



LEGISLATIVE CONFLICTS FACING ISLAMIC
BANKING IN MALAYSIA

BY

AISHATH MUNEEZA

A thesis submitted in fulfilment of the requirement for
the degree of Doctor of Philosophy in Law

Ahmad Ibrahim Kulliyyah of Laws
International Islamic University Malaysia

AUGUST 2013

ABSTRACT

This is a qualitative research focusing on the legislative conflicts facing Islamic banking in Malaysia. This research identifies the practical legislative conflicts facing Islamic banking in Malaysia by analysing the statutory provisions that have been invoked in the reported Malaysian Islamic banking cases from 1983-2011. The objectives of this research include finding out the most frequently invoked legislations in the reported Islamic banking cases and also to examine the legislative conflicts evident in the provisions of those legislations that have been utilised in deciding the cases. This research gives an overview of the legal development of Islamic banking in Malaysia and subsequently examines reasons for legislative conflicts in Islamic banking in Malaysia evident in regulatory laws, substantive laws and procedural laws applicable to Malaysian Islamic banking. It is hoped that this research will assist the harmonisation process of legislations to facilitate the sustainable development of Islamic banking in Malaysia and help to fill the gap between the literatures on legislative conflicts facing Islamic banking in Malaysia which is traditionally focused on either various products or parts of different legislations rather than looking at the legislations comprehensively.

خلاصة البحث

هذا البحث وصفي يركز على النزاعات التشريعية التي تواجه العمل المصرفي الإسلامي في ماليزيا. ويحدد هذا البحث الصراعات التشريعية العملية التي تواجه العمل المصرفي الإسلامي في ماليزيا من خلال تحليل الأحكام القانونية التي تم الاستناد إليها في حالات المصرفية الإسلامية الماليزية المحلة خلال الفترة من ٢٠١١-١٩٨٣. وتشمل أهداف هذا البحث معرفة تشريعات الاحتجاج في اغلب الاحيان في القضايا المصرفية الإسلامية وأفادت أيضا لدراسة الصراعات التشريعية واضحا في أحكام تلك التشريعات التي استخدمت في تحديد الحالات. هذا البحث يعطي لمحة عامة عن التطور القانوني للعمل المصرفي الإسلامي في ماليزيا، ويدرس أسباب النزاعات التشريعية في مجال الخدمات المصرفية الإسلامية في ماليزيا المعروفة في القوانين التنظيمية والقوانين الموضوعية والقوانين الإجرائية التي تنطبق على البنوك الإسلامية الماليزية في وقت لاحق. ومن المؤمل أن يساعد هذا البحث عملية مواءمة التشريعات لتسهيل التنمية المستدامة للعمل المصرفي الإسلامي في ماليزيا وتساعد على سد الفجوة بين الآداب في النزاعات التشريعية التي تواجهها مصرفية الإسلامية في ماليزيا والتي تركز تقليديا على أي من المنتجات المختلفة أو أجزاء من التشريعات المختلفة بدلا من النظر في التشريعات بشكل شامل.

APPROVAL PAGE

The Thesis of Aishath Muneeza has been approved by the following:

Rusni Hassan
Supervisor

Uzaimah Ibrahim
Co-Supervisor

Ahmad Azam Othman
Internal Examiner

Noor Inayah Yaacob
External Examiner

Faiz Ahmed Mohamed El-Faki
Chairman

DECLARATION

I hereby declare that this thesis is the result of my own investigations, except whether otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

Aishath Muneeza

Signature:..... Date:.....

INTERNATIONAL ISLAMIC UNIVERSITY MALAYSIA

**DECLARATION OF COPYRIGHT AND AFFIRMATION OF FAIR USE
OF UNPUBLISHED RESEARCH**

Copyright © 2013 by Aishath Muneeza. All rights reserved.

**LEGISLATIVE CONFLICTS FACING ISLAMIC BANKING IN
MALAYSIA**

No part of this unpublished research may be reproduced, stored in a retrieval system, or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording or otherwise without prior written permission of the copyright holder except as provided below.

1. Any material contained in or derived from this unpublished research may only be used by others in their writing with due acknowledgement.
2. IIUM or its library will have the right to make and transmit copies (print or electronic) for institutional and academic purposes.
3. The IIUM library will have the right to make, store in a retrieval system and supply copies of this unpublished research if requested by other universities and research libraries.

