

## SHARI'AH SUPERVISORY BOARDS IN MALAYSIAN ISLAMIC BANKS: EMERGING ISSUES, CHALLENGES, AND RESPONSES

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## ABSTRACT

This study investigates the key challenges by *Shari'ah* Supervisory Boards (SSBs) in carrying out their duties within Malaysia's Islamic banking sector. These challenges encompass institutional, operational, legal, jurisprudential, and professional obstacles that hinder SSB members from fulfilling their responsibilities effectively. A major issue highlighted is the shortage of experts in *fiqh al-mu'amalāt* (Islamic transactional jurisprudence), which complicates the development of new financial products, the exploration of innovative *ijtihād* (independent reasoning by qualified Islamic jurists), and the engagement with contemporary and emerging issues in Islamic finance. In response to these challenges, the study aims to analyze the barriers confronting SSBs and propose viable solutions. It employs both descriptive and analytical methods to examine these obstacles and their connection to directives issued by the *Shari'ah* Advisory Council (SAC) of the Central Bank of Malaysia. Furthermore, the study addresses the ongoing evolution of the Islamic banking sector, emphasizing the need for *Shari'ah* rulings to adapt to changes in time and context through the expertise of well-informed jurists. The key findings reveal a spectrum of institutional, legal, operational, and jurisprudential challenges. Proposed solutions include enhancing the role of SSBs within banks, diversifying investment instruments, and promoting Islamic financial engineering to develop alternative banking products that comply with *Shari'ah* principles while meeting customer needs. These findings offer valuable insights into the functioning of Islamic banking in Malaysia and serve as a guide for addressing and overcoming the challenges faced by SSBs.

## Introduction

Malaysian Islamic banking operations, which began in the early 1980s, have demonstrated their merit through a robust institutional framework and strong media support that reflects the aspirations of those advocating for the globalization of Islamic banking (Al-Atoum et al., 2013). This support also underscores the sector's positive reputation, which has fostered a spirit of innovation among the leaders of Malaysian Islamic finance. In response, they developed Islamic financial products that comply with *Shari'ah* principles. The establishment of Malaysian Islamic banking aimed to serve as a model for conventional banks and to correct flawed financial practices rooted in *ribā* (usury). The Malaysian experience has become a source of inspiration for others, offering valuable lessons and best practices. Consequently, foreign Islamic banks were permitted to enter the local market by establishing branches in Malaysia. Notable among these are Kuwait Finance House (KFH), Qatar Islamic Bank, Al-Rajhi Bank, and others. This development presents a promising opportunity to enhance the diversification of investment instruments within Malaysia's Islamic banking sector. However, such diversification necessitates the advancement of human capital—particularly in legal advisory and administrative competencies—to support the creation of new investment tools that remain faithful to *Shari'ah* principles (Edris, 2020).

The structure of *Shari'ah* supervision in Malaysia operates on two levels. The first is the central level, represented by the *Shari'ah* Advisory Council (SAC) of the Central Bank of Malaysia (Bank Negara Malaysia, BNM). Since its establishment in 1997, the SAC has played a pivotal role in providing *Shari'ah* certainty for the Malaysian Islamic financial industry. The second level is internal, comprising the *Shari'ah* committee formed within each financial institution (Bank Negara Malaysia, 2022). The SAC serves as the highest authority in overseeing Islamic finance for Islamic financial institutions (IFIs) in Malaysia. In cases of conflict between rulings issued by an institution's *Shari'ah* committee and those of the SAC, the SAC's decisions take precedence. Its rulings are binding on IFIs and serve as a primary reference. Courts and arbitrators are also required to consider SAC rulings in proceedings related to Islamic financial matters (Sequerah et al., 2023; Bank Negara Malaysia, 2019). SSBs exist to provide sound guidance to Islamic banks, ensuring that their operations, affairs, and activities comply with *Shari'ah* principles. Their responsibilities include advising the Board of Directors (BOD) on *Shari'ah* matters in business operations, endorsing *Shari'ah* compliance manuals, offering guidance to relevant parties upon request, assisting the SAC with references for advice, and issuing decisions and recommendations on operations that may trigger *Shari'ah* non-compliance events (Bank Negara Malaysia, 2022; Masruki et al., 2018).

The main duties and responsibilities of SSBs within each bank include advising BOD on *Shari'ah* matters in business operations, endorsing *Shari'ah* compliance manuals, validating relevant documentation, assisting related parties on *Shari'ah* issues upon request, providing written *Shari'ah* opinions, and supporting the SAC or other authorized bodies through reference-based consultations (Syarif, 2019). Although the role of SSBs is vital in Islamic banking, there is no uniform *Shari'ah* supervisory framework across countries where Islamic banks operate (Bashir et al., 2024). Malaysia and Sudan have established comprehensive frameworks for *Shari'ah* compliance and implementation, while Pakistan and Bahrain maintain well-regulated systems. However, in Pakistan, although an SSB or SAC exists at the central bank level, its authority is limited compared to Malaysia and Sudan. In Bahrain, *Shari'ah* boards operate solely at the institutional level, with no central representation.

Table 1 presents a comparative overview of the role of SSBs in Malaysia and selected Muslim countries. SSBs in Malaysian Islamic banks are among the most prominent governance bodies, receiving special attention from Bank Negara Malaysia (BNM). Their members are selected from distinguished scholars following interviews and evaluations of their academic publications and reputations. These scholars contribute to the development of innovative financial instruments that serve as alternatives during crises such as the COVID-19 pandemic. Contemporary challenges arising from such crises underscore the need to strengthen collective *ijtihād* (independent reasoning by qualified Islamic jurists) and promote global cooperation among Islamic banks to exchange ideas and devise effective, *Shari'ah*-compliant solutions.

