submit to the regulator a plan on the rectification of the non-compliance.**

EVERY				
Institution	Director	CEO	Senior officer	Shariah committee
<ul style="list-style-type: none"> at all times comply with the standards specified by BNM 				
<ul style="list-style-type: none"> to ensure that its internal policies and procedures are consistent with the standards specified by BNM 	<ul style="list-style-type: none"> to comply with the internal policies and procedures adopted by such institution to implement the standards specified by BNM 			
<ul style="list-style-type: none"> to manage its business, affairs and activities in a manner which is not contrary to Shariah (S.28) 	<ul style="list-style-type: none"> not to accept appointment unless have met the requirements specified by BNM and has obtained BNM's prior written approval (S.31 & 64) 			
<ul style="list-style-type: none"> to establish a Shariah Committee (S.30) 	<ul style="list-style-type: none"> institution to notify BNM within <u>7 days</u> upon cessation of positions (S.71) 		<ul style="list-style-type: none"> Institution <i>and</i> the member to notify BNM within <u>14 days</u> upon cessation of position (S.33 & 34) An institution cannot terminate the appointment of a member of its Shariah Committee without prior written approval of BNM (S.33) 	
<ul style="list-style-type: none"> to have a CEO (S.63) 	<ul style="list-style-type: none"> <u>have due regard</u> to any decision of the Shariah committee (S.65(2)(f)) <u>have regard</u> to the interests of depositors, investment account holders and takaful participants (S.65(3)(a)) 			

Statutory Duty: Compliance

- S28 (1) requires IFIs to ensure at all times that their aims, operations, business, affairs and activities are in compliance with Shariah.
- to ensure that its internal policies and procedures are consistent with the standards specified by BNM, to manage its business, affairs and activities in a manner which is not contrary to Shariah and to establish a Shariah Committee
- IFIs to carry out an audit on Shariah compliance. The BOD, CEO, Senior Officer and Shariah Committee shall be responsible to ensure that IFIs are at all times to comply with the standards specified by BNM.

Shari'ah Compliance

- The IFSA complements and strengthens the *Shari'ah* Governance Framework.
- Potential exposure of *Shari'ah* scholars to jail terms (First of its kind).
- Strict condition and vigorous *Shari'ah* compliance process and requirements.
- S 28 (3) to immediately notify any incidents of *Shari'ah* Non-Compliance, immediately cease from carrying on such business, and within 30 days submit a plan to the BNM on the rectification of the non-compliance.
- BNM Circular on Shariah Non-Compliance Reporting issued on 15 March 2013 and came into effect on 1 May 2013.

Shari'ah Audit

- S 37 and 38: External Shari'ah Audit
- BNM may require an IFI to appoint any person to carry out Shariah audit.
- BNM may appoint for an IFI any person to conduct a Shariah audit
 - The IFI will bear remuneration & expenses of the Shariah auditor/s.

Duty of institution to ensure Shariah compliance (s.28)

(3) Where an institution becomes aware that it is carrying on any of its business, affair or activity in a manner which is not in compliance with Shariah or the advice of its Shariah committee or the advice or ruling of the SAC, the institution shall —

(a) **immediately notify** BNM and its Shariah committee of the fact;

(b) **immediately cease** from carrying on such business, affair or activity and from taking on any other similar business, affair or activity; and

(c) **within 30 days** of becoming aware of such noncompliance or such further period as may be specified by BNM, **submit to BNM a plan** on the rectification of the non-compliance.

Statutory Duty: Reporting

- IFIs are required to immediately notify the BNM and its Shariah committee of any non-Shariah compliant activities and immediately cease from carrying on such business, affair or activity. The IFIs are required, within 30 days, to submit to the regulator a plan on the rectification of the non-compliance as provided in section 28(3)(c).
- Section 37 requires IFIs to submit Shariah audit compliance report.

BNM Circular on Shariah Non-Compliance Reporting 15 March 2013 and came into effect on 1 May 2013

<i>Actual Event</i>	<i>Potential Event</i>
<ul style="list-style-type: none">• Report shall be submitted on an “immediate”(14 days upon realization) basis “as and when” necessary.• During this period, the IFIs are required to obtain the confirmation from the Shariah Committee.• To submit rectification plan, to be approved by the BOD and the SC within 30 days.	<ul style="list-style-type: none">• Any pending decision by the SC on the identified issue shall be treated as potential Shariah non-compliance event.• Report shall be made on a monthly basis based on a calendar year which is not later than 2 weeks after the end of each monthly period.

