

Legal Aspects of Islamic Finance: LAB4112

Zulkifli Hasan, PhD

+ Contents

- 1. Introduction: Current State of the Muslims Ummah
- 2. An Overview of the Course
- 3. Key Performance Indicator





Current State of the Muslims

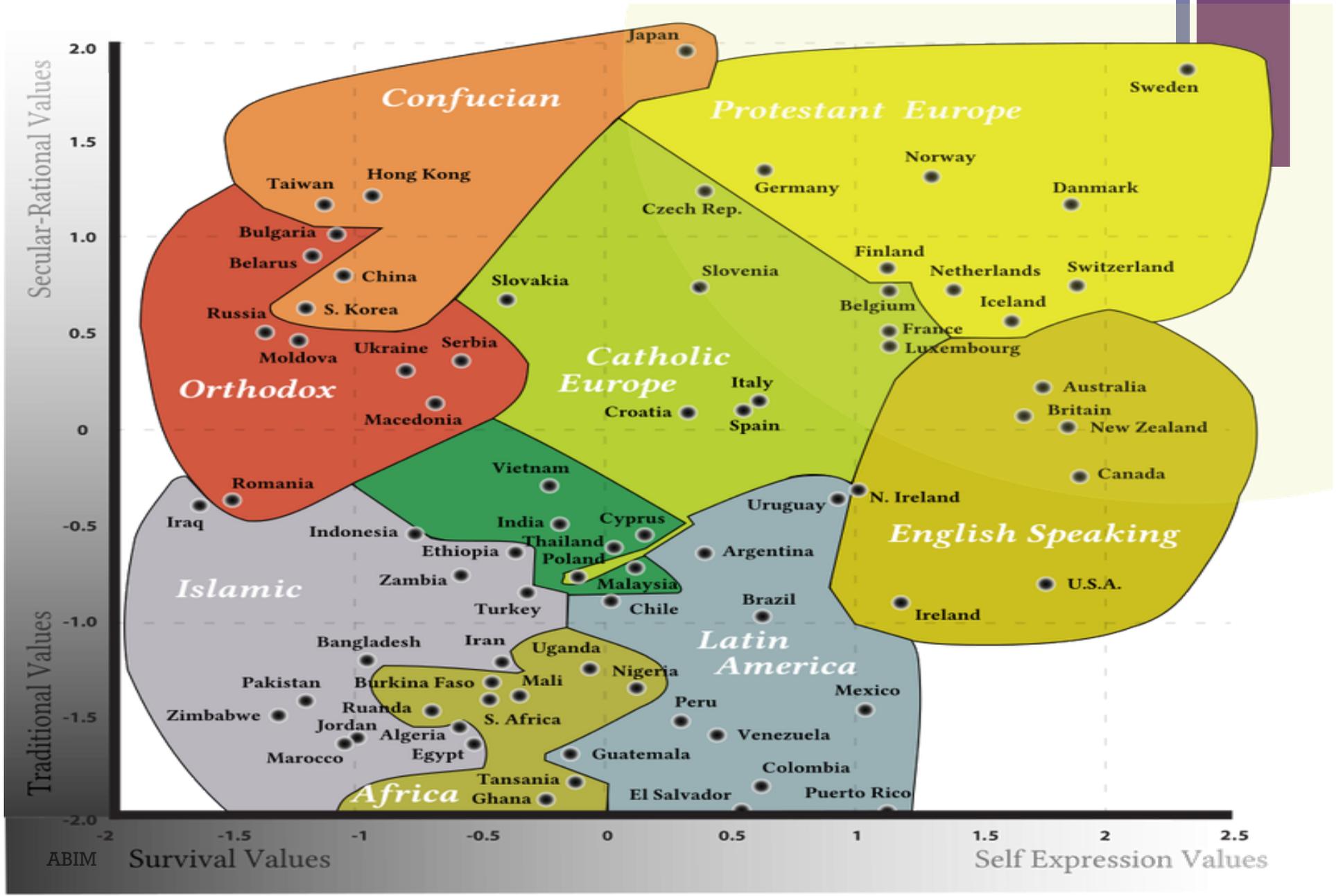
Thawban RA, narrated that the Prophet SAW said: “Soon the nations will call one another against you, just as people call one another to eat from a platter of food.” A man asked: “Will this be because we will be few in number, O Messenger of Allah?”