Affirmed by Aishath Muneeza

.....
Signature

.....
Date

*To My Loving Parents,
Mariyam Saada & late Hussein Yoosuf;*

*My Dear Husband,
Ismail Azzam Wajeih; and*

*My Parents-in-Law,
Aishath Ismail & Ahmed Wajeih.*

ACKNOWLEDGEMENTS

I praise Allah (SW) for giving me the strength to complete this research work. I also offer my deep appreciation and gratitude to my beloved main supervisor, Associate Professor Dr Rusni Hassan, who has been always there for me and has guided me throughout the tenure of my Ph.D. programme. She is an inspiration to me and she has always encouraged me to excel in everything I do. She has taught me that knowledge is sacred and no one shall ever fear to spread and disseminate knowledge for the betterment of *Ummah*.

My sincere thanks also go to my co-supervisor, Assistant Professor Dr Uzaimah Ibrahim for her great support and assistance in guiding me. She is a kind mentor whom I will never forget and will always remember for her constructive suggestions and recommendations to improve and enhance research skills.

Besides my Supervisors, I am deeply grateful to my internal examiner, Assistant Professor Dr Ahmad Azam Othman for his patience, motivation, enthusiasm, and immense knowledge in guiding me to complete my research work. I am also thankful to my external examiner, Professor Dr Noor Inayah Yaacob for the encouragement and insightful comments she has provided.

I also express a very special appreciation to Ms. Fathimath Shafeega for her encouragement and endless moral support. I owe my deepest thanks and appreciation to my mother and father who have been continuously supporting me. I also thank profusely to my beloved husband who has been awake for so many nights with me to complete my work and my parents in law for their support in completing this challenging journey. I also thank my uncle, Mr Ali Farooq and all the members of my family for their unabated encouragement.

A very special thanks to my loving sister Aiminath Suma Hussain for all the assistance and constructive suggestions she has given me. My sincere thanks to Hawwa Lamha Hussain, Thoiba Shareef and Mohamed Faih for their continuous support and motivation.

Last, but not least, I thank everyone who has contributed to the successful realisation of my thesis and my sincere apologies to those whom I could not personally name here.

TABLE OF CONTENTS

Abstract.....	ii
Abstract in Arabic.....	iii
Approval Page.....	iv
Declaration Page.....	v
Copyright Page.....	vi
Acknowledgements.....	vii
List of Tables.....	xii
List of Figures.....	xiii
List of Cases.....	xiv
List of Statutes.....	xvi
List of Abbreviations.....	xvii

CHAPTER ONE: GENERAL INTRODUCTION 1

1.1 Background of Study.....	1
1.2 Research Objectives.....	9
1.3 Statement of Problem.....	10
1.4 Hypothesis.....	14
1.5 Literature Review.....	15
1.6 Scope and Limitations of the Study.....	37
1.7 Methodology.....	37
1.8 Outline of Chapters.....	39
1.9 Conclusion.....	41

CHAPTER TWO: LEGAL DEVELOPMENT IN MALAYSIAN ISLAMIC BANKING 42

2.1 Introduction.....	42
2.2 Growth of Islamic Banking in Malaysia.....	43
2.3 Historical Development of Legislations Applicable to Islamic Banking.....	47
2.4 Banks Offering Islamic Banking Services.....	58
2.4.1 Islamic Banks.....	59
2.4.2 International Islamic Banks.....	61
2.4.3 Development Financial Institutions Offering Islamic Banking Services.....	64
2.4.4 Commercial Banks.....	67
2.4.5 Investment Banks.....	69
2.5 Conclusion.....	71

CHAPTER THREE: REASONS FOR LEGISLATIVE CONFLICTS IN MALAYSIAN ISLAMIC BANKING 73

3.1 Introduction.....	73
3.2 Meaning Of Legislative Conflict.....	76
3.3 Reasons For Legislative Conflicts In Malaysian Islamic Banking.....	79

3.3.1 Nature of Malaysian Legal System	80
3.3.2 Lack of Comprehensive Legal Framework for Islamic Banking	87
3.3.3 Societal Nature of Malaysian Population.....	99
3.4 Conclusion.....	101

**CHAPTER FOUR: LEGISLATIVE CONFLICTS IN REGULATORY LAWS
APPLICABLE TO MALAYSIAN ISLAMIC BANKING..... 102**

4.1 Introduction	102
4.1.1 Regulatory Legislations Invoked In Islamic Banking Cases	103
4.2 IBA 1983	104
4.2.1 Overview	106
4.2.2 Analysis.....	116
4.3 BAFIA 1989.....	117
4.3.1 Overview	119
4.3.2 Analysis.....	124
4.4 DFIA 2002	125
4.4.1 Overview	126
4.4.2 Analysis.....	127
4.5 CBMA 1958 and CBMA 2009	128
4.5.1 Overview	131
4.5.2 Analysis.....	138
4.6 Co-operative Societies Act 1993.....	139
4.6.1 Overview	139
4.6.2 Analysis.....	140
4.7 Bank Kerjasama Rakyat Malaysia Berhad (Special Provisions) Act 1978	140
4.7.1 Overview	141
4.7.2 Analysis.....	142
4.8 Conclusion.....	142