Diagram 1: Timeline for actual Shariah non-compliance reporting

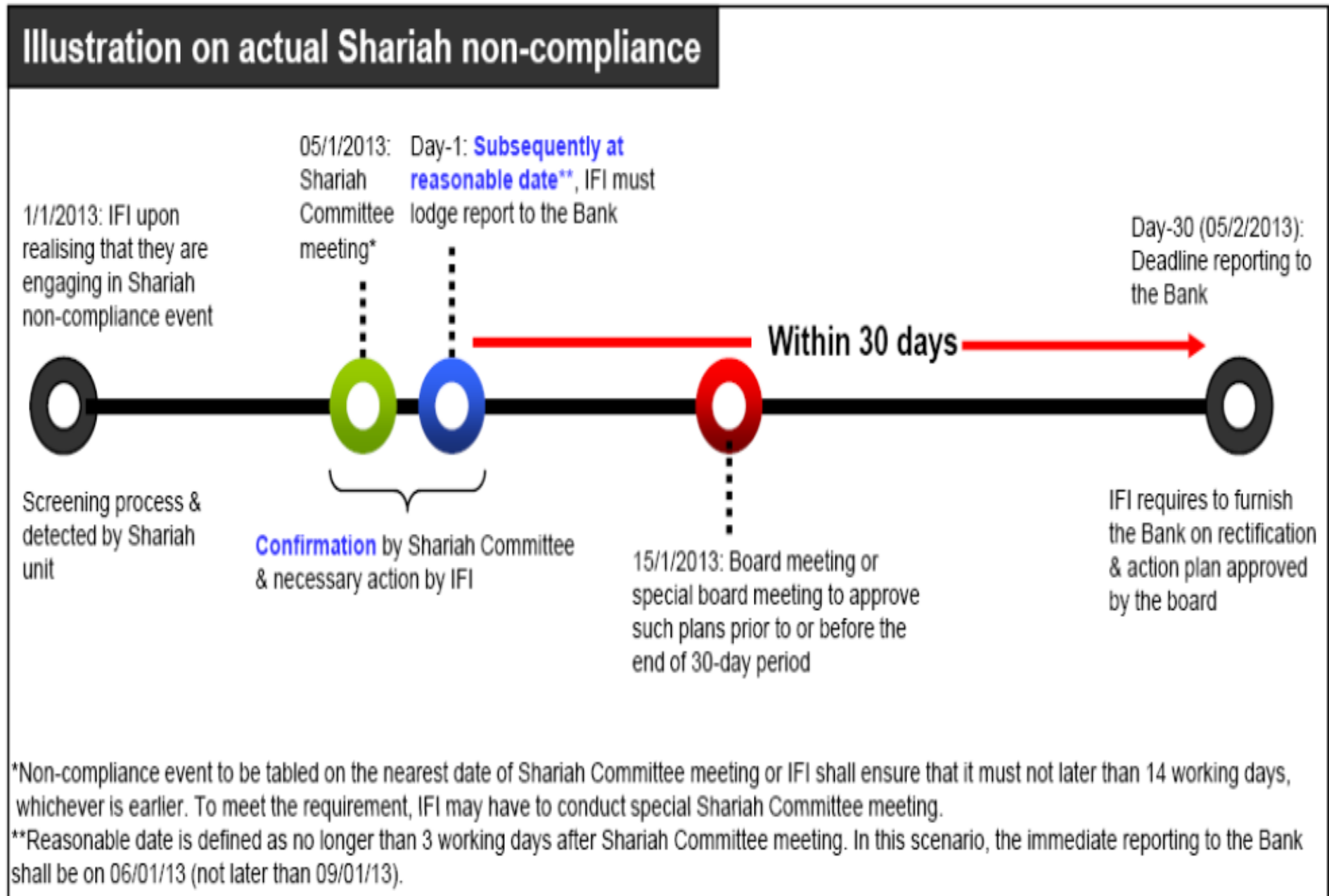
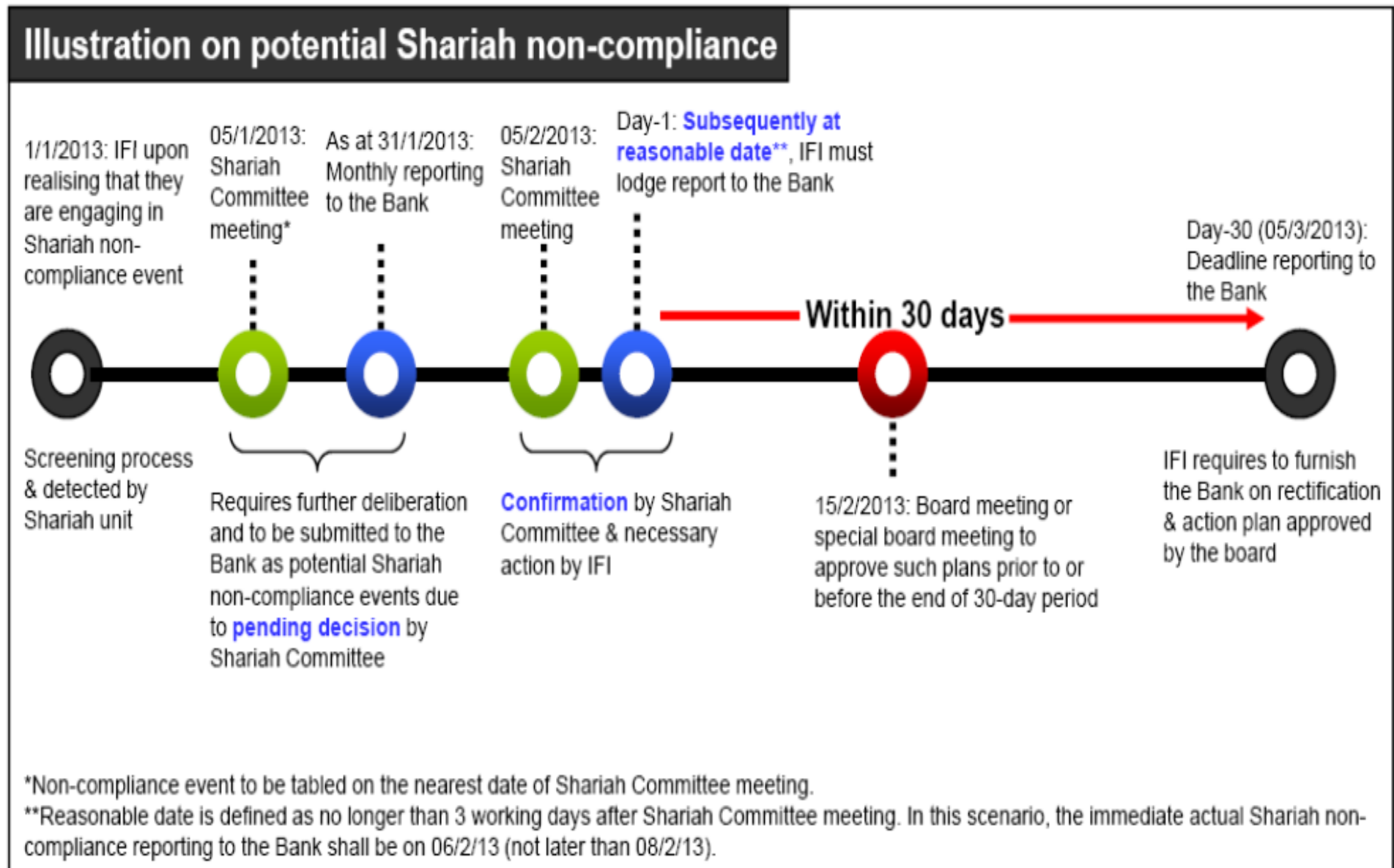


