



Legal, Regulatory and  
Governance  
Issues in

*Islamic*

Finance

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# Introduction



↳ what is it?

# Islamic *finance*

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- Islamic finance faced tremendous challenges when it first started. One of the main reasons is because there was no precedent to look up to.
- There was also the business risk of the acceptability of members of the public as bankers and lawyers thought that unfamiliar products might take longer to gain acceptability.
- In the end, banking transactions took their form by emulating products and contracts resembling those of conventional finance.
- Thus, most Islamic banking products began by structuring them to mirror their conventional counterparts, with appropriate adjustments to enable compliance with **Shariah**.

# Analysis of Islamic Banking Laws and Legal Frameworks

# Legal & Shariah Framework

## *Islamic Banking & finance*

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**Central Bank of Malaysia Act 2009**

**Islamic Financial Services Act 2013**

**Financial Services Act 2013**

**Development Financial Institution 2002**

**Government Funding Act 1983**

# Legal & Shariah Framework

## *Islamic Banking Transactions*

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**Contracts Act 1950**

**Hire Purchase Act 1967**

**Real Property Gains Tax Act 1976**

**Stamp Act 1949**

**National Land Code (Revised 2020)**

# Legal & Shariah Framework

## *Islamic Banking Transactions*

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**Anti-Money Laundering, Anti-Terrorism Financing and Proceeds of Unlawful Activities Act 2001**

**Rules of Court 2012**

**Electronic Commerce Act 2006**

**Digital Signature Act 1977**

**Power of Attorney Act 1949**

# **Evaluation of Regulatory Systems Overseeing Islamic Finance**

# REGULATORS

**Bank Negara  
Malaysia (BNM)**

**CENTRAL BANK OF  
MALAYSIA ACT 2009**

Islamic banks,  
International Islamic  
banks, Islamic  
windows and Islamic  
Development Financial  
Institutions (DFIs)

Family and General  
*Takāful*, Re-takaful,  
International takaful  
operators and  
intermediaries

**Securities  
Commission (SC)**

**SECURITIES  
COMMISSION ACT  
1993**

Islamic stockbroking  
companies, Islamic fund  
management  
companies, Islamic unit  
trust  
management  
companies, etc

Islamic crowdfunding  
platforms

**Labuan Financial  
Services Authority**

**LABUAN FINANCIAL  
SERVICES AUTHORITY ACT  
1996**

Offshore Islamic banks, Offshore  
Islamic capital  
market intermediaries, Offshore  
Islamic trusts and  
Offshore retakaful companies, etc

# Public Regulatory *Authorities*

## **CENTRAL BANK OF MALAYSIA ACT 2009**

An Act to provide for the continued existence of the Central Bank of Malaysia and for the administration, objects, functions and powers of the Bank, for consequential or incidental matters.

# Public Regulatory *Authorities*

## **SECURITIES COMMISSION ACT 1993**

An Act to establish the SC, an independent statutory body entrusted with the responsibility to regulate and develop the Malaysian capital market. It's mission is to promote a fair, efficient, secure and transparent securities market.

# Public Regulatory *Authorities*

## **LABUAN FINANCIAL SERVICES AUTHORITY ACT 1996**

An Act to establish the Labuan Financial Services Authority and to provide for its functions and powers, and for matters connected therewith.

# Other Standard *Setters*

## **Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)**

The AAOIFI was created on 26 February 1990 to ensure that participants conform to the regulations set out in Islamic finance. The rules, restrictions and requirements adopted for business and investment in Islamic finance must adhere to the principles of Shariah in order to be considered acceptable.

# Other Standard *Setters*

**The objectives of the AAOIFI are as follows:**

- To develop accounting, auditing and governance thoughts relevant to the activities of Islamic Finance Institutions (IFIs), with consideration of international standards and practices which comply with Shariah .
- To disseminate accounting, auditing and governance thoughts relevant to the activities of IFIs and its applications through training, seminars, publication of periodical newsletters, carrying out and commissioning of research and other means.

# Other Standard Setters

The objectives of the AAOIFI are as follows (Cont):

1. To prepare, promulgate and interpret accounting and auditing standards for IFIs.
2. To review and amend accounting and auditing standards for IFIs.

The following standards have been developed by AAOIFI which cover five important areas; Accounting, Audit, Ethics, Governance, Shariah

Countries where AAOIFI standards are mandatory/recommended: Bahrain, Malaysia, UAE, Saudi Arabia, Lebanon, Syria, Sudan and Jordan.