He peace and blessings of Allah be upon him replied: “No, you will be large in number, but you will be ghuthaa’a like the froth scum on the surface of a body of water, and Allah will remove from the hearts of your enemies their fear of you and shall place in your hearts wahn.” Those present asked: “What is wahn O Messenger of Allah?” He peace and blessings of Allah be upon him replied: “The love of this worldly life and hatred of death.” [Sunan of Abu Dawood Book 37, No 4284]

+ Muslims World



+ The WVS Cultural Map of the World



+ World Development Indicators

- More than 76% of the global R&D expenditures is spent by developed countries, 31.7% (USA), 23.2% (EU), and 10.9% (Japan).
- The OIC countries account for only 2.1% of the world total Gross Domestic Expenditures on R&D (GERD), or 8.8% of the total GERD of developing countries.
- Israel (4.39%), Finland (3.78%) and Korea (3.74%) are the top countries in terms of allocating resources for R&D. Top countries in OIC are Tunisia (1.1%), Malaysia (1.07%) and Turkey (0.84%). The Muslim world spend only 0.5% on R&D while the non Muslim world spend 5% on R&D.
- The Muslim world spends less than 4% of their GDP on education.

+ World Governance Indicators

- **Indicators.** 1) voice and accountability 2) political instability and absence of violence; 3) government effectiveness: 4) regulatory quality; 5) rule of law; and 6) control of corruption.
- **While developed countries outperform developing countries in all categories, other developing countries also do comparably better than OIC countries.**
- **In none of the categories, OIC countries as a group attain a positive score.**
- **Voice and accountability and political stability categories are the weakest categories for OIC countries.**

+ Democracy Index

- Freedom House's annual survey of political rights and civil liberties
- 4 Muslim countries are free: open political competition, a climate of respect for civil liberties, significant independent civic life, and independent media.
- 14 are partly free: limited respect for political rights and civil liberties.
- 9 are not free: basic political rights are absent, and basic civil liberties are widely and systematically denied.
- The Index of Election World: 13 Countries have democracy and 44 do not. Of these 44 countries: pseudo democracy, absolute monarchy, and dictatorship.

World University Ranking

- **The Times Higher Education World University Ranking**
 - Only 9 are in Muslim world.
 - The Top 100 Universities in the World—No Muslim University Ranked

- **QS World Ranking**
 - Only 20 are in Muslim world.
 - No Muslim University Ranked at the top 100 universities

+ The Programme for International Student Assessment (PISA)

- Among the 65 countries surveyed in the study, 5 of the 10 worst performers on the overall reading scale are the OIC member countries.
- Turkey as the best performing OIC country occupies only the 44th position.
- More than 30% of Malian youths aged 15–19 yrs who completed 6 years of schooling could not read a simple sentence.
- In Pakistan, tests of grade 3 children found that only half could answer very basic multiplication questions

+ Corruption Perceptions Index

- **Transparency International: 177 countries.**
- **Ranges from 10 (Least Corrupt) and 0 (Most Corrupt).**
- **8 Muslim majority countries were among the 10 most corrupt nations.**
- **Only 6 Muslim countries are above the borderline.**
- **Israel scored a 61 on the index and ranked 36th least corrupt.**

+ The Global Competitiveness Index

- The index covers 114 indicators under 12 pillars namely “institutions, infrastructure, macroeconomic environment, health and primary education, higher education and training, goods market efficiency, labour market efficiency, financial market development, technological readiness, market size, business sophistication and innovation”
- Average GCI score of 3.90 in 2013, as compared to the rest of the world 4.2 and developed countries 5.0.
- Only Qatar, United Arab Emirates, Malaysia and Brunei scores above 5.

+ The World Intellectual Property Organization (WIPO)

- The total patent applications in OIC countries reached almost 60,000; account for only 0.6% of total applications filled in the world.
- Countries with higher number of patent applications attained better positions in global competitiveness rankings.
- USA, Japan, China, and Republic of Korea accounted for almost 70% (7 million patent applications)

+ Logistics Performance Index (LPI)

- 45% of the OIC member countries had poor logistics performance with score below 2.47.
- Malaysia (3.59) and Somalia (1.77) were the two OIC member countries with the highest and lowest logistics performance index values.
- In contrast, 85% of the developed countries are considered to be logistics friendly with scores above 3.34.
- Transportation infrastructure in the OIC countries is incompetent and the transportation system as a whole offers poor connectivity.

+ OIC Economic Outlook

- The total GDP of the group of the OIC countries (1.5 billion population and 22% of the world population) is \$9.8 trillion representing only 11% share in the world total GDP.
- The number of unemployed around the world is estimated to have reached 201.8 million in 2013. Youth unemployment in OIC countries estimated at 15.6%.
- 3 out of every 4 US dollars of intra-OIC exports come from only ten countries. 4/5 of OIC exports and imports come from only ten countries representing only 9% of global exports.
- The average OIC per capita income was US\$3,600 while the average of the rest of the developing world was about US\$5,600.
- The OIC GDP of US\$3.2 while the US, US\$13.9 trillion. The entire Islamic world's GDP is only 23% of that of the United States.