**Table 1.** Comparison of SSB Characteristics by Country

Characteristics	Malaysia	Bahrain	Pakistan	Sudan
Presence of central SSB or SAC	✓	✗	✓	✓
Complete authority of central SSB/SAC over IFSs	✓	✗	✗	✓
Presence of SSB at the IFSs level	✓	✓	✓	✓
Separate regulations for <i>Shari'ah</i> compliance	✓	✗	✓	✓
Compliance with AAOIFI <i>Shari'ah</i> standards	✗	✓	✓	✓

The purpose of this study is to examine the key challenges faced by SSBs, particularly within Malaysian banks, and to explore emerging issues and product development in light of the role played by SSBs and the extent of compliance with *Shari'ah* provisions in banking operations and activities. Accordingly, the main questions this study seeks to answer are: how can emerging issues in Islamic banking be addressed through the role of SSBs, and how can product development respond to these challenges and offer *Shari'ah*-compliant solutions? The research adopts both descriptive and analytical approaches, drawing on the regulatory frameworks and legislation governing SSBs in Malaysia—whether at the level of the central bank or individual *Shari'ah*-compliant banks. It also examines banking transactions from a *Shari'ah* perspective. The study aims to present scholarly opinions and supporting evidence, and to compare theoretical frameworks with practical applications. Through this comparison, the study identifies challenges and proposes strategies to address them, with a focus on enhancing banking practices, product innovation, and full compliance with *Shari'ah* principles. Ultimately, the study contributes to the existing literature by highlighting the pivotal role of SSBs and offering an analysis of emerging issues related to *fatwā* (legal edicts) in Islamic banking and finance.

The current study aligns with Bashir and Babiker (2023) and Al-Siyabiya and Mujahid (2022) in its focus on evaluating the role of SSBs in Islamic banks. However, it differs in scope and detail, as it investigates the issues arising from the boards' roles, the challenges they encounter, and the responses specific to Malaysian Islamic banks. In contrast, Al-Siyabiya and Mujahid (2022) examined SSBs in the Sultanate of Oman, while Bashir and Babiker (2023) focused on SSBs in Saudi Arabian banks. This study also aligns with Edris (2014) regarding the role of SSBs in Malaysia but diverges in its emphasis on emerging issues, challenges, and institutional responses related to *Shari'ah* supervision. Similarly, it shares thematic ground with Saleh et al., (2021) on general *Shari'ah* supervisory practices, yet it offers a more focused discussion on the evolving challenges and responses concerning the role of SSBs in Islamic banking.

In conclusion, this study distinguishes itself from prior research by comprehensively addressing the institutional, administrative, operational, and methodological challenges faced by SSBs within the Malaysian Islamic banking context. It integrates comparative jurisprudential analysis with an evaluation of current practices and proposes actionable solutions to strengthen the role and responsibilities of SSBs in Malaysian banks.

### Methodology

This study adopts a descriptive-analytical approach, which is well-suited for assessing the current state of *Shari'ah* supervision in Malaysian Islamic banks. It analyzes strengths and weaknesses, examines prevailing challenges, and identifies influencing factors. A foresight (future-oriented) approach is also employed to propose improvements in supervisory board practices related to *Shari'ah* compliance. The study explores the views of scholars and experts in Islamic banking in Malaysia by presenting their jurisprudential opinions and identifying potential responses to the challenges encountered. It draws on existing literature and relevant legal and *Shari'ah* sources to illuminate the theoretical and conceptual frameworks underpinning *Shari'ah* supervision. The authors also benefited from the insights of five experts and scholars cited in a previous study by Edris (2014), which examined the challenges faced by SSBs in six Islamic banks—Bank Islam Malaysia, Bank Muamalat Malaysia, Commerce Tijari Bank, Hong Leong Islamic Bank, KFH, and RHB Islamic Bank—as well as conventional banks offering Islamic banking services through dedicated windows (e.g., Affin Bank, Alliance Bank Malaysia, AmBank, Citibank, EON Bank, HSBC Bank Malaysia, Maybank, OCBC Bank Malaysia, Public Bank, Southern Bank, and Standard Chartered Bank Malaysia).

As for its limitations, this study focuses exclusively on practices related to the roles and responsibilities of SSBs. It recommends that future research explore a broader spectrum of banking applications and transactions, along with emerging issues in the institutional, administrative, and governance dimensions of *Shari‘ah* supervision.

## Challenges Facing SSBs

### *Operational and Jurisprudential Aspects*

The following are among the most significant challenges that may adversely affect the duties of SSBs in Islamic banking practices in Malaysia:

- i. Operational challenges include the development of new and alternative Islamic financial products and the deliberation of emerging legal banking issues such as non-performing debts and the lack of liquidity in cash assets. As financial obligations are considered the rightful claims of their owners, they pose a challenge to Islamic financial institutions and necessitate a response from the *Iftā’* Council. In issuing such responses, the Council must consider the jurisprudential provisions of Islamic law, which are subject to change based on time and context.
- ii. Jurisprudential challenges include the proliferation of multiple fatwas among Islamic bank fatwa bodies, the tracking of doctrinal licenses, scholarly lapses, proposed opinions, jurisprudential stratagems, and the imitation of authorities who should not be followed due to violations of textual evidence, consensus (*ijmā’*), or clear analogical reasoning (*qiyās*). *Shari‘ah* bodies are not characterized by uniformity, and none of their features are binding (Saleh et al., 2021). Moreover, the coordination of collective *ijtihād* remains a persistent challenge for SSBs, particularly when addressing emerging issues that require collaborative jurisprudential deliberation. Such issues include cryptocurrencies and virtual electronic currencies like Bitcoin. Achieving consensus among jurists in collective *ijtihād* is both an ancient and contemporary challenge—especially in light of the expanding scope of digital financial services, which demand authoritative legal rulings. Strengthening cooperation among international Islamic banks and facilitating the exchange of ideas are essential for developing effective solutions to financial crises.

Malaysian Islamic financial institutions are currently facing a range of contemporary challenges that require urgent and strategic solutions. These include the lingering effects of the COVID-19 pandemic, ongoing conflicts in Islamic countries, and global economic fluctuations that began earlier this year and are expected to subside with the eventual resolution of the pandemic. To mitigate the impact of these challenges—which hinder the growth and resilience of Malaysian Islamic banks—the SAC of BNM, along with engaged researchers, must work collaboratively to identify effective responses. Accordingly, this research focuses on emerging challenges that adversely affect Islamic financial markets.

In addition, there is a pressing need for coordination among collective *ijtihād* bodies, both domestically and internationally, to derive legal rulings on complex and controversial issues that have intensified in the post-pandemic era. *Shari‘ah* bodies must foster cooperation and consultation among Muslim scholars and international Islamic banks to generate ideas and solutions for addressing global crises such as unemployment. Currently, *Shari‘ah* supervision practices in Malaysia are largely confined to issuing *fatwā* on banking transactions and financial products, without robust internal or external *Shari‘ah*-compliance auditing of daily operations. However, in practice, bankers often exceed the boundaries set by these *fatwā*, resulting in transactions that shift from the domain of permissibility to areas of suspicion or potential prohibition.

