

Islamic Finance Law and Regulations in Malaysia: A Macro *Maqāṣidic* Approach



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Islamic Finance Law and Regulations in Malaysia: A Macro *Maqāṣidic* Approach

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EXECUTIVE SUMMARY

The research aims to identify the main macro objectives (*maqāṣid*) of Shari'ah that regulators are supposed to realize in the laws and regulations governing Islamic financial institutions (IFIs). It also aims to assess the compliance level of selected Islamic finance laws and regulations in Malaysia vis-à-vis those *maqāṣid*.

The research starts with the conceptual framework of Islamic finance regulations, which addresses the objectives enshrined in legislative acts and in the guidelines promulgated by the Central Bank of Malaysia (Bank Negara Malaysia – BNM). The laws and regulations range from acts such as Islamic Financial Services Act (IFSA) 2013 to guidelines that address prudential and liquidity practices, market structure and competition, consumer protection, corporate governance, and standardization of Shari'ah and operational requirements, to mention but a few. This legal and regulatory environment has succeeded to a great extent in strengthening Shari'ah compliance via the robust Shariah Governance Framework (SGF) issued in 2010 and the special status accorded to the Shariah Advisory Council (SAC) of BNM. The latter has been made the ultimate reference in matters related to Islamic banking and finance, such that the civil courts must refer to its judgments in determination of matters of Islamic jurisprudence. This alone should bring about a regulatory environment that guarantees Shari'ah compliance and, hence, compliance with the *maqāṣid*.

After explaining the overall environment of Islamic finance in Malaysia, the research discusses some obstacles to Islamic finance regulations in Malaysia that make it difficult to fully realize *maqāṣid al-Shari'ah*. These obstacles are mainly:

- 1 'Leveraging' whereby Islamic finance regulations are deemed subordinate to conventional banking regulations in a dual banking system.
- 2 'Harmonization' between Shari'ah and law in a way that has led, according to many legal experts, to a lack of differentiation between Islamic and conventional financial

products. The objective of product development in the Islamic finance industry has been the replication of conventional financial products rather than innovation.

- 3 As a result of the first and second issues, extensive use of *hiyal* (legal stratagems) has emerged in the structuring of Islamic financial products, which Islamic finance regulations have failed to stop.

The research acknowledges that these three issues must be addressed in Islamic finance regulations to fully realize *maqāṣid al-Sharī'ah*. This is important to mitigate the reputational risk that could hinder the acceptability of Islamic finance to all stakeholders.

The research then proceeds to scrutinize some regulations in terms of their compliance with *maqāṣid al-Sharī'ah*. It has selected regulations pertaining to Sharī'ah governance, prudential and risk management regulations, market practice and consumer protection, financial technology (fintech) and policy documents outlining the Sharī'ah and operational requirements of Islamic financial institutions in Malaysia.

For the **SGF**, the research found that the framework provided the necessary instruments (*wasā'il*) to realize *maqāṣid al-Sharī'ah*. By establishing a robust governance structure featuring audit, management, review and research, and by strengthening the lines of reporting to avoid conflict of interest, SGF has ably strengthened compliance with the Sharī'ah and its *maqāṣid*. Compliance has been further bolstered by enhancement of the principles of responsibility, accountability, transparency, independence and disclosure, together with internal control procedures to deal with Sharī'ah non-compliance risks. The amendments to SGF made by BNM in 2019 (i.e., Shariah Governance Policy Document (SGP) issued in September 2019) have strengthened the oversight role of the board of directors on Sharī'ah matters and bolstered the requirements of Sharī'ah advisory. Further, the amendments instill a Sharī'ah-compliance culture and put high expectations on the internal control functions to strengthen this compliance. These amendments are expected to imbue the activities of IFIs with *maqāṣid al-Sharī'ah*. However, lacunae in SGFs across Islamic finance jurisdictions, including Malaysia, still pose a challenge to an ideal SGF. The research cites, as examples of such challenges, the agency problem and moral hazards in *muḍārabah* products vis-à-vis capital treatment (guarantee vs. protection).

As for **prudential and risk management regulations**, the research considers them Sharī'ah compliant in principle as they are technical in nature and, hence, compliant with *maqāṣid* unless proven otherwise. The capital adequacy ratio (CAR) and liquidity ratio are necessary instruments (*wasā'il*) to protect the IFI from deficiency or bankruptcy. Issues of the Sharī'ah compliance of subordinated *ṣukūk*, especially on the issue of *tanāzul* by *ṣukūk* holders, may raise *maqāṣid*-compliance issues in relation to justice and fairness. Recourse to the obligor instead of the asset in asset-based *ṣukūk* would raise an issue as to whether such a practice is in line with the objective of supporting the real economy. An oft-repeated claim of Islamic finance's early advocates was that support for the real economy is a feature that distinguishes it from conventional finance. This claim was based on academics' identification of support for the real economy as being an objective of the Sharī'ah with regards to wealth.

The third set of regulations selected for assessment in terms of *maqāṣid* compliance are the **policy documents on Sharī'ah contracts and SAC-BNM resolutions**. The latter

represent the regulatory references for Sharī'ah compliance of products and services offered by Islamic banking and finance. The standards encapsulate one of the most accurate, comprehensive, and practical *ijtihād* exercises in the modern world, realizing Sharī'ah and *maqāṣid* compliance and enhanced with operational procedures reflecting the best practices in the market. However, some differences are noted between the Malaysian Sharī'ah standards and those of AAOIFI. Although the above issues are Sharī'ah compliant as per the requirements of *ijtihād*, some have criticized them as being Sharī'ah non-compliant and far from *maqāṣid al-Sharī'ah*.

Regarding regulations on market conduct and consumer protection, they contain a number of precautionary measures aimed at keeping the consumer safe from any misleading or deceptive information. However, regulations on digital assets are still lagging behind as the regulator is still in public consultation with the relevant parties to regulate initial coin offerings (ICOs).

As a general outcome, the research found that the Malaysian expertise in Islamic regulation is very commendable but still in need of fully operationalizing *maqāṣid al-Sharī'ah*. The latter still face some challenges in a dual banking system such as leveraging, harmonization and lack of product differentiation. This would render the current dual banking system not in line with the objective of independence, which is one of the *maqāṣid* this research propounds. More importantly, the research delineates the macro *maqāṣid* that regulators have been entrusted to observe and infuse in the regulations of Islamic finance. These would include *maqāṣid* such as the development of the real economy, financial independence, an efficient regulatory regime, reduction of public debt, monetary and financial stability and value-based intermediation. From the analysis provided, it is difficult to ascertain whether the macro *maqāṣid* are fully embedded in the Malaysian laws and regulations of Islamic finance. The research has, however, identified some issues that trigger the *maqāṣid* compliance of regulations of Islamic finance in Malaysia. The study recommends the operationalization of the macro *maqāṣid* at the regulatory level first before operationalizing them at the level of Islamic financial institutions.

Keywords: macro *maqāṣid*, Islamic finance regulations, central bank, Sharī'ah compliance.

| INTRODUCTION

Islamic banking laws and regulations in Malaysia have been promulgated to ensure Shari'ah compliance, effective internal controls, adequate capitalization, good governance and adoption of best market practices. Operating in a dual system—Islamic and conventional—Islamic finance laws and regulations have had to accommodate both local and international banking regimes, especially the prudential ones. Research on this legal and regulatory environment has been mainly conducted from the legal perspective. It has not received nearly as much attention from the Shari'ah perspective. Although Islamic banking law and regulations have developed quite significantly in Malaysia, discourse on the relationship between the legal corpus of Islamic finance and *maqāṣid al-Shari'ah* appears quite scarce in modern academia.

Delving into this area is quite important in view of the criticism directed at the Malaysian experience of Islamic finance. Critics have labeled it as overly liberal and formalistic and have charged that the spirit of Islamic finance cannot be convincingly seen in the Malaysian experience. Despite robust laws and regulations such as IFSA 2013 and a myriad of guidelines and policy documents issued by the BNM, critics still maintain that *maqāṣid al-Shari'ah* have not been adequately embedded in the regulatory framework of Islamic finance.

There are two tiers of *maqāṣid* in Islamic finance: micro and macro. The former deal with objectives of the Shari'ah related to wholesale and retail financing undertaken by Islamic finance institutions while the latter *maqāṣid* are the purview of the legislative and regulatory authorities. In this research, the main focus of analysis is the macro *maqāṣid*.

This research was initiated for two major reasons. One is the necessity of assessing Islamic finance laws and regulations in light of *maqāṣid al-Shari'ah*. This undoubtedly necessitates the delineation of clear and well-defined macro *maqāṣid*. The second is to respond to Muslim scholars in non-Malaysian markets who have indirectly criticized Malaysia for adopting some controversial concepts such as *īnah*, sale of debt, late payment charges (*ta'wīd*), reversed *murābahah* (markup sale), and binding bilateral promise (*wa'd*). Those issues are controversial from the Shari'ah perspective but have been approved by the Shariah Advisory Council (SAC) and regulated in the form of policy documents issued by the Central Bank of Malaysia (BNM). Regarding prudential regulations, Malaysia has adopted Basel III for capital requirements, but that was not without a debate. Islamic financial institutions in Malaysia have resorted to subordinated *sukūk* based on *tawarruq* for tier 2 capital, a practice that continues to raise Shari'ah debates.

The research aims to shed light on the macro *maqāṣid* framework that can be used as a reference for framing Islamic finance regulations in Malaysia. It also aims to shed light on the *maqāṣid* compliance of certain regulations in broad terms. In view of the above objectives, the research aims to address the following questions:

- 1 What are the macro *maqāṣid* that must be imbued in the legal and regulatory framework of Islamic finance?
- 2 What are the obstacles to realizing *maqāṣid al-Shari'ah* in a dual banking system?

3 In general terms, to what extent do selected laws and regulations of Islamic finance in Malaysia comply with *maqāṣid al-Sharī'ah*?

The research is qualitative in nature, using content analysis to lay down the macro *maqāṣid* framework and assess certain regulations. Macro *maqāṣid* such as financial and monetary stability, debt reduction and financial independence are delineated as aspects of the protection of wealth. It utilises the inductive method to trace the different regulations related to macro *maqāṣid*. The analytical method is also used to relate the regulations under study with the relevant macro *maqāṣid*.

Following this introduction, **Section 2** deals with the macro *maqāṣid* framework for Islamic finance regulations. The main macro *maqāṣid* are explained vis-à-vis wealth creation and preservation. It also deals with macro *maqāṣid* related to the fundamentals of Islamic finance. **Section 3** deals with the overall legal and regulatory environment for Islamic finance in Malaysia. **Section 4** analyses, in general terms, selected Islamic finance regulations in Malaysia and assesses their general compliance to *maqāṣid al-Sharī'ah*. **Section 5** concludes the study by highlighting the core findings of the research and proposing some recommendations and further enhancements.

THE MACRO *MAQĀSHID* FRAMEWORK FOR ISLAMIC FINANCE REGULATIONS

The research envisages the *maqāshid* framework for Islamic finance regulations at the macro level. The latter are objectives intended by Sharī'ah and entrusted to the ruler to realize by virtue of his vast power and authority. In the context of modern Islamic finance, the regulators are supposed to imbue *maqāshid al-Sharī'ah* in the acts and guidelines issued to regulate the Islamic finance industry. The research argues that there cannot be a robust *maqāshid* framework unless it is provided by the central bank or monetary authority. The 'top down' approach in first realizing macro *maqāshid* would be automatically reflected in the operations of the IFIs (micro *maqāshid*). The latter are supposed to realize the Sharī'ah objectives of justice, wealth circulation, transparency, true transfer of ownership, true acquisition of assets, shunning of legal stratagems (*ḥiyal*), reduction of private debt, and financial inclusion. The following discussion sheds light on the components of the macro *maqāshid* framework for Islamic finance regulations. The micro *maqāshid* fall beyond the scope of this research.