Diagram 2: Timeline for potential Shariah non-compliance reporting



BNM Circular: Shariah Non-Compliance Reporting

No Shariah non-compliance event is detected

- Where there is no Shariah non-compliance event in the IFIs for any particular period, the IFIs are still required to submit the reports on a monthly basis which serves as a declaration or official attestation on the status of Shariah compliance of the IFIs.

Responsible Person

- The Chief Risk Officer/ senior management in charge of statutory reporting of the IFI is responsible and will be held accountable for the quality and accuracy of the information submitted to the Bank.

Information to be provided to Shariah committee (S 35 of the IFSA)

- (1) An institution and any director, officer or controller of such institution shall —
 - (a) provide any document or information within its or his knowledge, or capable of being obtained by it or him, which the Shariah committee may require; and
 - (b) ensure that such document or information provided under paragraph (a) is accurate, complete, not false or misleading in any material particular, to enable the Shariah committee to carry out its duties or perform its functions under this Act.
- (2) Except as provided in section 36, a member of a Shariah committee shall not disclose any document or information furnished under subsection (1) to any other person.

Extended to Financial Holding Companies

- **The BNM has powers to control, supervise and monitor FHC and these include authority to issue prudential requirements and directions.**
- **S 122 and 123 of the IFSA: FHC refers to:-**
- **Companies that holds in aggregate more than 50% interest in shares in a licensed entity; or**
- **Less than 50% of shares but has “control”, i.e. power:**
 - **to elect, appoint remove or prevent the election, appointment or removal of a majority of the directors of the licensed entity;**
 - **to make or cause to be made business decisions of the licensed entity;**

Strict Liability

- A director may be deemed guilty of an offence committed by a company, unless he proves that the **offence was committed without his knowledge, consent or connivance and that**
- *“he took all reasonable precautions and had exercised **due diligence to prevent the commission of the offence as he ought to have taken precautions or to have exercised...**” (s. 241(4), FSA) (in relation to civil actions for compensation)*
- *“he exercised such **diligence to prevent the commission of the offence as he ought to have exercised, having regard to the nature of his function in that capacity and to the circumstances.**” (s.249(1), FSA) (in relation to criminal offences)*

Strict Liability and Defense

- The words “deemed to be committed” by Director, Controller, Officer, Partner or anyone concerned with management of its affairs: Presumption that they have committed the offence unless if they can prove otherwise.
- The burden of proof is upon them to show that they have taken all reasonable precautions and exercised due diligence.
- Limit the element of defence
 - (1) the act done without consent and connivance and
 - (2) diligent action taken to prevent commission of offence, as he would have exercised.

Penalty

- The BNM may impose monetary penalty to IFIs in the case of breach to comply as provided in section 245 (4).
- The penalties provided in the IBA just range from a fine not exceeding RM2k for every day during which the default continues to RM50k or three to five years imprisonment or both.
- IFSA: the penalties provided range from one year to 10 years imprisonment or 5 to RM 50m fine or both. Eg. any person who commits an offence for acting on behalf of unlicensed person shall on conviction, be liable to imprisonment for a term not exceeding 10 years or to a fine not exceeding RM50 m or to both.

Penalties

- The IFSA vests the BNM with wide ranging powers to issue standards which are binding upon every director, officer or Shariah committee member of the institution.
- Section 28 (6) provides that a failure to comply with the standards issued is an offence under the Act and carries with a maximum penalty of 8 years imprisonment or a fine of 25 million ringgit or both.

Penalties

Form of Penalties	Penalties
Administrative	the BNM may make an order in writing requiring the person in breach to comply with or give effect to or to do or not to do any act in order to ensure compliance with such provision
Monetary	such amount as the Bank considers appropriate, not exceeding (RM5 mil- body corporate or RM1mil- individual);
Criminal Offence	Up to 10 years imprisonment or 5-50 million ringgit fine or both

Offence/Breach S 28 and 29	Penalty
Failure to comply with BNM standards on Shariah matters/ that give effect to SAC rulings, ruling of BNM SAC, advice of SC, Shariah principles (in general)	Not exceeding 8 years imprisonment or RM 25 M fine or both.
Failure to immediately report, or cease Shariah noncompliant activity, or submit rectification plan in accordance with the IFSA & Circular	Not exceeding 8 years imprisonment or RM 25 M or both.
Failure to comply with BNM standards on Shariah governance	s.245 (3), or 247, Schedule 15 (3).
Failure to comply with BNM standards in relation to the business, affair & activity of an institution for the purpose of Shariah Compliance	- not exceeding RM 5M if body corporate/RM 1 M if individual; - shall not exceed 3x the gross amount of pecuniary gain made or loss avoided as a result of the breach; or
Failure to ensure that internal policies & procedures on are consistent with BNM standards	- shall not exceed 3x the amount of money which is the SM of the breach, whichever is greater for
Failure to comply with internal policies &	

Director, controller, officer, partner, management deemed liable for offences.