+ An Economic Islamicity Index

- Measuring 208 countries' adherence to Islamic Economic principles using as proxies 113 measurable variables.
- 1) Economic opportunity and economic freedom; 2) Justice in property rights and the sanctity of contracts ; 3) Better treatment of workers 4) Higher education expenditures 5) Poverty eradication 6) Distribution of wealth and income 7) Better social infrastructure 8) Higher savings and investment 9) Higher moral standard, honesty and trust 10) Financial System: risk sharing and the abolition of interest 12) Higher trade/GDP, higher foreign aid/GDP and higher degree of environmental preservation.
- Non- Islamic, rich and developed, countries are performing well under principles embraced by Islam.
- The highest ranked Islamic country is Malaysia (33), followed in order by Kuwait (42), Kazakhstan (54), Brunei (55), Bahrain (61) and (64).

+ ICT Use in OIC Countries

■ World Bank WDI:

- With respect to mobile cellular subscriptions and internet use, OIC countries are performing fairly well. Some OIC countries show even better performance than developed countries.
- More than 85% of people in Qatar, Bahrain and UAE have internet access.

■ Google's report:

- Pakistan tops the list of most porn-searching countries and leads the way in porn searches for animals like pigs, donkeys, dogs, cats and snakes.
- Six of the top eight porn-searching countries were Muslim states. The country at number two in the list was Egypt, while Iran, Morocco, Saudi Arabia and Turkey came in at numbers four, five, seven and eight, respectively.
- Note: The sale of pornographic material has been banned in nearly every Arab country except Lebanon and Turkey.



An Overview of the Course

The Messenger of Allah (ﷺ) said, "He who goes forth in search of knowledge is considered as struggling in the Cause of Allah until he returns." (At- Tirmidhi)

+ Synopsis

- This course deals with the legal aspects of Islamic finance including its practices in Malaysia. It exposes the students to the regulatory frameworks of Islamic finance, which centred on examination of relevant statutes, case law, and jurisdiction of the courts and the role of Shariah advisory council. The main statutes introduced in this course are Islamic Financial Services Act 2013, Capital Market and Services Act 2007 and Central Bank of Malaysia Act 2009 (Act 701). Apart from that, this course will deal extensively on the jurisdiction of the courts and the decided cases relating to Islamic banking and finance. As an addition to the content of the course, this course will also briefly expose the students the concept of takaful, types of takaful and the laws relating to it. As an addition to the content of the course, this course will also expose the students to the concept of al-Rahnu and Islamic securities and the laws relating to the areas.

+ Introduction to Islamic Banking and Finance

- Overview of modern financial management of banking, insurance and capital market.
- Theories of Islamic Economic.
- History of Islamic banking and finance. The establishment of Islamic banks worldwide both in the Muslim and non-Muslim countries.
- Salient features of Islamic banking and finance.
- Regulatory authorities
- Regulatory structures

+ The Basis of the Introduction of Islamic Banking System

- The Prohibition of Usury, Maysir, Gharar and Khatar in Islamic Commercial Law.
- Foundational axioms: *adl* (social justice), *rububiyah* (nourishment and directing things their perfection) and *tazkiyah* (growth with purification)
- **The Islamic Commercial Contracts**
 - Gratuitous Contracts: Hibah, waqf, Qard, Ibra'
 - Trading Contracts: Ijarah, Murabahah, Istisna' etc;
 - Investment Contracts: Mudharabah, Musharakah;
 - Supporting Contracts; Wakalah, Kafalah, Hawalah, Jua'lah, etc.

+ Rationale for Regulations

- **Rationale for Regulations**
- Protecting the interest of depositors
- Ensuring compliance with Shari'ah
- Supporting the integration of IFIs in the financial system
- **Shariah Supervision**
- Law and guidelines for Shari'ah Governance
- Shariah Supervisory Board- Role and Responsibility.
- Shariah Compliance Review, Audit and Governance
- AAOIFI's Audit and Governance Standards
- IFSB Rules and Guidelines

+ Regulations on Islamic Banking and Finance in Malaysia

- The Role of Central Bank of Malaysia in both Conventional and Islamic Banking.
- Important Provisions of the Islamic Banking Act 1983 and Banking and Financial Institutions Act 1989.
- The Central Bank of Malaysia Act 2009
- Salient features of the Islamic Financial Services Act 2013
- Related Laws on Islamic Banking and Finance
- Legal Issues
- **Jurisdiction of the Malaysian Courts in Islamic Banking and Finance**
- Federal Constitution
- Cases Decided by the Malaysian Courts on Islamic Banking and Finance
- Cases decided in other jurisdictions: United Kingdom, United States, GCC Countries, India and etc.