**CHAPTER FIVE: LEGISLATIVE CONFLICTS IN SUBSTANTIVE LAWS
APPLICABLE TO MALAYSIAN ISLAMIC BANKING..... 145**

5.1 Introduction	145
5.1.1 Substantive Legislations Invoked In Islamic Banking Cases	147
5.2 Companies Act 1965	149
5.2.1 Overview	149
5.2.2 Analysis.....	154
5.3 NLC 1965	156
5.3.1 Overview	156
5.3.2 Analysis.....	166
5.4 SLC 1958	169
5.4.1 Overview	170
5.4.2 Analysis.....	172
5.5 Contracts Act 1950.....	172
5.5.1 Overview	173
5.5.2 Analysis.....	183
5.6 SRA 1950	187
5.6.1 Overview	188
5.6.2 Analysis.....	189

5.7	MLA 1951	191
5.7.1	Overview	192
5.7.2	Analysis	195
5.8	Kelantan Malay Reservations Enactment 1930	197
5.8.1	Overview	199
5.8.2	Analysis	202
5.9	Conclusion.....	203
 CHAPTER SIX: LEGISLATIVE CONFLICTS IN ADJECTIVE LAWS APPLICABLE TO MALAYSIAN ISLAMIC BANKING.....		205
6.1	Introduction	205
6.1.1	Adjective Legislations Invoked in Islamic Banking Cases.....	207
6.2	Evidence Act 1950	208
6.2.1	Overview	209
6.2.2	Analysis.....	217
6.3	RHC 1980.....	226
6.3.1	Overview	227
6.3.2	Analysis.....	235
6.4	Limitations Act 1950 & Limitation Ordinance 1953.....	238
6.4.1	Overview	239
6.4.2	Analysis.....	241
6.5	CJA 1964.....	243
6.5.1	Overview	244
6.5.2	Analysis.....	246
 CHAPTER SEVEN: CONCLUSIONS		249
7.1	Conclusion.....	249
7.2	Suggestions and Recommendations of the Study	257
7.3	Possible Areas of Further Research	264
7.4	Concluding Remark	266
 BIBLIOGRAPHY		268

LIST OF TABLES

<u>Table No.</u>		<u>Page No.</u>
1.1	Banking System Approaches Adopted by Countries	4
1.2	Categories of countries according to government stances in adopting Islamic banking	5
4.1	Frequency of the Usage of Regulatory Laws in Malaysian Cases 1983-2011	104
5.1	Frequency of Legislations Invoked in Islamic Banking Cases in Malaysia	148
6.1	Frequency of Adjective Legislations Invoked in Reported Islamic Banking Cases from 1983-2011	207
7.1	Information Extracted from Reported Islamic Banking Cases from 1983-2011, Malaysia	250
7.2	Legislations Invoked in Islamic Banking Cases Reported From 1983 to 2011	256

LIST OF FIGURES

<u>Figure No.</u>		<u>Page No.</u>
3.1	Possible Sequence of Events for the Cause of Legal Conflicts in Malaysian Islamic Banking	82
3.2	Classification of Legislations Applicable To Islamic Banking in Malaysia	97
3.3	Legal Provisions Invoked in Islamic Banking Cases Reported From 1983 to 2011	98