Examples of controversial issues that may conflict with jurisprudential considerations—or for which SSBs have not provided satisfactory resolutions—include *murābahah* applications, *salam* (forward sale), deferred sale, *sukuk*, the mixing of deposit accounts, profit margin determinations, and the imposition of fines for late payments. The latter practice persists despite *fatwā* from jurists prohibiting such fines, stating that “imposing a fine upon delay in payment of installments constitutes a form of forbidden *ribā* (usury) and resembles the practice of the people of *Jahiliyyah* (pre-Islamic ignorance), who would say to the debtor: Either pay in full or increase the amount owed” (Edris et al., 2023; Edris, 2014).

*Sharī'ah* explicitly forbids this and obliges creditors to grant respite to debtors in financial difficulty. As Allah SWT the Almighty said:

Translation: If the debtor is in a difficulty, grant him time till it is easy for him to repay.

(Surah Al-Baqarah, 2:8)

In the case of a solvent but delinquent debtor, *Sharī'ah* permits legal action to compel payment of outstanding debts (Biniti Zulkipli, 2019; Islam Web, 2014). Contemporary scholars have allowed the imposition of fines on such debtors as a deterrent, provided they are financially capable of repayment. These fines must be allocated for charitable purposes. In instances where direct taxes are levied on income derived from these fines, the bank is permitted to use the fines themselves to cover the tax liabilities (AlBaraka Forum, 1990; Abozaid, 2021). The Prophet (PBUH) said:

Translation: It is an act of oppression on the part of a solvent person to procrastinate in fulfilling his obligation.

(Muslim, 1955, Hadith No. 1564)

Additionally, a resolution (*fatwā*) issued by the International Islamic Fiqh Academy (IIFA) of the Organization of Islamic Cooperation (OIC) invalidates such contractual conditions, affirming that parties are not obligated to fulfill them (Eldeeb et al., 2023; IIFA, 2000). The composition of SSBs in Malaysia remains below optimal standards, as it lacks essential technical expertise beyond *Sharī'ah* scholarship—such as specialists in accounting, finance, commerce, and management (Pati et al., 2024; Edris, 2014).

Some Islamic finance experts attribute the divergence in *fatwā* to institutional pressures aimed at developing products that can compete with conventional financial counterparts. According to Elsharif and Khalid (2011), such variations in *fatwā* may undermine the credibility of Islamic financial institutions, particularly among depositors who hold high expectations for Islamic banking. Nevertheless, Islamic scholarship should allow room for differing views. Jurisprudential differences do not hold the same weight as the Qur'ān and Sunnah and are not obligatory to follow. In the presence of explicit textual evidence from the Qur'ān and Sunnah, personal opinions must be set aside. The diversity of scholarly opinions is a positive and constructive phenomenon, representing a process of truth-seeking. A notable example occurred when Egyptian scholars convened to deliberate the issue of loans with remuneration. Their discussions culminated in the proceedings of the Second Conference of the Islamic Research Complex in Egypt, which prohibited any form of remuneration on loans. The *fatwā* declared “all types of remuneration on all types of loans is *riba* and is prohibited. There is no difference in that regard between the so-called consumer loan and production loan. The texts of *Sharī'ah* are unequivocal that any amount of *riba* high or low is prohibited”.

Similarly, the IIFA issued a resolution in 1990 prohibiting transactions involving bonds with fixed or variable interest (IIFA, 1990). Among the cited evidences was the following verse:

Translation: If you repent, you may retain your principal—neither inflicting nor suffering harm.

(Surah Al-Baqarah, 2:279)

Jabir (may Allah be pleased with him) reported that the Prophet (PBUH) cursed the one who accepted usury, the one who paid it, the one who recorded it, and the two witnesses to it, declaring that they were all alike in guilt (Muslim, 1955). Accordingly, Islamic banks are prohibited from engaging in interest-based transactions and in bonds that yield fixed income (Al-Hauwari, 1980; Bashir, 2010). Prominent scholars, such as Sheikh Jad Al-Haq (the former Grand Imam of al-Azhar), have previously issued *fatwās* forbidding all interest-bearing loans, regardless of whether the lender or debtor is an individual or institution, on the grounds that such loans constitute prohibited *riba* (Al-Ghazali, 1993).

Despite the abundance of resolutions prohibiting *riba*, some scholars and researchers espouse contrary views which they sincerely believe to be correct. These views stem from *ijtihād*, a legitimate scholarly endeavor permitted to all qualified individuals. Nevertheless, it is incumbent upon us to seek sound guidance, pursue the truth, and respectfully challenge opinions that appear to contravene the consensus

(*ijmā'*) of the *ummah*. This must be done through intellectual discourse, grounded in Islamic ethics, as Allah commands:

Translation: Respond to evil with what is best.

(Surah Al-Fuṣilat, 41:34)

Translation: Invite all to the Way of your Lord with wisdom and kind advice.

(Surah An-Nahl, 16:125)

The Prophet (PBUH) also said:

Translation: He who is deprived of forbearance and gentleness is deprived of all good.

(Muslim, 1955, Hadith No. 2592)

Therefore, Islamic financial institutions should strive to unify their *fiqhī* authority without marginalizing other Sunni schools of jurisprudence, as is regrettably occurring in some Islamic countries. Much benefit can be derived from such unification, particularly if Islamic nations are committed to establishing resilient and ethically sound Islamic banks.

This marks the starting point for addressing a major challenge faced by the SSBs of Islamic banks—namely, the issuance of conflicting *fatwā*. These inconsistencies often confuse the public and stem from weak coordination among the SSBs of various institutions, the absence of a unified regulatory authority across Islamic countries, and the diversity of jurisprudential approaches, as previously noted (AlBaraka Forum, 1990). The practice of issuing periodic *fatwā* has become commonplace. However, scholars frequently fail to monitor the implementation of their rulings or to establish clear schedules and timeframes. They should, for instance, specify that a particular *fatwā* applies only within a defined period, and that others may not. Without a unified authority, SSBs will continue to face significant challenges in maintaining consistency and credibility.