# Other Standard

## Setters

**Financial Stability Board (FSB)** is an international body that monitors and makes recommendations about the global financial system, and promotes international financial stability

**The FSB was established to:**

- Assess vulnerabilities affecting the global financial system and identify/review, on a timely basis within a macro prudential perspective, the regulatory, supervisory and related actions needed to address these vulnerabilities, and their outcomes
- Promote coordination/information exchange among authorities responsible for financial stability
- Monitor and advise with regard to best practice in meeting regulatory standards

- Monitor/advise on market developments and its implications for regulatory policy
- Undertake joint strategic reviews of the international standard setting bodies and coordinate their respective policy development work to ensure this work is timely, coordinated, focused on priorities and addresses gaps
- Set guidelines for establishing and supporting supervisory colleges
- Support contingency planning for cross-border crisis management, particularly with regard to systemically important firms
- Collaborate with the international monetary fund (IMF) to conduct early warning exercises
- Promote member jurisdictions' implementation of agreed commitments, standards and policy recommendations, through monitoring of implementation, peer review and disclosure

# Other Standard *Setters*

## **Basel Committee for Banking Supervision (BCBS)**

- The Basel Committee for Banking Supervision (BCBS), established by the Central Bank Governors of the Group of Ten, or G 10 countries.
- Its objective is to enhance understanding of key supervisory issues and improve the quality of banking supervision worldwide.
- It seeks to do so by exchanging information on national supervisory issues and approaches and techniques, with a view to promoting common understanding.

# Other Standard Setters

## **The International Organization of Securities Commissions (IOSCO)**

- Established in April 1983, The International Organization of Securities Commissions (IOSCO) is an association of organizations that regulate the world's securities and futures markets.
- Its membership regulates more than 95% of the world's securities markets in more than 115 jurisdictions;
- By providing high quality technical assistance, education and training, and research to its members and other regulators, IOSCO seeks to build sound global capital markets and a robust global regulatory framework

# Other Standard *Setters*

## **International Islamic Financial Market (IIFM)**

- IIFM is a standard-setting organization for the Islamic financial services industry focusing on standardization of Islamic financial contracts and product templates relating to the capital & money market, corporate finance and trade finance segments of the industry.
- IIFM was founded in 2002 by the collective efforts of the Islamic Development Bank, Autoriti Monetari Brunei Darussalam, Bank Indonesia, Central Bank of Bahrain, Central Bank of Sudan and the Bank Negara Malaysia (delegated to Labuan Financial Services Authority) as a neutral and non-profit organization.

# Other Standard

## *Setters*

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- Besides the founding members, IIFM is also supported as member by certain regulatory and government bodies such as State Bank of Pakistan, Dubai International Financial Centre, Indonesia Financial Services Authority, The National Bank of Kazakhstan, and by a number of international and regional financial institutions and other market participants.
- IIFM plays its role in market unification by developing best practices at the global level and achieving Shariah harmonization through its efforts for creation of a robust, transparent and efficient Islamic finance industry.

# Other Standard *Setters*

## **Malaysian Accounting Standards Board (MASB)**

- The Malaysian Accounting Standards Board (MASB) is established in 1997 under the Financial Reporting Act 1997 with objective of improving the quality of external financial reporting in Malaysia.
- MASB is an independent authority to develop and issue accounting and financial reporting standards in Malaysia. The MASB, together with the Financial Reporting Foundation (FRF), make up the new framework for financial reporting in Malaysia.

# Other Standard Setters

The functions and powers of the MASB as provided under the Financial Reporting Act 1997 are to:

- Issue new accounting standards as approved accounting standards and to review, revise or adopt existing accounting standards as approved accounting standards;
- Issue statements of principles for financial reporting;- sponsor or undertake development of possible accounting standards
- Conduct public consultation as necessary

# Other Standard *Setters*

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- Develop a conceptual framework for the purpose of evaluating proposed accounting standards;
- Make such changes to proposed accounting standards as considered necessary.
- Seek the view of the FRF in relation to new and existing standards, statement of principles, and changes to proposed standards determine scope and application of accounting standards; and
- Perform such other function as the Minister of Finance may prescribe.

# Principles and Practices of Governance in Islamic Finance

# Principles of *Shariah* Governance



## Oversight, Accountability and Responsibility

Effective Shariah Governance requires clear lines of responsibility and strong oversight mechanism at every level of the Institution.



## Competency

Those involved in Shariah Governance must possess the appropriate qualifications, skills and expertise.