LIST OF CASES

Affin Bank Bhd v Zulkifli bin Abdullah. [2006] 3 MLJ 67
Al-Jehad Trust v Federation of Pakistan [PLD]1996 SC 324
Abdul Fata Mohamed Ishak v Rasamaya Dhur Chowdhury [1894] L.R. 221A 76
Arab-Malaysian Merchant Bank Berhad v Foreswood Industries Sdn Bhd & 4 Ors [2007] 1 LNS 539
Arab-Malaysian Merchant Bank Bhd v Silver Concept Sdn Bhd [2006] 8 CLJ 9
Arab-Malaysian Finance Bhd v Taman Ihsan Jaya Sdn Bhd & Ors; Koperasi Seri Kota Bukit Cheraka Bhd (Third Party) And Other Cases[2009] 1 CLJ 419
Bain v Whitehaven Railway Junction [1850] 3 H CL. 1-19
Bank Islam Malaysia Berhad v Adnan Bin Omar [1994] 3 CLJ 735
Bank Islam Malaysia Bhd v Azhar Osman & Another Cases [2010] 5 CLJ 54 [2010] 1 LNS 251
Bank Islam Malaysia Berhad v UMW Zipper Manufacturing Sdn Bhd & Ors [2010] 1 LNS 1560
Bank Islam Malaysia Bhd v Lim Kok Hoe & Anor and Other Appeals [2009] 6 CLJ 22
Bank Kerjasama Rakyat Malaysia Bhd v Emcee Corporation Sdn Bhd [2003] 1 CLJ 625
Bank Kerjasama Rakyat Malaysia Berhad v PSC Naval Dockyard Sdn Bhd [2008] 1 CLJ 784
Bank Kerjasama Rakyat Malaysia Bhd v Sea Oil Mill (1979) Sdn Bhd & Anor [2010] 1 CLJ 793
Bank Negara Malaysia v Mohd Ismail & Ors [1992] 1 CLJ 14 (Rep); [1992] 1 CLJ 627
Century Land Resources Sdn. Bhd. v Alliance Bank Malaysia Bhd
Chin Sen Wah v PP [1958] MLJ 154
CIMB Islamic Bank Bhd v LCL Corporation Bhd & ANOR [2011] 7 CLJ 594 [2011] 1 LNS 547
Citibank NA v Ibrahim bin Othman [1994] 1 MLJ 608
Citibank v Mohamad Khalid Farzalur Rahaman & Ors
Commissioner for Religious Affairs, Trengganu & Ors v Tengku Mariam binti Tengku Sri Wa Raja & Anor [1970] 1 LNS 21; [1970] 1 MLJ 222
Coramas Sdn Bhd v Rakyat First Merchant Bankers Bhd & Anor [1994] 2 CLJ 143
Dato' Abd Rahim Mohamad v Abdul Farish Rashid [2009] 1 CLJ 395
Dato' Hj Nik Mahmud Daud v Bank Islam Malaysia Bhd [1998] 3 CLJ 605
Dalip Kaur v Pegawai Polis Daerah Bukit Mertajam[1992] 1MLJ 1
Fatimah binti Mohamad v Salim Bahshuwen [1952] A.C. 1. [1992] 1 MLJ 513
Gibb & Co. v Malaysia Building Society Bhd. [1982] CLJ (Rep) 99
Gimstern Corp (M) Sdn Bhd & Anor v Global Insurance Co Sdn Bhd [1987] 1 CLJ 123; [1987] CLJ 102
Hajjah Halimatusaadiah bte Hj Kamaruddin v Public Service Commission
Ho Giok Chay v Nik Aishah [1961] MLJ 49
Kuching Plaza Sdn. Bhd. v Bank Bumiputra (M) Bhd [1991] 3 CLJ 1702; [1991] 1 CLJ 223
Kuwait Finance House Malaysia Berhad v Adil Perdana Sdn Bhd [2011] 1 LNS 424

KPM Khidmat Sendirian Berhad v Tey Kim Sue [1994] 3 CLJ 1
Light Style Sdn Bhd v KFH Ijarah House (Malaysia) Sdn Bhd [2009] 3 CLJ 370
Low Lee Lian v Ban Hin Lee Bank [1997] 2 CLJ 36
Malayan Banking Bhd v P K Ralamani [1994] 2 CLJ 25
Malayan Banking Bhd v Marilyn Ho Siok Lin [2006] 3 CLJ 796
Malayan Banking Bhd v Ya'kup Oje & Anor [2007] 5 CLJ 311
Margaret Chua v Ho Swee Kiew & Ors [1961] 1 LNS 61
Mariam v Mohamed Ariff [1971] 1 LNS 88; [1971] 1 MLJ 265
Malaysia Shipyard and Engineering Sdn Bhd v Bank Kerjasama Rakyat Malaysia Bhd
 [1985] CLJ 206 ; [1985] 2 CLJ 427; [1985] 2 MLJ 359
Maybank Islamic Berhad v Seri Mukali Sdn Bhd & Ors [2011] 1 LNS 647
Mohd Alias Ibrahim v RHB Bank Bhd & Anor [2011] 4 CLJ 654
Morgan Guaranty Trust Co of New York v Lian Seng Properties Sdn Bhd [1991] 1
 MLJ 96
Nik Mahmud Daud v Bank Islam Malaysia Berhad [1996] 1 CLJ 576
Ong Chan Tow v R [1963] MLJ 160
Perwira Habib Bank Malaysia Bhd v Lum Choon Realty Sdn Bhd [2005] 4 CLJ 345
Profound Heritage Sdn Bhd v Bank Islam Malaysia Berhad - Labuan Offshore Branch
 [2010] 1 LNS 1249
Public Bank Berhad v Rahmat Harun [2010] 1 LNS 1533
PP v Yuvaraj[1969] 2 MLJ 89
Ramah binti Taat v Laton binti Malim Sultan (1927) 6
 FMSLR 128
Re Ismail bin Rentah, Decd. Haji Hussain bin Singh v Lia binti Lerang & 3 Ors.
 [1940] 9 MLJ 98
Re Timah binti Abdullah, Decd. The Official Administrators, FMS v Magari
Mohihiko & 3 Ors [1941] 10 MLJ 51
RHB Sakura Merchant Bankers Bhd v Tan Sri Dato' Ting Pek Khiing (No. 1) [2004] 2
 MLJ 315
Sea Oil Mill (1979) Sdn Bhd & Anor v Bank Kerjasama Rakyat Malaysia Bhd [2009]
 3 CLJ 564
Shepherd Homes Ltd. v Sandham [1971] 1 Ch 340
Simon Mahanraj Appaduray & Anor v Reginald Ananda & Anor [1981] CLJ 136
Sivaperuman v Heah Seok Yeong Realty Sdn. Bhd. [1978] 1 LNS 184
Tahan Steel Corporation Sdn Bhd v Bank Islam Malaysia Bhd [2011] 1 CLJ 755
Tahan Steel Corporation Sdn Bhd v Bank Islam Malaysia Bhd (No 2) [2004] 6 CLJ
 131
Tan Sri Abdul Khalid Ibrahim v Bank Islam Malaysia Bhd & Another Case [2010] 4
 CLJ 388 [2009] 1 LNS 980
Tan Sri Abdul Khalid Ibrahim v Bank Islam Malaysia Berhad & Another Cases
 [2011] 1 LNS 1259
Tan Swee Hoe Co Ltd v Ali Hussain Bros [1979] 1 LNS 113
T Bariam Singh v Pegawai Pentadbir Pesaka Malaysia [1983] 1 MLJ 232
Tinta Press Sdn. Bhd. v Bank Islam (M) Bhd. [1987] CLJ 396
Ong Chan Tow v R [1963] MLJ 160
Wan Jalil Bin Wan Abdul Rahman & Anor v Public Prosecutor [1988] 1 LNS 150
Wah Loong (Jelapang) Tin Mine Sdn. Bhd. v Chia Ngen Yick [1975] 2 MLJ 109