Macro *Maqāshid*

The realization of *maqāshid* in Islamic finance requires that the regulations be in accordance with the objectives of the Sharī'ah regarding wealth. This research has identified certain *maqāshid* that the regulators are supposed to observe when enacting laws and regulations. They are confirmed by a multitude of evidence from Sharī'ah sources as well as modern financial systems and practices.

These macro *maqāshid* can be classified based on different considerations; however, for the purpose of this research, we classified them based on two approaches:

- 1 Macro *maqāshid* related to the establishment of fundamental principles of Islamic finance; and
- 2 Macro *maqāshid* related to the establishment of efficient implementations of Islamic finance in real life.

The first approach contains the theoretical building blocks for the second and is a prerequisite of its consideration. This means that failure to adhere to the macro *maqāshid* related to fundamental principles will nullify consideration of the latter. The exception to this comprises special circumstances where the ruling of necessities (*ḍarūriyyāt*)—and of needs (*ḥājjiyyāt*) that fall under the rubric of necessity—shall be applied.

The following is a general presentation of the macro *maqāshid* related to both approaches. Deep articulation of these macro *maqāshid* is beyond the scope of this paper.

Macro *Maqāshid* Related to the Fundamentals of Islamic Finance

As mentioned above, the macro *maqāshid* related to the fundamentals of finance represent the epistemological building blocks of Islamic finance. They are the prerequisite for the consideration of the macro *maqāshid* related to the efficient implementations of Islamic finance in the real economy. They also represent a

theoretical framework to prevent the exercise of *ijtihad* outside of its legitimate scope and context when enacting laws and regulations in Islamic finance.

In this paper, we have selected three main macro *maqāṣid* related to the establishment of the fundamentals of Islamic finance: (i) consideration of the explicit ruling of the Islamic legal text; (ii) consideration of a contract's own objective and implications; and (iii) consideration of justice and fairness in a contractual relationship.

1 Consideration of the explicit ruling of the Islamic legal text

Adherence to the explicit injunctions and prohibitions of the Islamic legal texts is one of the core macro *maqāṣid* principles of Islamic finance and the first prerequisite to discussing the efficient implementation of Islamic finance in the real economy. Al-Shāṭibī (1997, vol. 2, p. 289) emphasised this religious value-based approach in his definition of *maqāṣid*:

المَقْصَدُ الشَّرْعِيُّ مِنْ وَضْعِ الشَّرِيعَةِ إِخْرَاجُ مُكَلَّفٍ مِنْ دَاعِيَةِ هَوَاهُ حَتَّى يَكُونَ عَبْدًا لِلَّهِ اخْتِيَارًا كَمَا هُوَ عَبْدٌ لِلَّهِ اضْطِرَارًا.

The primary goal of the Shari'ah is to free man from the grip of his own whims so that he may be the servant of Allah by choice, just as he is His slave [in matters about which he has] no choice.

“Adherence to the explicit injunctions and prohibitions of the Islamic legal texts is one of the core macro *maqāṣid* principles of Islamic finance.”

Al-Shāṭibī (1997, vol. 3, p. 134) returned to this point when discussing the methods of identifying *maqāṣid*. He identified the explicit meaning of the Islamic legal text and the importance of observing its explicit injunctions and prohibitions as comprising the first fundamental method in identifying objectives of the Shari'ah:

مَقْصَدُ الشَّارِعِ يُعْرَفُ مِنْ جِهَاتٍ: إِحْدَاهَا: مُجَرَّدُ الأَمْرِ وَالتَّهْيِ الأَبْتِدَائِيِّ التَّضْرِيحِيِّ، فَإِنَّ الأَمْرَ مَعْلُومٌ أَنَّهُ إِنَّمَا كَانَ أَمْرًا لِإِقْتِضَائِهِ الفِعْلَ؛ فَوُقُوعُ الفِعْلِ عِنْدَ وُجُودِ الأَمْرِ بِهِ مَقْصُودٌ لِلشَّارِعِ، وَكَذَلِكَ التَّهْيِ مَعْلُومٌ أَنَّهُ مُقْتَضٍ لِتَنْفِي الفِعْلِ أَوْ الكَفِّ عَنْهُ؛ فَعَدَمُ وُقُوعِهِ مَقْصُودٌ لَهُ، وَإِيقَاعُهُ مُخَالَفٌ لِمَقْصُودِهِ، كَمَا أَنَّ عَدَمَ إِيقَاعِ المَأْمُورِ بِهِ مُخَالَفٌ لِمَقْصُودِهِ؛ فَهَذَا وَجْهٌ ظَاهِرٌ عَامٌّ لِمَنْ اِعْتَبَرَ مُجَرَّدَ الأَمْرِ وَالتَّهْيِ مِنْ غَيْرِ نَظَرٍ إِلَى عِلَّةٍ، وَلِمَنْ اِعْتَبَرَ العِلْلَ وَالمَصَالِحَ، وَهُوَ الأَصْلُ الشَّرْعِيُّ.

The objective of the Lawgiver can be known from various angles. One of them is the initial explicit command or prohibition considered in isolation. It is known from a command that it is issued in order to produce the commanded act. The occurrence of the act with the existence of the order to do it is the objective of the Lawgiver. Likewise, it is known that a prohibition is intended to stop an act or prevent it. That the act should not occur is the objective of the prohibition while its occurrence is a violation of that objective. Likewise, the failure to perform a commanded act is a violation of the objective in commanding it. This aspect is clear and comprehensive for anyone who considers the command or prohibition by itself without looking into the ratio *legis*, and it is also so for anyone who considers the ratio *legis* and the benefits [related to rules]. This is the [starting] principle of the Shari'ah.

What al-Shāṭibī intended from this important statement was to highlight the objectives of the Islamic legal text (*maqāṣid al-khiṭāb al-Sharī*). He considered observing the commands and prohibitions to be the first epistemological step in discussing the

objectives of the Sharī'ah rulings (*maqāṣid al-aḥkām al-Sharī'ah*), which are the wisdom and benefits (maṣāliḥ) intended in the application of the rule. Al-Shāṭibī wanted to say that when Allah commands something or forbids something we are obliged to obey His command and avoid His prohibition. As for the objectives of the Sharī'ah rulings (*maqāṣid al-aḥkām al-Sharī'iyah*), al-Shāṭibī's stand is that 'literal compliance is the default methodology in the area of acts of worship (*ibādāt*) while the consideration of purposes is the default methodology in the area of worldly dealings (*mu'āmalāt*)' (al-Shāṭibī 2003, vol. 2, p. 6).

Kamali (2008, p. 127) explains al-Shāṭibī's *maqāṣidī* principle in his discussion on Muslim jurists' approaches to the Islamic legal texts:

The first approach to be noted is the textualist approach, which confines the identification of the *maqāṣid* to the clear text, commands and prohibitions, which are the carriers of the *maqāṣid*. The *maqāṣid*, according to this view, have no separate existence outside this framework. Provided that a command is explicit and normative it conveys the objective *maqāṣid* of the Lawgiver in the affirmative sense. Prohibitions are indicative of the *maqāṣid* in the negative sense in that the purpose of a prohibitive injunction is to suppress and avert the evil that the text in question has contemplated. This is generally accepted, but there are certain tendencies within this general framework (Kamali 2008).

Al-Shāṭibī's statement is consonant with the stand of Imam al-Shāfi'ī and the majority of Muslim jurists. Al-Shāfi'ī (1940, vol. 1, p. 560) highlighted this principle when he elucidated the two types of disagreement (*ikhtilāf*) in his famous book al-Risālah:

Disagreement is of two kinds: one of them is prohibited, but I would not say the same regarding the other...On all matters concerning which Allah provided clear textual evidence in His Book or [a Sunnah] uttered by the Prophet's tongue, disagreement is unlawful among those to whom these [texts] are known. As to matters that are liable to different interpretations or are derived from analogy, such that he who interprets or applies analogy arrives at a decision different from that arrived at by another, I do not hold that the [same] constraint applies to this as to disagreement about clear textual [evidence].

Following in al-Shāfi'ī's footsteps, Muslim jurists recognised the division of Islamic legal texts into the following two types:

First type: the explicit and definitive texts of Qur'ān and Sunnah. They are texts related to faith (*'aqīdah*) such as the five pillars of Islam and explicit Sharī'ah texts that bring clear rulings such as the prohibition of interest-based transactions, gambling and drinking liquor or the command to adhere to the fundamental requirements of the contract such as mutual consent that is manifested in offer and acceptance in exchange contracts. It is prohibited to disagree on the behaviour required by these texts or to contravene them under any justification of *maṣlaḥah* or *maqāṣid* or *siyāsah Sharī'iyah* (Islamic public policy) or any other justification. However, a command may be contravened, and prohibition may be committed in the event of necessity or of need that is treated like general necessity. Nevertheless, Muslim jurists do not consider this to be contravention of the explicit Islamic legal text; rather, they consider this a shift to the new ruling triggered by these extraordinary circumstances.

Second type: non-definitive texts that carry more than one possible meaning; juristic disagreement is permissible regarding the interpretation of such texts and in *ijtihādī* issues that are based mainly on custom and time/space considerations. Instances

of this type are scholars' differences in benchmarking the non-*ḥalāl* element in a company involved in mixed activities or their differences on the status of a purchase undertaking in *ijārah*, *ṣukūk* or other Islamic financial products or instruments.

To sum up this first macro *maqāṣidī* approach, enactors of laws and regulations should treat this macro fundamental *maqāṣidī* approach as a prerequisite to the *maqāṣid* related to efficient implementations.

2 Consideration of a contract's objective and implications

One of the most prominent objectives of financial transactions within the framework of theoretical principles is that contracts should be consistent with the aims and implications that the Lawgiver intended to realize by them. The majority of scholars expressed this principle as 'not conflicting with the implications of the contract (*muqtaḍā al-ʿaqd*)'. Some others stressed that it should not conflict with the objective of the contract (*maqṣūd al-ʿaqd*). In order to clarify these two terms, it behooves us to briefly define each term and then explain the varying approaches of scholars towards them. The scholarly definitions of *muqtaḍā al-ʿaqd* can be summarized as: the aggregate of obligations required by the contract, whereby each contracting party is considered responsible for those which pertain to them without the counterparty needing to stipulate them. As for the objective of the contract (*maqṣūd al-ʿaqd*), Ibn Taymiyyah (1987, vol. 6, p. 261) defined it by saying:

Allah—hallowed be He—legislated contracts to be the causes that realize [certain] intended legal effects (*aḥkām*). He legislated sales as a cause for the ownership of property by way of exchange [for other property], and [He legislated] gifts as a cause for the ownership of property by way of donation. He legislated marriage as a cause for the right to intercourse and [legislated] *khulʿ* as a cause for the dissolution of marriage. The reality and objective of sales and gifts, which provide them their essential nature—and without which they are improper—is that they transfer property from its [original] owner to [a new] owner in a particular way. The ownership of property is the ability to treat it and dispose of it in any lawful manner....Anyone who intends an objective from a contract other than the objective for which it was legislated, and seeks to make it a cause [of another effect] that he wants to realize by means of that contract, is a cheat.