## Confidentiality and Consistency

Shariah Governance must be carried out in a manner that safeguards the confidentiality of sensitive information while ensuring consistency in decision.

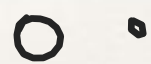
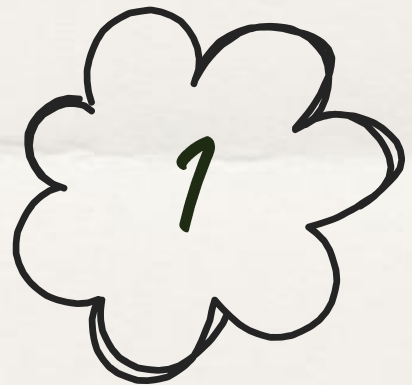


## Independence

To be independent is vital, to ensure that Shariah decisions are made objectively and without under influence. Shariah Committee Members must be free from conflicts of interest and provide impartial advice and rulings based on Shariah Principles.



# Governance as a Pillar of Islamic finance



## Real Economic Activities

Financial transactions must be supported by genuine, productive economic activities. Speculative dealings and financial instruments without underlying assets are prohibited.



## Ethical Values

Transactions must comply with Shariah rules emphasizing fairness, transparency, and avoidance of haram (*mafsadah*)

# Governance as a Pillar of Islamic finance



## Partnership-based Contract

Encourage profit-and-loss sharing and risk-taking under contracts like *mudarabah* and *musharakah*



## Governance

Provides the structure, supervision, and accountability needed to ensure all elements adhere to Islamic Principles.

# Shariah Governance *Policy Document*

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## **[S] Paragraph 10.2**

The Shariah committee has the responsibility to provide objective and sound advice to the IFI to ensure that its aims and operations, business, affairs and activities are in compliance with Shariah. This includes—

- (a) providing a decision or advice to the IFI on the application of any rulings of the SAC or standards on Shariah matters that are applicable to the operations, business, affairs and activities of the IFI;
- (b) providing a decision or advice on matters which require a reference to be made to the SAC;
- (c) providing a decision or advice on the operations, business, affairs and activities of the IFI which may trigger a Shariah non-compliance event;
- (d) deliberating and affirming a Shariah non-compliance finding by any relevant functions; and
- (e) endorsing a rectification measure to address a Shariah non-compliance event.

# Shariah Governance

## *Policy Document*

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- Issued pursuant to section 29(2), 57(1) & 155 of IFSA and section 33E(2), 41 & 116 of Development Financial Institutions Act 2002.
- Effective Date: 1 April 2020 (except paragraph 12.5 which comes into effect on 1 April 2023)
- This policy document outlines the BNM's strengthened expectations for effective Shariah governance arrangements that are well integrated with business and risk strategies of the Islamic financial institutions.
- Specifically, this policy document sets out strengthened oversight accountabilities on the board, Shariah committee and other key organs involved in the implementation of Shariah governance.
- Another area relates to Shariah committee's objectivity to reinforce sound decision-making process and robustness of internal control functions for effective management of Shariah non-compliance risks.

# Shariah Governance *Policy Document*

The Shariah Governance Policy Document (SGPD) 2019 outlines Bank Negara Malaysia's strengthened expectations for effective Shariah Governance.

Key Enhancements Introduced by BNM Shariah Governance Policy Document 2019:

- **Structural & Regulatory Enforcements**
- **Functional Enhancements and Control Strengthening**

# Shariah Governance *Policy Document*

## **Structural & Regulatory Enforcements**

### **a. Maximum 9-year Tenure for Shariah Committee Members**

- This allows for fresh perspectives while preventing overfamiliarity or bias.

### **b. Mandatory Notification to BNM for Additional Restrictions Beyond SAC Rulings**

- If SC imposes stricter rulings than those issued by Shariah Advisory Council (SAC), IFIs must notify BNM with proper notification and justification.

### **c. Explicit Prohibition on Policy-Exposed Persons (PEPs)**

- Policy explicitly prohibits active politicians from serving on SCs.

# Shariah Governance

## *Policy Document*

### **Structural & Regulatory Enforcements**

#### **d. Effective Communication Mandated Between Board and Shariah Committee**

- Board of Directors are required to proactively engage with SCs on all Shariah-related matters, including governance and non-compliance risk.

#### **e. Shariah Review Personnel Requirements**

- Review personnel must possess a sound Shariah understanding.

#### **f. No Mandatory Qualification for Shariah Researches**

- No standalone requirement for researchers to be qualified Shariah officers.