### ***Institutional and Legal Aspects***

Islamic banking institutions around the world have benefited from the sound institutional frameworks that support conventional banking (Utama, 2018). However, Islamic financial institutions continue to suffer from a lack of dedicated institutional support tailored to their specific needs. Consequently, the establishment of a robust institutional entity remains one of the most significant challenges facing Islamic finance. To address this issue, researchers have proposed a functional and resilient approach to institutional development (Al-Ziyadat, 2021). Furthermore, those responsible for overseeing Islamic finance must actively monitor and follow up on institutional tasks to ensure sustained and effective support (Khan & Chapra, 2009). In this context, Erdem Başçı, Governor of the Central Bank of Turkey, emphasized that Islamic banks “need to carry out structural reforms that can contribute to overcoming cyclical economic fluctuations and make financial systems more adaptive in the face of external shocks”, particularly in light of the economic turmoil affecting eurozone and other developed countries (Islamic Financial Services Board, 2012). For a detailed discussion on the institutional and legal dimensions, the following points may be clarified:

### ***An Appropriate Legal Framework and Its Supporting Policy***

Following this approach is important; however, the laws governing commerce, banking, and corporate entities in most Islamic countries are largely adapted from Western legal models. These laws are primarily designed to serve the conventional financial industry and may therefore be ill-equipped to support innovative Islamic financing tools. While experts in Islamic finance have drafted specialized legal frameworks tailored to the sector’s unique requirements, implementing these laws remains a significant challenge that demands substantial effort (Muntada al-Tamweel al-Islami, 2022). Existing banking legislation in Islamic countries typically addresses the establishment, operational performance, and regulatory supervision of Islamic banking institutions (IsDB & IFSB, 2023).

### **Laws Related to Financial Institutions**

Islamic financial institutions—other than banks—can generally operate within the existing legal frameworks of most Islamic countries. However, in other jurisdictions, there is an urgent need to revise and expand these frameworks to accommodate a broader scope of financing operations (Khan & Chapra, 2021). Without effective institutional administration, Islamic finance cannot grow at a sustainable pace or fulfill its intended functions. As institutions expand, their operational complexities increase, necessitating stronger administrative capacity. Long-term success depends on overcoming these challenges, and the ability of Islamic banks to do so will determine their resilience. Moreover, it is essential not to overlook or neglect measures that can enhance the performance and functionality of these institutions (Almutairi & Quttainah, 2017; Elamer et al., 2020; El-halaby & Hussainey, 2016).

### **The Supervisory Framework**

The supervision of Islamic banks is no less important than that of their conventional counterparts. As Chapra and Ahmed (2022) emphasize, “the members of the board of directors must have high supervisory qualifications, such as understanding the objectives of *Sharī'ah* and Islamic teachings related to transactions and financing”. To mitigate risks and strengthen the role of SSBs, effective coordination between SSBs and regulatory bodies such as BNM is essential. Regulation and supervision serve several critical purposes: enhancing transparency for investors, safeguarding the integrity of the financial system, and improving the formulation and implementation of monetary policies (Wijayanti & Setiawan, 2023).

### **Globalization**

Globalization presents a significant challenge to Islamic banks, as the global financial landscape becomes increasingly interconnected. The liberalization of trade and capital flows has led to the emergence of international markets, enabling conventional banks to establish branches in Islamic countries—particularly after joining the World Trade Organization. To address this challenge, Islamic finance requires updated regulations and the guidance of knowledgeable scholars. Globalization affects all aspects of life, and the term “financial globalization” refers to the expansion of banking operations across borders. This integration into global markets does not necessitate compromising Islamic principles.

On the contrary, trade in a globalized context should be conducted while upholding *Sharī'ah* values, thereby enhancing the efficiency and relevance of Islamic finance. One notable outcome of globalization is the rapid advancement of communication technologies, which have revolutionized payment systems and enabled near-instantaneous money transfers across borders. While these technologies pose certain risks, they also offer significant advantages. Islamic banks must embrace these innovations responsibly, using them to promote ethical finance and seek the pleasure of Allah the Almighty (Wazin et al., 2024). This presents an opportunity to expand Islamic banking services, combat Ribā, and foster industry growth. Although globalization poses challenges, it also offers grounds for optimism. It facilitates greater collaboration among Islamic financial institutions, enabling them to build internal capacities and prepare for global competition (Montanaro, 2020). The aspirations of Malaysia’s Islamic banks can only be realized through financial unity rooted in Islamic principles—an alternative to Western dominance in financial markets and products. In light of global transformations, it is imperative for Muslim societies to re-evaluate how to integrate ethical and religious heritage with innovative tools that comply with *Sharī'ah* and enhance the financial system.

### **Financial Engineering**

Researchers use the term financial engineering to describe the process of developing new financial products across various domains of financial activity. This includes efforts to attract savings, facilitate investment, manage risk, and achieve other financial objectives. Among the challenges faced by SSBs are operational issues in financial engineering—specifically, the formulation of financial instruments that meet societal needs while avoiding speculative tendencies (Haridan et al, 2023; Mansour, 2020). Regarding speculation, the author of *al-Mabsūt* concluded that it is impermissible due to the absence of equivalence in weight. He states: “It is not permissible to buy silver for silver at risk because of not knowing its weight or the weight of one of them,” citing the Messenger of Allah (PBUH), who said:

Translation: Silver for silver, like for like.

(Al-Bazzar, 2009, Hadith No. 3633)

The term “likeness” in the Hadith refers to equivalence in weight (As-Sarakhsī, n.d.). Speculation and gambling are closely related concepts. Speculation typically refers to high-risk decisions where the probability of loss exceeds the likelihood of profit. Gambling, on the other hand, denotes zero-sum exchanges in which mutual benefit is not possible (Al-Suwailem, 2021).

Markets are dynamic and increasingly complex. Financial engineering and innovation are essential tools for managing this evolving landscape (Ahmad et al., 2022). The development of Islamic financial institutions has often mirrored conventional models that were originally designed to meet the needs of earlier societies. To advance Islamic banking, the development of new contractual frameworks is crucial. As Al-Bardici (1959) notes, “Facts and new jurisprudential issues require a collective *ijtihād* derived from *Shari‘ah* arguments to overcome challenges that impede the rise of Islamic finance in times of financial crises”.

The principles of public interest (*maṣlahah*) and juristic preference (*istihsān*) are bounded by the parameters of necessity and the foundational tenets of Islamic finance (Abdul Shukor et al., 2024; Alias et al., 2024; Badran, 1996). For instance, one cannot sell assets that one does not own, as prohibited by the Prophetic Hadith. Nonetheless, exceptions exist—such as the contract of *salam* (Deferred Delivery Sale). The Messenger of Allah (PBUH) permitted *Salam* due to public interest and evident need.

Abu Al-‘Aynain explained that the prohibition of *salam* is rooted in the Prophet’s saying:

Translation: Do not sell what you do not have.