The majority of scholars—including the Ḥanafīs, Mālikīs, Shāfiʿīs and the dominant position within the Ḥanbalī School—consider a stipulated condition which contradicts the implications of the contract (*muqtaḍā al-ʿaqd*) to be voidable and to render the contract void (al-Kāsānī 1986; al-Ḥattāb 1992; al-Māwardī 1999; & Ibn Qudāmah 1995). There is, however, some difference of opinion between them regarding the particular cases in which both the condition and the contract are void and those in which the condition is void but not the contract. The most prominent evidence for the consideration of the implications of a contract is as follows (Jughaym 1998; al-Shubaylī 2014; al-Salamī 1429H):

- The sale contract requires that the buyer has the right to treat and dispose of what he has purchased in whatever manner he chooses. To impose a restriction upon him that he shall not sell it or give it away is a stipulation that contradicts the implications of the contract; therefore, it is void. Likewise, the *mushārahah* contract requires that the partners shall share in profit and loss; therefore, to change its conditions by having one of the partners guarantee the capital of another partner or guarantee the capital and the profit by any method of guarantee contradicts the implications of the contract.

- It leads to uncertainty regarding the subject matter of the contract and its deliverability. It also leads to *ribā* and is thus a way to consume the property of others unjustly.
- It disrupts the balance between the rights and responsibilities of the contracting parties that arise from the contract itself. That is because the stipulation of a [supplementary] benefit for one of the contracting parties disrupts the obligatory equilibrium and leads to disputes. Also, it is a benefit additional to the implications of the contract and is without matching consideration; therefore, it resembles *ribā*, which is prohibited by the Sharī'ah.

Some scholars voiced their reservation with the majority's prohibition of every stipulated condition that conflicts with the implications of the contract. They held that the key consideration is whether a condition contradicts the objective of the contract rather than its implications. Therefore, a contract that contradicts the implications of the contract but realizes its objective must be permitted. This was the view of Ibn Taymiyyah (1995). Some contemporary scholars have also inclined toward it (al-Shubaylī n.d.; al-Salamī 1429H). The gist of this view is that the consideration in accepting stipulated conditions is their consistency with the objective of the contract, and likewise their rejection is to be when they contradict the objective of the contract. Ibn Taymiyyah (1987, vol. 4, p. 93) says:

If someone says, 'This condition contradicts the implications of the contract,' he should be asked, 'Does it contradict the absolute implications of the contract, or does it contradict the implications of the contract absolutely?' If he means the first, then it applies to every condition. If he means the second, the point would not be conceded to him. The only thing that is forbidden is to contradict the objective of the contract; for example, to stipulate divorce in a marriage contract, or to stipulate annulment of a contract in the contract. If, however, he stipulates what is intended from the contract, he has not contradicted its objective. This position is the correct one as indicated by the Qur'ān, the Sunnah, scholarly consensus and due consideration along with the presumption of continuity [of the original ruling] in the absence of any evidence to negate this concept. This is what the Qur'ān and the Sunnah confirm, and it is the true position of the [Ḥanbalī] School.

An example some scholars give of a condition that conflicts with the implications of a contract is someone who sells a house at a very low price to a poor man with a big family and stipulates that if he decides to sell the house he has to sell it back to the original seller at the same price. From the viewpoint of Ibn Taymiyyah and others, the stipulation may seem to negate the implications of contract, which include the right to treat and dispose of what the owner has purchased in whatever manner he chooses. However, it does not negate the objective of the contract as it does not cause harm to any of the contracting parties; instead, it brings benefit to both. The buyer purchases the house for a very low price and is encouraged to maintain it for his family, and the seller will get his house back in case the seller decides to sell it.

“Scholars agree upon the parameter that a stipulated condition must concur with the objective of the contract.”

In summary, scholars agree upon the parameter that a stipulated condition must concur with the objective of the contract. They also agree that a stipulated condition is prohibited when it contradicts the implications of the contract and causes harm to one of the contracting parties or becomes a means that leads to something prohibited such as *ribā*. This is what makes these implications part of the objectives of the Sharī'ah within the theoretical framework of principles that govern Islamic finance.

3 Consideration of Justice and Fairness in a Contractual Relationship

It is an established legal principle in the law of contract that the agreement constitutes the law between the contracting parties and that agreements must be kept (*pacta sunt servanda*). This makes the contract binding by law. Therefore, the contract cannot be amended by addition or cancellation or exemption unless it is agreed by both parties—or one of them, if that has been stipulated in the contract.

Although the Sharī'ah agrees to this legal fundamental in principle, it sets a macro *maqāṣid* fundamental to ensure fairness in the contract; therefore, if it is found that the contract establishes an unfair preference to one contracting party over another, the Sharī'ah may impose some amendments even after the contract has come into effect. This macro *maqāṣid* fundamental is to ensure fairness in the contractual relationship, to balance the distribution of rights and responsibilities between the parties, and alleviate any possible harm in the event of unfair terms and conditions. This macro *maqāṣid* approach is supported by numerous Islamic legal texts, among them the verse of Sūrah al-Naḥl:

﴿ إِنَّ اللَّهَ يَأْمُرُ بِالْعَدْلِ وَالْإِحْسَانِ وَإِيتَاءِ ذِي الْقُرْبَىٰ وَيَنْهَىٰ عَنِ الْفَحْشَاءِ وَالْمُنْكَرِ
وَالْبُغْيِ يَعِظُكُمْ لَعَلَّكُمْ تَذَكَّرُونَ ﴾

'Allah commands justice, doing good, and generosity towards relatives, and He forbids what is shameful, blameworthy and oppressive. He teaches you so that you may take heed' (Qur'ān, 16:90).

There is also the famous *ḥadīth* reported from Samurah ibn Jundub that he had a row of palm-trees in the garden of a man of the Anṣār. The man had his family with him. Samurah used to visit his palm-trees, and the man was annoyed by that and felt it keenly. So he asked Samurah to sell them to him, but he refused. He then asked him to take something else in exchange, but he refused. So he came to the Holy Prophet (ﷺ) and mentioned it to him. The Holy Prophet (ﷺ) asked Samurah to sell it to the man, but he refused. He asked him to take something else in exchange, but he refused. He then said, 'Give it to him and you can have such and such,' mentioning something with which he tried to please him, but he refused. The Messenger of Allah then said, 'You are a nuisance,' and said to the Anṣārī, 'Go and uproot his palm-trees' (Abū Dāwūd 2009, vol. 3, p. 352, *ḥadīth* no. 3638).

There is also the legal maxim, extracted from the *ḥadīth* that states:

« لا ضَرَرَ وَلَا ضِرَارَ ».

'Harm shall neither be inflicted nor reciprocated' (Ibn Mājah 2009, vol. 3, p. 117, *ḥadīth* nos. 2340 and 2342; al-Dāraquṭnī 2004, vol. 4, p. 51, *ḥadīth* no. 3079, and vol. 5, p. 407, *ḥadīth* no. 4539).

This macro-*maqāṣidī* approach became a law in the contemporary legal practice and is deemed critical to customer protection. Among the major enactments of this type in Malaysia are the Unfair Contract Terms Act 1977 (UCTA) and the Unfair Terms in Consumer Contracts Regulations 1999 (UTCCR). The 1977 Act covers all business-

to-business contracts whereas the 1999 Regulations govern contracts that involve consumers. Certain contractual arrangements are covered by both UCTA and UTCCR. Similar enactments have been adopted by all countries to realize the objective of fairness and protecting customers' rights.

In summary, contractual imbalance creates a significant difference in the legal status of the contracting parties as a result of the imposition of arbitrary conditions by one party on the other. This may occur by one party exploiting its economic position, as in adhesion contracts (*idh'ān*), or by exploiting the other party's need or desire to sell or purchase, or by exploiting weakness in his legal or technical ability. The Shari'ah has set a fundamental macro objective that addresses this issue in its micro applications. It is fairness in the contractual relationship between the contracting parties, free of harm to either party.

Macro Objectives Related to Efficient Implementations

The following are the macro *maqāṣid* for efficient implementation that should be adopted to evaluate any regulation of Islamic finance in Malaysia.

1 Development of the Real Economy

The economy is of two types, financial and real. The real economy is related to real assets and resources that fulfill human needs in a direct way such as consumption of goods. On the other hand, the financial economy is related to financial assets such as Islamic bonds, equities and rights (Khaḍīrāt 2012). From the Shari'ah perspective, scholars of Islamic public policy (*al-siyāsah al-shar'iyyah*) maintain that the ruler must pursue an economic agenda that tends to build up and develop cities and nations. Enumerating the main duties of a ruler, Imam Māwardī (1979) mentioned that development of cities (*'imārat al-buldān*) is an important duty that should result in the protection of people's interests. Ibn Khaldūn (2004) reiterated this macro objective; i.e., the development of the real economy, when describing a state after it has been successfully established. The essential dimensions of this macro objective include: mobilizing wealth, controlling revenue, keeping records of public expenditure, building factories, developing sufficient housing and vast cities with high structures, and forming strong armies that are feared by enemies (Ibn Khaldūn 2004). The Shari'ah's legislation regarding wealth tends 'to create wealth for the individuals and for the entire nation' (Khalīl 2003, p. 250). One of the most important aspects of the real economy is that it works in parallel with the financial economy. The latter is represented by its financial assets and institutions such as banks and the capital market. Both should operate in harmony; otherwise, they can both be vulnerable to adverse effects (Bsīsū 2012). A factor that can undermine the real economy is the proliferation of financial instruments. A glaring example is the derivative market, which was blamed in part for the global financial crisis of 2008, whose economic and political aftereffects continue to plague the world (Roubini & Mihm 2010; cf. Madrick 2011).

2 Financial Independence

Financial independence refers to the ability of a country to provide sufficient resources for its people so that their interests and the interests of their sovereign governments are protected, and their destiny is free from external influence. The Shari'ah tends to secure

“From the Shari'ah perspective, scholars of Islamic public policy (*al-siyāsah al-shar'iyyah*) maintain that the ruler must pursue an economic agenda that tends to build up and develop cities and nations.”

the independence of the ummah that goes along its superiority over other nations as the Qur'ān has confirmed. Imam Māwardī (n.d.) states that one of the functions of the Muslim ruler is to provide his people with experts and manufacturers in order to be sufficient and independent from others. This idea has also been emphasized by Ṭāhir ibn 'Āshur (n.d.), who maintained that

the most important thing with regards to the wealth of a nation is to focus on the means to mobilize and protect wealth by adopting sound economic measures so that the *ummah* would be independent from seeking assistance from others at the time of need, because need is a kind of slavery (p. 197).

Thus, any regulation of Islamic finance in the modern world should ensure that the wealth of the nation is not stolen, weakened or exploited by foreign elements.

In modern banking practices, excessive leveraging coupled with external sovereign debt means total submission to the lenders' terms and conditions such as decreasing subsidies and laying off workers. This has grave political and economic repercussions, namely the loss of sovereignty and the beginning of economic woes. Needless to say, the central bank, being the bank of the government, is responsible, among others, for the financial stability of a country.

Within the Islamic finance context, Islamic banks operate either in a dual banking system or a single one. The former allows conventional and Islamic banks to simultaneously operate, and the latter allows for a conventional bank to provide both conventional and Islamic financial products (Islamic window). There are two pertinent questions as far as the independence of Islamic institutions is concerned:

First: in a dual banking system such as that of Malaysia, are Islamic banks really independent from the conventional system?

Islamic banks operating in Malaysia have a separate legal and regulatory environment. With respect to governance, they have their own boards of directors, management and internal control systems. They have their own prudential, reporting and performance indicators that would differentiate them from conventional banks.

Second: do Islamic windows fulfill *maqāṣid al-Sharī'ah*, in light of the fact that an Islamic window is not fully independent from its mother conventional bank? Although regulators stress the separation of accounts, operations and investment portfolios with end-to-end Sharī'ah compliant operations, there are some questions as to whether the Islamic window model is in line with *maqāṣid al-Sharī'ah*.