LIST OF STATUTES

Arbitration Act, 2005 (Act 646)
Banking and Financial Institutions Act, 1989 (Act 372)
Bank Kerjasama Rakyat Malaysia Berhad (Special Provisions) Act, 1978 (Act 202)
Bills of Sale Act, 1950 (Act 268)
Central Bank of Malaysia Act, 2009 (Act 701)
Central Bank of Malaysia Act, 1958 (Act 519)
Civil Law Act, 1956 (Act 67)
Companies Act, 1965 (Act 125)
Contracts Act, 1950 (Act 136)
Co-operative Societies Act, 1993 (Act 502)
Court of Judicature Act, 1964 (Act 91)
Development Financial Institutions Act, 2002 (Act 618)
Evidence Act, 1950 (Act 56)
Exchange Control Act, 1953 (Act 17)
Federal Constitution, 1957
Financial Service Act, 2013 (Act 758)
Government Contracts Act, 1949 (Act 120)
Hire Purchase Act, 1967 (Act 212)
Islamic Banking Act, 1983 (Act 276)
Islamic Financial Services Act, 2013 (Act 759)
Income Tax Act, 1967 (Act 53)
Insurance Act, 1996 (Act 553)
Kelantan Malay Reservations Enactment, 1930 (Enactment No. 18)
Limitation Act, 1953 (Act 254)
Limitation Ordinance, 1953 (Ord. 49)
Limitation Ordinance, 1952 (Ord. 72)
Malay Reservation Enactment, 1938 (Enactment No. 14)
Moneylenders Act, 1951 (Act 400)
National Land Code, 1956 (Act 65)
Payment Systems Act, 2003 (Act 65)
Pilgrimage and Fund Board Act, 1969 (Act No. 08)
Real Property Gains Tax Act, 1976 (Act 169)
Rules of Court, 2012 (PU(A)50/2012)
Rules of High Court, 1980 (PU(A)50/1980)
Sarawak Land Code, 1958 (Act 81)
Sales of Goods Act, 1957 (Act 382)
Securities Commission Act, 1993 (Act 498)
Specific Relief Act, 1950 (Act 137)
Stamp Duty Act, 1949 (Act 378)
Takaful Act, 1984 (Act 312)