(Abu Dawood, 2009, Hadith No. 3503)

As public perceptions evolve, so do the financial needs of individuals and businesses. In response, modern financial engineers have introduced instruments such as mortgages, options, derivatives, hedging mechanisms, and retirement insurance programs (Chapra & Ahmed, 2020). These innovations present challenges for SSBs, which must determine how to implement them in a *Shari‘ah*-compliant manner. The term hedging in this context refers to the neutralization and mitigation of financial risks. In Islamic finance, hedging is justified when it serves to avoid undue risk. As Al-Suwailem (2007) explains, “the *Shari‘ah* method links risks to ownership and then to the real activity producing wealth”. A number of pressing issues require immediate attention and the strategic application of financial engineering to develop innovative, *Shari‘ah*-compliant solutions. These can be outlined as follows:

### ***Lack of Financing by Profit-Sharing Mechanisms***

Islamic financial transactions are generally categorized into two types: those based on a fixed premium and those based on profit-sharing. In both cases, financing is conducted through the buying and selling of real goods, in contrast to conventional finance, which is based on lending money in exchange for a fixed fee known as interest. This interest-based system has a significant impact on the level of economic development (Ahmad et al., 2022).

### ***Non-liquidity of Assets***

Liquidity challenges arise when financial instruments are structured around debt. As Chapra and Ahmed (2022) explain, “the difficulty resides in turning these instruments into financing tools that can be negotiated. There is a legal restriction in selling debt, which represents a considerable portion of Islamic banking assets. If debt cannot be sold, Islamic banking will face liquidity issues”. Bashir (2010) adds, “a debt, which cannot be traded except at nominal value, makes Islamic financial markets largely illiquid.” This presents a significant obstacle to the development of secondary markets for Islamic financial instruments.

### ***Mobilizing Deposits and Investing Funds Locally***

Historically, Islamic banks have succeeded in mobilizing deposits. However, greater efforts are needed to sustain consistent growth in the future. In the past, individuals often saved their assets in conventional banks without earning interest, or they preserved their wealth through traditional customs. Today, Muslim assets are increasingly entrusted to Islamic banks, whose popularity stems from their adherence to Islamic teachings as both a legal and moral framework. One of the key objectives of Islamic financial institutions is to facilitate the transfer of resources and deposits from Western countries to Islamic nations. This goal presents a considerable challenge, as the repatriation of these deposits and emigrated wealth remains an urgent priority (Uthman, 2019; Chapra & Ahmed, 2022).

### ***Competition***

The emergence of conventional banking institutions offering Islamic financial services is a significant development in recent years (IsDB & IFSB, 2023). This growing competition compels Islamic banks to enhance their technical administration and investment tools. To remain competitive, Islamic banks must innovate and develop products that are not only equivalent to those offered by traditional banks but also superior in terms of financial engineering capabilities (Bashir, 2010).

### ***Education, Training, Searching, and Development***

Investment in education, training, research, and development is a critical driver of growth. Among all sectors, banking operations are particularly in need of rigorous research. Islamic finance, still considered a small and emerging field, requires competent scholars capable of resolving jurisprudential issues that arise with new financial products. However, there is a noticeable shortage of scholars who possess expertise in *fiqh*, economics, and modern finance. It is imperative for those managing Islamic banks to recognize this gap and take proactive steps to address it. SSBs must intensify their efforts to bridge this divide. In response to this need, BNM established the International Shariah Research Academy (ISRA) in 2008 to provide the Malaysian financial industry with original and applied research that addresses both local and global challenges, while also supporting the development of innovative financial products (Ibn Anas, 1985).

### ***Developing Islamic Financial Products and Investments***

#### ***Platform of Bursa Suq Al-Sila'***

Malaysia has reinforced its position in the global Islamic financial system by launching an innovative platform that may only be replicated with permission from Malaysian authorities. This platform, known as Bursa Suq Al-Sila' (BSAS), is operated by Bursa Malaysia and serves as a commodity market designed to facilitate liquidity management through the *tawarruq* mechanism.

Through BSAS, the Malaysian stock exchange aims to increase the average daily volume of transactions conducted via the Murābahah system using primary commodities. This approach enables exponential growth in transaction volumes, thereby enhancing profitability and supporting the expansion of Islamic financial products into international markets. BSAS allows Islamic banks to manage their liquidity by trading commodities directly on the exchange. This helps them avoid the limitations of conventional stock exchanges, which typically prohibit commodity trading—a key requirement for the validity of contracts under Islamic *Shari'ah* principles.

According to its official website, BSAS is a dedicated commodity trading platform developed specifically to support liquidity management and financing for Islamic financial institutions. The initiative began as a national project through collaboration between BNM, the Securities Commission Malaysia (SC), and Bursa Malaysia.

### **Commodity Exchange Challenges**

Although Malaysian scholars have sought to innovate new products based on the rich array of commercial concepts found in classical Islamic legal texts, Islamic financial transactions in the stock exchange continue to face several obstacles. These include the high cost of trading fees and the limited availability of investment products that comply with Islamic *Shari‘ah* rulings.

Additional challenges were highlighted by scholars and experts at the Islamic Economic Forum in their Statement No. 4/2020. Their primary concern pertained to the practical application of *Shari‘ah* principles. Specifically, they addressed the issue of commodity delivery, which is essential for transferring risk to the new owner. Only upon taking possession of the commodity—acquired through deferred *Murābahah*—should the new owner be permitted to sell it. Without full transfer of ownership and risk, such a sale would not be *Shari‘ah*-compliant.

The discussion focused on *tawarruq* transactions involving two types of palm oil available on the platform: Crude Palm Oil (CPO) and Refined Bleached Deodorized Olein (RBD Olein). Scholars examined the *Shari‘ah* requirements for delivery and risk transfer from seller to buyer.

Over the course of approximately 300 hours, participating *Shari‘ah* scholars deliberated on various opinions, fiqh texts, their legal foundations, and the views of contemporary jurists. They rigorously analyzed the criteria for valid delivery and risk transfer, which would permit the resale of commodities through deferred *murābahah*. They also assessed the extent to which *tawarruq* practices on the BSAS platform meet these criteria.