In an Islamic window model, the capital adequacy may be calculated as part of the total risk weighted capital (RWC) of the mother bank or can be calculated separately (IFSB 2010). In case of the former, i.e., total RWC, the capital portion of the Islamic window is effectively supporting the conventional capital portion. This can be seen as comingling the capital of the conventional bank and its Islamic window.

Another area that needs attention is the dependence of the Islamic finance industry's profit benchmark on the London Interbank Offered Rate (LIBOR). This is a macro concern that led the Islamic finance industry to search for an independent Islamic benchmark. Several benchmarks have been proposed in view of the intended abolishment of LIBOR by 2021 according to the United Kingdom's Financial Conduct Authority¹.

¹ Financial Conduct Authority, <https://www.fca.org.uk/markets/libor>, accessed on Dec 30th, 2019.

Some in-depth studies on an Islamic benchmark have been conducted by the International Shari'ah Research Academy for Islamic Finance (ISRA), the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and the Islamic Research and Training Institute (IRTI). The common feature of all of them is that they are entirely based on real economy determinants. Some have proposed different benchmarks depending on the sector, and some have proposed the weighted average of several sectors of the economy. As the delineation of these proposed benchmarks falls beyond the scope of this research, it suffices to say that efforts are under way to develop Islamic benchmarks separate from conventional ones (Waqf Fund of the Central Bank of Bahrain 2019).

3 Efficient Regulatory Regime

Efficiency in regulating the market is a very broad topic. The task of the regulators is even more daunting at a time of recession or economic crisis. The efficiency policies governing the Islamic financial sector require the harmonious operation of three main frameworks: the Shari'ah framework, the legal framework and the overall economic and market framework. The Shari'ah framework necessitates the establishment of the Shari'ah advisory function at the level of the regulators and the Islamic financial institutions. It also requires the setting up of Shari'ah governance mechanisms and remedial systems for Shari'ah non-compliant events. This will ensure Shari'ah standardization and the avoidance of fatwa conflict, in addition to market confidence about Shari'ah compliance. All these are complementary *maqāṣid* that will be achieved as a result.

As for the legal and regulatory framework, the Islamic finance industry is governed by the law of the land and a set of statutory guidelines in a dual banking system. The prudential regulations such as those related to liquidity and capital adequacy are applicable to both conventional and Islamic financial institutions. However, regulatory Shari'ah resolutions are only applicable to IFIs and Islamic windows. For an efficient legal framework, harmonization between conventional law and Shari'ah must be pursued.

The third framework, which is the economic and market framework, takes into consideration the alignment of Islamic finance regulations with a nation's economic and financial blueprint. In Malaysia, the Financial Sector Blueprint 2011-2020 (BNM 2011) focuses on certain areas such as effective intermediation for a high added-value and high-income economy. It gives consideration to the following:

- The development of deep and dynamic financial markets;
- Financial inclusion for greater shared prosperity;
- Strengthening of regional and international financial integration;
- Internationalization of Islamic finance;
- A regulatory and supervisory regime to safeguard the stability of the financial system;
- Empowering consumers; and
- Talent development to support a more dynamic financial system.

Two major factors may hinder the development of Islamic finance in modern banking. The first is the lack of regulations in certain countries, especially important regulations such as Shari'ah corporate governance. The second is the trend to convergence between conventional and Islamic finance regulations. That is because Islamic finance is operating under the ambit of the former and continues to replicate conventional financial products. Regulations of Islamic finance should thus lay the ground for product differentiation and the enhancement of value-based intermediation.

The Malaysian Islamic ecosystem has developed the necessary Shari'ah, legal and regulatory framework for ensuring technical Shari'ah compliance. Compliance with *maqāṣid* is still triggering debates and calls for further refinement and enhancement.

“Regulations of Islamic finance should thus lay the ground for product differentiation and the enhancement of value-based intermediation.”

4 Reduction of Debt (Private and Public)

Debt in fiscal policy is supposed to be managed in a way that does not affect economic stability. In Malaysia in the first half of 2019, statistics have shown positive signs that debt management is under control despite concerns over increased household and corporate debt ratios. On the positive side of debt management, BNM (2019a, p. 11) maintained that 'risks to financial stability from the household sector continue to be largely contained, with debt at-risk (DAR) sustained at a low level of 5.2% of total household debt.' Despite this containment, BNM cautioned that 'some Household Segments remain vulnerable to income shocks'. On the negative side, BNM confirmed that 'aggregate household debt levels remain **elevated**'.

Two factors seem to mitigate the risk of elevated household debt levels: (i) the asset-to-debt ratio of the household sector, and (ii) exposure to vulnerable borrowers. According to BNM (2019a), 'at the aggregate level, total household assets exceeded debt by 4.1 times'. According to the same report, the exposure level to the vulnerable segment of borrowers has declined, as it stood at 18.5% in the first half of 2019.

The banks' external debt management is also a deciding factor of the banking sector's stability. In Malaysia, 'the share of external debt held by domestic banking groups (DBGs) and locally incorporated foreign banks (LIFBs) has remained broadly stable over the years' (BNM 2017b, p. 24).

The external debt levels for the whole country reflects a great deal on the country's economic health. External debt in Malaysia 'averaged 259160.70 MYR Million from 1990 until 2019, reaching an all-time high of 933396.80 MYR Million in the third quarter of 2018 and a record low of 9063 MYR Million in the second quarter of 1997' (Trading Economics 2019).

Table 1: Malaysia External Debt as at Q2, 2019

SDDS Data Category and Component	Unit Description	Q1/17	Q2/17	Q3/17	Q4/17	Q1/18	Q2/18	Q3/18	Q4/18	Q1/19	Q2/19
Gross External Debt	RM million	894,181	878,518	880,650	885,218	884,911	927,293	933,397	924,887	903,680	931,083
General Government	RM million	175,009	188,801	195,096	202,753	205,513	183,960	183,799	178,847	192,471	190,017
Short-term	RM million	1,049	1,212	2,656	3,331	4,891	2,548	4,644	3,733	2,132	1,813

SDDS Data Category and Component	Unit Description	Q1/17	Q2/17	Q3/17	Q4/17	Q1/18	Q2/18	Q3/18	Q4/18	Q1/19	Q2/19
Long-term	RM million	173,960	187,589	192,440	199,422	200,622	181,412	179,155	175,114	190,339	188,204
Bond	RM million	167,529	181,368	186,484	193,737	195,032	175,799	173,674	169,517	184,982	182,628
Loan	RM million	6,431	6,221	5,956	5,685	5,590	5,613	5,481	5,597	5,357	5,576
Monetary Authorities	RM million	13,614	14,925	13,397	12,109	12,041	11,645	11,772	12,743	12,620	12,722
Banks	RM million	336,911	318,879	318,153	316,793	309,575	359,393	357,487	353,349	323,177	348,383
Short-term	RM million	295,697	278,950	271,612	268,768	262,079	312,950	310,680	306,173	275,443	297,787
Loan	RM million	211,622	192,340	172,693	172,199	169,711	223,258	211,879	204,315	177,493	202,142
Currency & deposits	RM million	77,835	78,865	91,545	92,025	87,795	85,609	94,860	98,238	93,558	91,301
Others	RM million	6,239	7,745	7,374	4,544	4,573	4,083	3,940	3,620	4,392	4,344
Long-term	RM million	41,214	39,929	46,540	48,025	47,496	46,444	46,808	47,175	47,733	50,597
Bond/Loan	RM million	41,214	39,929	46,540	48,025	47,496	46,444	46,808	47,175	47,733	50,597
Others	RM million	0	0	0	0	0	0	0	0	0	0
Other Sectors	RM million	368,647	355,914	354,005	353,562	357,782	372,295	380,339	379,949	375,412	379,961
Short-term	RM million	103,451	102,084	77,415	75,367	79,470	84,709	90,341	90,430	85,876	83,788
Loan	RM million	35,396	35,875	15,094	15,290	24,060	24,939	26,881	29,337	30,744	30,689
Others	RM million	68,054	66,209	62,322	60,077	55,410	59,769	63,460	61,093	55,132	53,098
Long-term	RM million	265,196	253,830	276,590	278,195	278,312	287,586	289,998	289,519	289,537	296,173
Bond/Loan	RM million	261,186	249,491	268,002	269,721	268,220	276,987	279,548	280,376	280,084	286,108
Others	RM million	4,011	4,339	8,588	8,474	10,091	10,598	10,450	9,143	9,452	10,065

Source: Bank Negara Malaysia

Despite this manageable environment of internal and external debts, Muslim economists have cautioned against the rise of private and public debt as that is against *maqāṣid al-Sharī‘ah*.

Looking at debt-based contracts from the economic perspective, many Muslim economists have noticed that Islamic banking and finance (regulations included) have not achieved the *maqāṣid al-Sharī‘ah* of wealth identified by scholars such as Ibn ‘Āshūr. These include *‘adl* (justice), *rawāj* (wealth circulation), *wuḍūh* (transparency), *thabāt* (stability), *hifz* (protection). After mentioning the positive effects of debts, Suwailem (2009) highlighted what he perceived to be the harmful aspects of debts. In listing the effects mentioned by Suwailem, the authors will provide a brief explanation for each.

- (a) Debt syndrome leading to inflation: this refers to the general tendency of financial institutions to create debt via lending and borrowing. With more debt in the market, inflation may rise. In an empirical study to test the relationship between public debt and inflation, Barquero and Loaiza (2017, p. 58) maintained that 'with a net debtor country given, increases in government debt tend to increase inflation, above all in countries with high levels of public debt'.
- (b) Risk-averse attitude: this refers to the trend of financial institutions to adopt risk-transfer instead of risk-sharing modes of financing.

- (c) Impending bankruptcy as a result of high debt-to-income ratio: this refers to the situation where the debt of the individual, institution or government is higher than its income. In support of this point, the World Bank, in its December 2019 report on Malaysia, pointed out that there are 'high rates of bankruptcy because of borrowing for consumption rather than for wealth accumulation' (IBRD/The World Bank 2019, p. 74).
- (d) Economic instability: this refers to the macro and micro impact on production, consumption, distribution, financial stability, monetary stability, erosion of foreign reserves, etc. High debts will ultimately affect these elements, regardless of the level of impact each one of them may have on the economy.

Suwailem (2009) pointed out that debt reduction is one of the *maqāṣid al-Sharī'ah* championed by Ibn Qayyim al-Jawziyyah. He also reiterated that an Islamic financial product must be both Sharī'ah compliant and economically viable. Some Muslim economists enumerated the alarming effects of rise of debt in any economic system. They include the risk of bankruptcy, volatility in revenues, rise of delinquency rates, inflation and high public expenditure (al-Zarqa 2012). This situation may be aggravated by the mechanism of fractional reserve, which creates money from thin air, hence deepening the debt problem. Lending a multiple of deposits is also the norm of Islamic banks. Warning against the proliferation of debt, whether in conventional or Islamic banks, Azura (2017, p. 13) stated:

The current fractional banking system, which allows multiple amounts of money to be created out of a given amount of deposits received, and the development of complex financial derivatives, has resulted in credit expansion outpacing the growth of the real sector of the economy.

5 Monetary Stability

The regulators, namely central banks, are entrusted to design, implement and monitor the monetary system and work constantly for its stability. Rose and Hudgins (2010, p. 52) clarify that

A central bank's primary job...involves making sure that the financial system functions smoothly and that the supply of money and credit from the system contributes to the nation's economic goals.

A central bank also plays a role in curbing inflation, protecting local currency from depreciation, and supervising local banks. These functions would ultimately lead to monetary stability, hence the realization of a macro objective.