LIST OF ABBREVIATIONS

BAFIA	Banking and Financial Institutions Act 1989
BBA	<i>Baī ° Bithaman Ajil</i> (deferred sale)
BNM	Bank Negara Malaysia
CA	Court of Appeal
CBMA 2009	Central Bank of Malaysia Act 2009
CBMA 1958	Central Bank of Malaysia Act 1958
CJA	Court of Judicature Act 1964
CLA	Civil Law Act 1956
CLJ	Current Law Journal
DFIs	Development Financial Institutions
FC	Federal Court
MLJ	Malayan Law Journal
DFIA	Development and Financial Institutions Act 2002
FSA	Financial Services Act 2013
HC	High Court
HLC	House of Lords Cases
HPA	Hire Purchase Act 1967
IBA	Islamic Banking Act 1983
IFSA	Islamic Financial Services Act 2013
IIB	International Islamic Bank
MLA	Moneylenders Act 1951
NLC	National Land Code 1956
RC	Rules of Court 2012
RHC	Rules of High Court 1980
RM	Ringgit Malaysia
SAC	<i>Sharī°ah</i> Advisory Council
SAW	<i>Sallallāhu °Alaihi Wasallam</i> (Peace be upon him)
SLC	Sarawak Land Code 1958
SRA	Specific Relief Act 1950
SW	<i>Sub°hanahū Wa ta°alā</i> (May He be Glorified and Exalted)

CHAPTER ONE

GENERAL INTRODUCTION

1.1 BACKGROUND OF STUDY

When and where exactly Islamic banking originated is not traceable, as different literatures had indicated different periods of time and places.¹ It had perceived that the modern Islamic Finance began due to decolonization of Muslim countries after the Second World War.² But, one thing which all of them agreed is that Islamic banking dates back to the time of Prophet (SAW). For example, some said that although banks did not exist during the Prophet's (SAW) time, innovative financial instruments were a part of commercial life and an often used expression is that they were “bankers without banks.”³

Likewise, others observed that though contemporary Islamic banking is a recent development, Muslims were able to access financial systems operating without interest ever since the beginning of Islamic history.⁴ Hence, it is not wrong to state that the concept of Islamic banking dates back to the Prophet's (SAW) time when the usury was prohibited. For instance, Sudin⁵ said that in the early days of Islam, Zubair bin Awwam was entrusted by the public as a keeper of their money and valuables and at one time the total money deposited with him amounted to 2,200,000 (Two Million Two Hundred Thousand *dirhams*).

¹ For example see LexisNexis, “Islamic Banking” in *Halsbury's Laws of Malaysia* (Kuala Lumpur: Lexis Nexis, 2008), 378. and; Zamir Iqbal, Abbas Mirakhor, *An Introduction to Islamic Finance, Theory and Practice* (USA: John Wiley & Sons (Asia) Pte Ltd, 2007), 23.

² Frank E. Voge, Samuel L. Hayes III, *Islamic Law and Finance, Religion, risk and return* (USA: Kulwer Law International, 1998), 4.

³ Iréne Björklund, Lisbeth Lundström, “Islamic Banking: An Alternative System,” (B.A. dissertation, Kristianstad University, 2004), 17-18.

⁴ Mohamed Abdelhamid, “Islamic Banking” (B.A. dissertation, Carleton University, 2005), 5-6.

⁵ Sudin Haron, *Islamic Banking: Rules and Regulations* (UK: Peland UK publications, 1997), 51.

The origin of Islamic banking that dated back to the Prophet (SAW)'s time is growing in the world today and Malaysia is often dubbed as the “cranium of Islamic banking.”⁶ To develop and sustain Islamic banking for the upcoming generations, it is imperative to resolve any potential conflicts facing Islamic banking today.⁷ Malaysia, the leading country of Islamic banking is facing some legal conflicts even after more than 27 years of Islamic banking.⁸ Some of these legal conflicts include legislative conflicts, money laundering conflicts, documentary conflicts and governance conflicts.⁹ Of these numerous conflicts, one of the least researched conflicts with equal significance are legislative conflicts. Hence, this research is attempted to discuss and suggest ways to help overcome legislative conflicts facing Islamic banking in the country.

Malaysia is a unique nation with a dual banking system.¹⁰ Dual banking system simply means that conventional banking and the Islamic banking exist parallel to each other. The Central Bank of Malaysia in its annual report stated:

With the implementation of the interest free banking scheme, Malaysia has emerged as the first country to implement a dual banking system, whereby an Islamic banking system functions on a parallel basis with the conventional banking system.¹¹

⁶ See: Malaysian Bar, “Legal and Regulatory Framework of Islamic Banking and Finance in Malaysia,” MIFmonthly, <http://www.mifmonthly.com/pdf/2008/legal_sup.pdf> (accessed 18 July, 2010). ; Seif el-Din Tag El-Din & Nurdianawati Irwani Abdullah, “Issues of Implementing Islamic Hire Purchase in Dual Banking Systems: Malaysia’s Experience”, *Thunderbird International Business Review*, vol. 49, no.2 (2007): 225–249.; Aishath Muneeza, Rusni Hassan, Ismail Azzam Wajeih, “Legal Obstacles Facing Islamic Banking In Malaysia”, *World Journal of Social Sciences*, vol.1 no. 5 (2011): 127-132.; Mohamed Ismail b Mohamed Shariff, “The Development Of Islamic Banking Juridical And Practical Issues - Is The Law Equipped?,” *Finance Islam*, <http://www.financeinislam.com/article/6_31/1/491> (accessed 11 July, 2010).