Professionals from banks engaged in *tawarruq*, along with experts and specialized researchers in BSAS, participated in the dialogue and reached the following conclusions (Asni & Sulong, 2018; Dewaya, (2024; Yusl et al., 2024):

- i. Rectifying the status of possession and risk was deemed less critical than ensuring compliance with specific conditions for *tawarruq* transactions. According to the Forum’s endorsement statement, such transactions must meet the following *Shari‘ah* conditions (Edris, 2012):
  - a. Collusion among the parties leading to a simulated contract (*‘aqd ṣūrī*)
  - b. Devolution into tripartite *‘inah* (*‘inah thulāthyah*)
  - c. Direct cancellation of one debt through another debt (*faskh al-dayn bi al-dayn*).
  - d. Direct triggering of revolving debt (*qalb al-dayn*)
- ii. These considerations, along with other factors supporting the prohibition of *tawarruq*, are publicly accessible for further research via the Islamic Economics Forum. In response, guiding directives have been initiated to develop an alternative Islamic banking model—one that moves beyond *tawarruq*-based mechanisms. These initiatives aim to offer a more ideal and sustainable solution for managing liquidity and financing within Islamic financial institutions.

### **BSAS Transactions**

According to informant 1:

The most important primary commodity used in BSAS is palm oil. It is supported by the Ministry of Agricultural Industries and Commodities, through the Malaysian Palm Oil Council and the Malaysian Palm Oil Association. However, there are plans to introduce new commodities and raw materials to broaden access for a larger segment of investors in this market.

(Informant 1, personal communication, February 19, 2020)

One of the key factors attracting Islamic finance investors to Malaysia is the proactive approach of BSAS management: “the management of BSAS seeks to remove barriers for investors and encourage participation in this type of investment. There are also vigorous efforts underway for BSAS to enter foreign markets such as Turkey, the UAE, and others”.

### **New Markets**

The value of transactions conducted through BSAS under Islamic *Sharī'ah* provisions via *Murābahah* is approximately one billion Malaysian Ringgit (with one USD equivalent to four Malaysian Ringgit). The Malaysian Stock Exchange aims to double this figure annually. However, transaction volumes during the COVID-19 pandemic may have fluctuated due to the global crisis. Officials overseeing the Islamic segment of the Malaysian Stock Exchange stated that they:

Are looking to expand the activities of the Stock Exchange into Middle Eastern and North African markets, aspiring to capture a global market share that has yet to be achieved.

(Informant 2, personal communication, May 15, 2020)

According to stock exchange data, approximately 88% of *sukuk* instruments traded on BSAS comply with Islamic *Sharī'ah* rulings. These instruments are screened by specialized *Sharī'ah* councils to ensure compliance. Among the Islamic contracts developed within the BSAS platform as a new product for banking use is commodity *murābahah*. This contract enables Islamic financial institutions to conduct *Murābahah* transactions using commodities as the underlying assets for Islamic *sukuk* structures (Ghezal, 2021). Commodity *murābahah* allows *Sharī'ah*-compliant lenders to engage in financial transactions involving tangible assets, thereby fulfilling the requirement for real economic activity in accordance with Islamic principles.

When an Islamic bank employs commodity *murābahah* to provide financing, the process typically involves the bank first purchasing a commodity. The bank then sells the commodity to the customer on a deferred payment basis. Subsequently, the customer appoints the bank as an agent to sell the commodity to a third party. The proceeds from this sale are then transferred to the customer. This arrangement results in the customer becoming indebted to the bank for the deferred sale price agreed upon in the initial transaction.

### ***Murābahah* Obstacles**

Despite its contribution to real economic activity, some Islamic scholars have criticized *murābahah* transactions for resembling conventional lending instruments. This presents an ongoing challenge for SSBs.

There are four distinct methods by which commodity transactions are conducted in organized markets:

- i. The contract grants the right to receive both the commodity and the payment on the spot, either while the commodity is physically present or when a valid receipt is held by the seller. This type of contract is permissible, provided the established conditions of sale are fulfilled. These conditions include: the purity of the sale object, its lawful and beneficial nature, deliverability, and clarity regarding its species, type, description, and quantity.
- ii. The contract allows for the receipt of the commodity and payment on the spot, guaranteed by the market authority. Scholars deem this contract permissible, provided it meets the established requirements for sale.
- iii. The contract stipulates the delivery of a specified commodity at a future date, with payment made upon delivery. This arrangement is permissible due to the deferment of both counter-values.
- iv. Similar to the third method, this contract involves the delivery of a specified commodity at a future date with payment upon delivery. However, in practice, this is the most commonly used method in commodity markets and is considered unacceptable by scholars (Jum'a & Sarraj, 2019).

### **Commodity *Murābahah* Product**

Malaysian Islamic banks have introduced several new instruments for treasury operations, one of which is Commodity *murābahah*. Al Rajhi Bank Malaysia was the first Islamic financial institution to adopt this instrument for the daily management of its cash transactions in the market. The *Shari'ah* SSB affirms that Commodity *murābahah* transactions, when supported by a formal undertaking, offer an effective alternative to meet the growing demand among Malaysian Islamic banks for liquidity management tools.

The low credit risk associated with Islamic financial instruments used for interbank financing and lending has played a significant role in the money market. Under the guidance of the BNM, Islamic banks have been enabled to benefit from their surplus cash liquidity. According to informant 3, this guidance encourages banks to utilize their holdings of negotiable *sukuk* and other *Shari'ah*-compliant securities that meet liquidity requirements.

(Informant 3, personal communication, August 23, 2020)

On the other hand, the informant 4 stated that:

Using commodity *murābahah* avoids dealing in *'Inah* sale (sale and buy back), *bay' ad-dayn* (sale of debt), derivatives based on *wa'd* (undertaking) and organized *tawarruq* (a sale and repurchase of a commodity, pre-arranged between multiple parties to obtain financing).

(Informant 4, personal communication, August 13, 2020)

This product was developed in collaboration with the Association of Islamic Banking and Financial Institutions Malaysia (AIBIM), which conducted studies on these instruments and *sukuk* to ensure their compliance with both industry practices and *Shari'ah* standards. According to informant 5, AIBIM received support from BNM and its SAC to launch new initiatives aimed at advancing the Malaysian banking industry and Islamic financial markets.

(Informant 5, personal communication, September 11, 2020)

### **Organized *Tawarruq* Instead of *'Inah***

Among the recently developed investment products in Malaysia is organized *tawarruq*, which was introduced as an alternative to *'Inah*. It is utilized by Kuwait Finance House (KFH) Malaysia, one of the pioneering foreign Islamic banks in offering innovative *Shari'ah*-compliant financial products. KFH Malaysia was among the first foreign Islamic banks to adopt *tawarruq* in place of *'Inah* for its commodity-based investment products. This observation is consistent with informant 6's statement, who explained that the bank employs crude palm oil as the underlying commodity traded for investment and profit generation.

