

The Islamic Financial Services Bill 2012 - Shariah Compliance

(Part 2 of 4)

**By Gopal Sundaram
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Malaysia must be one of the few countries in the world, if not the only country, where the Islamic finance regulator, is given a mandate to promote Shariah compliance among Islamic financial institutions. The long title to the Islamic Financial Services Act 2012 explicitly states that it is an Act to provide for the regulation and supervision of Islamic financial institutions ... to promote financial stability and compliance with Shariah ... Section 6 of the Act reiterates that the principal regulatory objectives of the Act are to promote financial stability and compliance with Shariah.

In many countries where Islamic finance is practised there is also no statutory requirement to comply with Shariah in conducting Islamic finance. The motivation for Shariah compliance by Islamic financial institutions in such jurisdictions may be religious, social, ethical or economic. In countries where Islam is the law of the land, Shariah compliance is of course a legal, religious and moral obligation, although such legal compulsion may not necessarily be statutory.

In other countries like the United Kingdom and Malaysia, hitherto the motivation for Shariah compliance has been largely economic and regulatory moral suasion. Islamic financial business carries with it an operational risk that is unique to Islamic finance – the Shariah risk which when it crystallises has legal and financial ramifications; hence the economic compulsion for Shariah compliance. The new Act now imposes a statutory duty under section 28(1) for Islamic financial institutions authorised under the Act to ensure at all times that their aims, operations, business, affairs and activities are in compliance with Shariah. The provision is also penal in nature and any person who contravenes the section commits an offence and shall on conviction be liable to imprisonment for a term not exceeding 8 years or to a fine not exceeding RM25 million or both.

An Islamic financial institution once it becomes aware that it is carrying on any of its business, affair or activity in a manner which is not in compliance with Shariah is required to immediately notify the regulator and its Shariah committee of the fact and immediately cease from carrying on such business, affair or activity and from taking on any other similar business, affair or activity. The Islamic financial institution is also required, within 30 days, to submit to the regulator a plan on the rectification of the non-compliance. The Act empowers the regulator to carry out an assessment to determine the rectification has been carried through. As most of Islamic financial institutions are aware, the rectification normally resorted to is to annul the transaction where possible and in any case to donate any profits made under the transaction to charity.

Islamic financial institutions under the Act are required to comply with Shariah standards issued by the regulator in accordance with the advice of the Shariah Advisory Council, Bank Negara Malaysia. This requirement to comply with the Shariah standards issued by the regulator also are imposed on the directors of the financial institution, the chief executive officer, senior officers and members of the Shariah committee of the financial institution.

The regulator is also empowered to require the Islamic financial institution to appoint any person approved for the purpose by the regulator to carry out an audit on Shariah compliance by the institution. Such a person appointed by the institution shall have such duties and functions as may be specified by the regulator and is required to submit a report to the regulator on the audit so carried out. The remuneration and expenses of the appointed person shall be borne by the institution. In addition the appointed person enjoys a statutory protection for liability for a breach of duty of confidentiality between that person and the institution in respect of matters reported to the regulator pursuant to the Shariah compliance audit.

Where the Islamic financial institution fails to appoint a person to carry out the Shariah compliance audit or in circumstances as the regulator deems appropriate the regulator may itself appoint a person to carry out the Shariah compliance audit. The regulator is also empowered to appoint another person in addition the person appointed by the financial institution to carry out the Shariah compliance audit.

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Gopal began his highly distinguished career in Bank Negara Malaysia (BNM) in 1982, pursuant to graduating from University of Malaya on a Bank Negara scholarship. He was appointed as Assistant Governor in 2006. As Assistant Governor he was responsible for the Legal Department, Finance Department and the IT Services (Computer) Department as well the Money Museum and the Art Gallery. During his tenure, he was a member of various committees chaired by the Governor, inter alia, the Management Committee, the Monetary Policy Committee, the Financial Stability Committee, the Budget Committee, the Risk Management/ Committee and in attendance at the Malaysia International Islamic Financial Centre Executive Committee (MIFC), a multi-agency committee appointed by the Prime Minister.

Upon his retirement in 2011, he was appointed as Project Advisor to BNM to advise and supervise the drafting of an omnibus legislation for banking, insurance, payments systems and exchange control as well as an omnibus Islamic legislation for Islamic banking, takaful, payment systems and exchange control proposed to be tabled in Parliament later this year.

Gopal is the only member of the International Monetary Law Committee of the International Law Association (MOCOMILA) from Malaysia. He is also in the Executive Committee of the Malaysian Chapter of ASIL (Asian Society for International Law). Gopal sits on the Board of Directors of Kuwait Finance House (Malaysia) Berhad, the Board of Management of Methodist College Kuala Lumpur, the Council of Education, Methodist Church in Malaysia and the Judicial Council, Methodist Church in Malaysia.

He is a leading adviser on the new Financial Services Act (FSA) and Islamic Financial Services Act (IFSA).

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