- Only defence is that offence was committed without consent AND diligence has been exercised to prevent its commission
- Delegation to or reliance on 3rd parties is not a defence
- Civil actions can be brought by any persons or institutions or by BNM on their behalf against any persons who contravenes or is in breach of the IFSA provisions.

Statutory Protection

- the BNM to specify the duties and functions of the SC.
- SC enjoys statutory protection for actions for breach of confidentiality provided they have acted in good faith in the course of the discharge of their duties and performance of their functions.
- Shariah committee members are also statutorily protected from actions for defamation in respect of any statement made by them without malice in the discharge of their duties as stipulated in section 36 (b).

New Requirements under Takaful

- **Single licensed takaful business. S 16 of the IFSA requires takaful operator to separate its family business with general takaful business. (5 years to split both business, family business and general takaful business into separate entities).**
- **S 94 prohibits a licensed takaful operator from making any withdrawal from a takaful fund, whether from the surplus, or otherwise, of that takaful fund unless all the conditions set out is fulfilled.**
- **S 91 makes it mandatory for takaful operator to separate takaful fund and shareholders' fund.**
- **S 95 makes *qard* or loan provision is compulsory to every takaful operator in the event of deficit of the risk fund.**

IFSA 2013

Express provision to empower the Minister **on recommendation of BNM** to prescribe certain activities

Powers of the Bank to prescribe Prudential Requirements – relates to capital adequacy, liquidity, corporate governance, risk management, maintenance of reserve funds, etc.

IBA & TA

BNM had implied power to prescribe for certain businesses or activities

Provides for business to be conducted in a prudent manner – relates to maintenance of net assets, integrity and skill of business,

IFSA 2013

'Fit and Proper' requirements for directors, etc. – BNM allowed to set and specify requirements in the future

BNM empowered to fix breaches of IFSA/ prudential issues. Broader triggers for exercising power. **Ministerial approval not required.**

IBA & TA

Scope of 'Fit and Proper' requirements are laid out in the Acts

Power to step in where interests of depositors affected. Intervention by BNM requires Ministerial approval.

IFSA 2013

IBA & TA

Assume control of an institution with approval of the Minister, suspending the powers of the Board. Also, allowed to order the sale of the business or assets, or parts of the business

No direct predecessor. Previously, parties to a transaction could apply to the High Court for approval

Appoint receiver to an Institution

No previous power. Other parties could apply to High Court for such an order.

IFSA 2013

Requires Ministerial approval on advise by Bank for changes of share control

Bank to order that another company in a corporate group be designated as the group's 'financial holding company', requiring corporate rearrangement.

IBA & TA

Changes of control not directly regulated: regulated via requiring changes to holdings of more than 5% to be approved

No power to dictate precise corporate structure

IMPLICATIONS, ISSUES AND CHALLENGES

The LHC

- The Law Harmonization Committee Report formulated several recommendations to resolve issues in Islamic finance. The Committee is also studying the legal implications on the implementation of Islamic Financial Services Act 2013.
- The Committee introduced several new legal provisions in court such as rules on imposition of late payment charges on judgment debts, to allow better access to Islamic financing for consumers through recommended amendments to reserve land legislations at all states, to facilitate Islamic financing involving landed property through recognition of Islamic finance in the National Land Code 1965 and to amend the Companies Act 1965

Shariah Non-Compliance Framework

- The BNM utilises an integrated system known as the Operational Risk Integrated Online Network (ORION) for guidance on treatment of *Shari'ah* non-compliant items.
- ORION is the BNM regulatory reporting system and processes. This system enables efficient reporting and supervision. Through this system, the BNM can easily monitor and supervise any *Shari'ah* non-compliance cases in IFIs. It is reported that since its effective date, the BNM received more than 100 submissions from IFIs for *Shari'ah* non-compliance reporting and less than 21% are actual *Shari'ah* non-compliance.