+ **Regulatory framework of Islamic finance in other jurisdictions**

- Bahrain
- UAE
- Kuwait
- Qatar
- United Kingdom
- Saudi Arabia
- Indonesia
- Pakistan

+ Legal Issues on Islamic Financial Products

- Debt-based financing
- BBA, Inah, Murabahah, Istisna, Salam, Ijarah and etc.
- Home financing, project financing, corporate financing, investment financing.
- Cases Commentaries
- Equity-based Financing: Musharakah and mudharabah
- Deposit Products: Saving account, current account and investment account

+ Legal Aspects in the Structuring of Islamic Banking and Finance Products

- Islamic sources of fund- Overview of Islamic banking accounts and instruments, Saving account, current account and general investment account.
- Structuring of Products (Identifying needs of Clients, Applying and Assimilating the Islamic Commercial Contracts – Contemporary Islamic Banking Products and Instruments (e.g Asset Financing, Credit Card, Factoring, Working Capital, Letter of Credits)
- Understanding and Identifying Legal Documentations Relating to Islamic Banking and Finance Products.
- **Legal Documentation on Selected Islamic banking products**
- Debt Financing: BBA House financing, Bay Inah, Bay Al-Dayn and Ijarah financing facility.
- Equity Financing: Mudharabah and Musyarakah
- Trade Financing: Letter of Credit.

+ Islamic Securities

- Conceptual framework of Islamic securities
- Development on Islamic Securities
- Regulatory Framework
- Types of Islamic Securities Asset-Backed Securities Asset-Based Securities

+ Islamic Securities

- **Security regulations in Malaysia.**
- Securities industry law in Malaysia
- Securities Commission Act 1993
- Securities Industry Act 1983
- Securities Industry (Central Depositories) Act 1991.
- Bursa Malaysia Berhad
- Securities Commission Act 2003
- Capital Markets and Services Act 2007
- Market misconduct and other prohibited misconduct
- Legal Issues on Islamic Securities

+ Takaful

- Concept of Insurance
- Concept of Takaful
- Why conventional insurance is not accepted by Shari'ah
- Shari'ah ruling on Takaful
- Riba, gharar, maysir and other prohibited elements.
- Differences Between Takaful and Insurance
- IFSB Standards
- Laws Relating to Takaful
- Salient features of Takaful Act 1984
- The Islamic Financial Services Act 2013 and Takaful.
- Shari'ah Governance and Supervision

+ Takaful Models

- **Takaful Models**
- **Takaful Products**
- Structuring of Takaful Products and Comparison to Conventional Insurance
- Types of Takaful Products
- General Takaful, Family Takaful
- Re-Takaful
- **Operational Framework of Takaful**
- Legal Documentation on Takaful
- Participant benefits, Utmost good faith, Insurable Interest, Proximate Cause, Indemnity
- Shari'ah and Legal Issues Relating to the Application of Takaful

+ Al-Rahnu

- Concept
- Development on al Rahnu
- Conditions of al-Rahnu
- Regulatory framework

+ Al-Rahnu

- Laws Relating to Al-Rahnu
- Structuring of Al-Rahnu Product
- Legal Documentation on Al Rahnu
- Shariah and Legal Issues on al Rahnu

+ References

- Bakar, M.D. and Engku Ali, E.R.A. (Ed.s). (2008). *Essential Readings in Islamic Finance*. Kuala Lumpur: CERT Publication.
- Dusuki, A.W.D. (Ed). (2011). *Islamic Financial System, Principles and Operations*. Kuala Lumpur: ISRA Publication
- Hasan, Z. (2012). *Shari'ah Governance in Islamic Banks*. Edinburgh: Edinburgh University Press. **(MAPIIM Best Publication Award in the Category of Social Science)**.
- Nik Nozrul Thani, Mohamed Ridza and Megat Hizaini. (2003). *Law and Practice of Islamic Banking and Finance*. Kuala Lumpur: Thomson.
- Mohd Ma'sum Billah. (2007). *Applied Islamic and Modern Insurance*. Sweet and Maxwell.
- [Ausaf Ahmad](#) . (1993). [Instruments of Regulation and Control of Islamic Banks by the Central Banks](#). IRTI.
- Hasan al-Amin. (2000). [Legal Status \(Hukm\) of Contemporary Banking Transactions with Interest](#). IRTI.
- [Tariqullah Khan, Mohammad Umar Chapra](#) . (2000). [Regulations and Supervision of Islamic Banks](#). IRTI.



Key Performance Indicators

“God does not change the condition of a people until they change their inner selves” (al-Ra’d: 11).

+ Assessment

- Mid semester exam = 15%
- Presentation/Ethics= 10%
- Written assignment/ Publication = 15%
- Final examination = 60%



“Alone he is weak and powerless, his energies are scattered and his minds are narrow, diffuse and indefinite. It is the active and living memberships of a vital community that confers on him a sense of power and makes him conscious of great collective purposes which deeper and widen the scope for the growth of his individual self” Allama Iqbal