# Shariah Governance *Policy Document*

## Functional Enhancements and Control Strengthening

### a. Board Oversight of Shariah Function

- Board must provide strategic oversight over Shariah-related matters.

### b. Robust Shariah Committee Deliberations

- SC meetings must involve meaningful engagement with members equipped to provide in-depth discussions on product development, compliance concerns, etc.,

### c. Policy and Procedure Enhancement

- Institutions encouraged to refine internal policies to align better with Shariah expectations.

# Shariah Governance *Policy Document*

## Functional Enhancements and Control Strengthening

- d. **Shariah Risk Identification Across All Units** - Must be empowered to detect, assess and monitor Shariah non-compliance.
- e. **Quality Shariah Review** - Reviews must be regular, comprehensive and include update of legal and Shariah changes.
- f. **Capability Development and Certification** - Continuous professional development
- g. **Empowerment of Shariah Knowledge Across Business Functions** - Promotes end to end Shariah compliance rather than viewing it as a bank-end control.

# Corporate Governance

## *Policy Document*

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- The policy emphasizes the importance of strong corporate governance for DFIs to ensure they can fulfil their mandate of supporting priority economic sectors and managing public funds responsibly.
- Effective governance is central to BNM's supervisory assessment, requiring boards to be competent, independent, and able to challenge senior management, while senior management is accountable for prudent daily operations.
- A sound governance framework must also be supported by an ethical corporate culture shaped by the board and senior leadership.

# Review of Recent Legal Cases Impacting Islamic Finance in Malaysia

# Non-Shariah Compliance

# Bank Kerjasama Rakyat Malaysia Bhd v Temasek Blooms Sdn Bhd & Ors [2025]

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Issue 1: Whether commodity *murabahah* transaction breached Shariah principles?

It was the customer's contention that it was not informed of the specific commodities involved in the commodity *murabahah* transaction, and that it was not made aware that it would bear 50% of the commodity trading fee.

Held:

- Details of the commodity sold was provided to the customer, as evidenced by the details in the *murabahah* sale contract executed by customer and the e-certificate issued by Bursa Malaysia Islamic Services Sdn Bhd.
- Customer had appointed the Bank to be its agent, as evidenced by the *wakalah* letter executed on the customers letterhead and signed by the customer's director.

# Bank Kerjasama Rakyat Malaysia Bhd v Temasek Blooms Sdn Bhd & Ors [2025]

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Held (cont.):

- The details of the sharing of commodity trading fee was set out in the bank's letter of offer and standard terms and conditions issued to the customer, which document was accepted by the customer.
- The court also referred to Section 281 of Islamic Financial Services Act (IFSA) 2013 and the Court of Appeal *Maybank Islamic Bhd v Golden Base Construction Sdn Bhd*, to hold that even if the above were not Shariah compliant, "*... a breach of Shariah principle alone does not render the existence of a triable issue in a summary judgment application.*"

# Bank Kerjasama Rakyat Malaysia Bhd v Temasek Blooms Sdn Bhd & Ors [2025]

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Issue 2: Whether *murabahah* profit rate & *ta'widh* are unlawful, and whether *ibra'* must be included in bank's claim

It was the customer's contention that the amount claimed by the bank is incorrect, due to the inclusion of "unlawful charges" specifically the *murabahah* profit rate, *ta'widh* and failure to include *ibra'* to reduce the amount claimed.

Held:

- Details of the *murabahah* profit rate are set out in the letter of offer, which has been accepted by customer
- Details on the imposition of *ta'widh* for late payment are provided in the relevant clause in the facility agreement.

# Bank Kerjasama Rakyat Malaysia Bhd v Temasek Blooms Sdn Bhd & Ors [2025]

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Held (Cont):

- Details of *ibra'* are set out in the facility agreement, which amongst other provide for the reduction on the basis of *ibra'* upon settlement of the facility (not at time of bank's claim against the customer/guarantor for the outstanding/unpaid amount)

# Sanctity of Shariah

# Low Chin Meng v CIMB Islamic Bank Berhad [2015] 5 CLJ 324 (Court of Appeal) – Idrus Harun JCA

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- Low Chin Meng ("LCM") entered into a *Bai' Bithaman Ajil* (BBA) Facility agreement by executing a Sale and Purchase Agreement (SPA), Asset Lease Agreement (ALA), and a gift letter, in which LCM gifted the shares to the company.
- The company failed to make payments, causing CIMB to exercise its rights under the Security Deposit Memorandum by selling the shares.
- LCM filed a counterclaim for damages regarding the unlawful disposal of the shares by CIMB and sought a declaration that the transaction was void and invalid, claiming it contravened **Section 67 and Section 67A of the Companies Act**, which prohibits a company from dealing with its own shares.