Professional Indemnity Insurance

- the IFSA makes *Shari'ah* scholars legally accountable and liable for their duties as any *Shari'ah* committee members may be jailed for up to eight years or fined up to RM25 million which is equivalent of approximately USD7.6 million if they fail to comply with the IFSA.
- This serious legal implication triggers the need of having professional indemnity Islamic insurance for *Shari'ah* scholars as in the case of advocate and solicitor or medical practitioners.

Reclassification of Deposit

- 30th June 2015 was the deadline for IFIs to clearly separate between the deposits account and investment account.
- IFIs must introduce a new structure of *mudharabah* investment account, which reflect the actual characteristics of investment.
- Islamic deposit as principal guaranteed and investment as non-principal guaranteed. The deposit insurance or takaful also will be no longer relevant for investment-type of accounts.
- The reclassification of deposits is not favourable to IFIs. The reclassification of deposits imposes a great challenge to IFIs to accumulate deposits, which are based on *mudharabah* principle.

Investment Account Platform

- The IFSA requirement on the separation of Islamic deposit and investment account is actually to allow the banks to customise their products according to the customers' profile and risk appetite.
- IFIs are now can offer higher returns to any investors for their investment account.
- To facilitate this transition period, the Malaysian government backed the IAP with an initial start-up fund for RM150 million and tax exemption for 3 consecutive years. Lembaga Tabung Haji also allocated RM200 million for the establishment of the *Shari'ah* compliant Restricted Investment Account.
- There are four IFIs have participated in the IAP namely BIMB, Maybank Islamic, Affin Islamic and BMMB.

Judicial Oversight over the BNM

- The BNM has more power to dictate- IFIs and and its holding company and these include its Capital Requirements, Corporate Governance, Consumer Protection, Shareholding, Intervention and even *Shari'ah* compliance.
- Power not only to advise but also to recommend the decision made by the Minister.
- There must be certain legal mechanism to limit and restrict such authorities and to find the best avenue to review and oversee the BNM's action.

Potential Conflict of Interest Between Shareholders and Other Stakeholders

- The BOD of an institution shall have regard to the interests of depositors, IAH and takaful participants.
- The IFSA seems to promote stakeholders value based approach in Islamic financial institutions rather than the shareholders value model.
- Potential conflict of interest between shareholders and other stakeholders.

Cost and Efficiency

- The element of strict liability in the IFSA will expose IFIs with further cost and expenses.
- Vigorous *Shari'ah* compliance requirements will also increase the cost of business and finally will affect the level of efficiency.
- Since precautions and due diligence have to be exercised to prevent the commission of the offence, any measures to mitigate this legal risk will cost additional expenses. Eg. Professional Indemnity Insurance.

Innovation of Product and Services

- Heavy regulated business environment- may negate innovation/ lack of innovation/ influence the market behavior and the players will opt for products of lesser constraints.
- Eg. All contracts under *wakalah* and *mudharabah* are deemed as investment products and hence require additional treatment: Documentation, operation, system and etc.
- Effect: Concentrating on debt-based products and consistently neglecting the equity-based products both from asset and liabilities sides.

CONCLUSION

Recommendations

- **Exercise extra care & vigilance on Shariah compliance matters through effective internal Shariah compliance functions: Full information on products & transactions; pre- and- post approval monitoring, supervising conduct of Shariah review & Shariah audit reports; monitoring rectification measures.**
- **Examine internal gaps to attain “end-to-end” Shariah compliance;**
- **Examine Shariah review & audit reports & implement rectification plans;**
- **Assess and adhere internal policies & procedures and also BNM standards;**

Concluding Remarks

- **The IFSA provides a framework to facilitate the creation and optimize a healthy and viable environment for Islamic finance system in Malaysia.**
- **Despite positive features of the IFSA, there are loopholes, issues and shortcomings that may negate its objectives.**
- **These factors finally may lead to lack of appetite for product innovation on the part of IFIs.**
- **Considering these great challenges, it is recommended for the BNM and the industry stakeholders to review and discuss seriously the implications and consequences of the IFSA.**
- **Years ahead will be a real test for true potential of Islamic finance in Malaysia.**

THANK YOU



Pioneering Islamic Science
Spearheading Knowledge
نترأس العلوم الإسلامية ، ونقود العلماء

www.usim.edu.my

www.usim.edu.my