Further, the instruments used by central banks to achieve monetary stability include setting statutory reserve regimes to monitor credit levels, determining the discounting rate when lending to local banks, and participating in the open market to buy and sell securities (Nasar 2006). From a *maqāṣid* perspective, the above instruments are the *wasā'il* (means) meant to achieve a particular objective of the Sharī'ah. From a *maqāṣid* perspective, the means holds the same ruling as the objective, as will be highlighted in the last section of this article. Thus, all regulations pertaining to those instruments are intended by Sharī'ah and are part of the macro *maqāṣid* under discussion; i.e., monetary stability.

In Malaysia, the overnight policy rate (OPR) set by BNM has a direct impact on the base lending rate (BLR) for conventional banks, and on the base financing rate (BFR) for Islamic banks. A rise of the OPR means an increase of the loan amount or the financing amount that the client has to pay to the lending or financing bank. Undoubtedly, this monetary policy instrument will determine the demand and supply for banking products. It has an impact on debt servicing for floating rates and will curb inflation when it is high.

The main issue that has yet to trigger deep and thorough research is the role of a Sharī'ah-compliant central bank in realizing *maqāṣid al-Sharī'ah* in the financial system. Most central banks are Sharī'ah non-compliant in terms of assets and operations as they deal extensively with *ribā*. They have also provided an environment where conventional and Islamic financial systems converge rather than diverge. Whether Islamizing the Central Bank of Malaysia, for example, would accelerate the *maqāṣid* compliance of the banking system remains a fertile area of research, waiting to be simulated and tested. However, even with a Sharī'ah non-compliant central bank, the latter's role in stabilizing the monetary system and supervising local banks is very important from the Sharī'ah perspective.

Another issue that has proven devastating to local currencies and that needs robust regulations is manifested in the demand for, and supply of, a foreign currency, especially the US dollar. When investors prefer to hold foreign currencies of strong economies at the expense of the local currency, the latter would depreciate as a result of high demand for the foreign currency (Salhi 2010). Besides, allowing companies to take short-term foreign loans to finance long-term projects would create a mismatch between short-term liabilities and long-term assets when the interest rate rises (Suwailem 2018). This is exactly what happened to Turkey in 2018 when the local currency, the lira, depreciated by 40%.

To further enhance monetary stability, the central bank has to operate in consonance with the pre-requisites of financial stability. There is an interplay between monetary policy and financial stability at the macroeconomic level. IFSB Standard 17 (IFSB 2015, p. 9) states:

Sound macroeconomic policies (mainly fiscal and monetary policies) are the foundation of a stable financial system. Without sound policies, imbalances such as high government borrowing and spending, and an excessive shortage or supply of liquidity, may arise and affect the stability of the financial system (IFSB 2015).

6 Financial Stability

Financial policy generally aims at optimizing resources in terms of balanced wealth mobilization and allocation. This would ensure economic stability and fair distribution of resources and income (Salhi 2010). For central bankers, financial stability 'describes the condition where the financial intermediation process functions smoothly and there is confidence in the operation of key financial institutions and markets within the economy' (BNM n.d.). This is the work of central bankers, who are entrusted to keep inflation low and stable, facilitate high and stable growth, ensure stable financial markets, stable interest rates and stable exchange rates (Cecchetti 2010). In the context of Islamic banking, the same objectives are pursued within a set of Sharī'ah rulings and

“The main issue that has yet to trigger deep and thorough research is the role of a Sharī'ah-compliant central bank in realizing *maqāṣid al-Sharī'ah* in the financial system.”

principles. Thus, it can be argued that the objectives of conventional financial policy are similar to the objectives of financial policy in Islamic finance except that in Islamic banking, the Shari'ah framework must be the overriding framework.

Financial stability is one of the macro *maqāṣid* of an Islamic financial system. In classical jurisprudence, the Muslim ruler is free to administer the resources of the land based on *maṣlaḥah mursalah* (public interest). This falls under the Islamic legal maxim 'Acts of those with authority over people must take into account the interests of people' (Suyūṭī 1990, p. 121). According to Imam al-Māwardī, rule of a nation is based on four principles: physical development, guarding people, administering the army, and putting in place a fair financial policy (*taqḍīr al-amwāl*). In elaborating the latter, al-Māwardī (n.d.) maintains that if the financial policy is truly fair, nations become stable.

In Malaysia, the financial system seems stable according to a number of indicators in the first half of 2019. Financial institutions remained resilient in terms of capitalization and profitability of the banking sector, including the Islamic ones. There was sufficient liquidity supported by stable funding sources. The domestic financial markets are deemed orderly despite domestic and external headwinds. As for the debt-servicing capacity of households and businesses, it was deemed sufficiently sustained. The asset quality in the banking system remained intact. All these must be operated within a cohesive cyber security and digitalization framework (BNM, 2019).

Table 2: Financial Stability Factors in Malaysia as at Q2, 2019

Stability Factor	Components			Remark
Financial institutions	<p>Capitalization</p> <ul style="list-style-type: none"> ▪ Banking: Total capital ratio: 17.4%. ▪ Insurance/<i>takāful</i>: Capital adequacy ratio: 230% 	<p>Profitability</p> <ul style="list-style-type: none"> ▪ Return on equity: 13%. ▪ Return on equity: 20% 	<p>Liquidity</p> <ul style="list-style-type: none"> ▪ Liquidity coverage ratio (for banking): 153.0% 	Strong capitalization, sound profitability and sufficient liquidity
Domestic financial market	Financial market stress index increased to 2.5% in Q2, 2019, but remained well below 2018 levels of around 11%.			Market risk exposure remained manageable.
Debt servicing capacity of household businesses	<ul style="list-style-type: none"> ▪ Financial asset-to-debt ratio: 2.2 times (the average household has assets more than double its debt burden). ▪ Liquid financial asset-to-debt ratio: 1.5 times. 			Overall financials of households and business remained healthy.
Asset quality	<ul style="list-style-type: none"> ▪ Impaired loans/financing levels are kept low due to sound risk management practices. ▪ Loan/financing loss coverage ratio: 126.9% is deemed a strong buffer to absorb future losses. 			Asset quality remained intact.

Source: Adapted from BNM, Financial Stability Review, 2019

“Malaysian Islamic finance regulations are deemed robust to realize the macro objective of financial stability, which is necessary for Islamic finance to sustain its value proposition.”

Based on the above data, Malaysian Islamic finance regulations are deemed robust to realize the macro objective of financial stability, which is necessary for Islamic finance to sustain its value proposition.

7 Value-Based Intermediation (VBI)

The Central Bank of Malaysia launched an initiative to imbue Islamic finance practices and activities with socio-economic impact elements within the framework of *maqāṣid al-Sharī'ah*. According to the Financial Stability and Payment Systems Report 2017 'VBI aims to achieve the intended outcomes of Sharī'ah in promoting good and preventing harm' (BNM 2017e, p. 94). In a strategy paper circulated by BNM in 2017, three major *maqāṣid* have been identified as the intended outcome of Sharī'ah in Islamic finance. The three *maqāṣid* are justice, wealth preservation and wealth circulation (BNM 2017). The three *maqāṣid* were initially identified by Imam al-Ṭāhir ibn 'Āshūr (2011) as the ultimate objectives of wealth beside *wuḍūh* (transparency) and *thabāt* (stability). Operationally, the emphasis should be on positive impact to individuals and businesses. The Financial Stability and Payment Systems Report 2017 (BNM 2017e, p. 94) states:

Important areas of focus [of VBI] include enhanced assessments of a customer's application for financing, where the traditional credit assessment methodology would be supplemented with an assessment of the positive impact of the financing to the community and the economy. For business financing in particular, such an assessment will be based on a wider set of considerations which may include the potential for the financing to contribute towards generating sustainable employment opportunities and entrepreneurship.

This new initiative undoubtedly needs a considerable deal of alignment with the existing regulations, if not new ones. It constitutes a paradigm shift in the world of Islamic finance; the discourse on *maqāṣid al-Sharī'ah* in finance is now an important agenda of the regulators and is no longer confined to Sharī'ah scholars and fatwa authorities. Thus, VBI should translate itself into business models, development projects and new products that have clear socio-economic impact.

The VBI agenda is, in principle, aligned with international ethical and sustainable initiatives such as environmental, social and governance (ESG) considerations, sustainable and responsible investment (SRI), ethical finance and the sustainable development goals (SDGs) of the United Nations. Table 3 sheds light on a few initiatives taken by various Islamic banks in Malaysia that are in line with the VBI value proposition. The table also refers to initiatives taken by Islamic banks before the official launching of VBI in 2017 that serve the same purposes as VBI.

Table 3: VBI Initiatives by Islamic Banks in Malaysia

Bank	VBI project	Remark
Bank Islam	1 Shari'ah Environment, Social and Governance (ESG) Asset fund.	The fund manages ESG assets (equities and <i>sukūk</i> from local, regional and global markets).
	2 Al-Waqf Home financing -i	The product resulted in the construction of 76 residential and nine (9) commercial lots as of 2016.
Bank Muamalat ²	Waqf funding for health and education.	Reports are published every three (3) months on the bank's website.
HSBC Amanah ³	1 ESG Islamic structured products launched in June 2019.	The product invests in businesses that have no negative effect on the environment and society.
	2 SDG <i>sukūk</i> issued in 2018	Proceeds are used in line with the following SDGs: <ul style="list-style-type: none"> 1 SDG 3: Good health and well being 2 SDG 4: Quality education 3 SDG 6: clean water and sanitation 4 SDG 7: affordable and clean energy 5 SDG 9: Industry, innovation and infrastructure. 6 SDG 11: Sustainable cities and communities. 7 SDG 13: Climate action.
Maybank Islamic ⁴	Maybank Islamic World Master Card Ikhwan ⁵	0.2% from cross-border spending on the Maybank Islamic World Mastercard Ikhwan Card-i will be donated to waqf & zakat managed by Maybank Islamic to help those without basic needs and necessities (<i>faqir / miskin</i>).
Maybank Group ⁵	All services are provided in line with the mission of 'Humanizing Financial Services' whereby clients in financial distress are helped. About 1% of net profit is channelled towards corporate social responsibility (CSR)	The efforts earned Maybank Group an 'A' rating by MSCI ESG Research for the 5 th consecutive year.
CIMB Islamic ⁶	Program Keusahawanan by Taylor's and CIMB Islamic	A community empowerment programme which develops entrepreneurial abilities among B40 communities.

² <https://www.muamalat.com.my/wakafmuamalat/Laporan-Wakaf.html>, accessed on September 15th, 2019.

³ https://www.undp.org/content/undp/en/home/news-centre/news/2018/HSBC_Amanah_Malaysia_issues_worlds_first_United_Nations_Sustainable_Development_Goals_sukuk.html, accessed on September 19th, 2019.

⁴ Maybank Annual Report, 2018, p. 15

⁵ https://www.maybank2u.com.my/maybank2u/malaysia/en/personal/cards/credit/wmc_ikhwan.page? Accessed on Dec. 2nd, 2019.

⁶ Implementation Guide for Value-based Intermediation, BNM, 2018, p. 20.