# Low Chin Meng v CIMB Islamic Bank Berhad [2015] 5 CLJ 324 (Court of Appeal) – Idrus Harun JCA

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## •Issue:

Whether the BBA transaction violates **Section 67 and Section 67A** (financial assistance and prohibition for a company to deal with its own shares), thereby rendering the transaction invalid.

## •Decision:

The Court stated that if the transaction does not result in a reduction of the company's capital, there is no prohibition for the company to deal with its own shares, and therefore, it does not contravene **Section 67**.

The Court also found that the sale of the shares was not intended to reduce the company's capital, but rather to fulfill the prerequisites of the BBA facility in order to ensure compliance with Shariah principles.

# Low Chin Meng v CIMB Islamic Bank Berhad [2015] 5 CLJ 324 (Court of Appeal) – Idrus Harun JCA

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*“[56] We must emphasise that the execution of the sale and purchase of the property by parties involved is a prerequisite in the concept of Islamic financing of “Al Bai Bithaman Ajil”. The sale and immediate resale of the property which are carried out by executing asset purchase and sale agreements form an essential step in this mode of Islam financing before the company could avail itself of the financial facilities provided by the respondent. Thus, it is wholly erroneous for the appellant to say that the BBA transactions were asset sale and purchase transactions simpliciter. [Emphasis added]*

.....

*It must be emphasised that the so-called ‘purchase’ of the Shares under the Asset Sale Agreements was in pursuance of an Islamic financing transaction that requires a sale and a buy-back of the Shares. It was not a purchase as envisaged in section 67A in the sense that the company uses its own funds to purchase the shares resulting in the shares being transferred to the company.”*

# Section 281 IFSA 2013



# RHB Islamic Bank Bhd v Alam Maritim (L) Inc [2025] 8 MLJ 525

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[56] As the provision pertaining to financial institution's duty to comply with Shariah principle and the rulings of SAC is within s 28 of the IFSA 2013, it follows that **based on s 281 of the IFSA 2013, the non-compliance of such section does not render the banking facility or any instrument thereunder void.**

[57] This is supported by the academic analysis of Mohd Johan Lee in his book titled Islamic Banking in Malaysia, Lexis Nexis (2017), where he posits that **s 281 of the IFSA 2013 preserves the validity and enforceability of a contract even though it is non-Shariah compliant.**

# RHB Islamic Bank Bhd v Alam Maritim (L) Inc [2025] 8 MLJ 525

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[59] Post-2013, allegations of non-compliance with Shariah principles appear to be a matter between Bank Negara Malaysia and the individual financial institutions, potentially arising from a customer complaint. If a financial institution or its officers fail to adhere to the required Shariah principles, they may face criminal sanctions under s 28(5) of the IFSA 2013. However, **under s 281, non-compliance with Shariah principles alone does not invalidate an agreement between the parties. Therefore, an agreement that contravenes SAC rulings is not necessarily void unless it also violates provisions of the Contracts Act 1950.** This may include considerations such as whether the reasons for Shariah non-compliance involve factors that could render the contract void due to illegality (s 24) or uncertainty (s 30).

# Cross Border Jurisdiction Issues and Arbitration Mechanism

# Cross Border *Jurisdiction Issues*

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**Lack of harmonisation in Shariah Regulations across different jurisdictions**

**Uncertainty regarding the appropriate jurisdiction to hear disputes and issue awards**

**Divergence of opinions on the level of Shariah Compliance required for specific practices**

**Complex Hybrid Issues and Legal Framework**

# Arbitration *Mechanism*

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- In Malaysia, the Asian International Arbitration Centre (AIAC), acts as a neutral and expert-led forum which provides credible and efficient alternative to court litigation.
- It particularly deals with disputes involving parties from different jurisdictions or especially where confidentiality is paramount.
- AIAC introduced the **i-Arbitration Rules** which were first introduced in 2023 to align with contemporary international arbitration standards and Shariah-compliance requirements.
- On 1 January 2026, the i-Arbitration Rules 2026 will come in force.

# Arbitration *Mechanism*

Arbitration in Islamic Finance mainly concerns:

- *Murabahah, ijarah, istisna'* and *tawarruq* financing disputes
- Sukuk Investment Structures
- Cross Border Islamic syndicated financing
- Islamic Project Finance
- Disputes involving Islamic Financial Institutions and multinational Corporations

# Thank you!



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