⁷ See: Hakimah Yaacob, *Analysis of Legal disputes in Islamic finance and the way forward: With special reference to a study conducted at Muamalat Court* (Kuala Lumpur: International Shari’ah Research Academy, 2011), 10-25. ; Aishath Muneeza, Rusni Hassan, and Ismail Wisham, *Islamic Banking under the Malaysia Law* (Kuala Lumpur: A.S. Nordeen Publications, 2011), 145-170.

⁸ Muneeza, *Legal Obstacles Facing...*, 127-132.

⁹ *Ibid.*

¹⁰ Section 27, CBMA, 2009

¹¹ Bank Negara Malaysia, *Annual Report* (Kuala Lumpur: Bank Negara Malaysia; 1993), 57.

The approaches taken by the countries to welcome Islamic banking is necessary to analyse, so that the methodology in establishment of Islamic banking in the world would be comprehended. This would prove that Islamic banking is a voluntary movement which gained momentum and respect in the world due to its own potential and benefits it stimulated. Furthermore, this would clarify the nature and features of a dual banking system.

Hakimah¹² grouped the OIC member countries into four divisions depending on the base of their loom in the execution of Islamic banking. She said that there are countries which converted the existing conventional banking system into Islamic banking system. As a result, these countries have Islamic banking system only. The countries which adopted this system include Pakistan, Sudan and Iran. But it can be said that this approach is a radical method to adopt Islamic banking as measures taken in this approach are too radical as they try to close down and transform the whole economy into a *Shari'ah* compliant one over a short period of time. Due to this, there is a possibility that the growth of the economy might be jeopardised in the long-term. Pakistan today has suffered this and is now trying to implement the gradual approach of Islamizing the economy. The second approach is “dual system” approach in which the Islamic banks are given permission to operate parallel to the conventional banks by sharing the same resources and infrastructure, while competing to survive. This is the method utilised by Malaysia in adopting Islamic banking. This way seems to work up until now as Malaysia has maintained this balance successfully from 1983 onwards. The third technique to adopt Islamic banking into the economy of a country is by allowing a few Islamic banks to operate in the country, though the majority of

¹² Hakimah Yaacob, “Developing an Islamic Banking System: The Malaysian Model,” Kementerian Kewangan Malaysia, <http://www.treasury.gov.my/index.php?option=com_content&view=article&id > (accessed 1 July, 2010).

the banks operating are conventional. This method is evident in Saudi Arabia and Bangladesh. The final approach used is to block Islamic banking totally and give no room in the economy for Islamic banking. Countries like this would have just conventional banking system only. These four approaches are described in the table 1.1, below:

Table 1.1 Banking System Approaches Adopted by Countries

Approach	Details	Example of Nations
Transformation System	Conventional banking system inherent in the society was transformed into hundred percent Islamic banking system	Iran, Pakistan, Sudan, Bahrain
Dual System	The Conventional System of banking operating in the society was kept as it is; but Islamic banking was introduced to the country existing and operating parallel to these	Malaysia
“Conventional Plus” System	The system is basically a conventional system with a few Islamic banking institutions operating on the fringe of the banking system	Saudi Arabia, Egypt, Bangladesh, Guinea, Brunei, Indonesia
Only Conventional System	Islamic banking is still not welcomed to these countries. The banking system is solely based on conventional banking system	Albania, Chad, Algeria, Cameroon, Azerbaijan, Comoros, Benin, Djibouti, Burkina Faso, Gabon

Frank et al.,¹³ divided the countries of the world according to the government stances taken to adopt Islamic banking into four categories. They have divided countries into those that have entirely transformed the internal financial system to an Islamic system (Iran, Pakistan and Sudan); those that adopted Islamic banking as a

¹³ Vogel, 11.

national policy and applies it in a dual banking system (Brunei, Kuwait, Malaysia, Turkey, United Arab Emirates); those that neither oppose nor support Islamic banking within their jurisdictions (Egypt, Yemen, Singapore, and possibly Indonesia); and those that actively discourage a separate Islamic banking presence (Saudi Arabia and Oman).¹⁴ The following Table 1.2 summarizes this classification.