THE OVERALL ENVIRONMENT OF ISLAMIC FINANCE REGULATIONS IN MALAYSIA

Islamic finance regulations have developed in tandem with the development of Islamic finance products and services. Pioneering markets such as Malaysia adopted a dual banking system (conventional and Islamic) in the early 1980s and put forward prudential, governance and Shari'ah regulations that aimed to realize Shari'ah, legal and technical compliance. To enhance Islamic banking, a set of regulations has been put in place. They can be divided into six categories:

- 1 **Acts:** Malaysia has enacted two major Islamic banking Acts since the inception of Islamic banking, these are Islamic Banking Act 1983 and Islamic Financial Services Act (IFSA) 2013. The latter repealed the former with additional features, which will be highlighted later in this research.
- 2 **Prudential and liquidity management:** these are sets of regulations intended to achieve soundness via prudent measures such as capital adequacy requirements (disclosure, assessment, components, risk weighting), Basel III, credit exposure and single customer limits, securitization and risk management, among others.
- 3 **Market structure and competition:** this includes guidelines to regulate the position of banks vis-à-vis the financial market and to regulate investment banks and international Islamic banks in order to promote competition.
- 4 **Consumer protection:** this includes guidelines regulating base rate ceiling, personal information protection and deposit insurance.
- 5 **Shariah governance framework:** This is a framework that regulates the main organs of the Islamic financial institutions such as the board of directors and its main committees (risk management, audit, nomination and remuneration) so that the rights and responsibilities of all stakeholders are spelt out and the Shari'ah principles are strictly adhered to.
- 6 **Standardization of Shari'ah and operational requirements:** These have been regulated via the policy documents highlighting all Shari'ah contracts and the supporting Shari'ah principles as well as the operational environment in which they should operate.

The key regulations delineated in Table 4 below are generally of two categories: Shari'ah and operational/technical. The Shari'ah standards have observed the most sophisticated norms of standardization as well as the principles of *ijtihad* and fatwa. They have also considered the best practices in the market, on the basis of which Shari'ah clauses have been formulated in the policy documents and various views of Muslim jurists have been adopted. The technical regulations have adopted local and international standards that best suit the Malaysian banking sector. Despite their sophistication, the two sets of regulations have been questioned either directly or indirectly by Shari'ah scholars and some practitioners in other markets, a point that will be addressed later in the research.

In Malaysia, the regulatory and supervisory authority is represented by the Central Bank (BNM) as enshrined in IFSA 2013, the primary legislation for Islamic banking in Malaysia. Under the purview of IFSA 2013, BNM is established as the only regulator mandated to ensure Shari'ah compliance of Islamic banks businesses and operations. BNM also

provides the legal ground for the codification of the resolutions issued by the Shariah Advisory Council (SAC) and pursues punitive measures for breaches punishable under IFSA 2013.

However, the position of IFSA 2013 vis-à-vis Financial Services Acts 2013 (FSA) has raised concerns of subordination of the former to the latter, that it has been the object of an agenda of harmonization between Sharī'ah and law led by BNM. The conflict between Sharī'ah and law in some practices has an effect on the compliance of Malaysian Islamic finance regulations with *maqāṣid al-Sharī'ah*. This will be addressed in the following discussion.

Regulators and Regulations as *Wasā'il* (Means) to Achieve Higher Ends (Macro *Maqāṣid*)

The doctrine of *wasā'il* (means) is part of the theory of *maqāṣid al-Sharī'ah* as propounded by Muslim jurists. Ibn 'Āshūr (2011) highlighted that '*wasā'il* are the means leading to *maqāṣid*. The means to the best *maqṣad* is the best means, and the means to the worst *maqṣad* is the worst means' (p. 145). The means are also Sharī'ah rules that are meant to preserve the higher objectives of Sharī'ah; so much so that the pursuit of *maqāṣid* is also the pursuit of their means (*wasā'il*). Ascertaining this doctrine, Imam Ibn Qayyim al-Jawziyyah (1991, vol. 3, p. 108) maintained that '*wasā'il* have the same rulings as *maqāṣid*'.

Wasā'il are of two categories, the first comprises a set of rulings stated in the sources of Sharī'ah, and the second are means promulgated or formulated based on *ijtihād*. In the context of finance, some of the means of preserving wealth are stated in the Sharī'ah sources while others are formulated by people in charge of wealth, be it individual or public wealth. In the case of the latter, the rulers are entrusted by Sharī'ah to come up with every possible means to preserve wealth and develop it for the betterment of the community. In the banking context, the regulators are the ones that must issue regulations pertaining to the wealth of the nation. This paper argues that the regulators are the means (*wasīlah*) to the preservation of wealth (*hifẓ al-māl*). Imam al-'Izz ibn 'Abdul al-Salām (1991, vol. 1, p. 58) stated:

There is no doubt that the appointment of judges and rulers are *wasā'il* (means) to realize public and private benefits (*al-maṣāliḥ al-'āmmah wa al-khāṣṣah*). As for the appointment of assistants to the judges and rulers, it is deemed as a means to the means (*wasā'il al-wasā'il*).

Regulations of Islamic banking are the means that are supposed to realize *maqāṣid al-Sharī'ah*. From the Sharī'ah perspective, the ruler is allowed to come up with any arrangement (*wasīlah*) to safeguard the interests of the ruled. Imam Ibn 'Āshūr (2011) considered the bindingness of a contract of exchange a means (*wasīlah*) to not rescinding it. He also considered the expression of a contract (*ṣiḡḡah*) as a means to determine the intention of the contracting parties. All these are captured in the policy documents published by BNM. For example, the Murabahah Policy Document states: '*Murābahah* is a sale and purchase contract which is binding in nature. Thus, the contract shall not be terminated unilaterally by any of the contracting parties.'

Looking into the nature of regulations, they can be considered as *wasā'il* meant to protect wealth (*hifẓ al-māl*), facilitate its circulation (*rawāj*), ensure its fair mobilization and allocation (*'adālah*), and realize its stability (*thabāt*) by determining the roles and responsibilities of all stakeholders.

A general idea of how the existing Malaysian regulations of Islamic banking fit into the framework of *wasā'il* (means) towards the realization of *maqāṣid al-Sharī'ah* is presented in Table 4.

Table 4: BNM Guidelines as Means to Realize *Maqāṣid al-Sharī'ah*

<i>Wasā'il</i> (means): Guidelines/Exposure draft/Circular	Relevant objective of Sharī'ah to be realized
Financial Reporting for Islamic Financial Institution 30 September 2019 28 June 2013	Protection of wealth
Net Stable Funding Ratio 23 March 2018	Protection of wealth
Basel III compliance 23 March 2018	Protection of wealth
Capital Adequacy Frameworks for Islamic Banks 2 February 2018	Protection of wealth
Leverage Ratio 8 December 2017]	Protection of wealth
Stress Testing 26 September 2017	Protection of wealth
Capital Funds for Islamic Banks 3 May 2017	Protection of wealth
Klibor Rate Setting 27 December 2016	Protection of wealth
Prohibited Business Conduct 22 November 2016	Protection of wealth
Financial Technology Regulatory Sandbox Framework 18 October 2016	Protection of wealth
Liquidity Coverage Ratio 26 August 2016	Protection of wealth
Operational Risk 11 May 2016	Protection of wealth

<i>Wasā'il</i> (means): Guidelines/Exposure draft/Circular	Relevant objective of Sharī'ah to be realized
Reference Rate Framework 19 March 2014	Protection of wealth
External Auditor 28 June 2013	Protection of wealth
Anti-money Laundering and Counter Financing of Terrorism 4 March 2013	Protection of wealth
Guidelines on Credit Transactions and Exposures with Connected Parties 1 January 2008	Protection of wealth
Introduction of New Products 7 March 2014	Protection of wealth and religion
Risk-informed Pricing 16 December 2013	Protection of wealth and stability
Circular on Standardized Documentation for Description of Key Terms for Housing Loan/ Home Financing Agreements 1 January 2013	Transparency
Shariah Governance Policy Document (SGP) 20 September 2019	Protection of <i>dīn</i>
Shariah Governance Framework 26 October 2010	
Fit and Proper Criteria 28 June 2013	Accountability and responsibility
Guidelines on International Islamic Banks 24 March 2008	Internationalization of Islamic finance
Guidelines on Investment Banks 1 July 2005	Development of real economy via profit-and-loss sharing within the <i>maqṣad</i> of justice
Guidelines on Permitted Capital Market Activities by Islamic Banks 2018	Development of real economy via profit-and-loss sharing within the <i>maqṣad</i> of justice
Management of Customer Information and Permitted Disclosure 17 October 2017	Transparency (<i>wuḍūh</i>)

The Conceptual Framework of Islamic Finance Regulations in Malaysia

Regulations of Islamic finance have been discussed by some eminent Muslim economists. Chapra and Khan (2000) are of the view that there are four reasons for the development of a deep and dynamic financial market, regulating Islamic finance institutions: systemic considerations, the protection of depositors, compliance with Shari'ah, and the integration of Islamic finance in the international financial system. In another study, Chapra (1995) identified human well-being as the ultimate objective of Shari'ah. To him wealth is only a 'means, though an important and indispensable one, for realizing human well-being'. This theoretical element is well substantiated in the classical theory of *maqāṣid al-Shari'ah* propounded by al-Juwaynī, al-Ghazālī and al-Shāṭibī, and in the modern world by scholars such as Ibn 'Āshūr.

Countries that adopted Islamic finance under a dual banking system have mandated their central banks or monetary authorities to regulate Islamic finance business. Siddiqi (2004) observed that *maqāṣid al-Shari'ah* are the ends that legislators (and regulators) 'are supposed to keep in view while making new laws to handle new situations'. In any banking system, the central bank's agenda is to strive to realize objectives such as stability of the monetary, financial and payment systems (BNM 2018). These are very much in line with the *maqāṣid al-Shari'ah* regarding wealth.

While the Central Bank Act 2009 of Malaysia (section 27) reiterated that Malaysia has a dual banking system, it empowered BNM's Shariah Advisory Council by requesting the court and the arbitrators to refer to SAC-BNM [section 56 (1)] and by considering the rulings of SAC-BNM binding on IFIs, courts and arbitrators (section 57). This development is deemed unprecedented. The recent case of Kuwait Finance House (KFH) Bhd vs. JRI Resources, involving a dispute over who should bear the maintenance cost of leased assets, proved that SAC-BNM is the apex authority in Islamic financial matters. The dispute was triggered as the *ijārah* documents of the two parties have apparently contradicting clauses on the issue. After SAC's ruling that the *ijārah* agreement is Shari'ah compliant, a legal dispute followed as to whether SAC's resolution is now binding upon the high court. In addressing the matter, BNM clarified that SAC merely ascertained whether the agreement is in line with Islamic law and that it has not usurped the functions of the courts (Anbalagan 2018).

The conceptual framework of the Islamic finance regulations in Malaysia is generally highlighted in two important documents, the 'Financial Sector Blueprint' published by BNM in 2011 and Islamic Financial Services Act 2013. According to the 'Financial Sector Blueprint', the objectives of banking regulations in Malaysia, be they conventional or Islamic, are to realize a high value-added, high-income economy. In addition, they are intended to promote:

- financial inclusion for greater shared prosperity,
- regional and international financial integration,
- the internationalization of Islamic finance, and
- a regulatory and supervisory regime to safeguard the stability of the financial system.

All these objectives are *maqāṣid* compliant as they do not encroach upon any Sharī'ah principles. However, achieving the same objectives in Islamic finance would exclude *ribā*, *gharar* and *maysir*, as the Shariah Advisory Councils of BNM and Securities Commission have determined.

The second document is the Islamic Financial Services Act (IFSA 2013). Section 6 of the Act addresses the objectives of IFSA 2013 as follows:

The principal regulatory objectives of this Act are to promote financial stability and compliance with Sharī'ah, and in pursuing these objectives, the Bank shall–

(a) foster –

- (i) the safety and soundness of Islamic financial institutions;
- (ii) the integrity and orderly functioning of the Islamic money market and Islamic foreign exchange market;
- (iii) safe, efficient and reliable payment systems and Islamic payment instruments; and
- (iv) fair, responsible and professional business conduct of Islamic financial institutions; and

(b) strive to protect the rights and interests of consumers of Islamic financial services and products.