However, researchers have expressed reservations regarding the *fatwā* issued by the SSB of KFH Malaysia endorsing organized *tawarruq*. They favor the opinion of scholars who argue that the organized *tawarruq* practiced by the bank is prohibited, based on the rulings of contemporary scholars from the IIFA, which has issued a *fatwā* against organized *tawarruq*. The two primary arguments are as follows (Shabir, 2019). Firstly, the seller's commitment in the *tawarruq* contract to act as a proxy and arrange for the commodity to be sold to a third party renders the transaction similar to *'Inah*, which is prohibited in *Shari'ah*—whether the commitment is explicitly stated or implied by customary practice. Secondly, the transaction often fails to meet the essential *Shari'ah* condition of taking delivery. In reality, the arrangement functions as a mechanism for cash financing, with the customer paying a premium. The purchase and sale transactions are largely fictitious (Shabir, 2019; Edris et al., 2024).

This study found that the use of *tawarruq* as a substitute for *'Inah*, as practiced by KFH Malaysia, remains a matter of scholarly contention. According to informant 7, although contemporary jurists hold differing opinions regarding the *Shari'ah* validity of organized *tawarruq*, the Shariah Supervisory Board (SSB) approved its implementation as part of the bank's initiative to provide *Shari'ah*-compliant and innovative financial services. An interview conducted with the *Shari'ah* sector at KFH Malaysia confirmed that the bank considers its *tawarruq* product *Shari'ah*-compliant. However, the interview also acknowledged that

this status is not without controversy. Some jurists argue that *tawarruq* does not belong to the form of investment or the financing and providing it for financing is only permissible in it due to need and with specific conditions.

Accordingly, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) states in its *Sharī'ah* Standard No. 30 (2019), monetization (*tawarruq*) is not a mode of investment or financing. It has been permitted when there is a need for it, subject to specific terms. Therefore, the Islamic financial institutions shall not use *tawarruq*. Therefore, the Islamic financial institutions shall not use monetization as a means of mobilizing liquidity for their operations and exert no effort for fund mobilization through other modes such as *mudarabah*, investment agency, *sukuk*, investment funds, and the like.

AAOIFI *Sharī'ah* Standards further stipulates the Islamic financial institutions shall avoid proxy in selling the *tawarruq* commodity, even if the proxy is to be arranged with a third party. In other words, institutions shall use their bodies for selling the monetization commodity, though using brokers for this purpose is permissible (AAOIFI, 2019).

A member of the Shariah Supervisory Board (SSB) at KFH Malaysia observed that *tawarruq* has gained significant popularity and acceptance in international Islamic financial markets. According to informant 7, its appeal lies in its capacity to fulfil customer needs while ensuring transparency and fairness among all parties involved. Nevertheless, some researchers remain cautious about the product, expressing concerns over its close resemblance to the prohibited *'inah* transaction.

#### **New Islamic Financing Product to Solve the Problem of Tawarruq**

When objections and reservations regarding the *tawarruq* product intensified, Malaysian jurists introduced a share trading mechanism through the financial markets. According to expert informant 8, the implementation of this product began three years prior (Edris, 2024). It is linked to Bursa Malaysia and operates on the actual circulation of commodities within a tightly regulated system overseen by financial institutions. Under this arrangement, the bank purchases the commodity from Bursa Malaysia and subsequently sells it to the customer, with the commodity being transferred directly to the customer. Upon executing the *murābahah* contract, the customer informs the broker who facilitated the transaction that the commodity has been sold. The commodity is then transferred to the customer's wallet, accompanied by a certificate confirming ownership, which is duly registered. As the legal owner, the customer retains the right to sell the commodity to another party.

According to informant 8, the operation of this product closely resembles stock trading on an exchange. The trading process is genuine, as it adheres to the *Sharī'ah* principle prohibiting the sale of non-existent commodities. This is supported by the hadith narrated by Ibn Majah, in which the Prophet (PBUH):

Translation: I asked the Prophet—may Allah's prayers and peace be upon him—‘A man came to me asking to buy something I did not possess. May I purchase it from the market and then deliver it to him?’ He replied, ‘Do not sell what is not with you’.

(Ibn Majah, 2009, Hadith No. 2187)

With the development of this product, the controversy surrounding the legality of *tawarruq* transactions was effectively resolved. Subsequently, Malaysian banks moved to develop a specialized financial instrument as an alternative to *tawarruq*, which reignited scholarly debate among jurists (Ahmad et al, 2017).

#### **Exchanging Debt for Financial Commodities**

In its efforts to innovate Islamic financial products, the Islamic banking sector has recently introduced developments that are either borderline impermissible or subject to suspicion and criticism. These services have become a focal point of scholarly debate, as some mechanisms appear to circumvent the prohibition of usury (*ribā*), while others seem compliant only in form, not in substance.