Table 1.2 Categories of countries according to government stances in adopting Islamic banking

Approach based on government stance	Details	Example of Nations
Transformation System	Those that have entirely transformed the internal financial system to an Islamic system	Iran, Pakistan, Sudan, Bahrain
Dual System	The Conventional System of banking operating in the society was kept as it is; but Islamic banking was introduced to the country existing and operating parallel to these	Brunei, Kuwait, Malaysia, Turkey, United Arab Emirates
“Neither support nor oppose” system	Those that neither oppose or support Islamic banking within their jurisdictions	Egypt, Singapore, Yemen, (possibly Indonesia)
“Actively discourage a separate Islamic banking” System	those that actively discourage a separate Islamic banking presence	Saudi Arabia, Oman

In Iran, the government transformed the whole country’s economy to adopt Islamic banking after the revolution of 1978-79, though this process was not an easy task.¹⁵ Iran enacted a new banking legislation in August 1983 to swap “interest-based banking by interest-free banking.”¹⁶ The Pakistani process of converting the financial

¹⁴ Ibid.

¹⁵ Ibid.

¹⁶ Ziauddin Ahmad, “Islamic Banking: The State of the Art,” Islamic research Training Institute, <<http://www.irti.org/irj/go/km/docs/documents.pdf>> (accessed 1 January, 2010).

system began with presidential order to the local Council of Islamic Ideology (CII) on September 29, 1977.¹⁷ The adoption of Islamic banking in Sudan did not happen smoothly due to political changes in the government.¹⁸ The first attempt to Islamize the whole economy of Sudan took place in 1984 when a presidential decree was made to convert all interest-based dealing offered by the conventional banks to interest-free dealings.¹⁹

Brunei followed Malaysian approach of adopting Islamic banking when in 1985 the Sultan decreed an Islamic banking option to operate side by side the conventional banking existing in the country, but the first Islamic bank in the country, Tabung Amanah Islam Brunei was opened in 1991.²⁰ In Turkey, Islamic banking began under the regime of President Ozal in 1982 as a way to lure depositors from Gulf countries.²¹

Oman is a nation which has refused to participate in Islamic banking actively.²² In Saudi Arabia, Islamic windows are permitted to operate in the country with the permission of the government, though the government is reluctant to introduce full-fledge Islamic banking to the country.²³ Hence, in Saudi Arabia we find many of the western banks such as Saudi British Bank, Saudi American Bank, Saudi Hollandi Bank, Citigroup offering Islamic banking window services.

¹⁷ State Bank of Pakistan, "Annual Reports (1999-2003)," State Bank of Pakistan, <<http://www.sbp.org.pk/ibd/Islamic-Bkg-Review-03-07.pdf>> (accessed 1 January, 2010).

¹⁸ Ziauddin, n.17.

¹⁹ Ibid.

²⁰ Vogel, 11.

²¹ Ibid.

²² Islamic Finance Asia, "Oman, The Time is Right," Islamic Finance Asia, <<http://www.islamicfinanceasia.com/article.asp>> (accessed 5 March, 2011).

²³ Vogel, 11.

The above classification based on the stances of government has been criticized for a few inaccurate statements.²⁴ It has been said that describing Sudan, Pakistan and Iran as “three totally Islamic economies”²⁵ is a “bit exaggeration”²⁶ as in practice, these countries have not “transformed their entire financial system to an Islamic form” or they are fully changed Islamic economies as “all the three countries have had varying degrees of success.”²⁷ On the dual banking classification, it has been viewed that except Malaysia and Bahrain, it will be “difficult to obtain any clear cut policy statement” and “Egypt and Indonesia could not be described as neutral to Islamic banking as it has been made to be” as “both counties have given permission for Islamic banks to operate in their countries.”²⁸ Furthermore, the statement that Saudi Arabia “discourage a separate presence of Islamic banking” is also regarded as inaccurate because many commercial banks in Saudi Arabia, like National Commercial Bank, Saudi American Bank, Saudi British Bank, Riyadh Bank, etc. have Islamic windows and operate Islamic investment funds.²⁹

Now the probing question would be which system is the best? Each of the above mentioned system has its own unique advantages and disadvantages depending on the angle one looks into it. For instance, the transformation system has the advantage of rejecting the *riba* (usury) based conventional system altogether from the economy. But the problem with this type is that the time which is used to transform the system is short, hence, in the long-term the economy might suffer. Another disadvantage is that Islamic banks would have no counterpart to compete with it and

²⁴ Ausaf Ahmad, “Review on Islamic Finance by Vogel and Hays,” Ausaf Ahmad, <http://www.ausafahmad.info/review_islamic_finance_vogel.html> (accessed 1 January, 2010).

²⁵ Vogel, 11.

²⁶ Ausaf, n. 24.

²⁷ Ibid.

²⁸ Ibid.

²⁹ Ibid.