The objectives referred to in the section above are in line with *maqāṣid al-Sharī'ah*. The section mentions financial stability, which aims at wealth protection (*hifẓ al-māl*), Sharī'ah compliance (*hifẓ al-dīn*), fairness (*'adālah*), and consumer protection (*hifẓ al-naḥs wa al-māl*). The rest of the points in section 6 are the instruments used to realize those objectives. From this perspective, IFSA 2013 has incorporated macro *maqāṣid*, which have been translated into various guidelines issued by BNM such as Shariah Governance Policy Document (SGP) 2019. The latter, undoubtedly, aims at the protection of wealth, and therefore the protection of religion (*hifẓ al-dīn*).

The Obstacle of Subordinating Islamic Banking Regulations to Conventional Regulations

Zulhibri and Ghazal (2015) investigated regulations of Islamic banking in 13 Muslim and non-Muslim countries, including Malaysia. They concluded that the relevant regulations in most of those countries are formulated in the image of the conventional banking system. Although the Islamic finance regulation (Islamic Banking Act 1983) referred to by Zulhibri and Ghazal was repealed and substituted by IFSA 2013, the outcome of the research seems to imply that the dual banking system in Malaysia is featured by adopting both domestic reporting and international standards. Citing challenges of harmonization at the domestic level, Zulhibri and Ghazal (2015) call for regional harmonization whereby Malaysian regulations to be harmonized with countries of the same region. However, the authors did not clarify how regional harmonization can serve Islamic finance in the presence of different legal and regulatory frameworks in the respective countries.

“IFSA 2013 has incorporated macro *maqāṣid*, which have been translated into various guidelines issued by BNM such as Shariah Governance Policy Document (SGP) 2019.”

Despite the dual banking system in Malaysia, many civil laws seem to have a status that overrides the Islamic banking practices, a factor that could prevent the realization of *maqāṣid al-Sharī'ah* in Islamic finance. To mitigate this legal risk, efforts to harmonize civil law with Islamic law culminated in the establishment of the Harmonization Committee under the Central Bank of Malaysia with the mandate of realizing legal certainty and removing impediments to efficient conduct of Islamic finance. In its sole report published in 2013, the Committee identified nine issues, four of which were recommended for amendment. It found that four issues did not require any amendments, and one was highlighted for further research.

According to the report, the only harmonization initiative that has been completed is the one related to the legal recognition of the Sharī'ah permissibility of imposing late payment charges on judgment debts in Islamic finance cases. It has been incorporated in Order 42 Rule 12A of the Rules of Court 2012. The rest of the harmonization initiatives are still in progress (BNM 2013).

Harmonization is not a simple matter. Engku Ali (2009) addressed the intricacies of harmonizing civil law and Sharī'ah in the Islamic financial services industry. The author pinpointed the lack of differentiation between Islamic and conventional finance products as the result of a lack of clear-cut boundaries between civil law and Islamic banking regulations. This is important to mitigate the reputational risk that could hinder the acceptability of Islamic finance by all stakeholders. Abdullah (2009) referred to certain non-compliance issues facing *al-ijārah thumma al-bay'* (AITAB), which operates under the purview of the Hire-Purchase Act 1967. They referred to issues pertaining to the Sharī'ah framework, ownership, maintenance responsibility, deposit payment, penalty in case of default, intention and lack of understanding of parties, signing of two separate documents in sequence, and interest-based calculation of profit. According to Abdullah, there is a need for a Mu'āmalat Hire-purchase Bill independent of the Hire-Purchase Act 1967, though the proposal was rejected by the Attorney General.

Hence, the premise of subordinating Islamic finance regulations to civil law may have resulted in an incomplete version of harmonization. As a result, Islamic finance found itself leveraging on conventional finance in a way that may have obscured the difference between Islamic financial products and conventional products in the eyes of some practitioners and Sharī'ah scholars. This scenario may be obstructing the realization of *maqāṣid al-Sharī'ah* in Islamic finance in Malaysia.

SELECTED ISLAMIC FINANCE REGULATIONS UNDER SCRUTINY

This part of the research briefly scrutinizes some regulations of Islamic finance in Malaysia and assesses in broad terms their compliance to *maqāṣid al-Sharī'ah*.

Governance Framework

Some studies were fully dedicated to the Shariah Governance Framework (SGF) issued by BNM in 2010, highlighting the main structure and the four main functions, namely audit, risk management, review and research. At the core of SGF, BNM as a regulator aims to enhance the principles of accountability, independence, justice, transparency and disclosure at the level of Islamic financial institutions (Hassan 2014). The said principles are imbued with ethical values that are supposed to contribute towards the realization of *maqāṣid al-Sharī'ah* in the Islamic financial institutions' operations.

In 2019, BNM issued the revised version of the Sharī'ah governance framework (i.e. SGP) that introduced key enhancements to the existing SGF. The enhancements include:

- strengthened board oversight on accountability and responsibilities over Sharī'ah governance;
- enhanced requirements for the Sharī'ah committee in providing objective and sound advice to Islamic financial institutions,
- bringing it in line with the IFSA 2013;
- enhanced expectations for the board and senior management to promote a Sharī'ah-compliant culture and further integrate Sharī'ah governance considerations in business and risk strategies; and
- enhanced regulatory expectations on the quality of internal control functions to ensure effective management of Sharī'ah non-compliance risks (BNM 2017a).

All these are *wasā'il* (means) to achieve a greater level of *maqāṣid al-Sharī'ah*.

The realization of *maqāṣid al-Sharī'ah* may, however, be hindered by some obstacles at the governance level. The present SGF is unlikely to completely solve some governance issues such as the agency problem. Hasanuddin (2009) is of the view that the information asymmetry arising between the Islamic bank as an agent and the investor as the principal still poses a problem in the governance structure of Islamic banks. By having the necessary expertise to do business, the bank possesses the right information about the nature of a business and the prospects of its success. The same information may not be accessible to the client, putting him at risk as he cannot prove the bank wrong should the investment fail. This is related to SGF as the latter emphasizes transparency and disclosure, especially for products having medium or high risk. This would include the obligation by the bank to explain the investment risks to the client.

Besides, the SGP 2019 (BNM 2019c, p. 6) suggests that the board of directors (BODs) may have a view different from its Shari'ah committee. In that scenario, paragraph 9.1 (c) and (d) state that the BODs should have due regard for the Shari'ah committee's decision and shall:

(c) put in place conflict resolution mechanism to deal with any differences in views between the board and the Shariah committee; and

(d) maintain a record of deliberations between the board and the Shariah committee in matters where the differences in views exist, and its [sic] resolution.

The above paragraph raises a concern about the enforceability of the Shari'ah committee's view. It may open the door for BODs to play the role of Shari'ah scholars in Shari'ah matters. This raises the question of whether BOD members are qualified to undertake deliberations of Shari'ah nature. Further, enforceability of Shari'ah opinion may be semantically disputed as a result of using the expression 'due regard' in paragraph 9.1 below.

'Due regard' is an ambiguous wording that could be interpreted to mean the Shari'ah committee's opinion is not necessarily binding. If the BODs understand it as not binding, then the industry may brace itself for debates between BODs and Shari'ah committees. On the other hand, there is a possibility that the Shari'ah opinion may not be in line with the business strategy of the IFI, affecting revenues or having repercussions on the IFI. This may be what is referred to in paragraph 9.1 (b) that guides the BOD to assess the implication of the Shari'ah committee's opinion on the IFI. The paragraph states:

S 9.1 The board must have due regard to any decision or advice of the Shari'ah committee on any Shari'ah issue relating to the operations, business, affair or activity of the IFI. This duty requires the board to-

(a) give sufficient attention to the facts, rationale and basis for any decisions or advice of the Shariah committee before arriving at its own decision;

(b) give fair consideration to the implications of implementing any decision or advice of the Shari'ah committee;

Poor governance structures may cause some Islamic financial products to fade away from the market. *Muḍārabah*, for instance, has yet to make a headway in the market despite IFSA 2013's clear separation between deposit and investment accounts. Moral hazards in *muḍārabah* investment, according to Siddiqi (1993), are beleaguering the trust in Islamic banks' striving to achieve their objectives. This is mainly due to lack of initiatives for capital protection, which is confused with the prohibited capital guarantee of *muḍārabah* capital. The moral hazards may be due to not fully disclosing the risk associated with a *muḍārabah* venture. The burden of proof of negligence in case of a sharp shortfall in *muḍārabah* ventures must be regulated to protect investors from the claims made by IFIs due to the complexities of modern investments. Although Siddiqi's observation was made in the 1990s, his concern is still relevant in the current Islamic banking environment where *muḍārabah* investment is at its lowest level, standing at about 1.7% of total Shari'ah contracts used in Islamic banking worldwide (World Bank-IBDG 2016). To address this concern, BNM (2017) has made it mandatory for IFIs to have a risk management strategy formulated and approved by the board of directors. Mudarabah Policy Document (BNM 2017, p. 68) reads, 'The IFI shall institute and

implement a sound and integrated risk management system to effectively manage risks throughout the life cycle of the *mudarabah* venture.'

As part of a robust governance system, the unique ethical code embedded in Islamic finance regulations is supposed to be a selling point for IFIs, locally and abroad. Shared prosperity via financial inclusion, profit sharing, and dealing with real assets and the real economy are the most ethical elements of a viable *maqāṣid*-based regulatory framework. These much championed and chanted features have barely been actualized in the present models and products of Islamic banking and finance. This state of affairs has elicited considerable criticism from renowned Sharī'ah authorities and scholars.

On the oversight side, weakness in the oversight mechanism and internal control of Islamic banks in Malaysia sometimes leads to Sharī'ah non-compliant processes and transactions. Asmadi (2014) warned against the pitfalls of pre-signing contracts that some Islamic banks might have engaged in, suggesting a lack of oversight in regulating this matter. In addition, some mistakes have been noted in the legal documentation of Sharī'ah contracts applied by Islamic banks, implying another lacuna in the oversight and governance system (Lee 2014).

Further, SGF places the duty of overseeing Sharī'ah compliance on the BODs and the management. Ascertaining Sharī'ah compliance requires deep Sharī'ah knowledge. The BODs and members of management are not sufficiently equipped with Sharī'ah knowledge, and yet they are fully accountable and responsible before the regulators, who may impose heavy punishments as stipulated in IFSA 2013. This led BNM to introduce a special program named 'Islamic Finance for Boards of Directors', which is compulsory on all board members of IFIs, subsidiaries, windows and development institutions to complete by the end of 2020 (ISRA Consultancy, 2018).

Prudential and Risk Management Regulations

Prudential regulations are manifold. They are mainly centered on capital adequacy and risk management. According to Simon and Rifaat (2013), IFSB set out standards for Islamic banks based on the Basel Accords that include eligible capital, risk weighting for assets, treatment of unrestricted investment accounts and displaced commercial risk (DCR) in the calculation of capital adequacy. John Lee (2013) is of the view that risks inherent to Islamic financial institutions are different from those of their conventional counterparts. While this true in *mushārah* and *muḍārah* products due to their profit and loss sharing (*mushārah*) and profit sharing (*muḍārah*), credit products are not very much different in terms of credit assessment, pricing, recovery and other technical aspects.

Possible risk issues include capital adequacy ratio (CAR) miscalculation of DCR, unrestricted investment accounts, and default risk for Additional tier 1 capital and tier 2 capital that use subordinated *ṣukūk* or unsecured *ṣukūk*. There are concerns about the legitimacy of the *tanāzul* concept in debt-based subordinated *ṣukūk*. The *ṣukūk* holders do not rank *pari passu* with creditors, triggering issues of fairness and justice, though the element of consent of *ṣukūk* holders may be used as grounds for legitimizing such *ṣukūk*. From a risk management perspective, a higher CAR would mitigate such risks and reflect a healthy banking market; however, that is yet to become mandatory

“Shared prosperity via financial inclusion, profit sharing, and dealing with real assets and the real economy are the most ethical elements of a viable *maqāṣid*-based regulatory framework.”

beyond the threshold of 8% as most banks tend to maintain higher capital ratios. The average CAR for tier 1 and tier 2 capital for Islamic banks in 18 countries, representing over 95% of the global Islamic banking assets as of 1H2017, stands at 12.0% (IFSB, 2018).

In Malaysia, Sairally et al. (2013) found that Islamic banking institutions have been issuing mainly general obligations, subordinated and unsecured *ṣukūk* to meet the Basel III tier 2 capital requirement. This, according to the researchers, raises a number of Shari'ah concerns. One is the permissibility of issuing asset-based *ṣukūk* in which recourse is to the obligor in case of default. Others are the priority right of senior *ṣukūk* holders to receive their return, and the issue of issuing *ṣukūk* without collateral. These features clash with the objective of promoting the real economy since the *ṣukūk* holders do not have the right to dispose of the asset to a third party in case the obligor defaults. They also make *tanāzul* upfront with respect to receiving their returns in case of default or winding up. This also raises issues as to why the regulations allow such conditions if they are deemed harmful to the stakeholders.

Market Conduct and Consumer Protection Regulations

Market conduct and consumer protection regulations have been formulated with the same vigor and rigor as other regulations. Generally speaking, the protection of wealth as an objective of Shari'ah cannot be entirely achieved without protecting the wealth's owner as a consumer. In this regard, some laws and regulations are enforced to protect the customer in two ways: regulating the conduct of business that a financial institution may have with a consumer, and regulating the way the personal data of the consumer is protected.

BNM issued guidelines on prohibited business conduct by a financial institution that aim to protect the consumer from any misleading or deceptive information related to an offered product or service. It also aims at protecting the consumer from exploitation or restriction of freedom to choose between financial services. The guidelines provide a non-exhaustive list of examples of misleading and deceptive conducts by a financial institution. These include the false claim that an offered product or service has been authorized by a certain body, the claim that a non-principal protected product is a deposit product, and deceptive description of a product or a service as free when in reality it is not (BNM 2016b).

Personal Data Protection Act 2010 has provided detailed provisions to protect the consumer's personal information. These include:

- the general principle of consumer consent;
- the principle of 'Notice and Choice', whereby the data subject (consumer) must be notified about usage of the collected data;
- the principle of 'Data Disclosure' and its parameters;
- the 'Retention Principle' that sets a maximum time frame for keeping data;
- the principle of data integrity, which calls for accuracy, completion and updating of the data collected; and lastly

- the principle of access, on the basis of which the data subject can access his personal data held by a data user and correct it if it is deemed inaccurate or incomplete (Personal Data Protection Act 2010).

Besides, the 'Management of Customer Information and Permitted Disclosures' Policy Document (BNM 2017c) urges a financial service provider (FSP) to come up with policies and procedures that protect the consumer's information throughout the processes of collection, storage, use, transmission, sharing, disclosure and disposal. From a *maqāṣid* perspective, all the above regulations are means to achieve a higher objective of the Sharī'ah, namely protection of wealth and honor as well as the realization of transparency.

Financial Technology (Fintech) Regulations

Finance, be it conventional or Islamic, is undergoing disruption by technological developments. Regulatory efforts are being made to promulgate regulations for Islamic financial technology (fintech) to control and supervise the rapid growth of fintech start-up companies. With the introduction of a Fintech Regulatory Sandbox Framework, BNM has laid down detailed provisions for sandbox participants, including the protection of the confidentiality of customer's information (BNM 2016a). There is a general impression that fintech provides a safer business environment and faster operations. However, fintech startup companies will have to deal with challenges that may expose consumers to various risks such as the sudden disruption of their existing businesses procedurally and operationally, the loss of traditional jobs, and the creation of unhealthy competition between savvy investors and traditional ones. In the same vein, consumer protection remains a big concern with regard to initial coin offerings (ICO) whereby investors may be exposed to potential risks such as fraud, money laundering, hacking and theft of online personal information. These are all risks to wealth; hence, undermining the Sharī'ah objective of protecting wealth (*hifẓ al-māl*). In a public consultation paper (No. 1/2019), the Securities Commission of Malaysia warned against these risks and embarked upon the formulation of new regulations to protect investors from fraud and manipulation (Securities Commission Malaysia 2019).

Malaysia Shariah Standards (Policy Documents) and SAC-BNM Resolutions

Bank Negara Malaysia has launched its Shariah and Operational Standards, better known as Policy Documents, since 2014. They regulate Sharī'ah rulings on *murābaḥah*, *muḍārabah*, *mushārahah*, *tawarruq*, *istiṣnā'*, *kafālah*, *wakālah*, *qarḍ*, *wadī'āh*, *hibah*, *ijārah*, *wa'd*, *rahn* and *ṣarf*. They address both Sharī'ah and operational requirements. The latter deals with governance, risk management, transparency and the role of the BODs and management in ensuring end-to-end Sharī'ah compliance. They are mandatory on Islamic financial institutions as well as financial institutions providing Islamic finance products and services. SAC-BNM resolutions are also mandatory to follow in relevant cases before civil courts and arbitrators.

The BNM Policy Documents have followed the methods of *ijtihād*, namely deducing the Sharī'ah view from the Qur'ān and Sunnah using all the instruments of *ijtihād* such as *qiyās*, *maṣlaḥah mursalah*, *'urf* and *istiḥsān*, and methods of textual inference (*ṭuruq*

“Fintech startup companies will have to deal with challenges that may expose consumers to various risks such as the sudden disruption of their existing businesses procedurally and operationally, the loss of traditional jobs, and the creation of unhealthy competition between savvy investors and traditional ones.”

al-istinbāṭ). Some clauses of BNM's Policy Documents are mandatory, but some are optional for Islamic financial institutions to apply. While all schools of jurisprudence have been consulted in the formulation of the Shari'ah standards, the Shāfi'ī School, being the Islamic jurisprudence of the country, has been used as the major reference. This is reflected in the sale of debt and organized *tawarruq*, which finds its legitimacy in the *īnah* transaction allowed by Imam Shāfi'ī. However, Imam Shāfi'ī, according to critics ('Abd al-'Azīm 2008) did not allow *īnah* as practiced nowadays, a matter that triggered hot debates on whether Malaysia has practiced the wrong *īnah* since 1984. The long-term debate may have been the reason for the 2014 SAC resolution which prohibited the inter-conditionality between the first and second legs of the *īnah* transaction.⁷

⁷ https://amlcft.bnm.gov.my/index.php?ch=en_about&pg=en_sac_updates&ac=298 accessed on Nov. 15th, 2019.

Some differences are noted between the Malaysian Shari'ah standards and AAOIFI's, particularly on *tawarruq*, sale of debt, late payment charges, bindingness of bilateral *wa'd*, reverse *murābahah*, debt restructuring via *qalb al-dayn*, and dual agency. Malaysia has long been criticized for adopting the above issues, which are now part of the Policy Documents. Parts of them would thus be *maqāṣid* non-compliant according to AAOIFI and the Islamic Fiqh Academy of the OIC.

'Abd al-'Azīm (2008) is of the view that the Malaysian *tawarruq* is not Shari'ah compliant as it goes against *maqāṣid al-Shari'ah*, and so does *īnah* and sale of debt. Thus, all banking and capital market products that use *īnah*, *tawarruq* and sale of debt are Shari'ah and *maqāṣid* non-compliant. Shaykh 'Alī Qaradāghī (2011) is an ardent critic of organized *tawarruq*. According to him, 'organized *tawarruq* as practiced by Islamic banks is a clear trick (*hīlah*)' (p. 93) to circumvent the prohibition of *ribā*. Suwailem (2009) maintains, '*Tawarruq* is against *maqāṣid al-Shari'ah*' (p. 407). This is echoed in the writings of Shaykh Taqī al-Uthmānī (2011), Rafiq al-Maṣri (2007) and many other Muslim scholars. *Tawarruq* was prohibited by the International Islamic Fiqh Academy-OIC in 2009. The position taken by many Muslim scholars is that *tawarruq* is a legal stratagem (*hīlah*) to circumvent the prohibition of *ribā*. The AAOIFI standard only allows the usage of *tawarruq* in very strict circumstances and dire need such as liquidity shortage, financial deficit and operational breakdown (AAOIFI 2015).

However, the regulators in Malaysia provided for the introduction of a platform that facilitates liquidity and cash financing; i.e., Bursa Suq al-Sila'. The platform is based on organized *tawarruq* but has not received much criticism as it has been seen as a preferable alternative to the London Metal Exchange (LME), which raised Shari'ah concerns on the ownership of assets and their real transfer. Bursa has established a system that evaded the main controversial issues against *tawarruq*, namely the ownership of the asset, its true transfer to the buyer, and the transaction sequence. The asset in Bursa does not go back to its original seller, but the client still appoints the IFI as an agent to sell the asset to Bursa in order to generate the cash flow intended from the whole operation.

From the discussion above, one can derive the following observations:

- 1 There are concerns that Islamic finance regulations in Malaysia mirror conventional regulations, threatening the realization of *maqāṣid al-Shari'ah* in Islamic finance.
- 2 The statutory relationship between SAC-BNM and the courts under the Central Bank Act 2009 and the first test of such a relationship have shown that some legal

experts are yet to familiarize themselves with CBA 2009.

- 3 Islamic finance in Malaysia is still facing the conundrum of form versus substance in the view of critics. It may be argued that Islamic finance regulations in Malaysia have played a role in stoking the debate.
- 4 Most criticism against the Malaysian regulations have been directed at the Sharī'ah framework represented by SAC-BNM. Criticism has not focused much on the codification of Sharī'ah contracts and principles in the recently issued policy documents, which merge Sharī'ah compliance and best practices.

| CONCLUSION

Islamic banking regulations in Malaysia have developed considerably over time and demonstrate a great deal of robustness. Despite their sophistication, the said regulations are yet to completely reflect the macro *maqāṣid* of Sharī'ah such as financial independence, financial stability and value-based intermediation. This research has specifically emphasized the macro *maqāṣid* for two reasons: first, because the realization of macro *maqāṣid* at the level of the regulators would facilitate the realization of micro *maqāṣid* at the level of Islamic financial institutions. The second reason is the need to use macro *maqāṣid* as the benchmark to measure compliance of the Islamic finance regulations in Malaysia with the objectives of the Sharī'ah.

The Malaysian regulations on Islamic finance are operating within the conventional regulatory and financial environment. This is purportedly one of the main obstacles for realizing the macro *maqāṣid*. However, the major criticism leveled against the Malaysian regulations has been addressed toward the resolutions of the Shariah Advisory Council, which form one of the bases for the Shariah Standards published by the Central Bank in 2016 and 2017. The Standards are largely in conformity with GCC regulations and AAOIFI Sharī'ah Standards; however, they contain certain controversial issues that have divided the Malaysian and GCC markets in terms of Sharī'ah compliance. These include sale of debt, organized *tawarruq* and dual agency. For macro *maqāṣid* to reign supreme in the regulatory framework Malaysia, the research recommends propounding a specific theory of *maqāṣid* using the macro *maqāṣid* discussed in this research and capitalizing on the existing VBI initiative, which is micro oriented. With macro and micro *maqāṣid*, the Malaysian experience in Islamic finance regulations will be ushered to greater heights.

“The Malaysian regulations on Islamic finance are operating within the conventional regulatory and financial environment. This is purportedly one of the main obstacles for realizing the macro *maqāṣid*.”

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