- i. Resale: The *īnah* sale (*bai’īnah*) is among the most widely used financial instruments in Islamic banks across Southeast Asia. *Murābahah*, for instance, transforms into a *īnah* sale when the seller is the customer himself. In such a case, the bank purchases a commodity from the customer (Zaid) and then resells it to the same customer at cost plus a deferred profit margin. The profit rate in this arrangement closely resembles conventional interest rates (AlBaraka Forum, 1990; 2004; Edris et al., 2023). To clarify the resale mechanism: suppose the customer requires USD 1,000. He sells a commodity to the bank for USD 1,000, and then repurchases it from the bank at an inflated price of USD 2,000 on a deferred payment basis. The customer ultimately pays USD 2,000 to the bank instead of USD 1,000, raising concerns of resemblance to interest-based lending, as the deferred amount effectively represents the principal plus interest. This poses a challenge for SSBs in evaluating the legitimacy of such financing mechanisms. When the deferred sale and *īnah* sale are combined into a single financing structure—executed without reference to the fair market value of the underlying commodity—the result mirrors conventional interest-bearing loans with compounded returns. There is little distinction between this method and the usurious loan model, particularly in the cash financing practices of Bank Muamalat Malaysia. This method operates as follows: the commodity may originate from either the bank or the customer. The sale price, delivery date, and terms of deferred payment are mutually agreed upon. The deferred sale price is credited to the customer’s current account, while the profit portion is paid monthly. The principal amount is settled either in a lump sum or according to a schedule agreed by both parties. A financial deficit or negative balance in the current account reflects the utilization of the financing facility. A rebate or discount may be offered for any unused portion, at the bank’s discretion. Finally, the financing arrangement may be renewed prior to the expiration of the initial term.
- ii. Credit card design mechanism: The financing mechanism based on *īnah* offers complete flexibility in terms of financial limits and tenures. It also guarantees a fixed profit for the bank. One application of this mechanism is in the design of credit cards, whereby the bank can execute repeated sale and purchase contracts using a single plot of land with each customer. Scholars have not objected to the design of such cards, provided that the arrangement does not involve the taking or giving of interest—whether overtly or covertly—by either the bank or the customer (Ahmed & Abu Ghada, 1998). However, several challenges arise, as reflected in the following questions: What is the size of the portfolio or guarantee associated with the plot of land provided by the bank? - Is a separate plot of land allocated for each customer? Is the sale value of the plot of land aligned with its fair market value? Is the credit card limit subject to penalties? These questions pose significant challenges for the SSB in evaluating the legitimacy and compliance of this financing structure.
- iii. Implementation of *tawarruq* in trading debt for commodities: The *tawarruq* contract involves three parties: the customer, the seller, and the bank. At the outset, the transaction is implemented through the following steps: The customer approaches the bank in need of a specific amount of money—for example, USD 1,000. The bank purchases a commodity (e.g., a bicycle) from the seller for the amount requested by the customer (USD 1,000). The bank then sells the commodity to the customer at a deferred payment price of USD 2,000 (i.e., USD 1,000 plus a profit margin). Acting as the customer’s agent, the bank sells the commodity back to the original seller for USD 1,000 in cash. The customer receives USD 1,000 in cash and is obligated to repay the bank USD 2,000 in installments. Fluctuations in commodity prices present an additional challenge that must be considered. From a risk and return perspective, there must be a time gap between the initial purchase and the resale; otherwise, the absence of risk renders the profit questionable and exposes the transaction to suspicion of *ribā* (usury). To ensure *Shari’ah* compliance, the seller of the commodity must be a party other than the bank; otherwise, the transaction resembles a form of *īnah*. Furthermore, there must be no pre-arranged agreement among the three parties. The commodity used in *tawarruq* must be a real, tangible asset with a genuine market price subject to supply and demand. *Tawarruq* can also be employed in the design of credit cards and short-term financing instruments.

### *Applications of Bai' Al-Dayn (Sale of debt)*

The application of *bai' al-dayn* (sale of debt) has become an important instrument in contemporary Islamic finance, particularly for liquidity management, whereby an existing debt is exchanged for an immediate cash amount. Zakariya (2020) notes that its permissibility depends significantly on the structure of the transaction. Selling a debt back to its original debtor is generally accepted, as it simply restructures an existing obligation without introducing prohibited elements. However, when the transaction involves selling the debt to a third party, especially at a discounted rate and in exchange for an asset of the same kind, the matter becomes contentious. Such a structure may trigger issues of *ribā*, *gharar*, and the classical prohibition of *bai' al-kāli' bi al-kāli'*, thus requiring deeper scrutiny.

In Malaysia, several contemporary scholars have adopted a relatively permissive view regarding the sale of debt, particularly in their *fatwā* on discounted promissory notes. Their reasoning rests on the distinction between debts arising from loans and debts generated through deferred sales transactions. According to this position, a debt originating from a loan is merely a monetary liability without any underlying asset; therefore, trading it would be equivalent to exchanging money for money, which may contravene the prohibitions of *ribā*. In contrast, a debt arising from a deferred sale (*bai' muajjal*) is said to be underpinned by the goods previously transacted. Consequently, the document evidencing the debt—such as a promissory note—is viewed not simply as a representation of money, but as a symbolic extension of the goods sold. On this basis, the trading of such a debt is conceptualised as a continuation of the sale of goods, rather than a prohibited exchange of monetary equivalents.

Muhammad Taqi Usmani, however, rejects this justification and offers a critical counter-analysis, as recorded by Edris (2014). He argues that the Malaysian scholars' reasoning does not withstand scrutiny because, in classical fiqh, a sale results in the complete transfer of ownership of the asset to the buyer. Once the sale is concluded, the seller no longer has any remaining claim over the goods; the only right that remains is a claim to the price, which now exists as a pure debt on the buyer. The subsequent promissory note merely documents that debt and does not retain any substantive connection to the asset originally sold. From the perspective of Eastern jurists, there is therefore no meaningful distinction between a debt arising from a loan and a debt arising from a sale because, in both cases, the post-sale debt represents nothing more than a monetary obligation. Allowing such a debt to be traded—particularly at a discount—would effectively permit money to be exchanged for money with disparity, which is a clear form of *ribā*. Taqi Usmani further warns that if such reasoning were accepted, any sum of money could be artificially linked to goods from a previous transaction, thereby justifying premium exchanges that classical jurists have unanimously rejected. This, he argues, would undermine the foundational Shariah principles that regulate commercial transactions and safeguard against exploitation and financial injustice.

Second, equating the sale of a promissory note with the sale of goods implies that the same goods can be sold to two parties simultaneously. However, once the goods are sold to the issuer of the promissory note, they become his property. It is not possible for the holder of the note to sell the goods to another party when ownership has already transferred. Moreover, the goods will not be transferred again at any subsequent stage (Edris, 2014).

Third, this position contradicts the Hadīth narrated by 'Abdullāh ibn 'Umar:

Translation: I used to sell camels at al-Baqi for dinars and take dirhams for them and sell for *dirhams* and take *dinars* for them. I would take these for them and give them to them. I went to the Messenger of Allah (PBUH) who was in the house of Hafsah. I said: Messenger of Allah, take it easy, I shall ask you (a question): I sell camels at al-Baqi'. I sell (them) for *dinars* and take *dirhams* and I sell for *dirhams* and take *dinars*. I take these for these and give these for these. The Messenger of Allah (PBUH) then said: There is no harm in taking them at the current rate so long as you do not separate leaving something to be settled.

(Al-Tirmidhi, 1996, Hadith No. 1242)

From this Hadīth, it can be inferred that if the price was set in a type of currency, it can be paid in another type with two conditions: the exchange rate must reflect the prevailing market rate on that day, and the payment must be completed in full during the same sitting (Usmani, 1998).

- i. Securitized debt differs from cash and is not subject to the rules of *ṣarf*, which require equal amounts and immediate exchange. Accordingly, Zakaryia (2007) states: “Selling debt security for cash is different than selling cash for cash, as the security represents the right debt and is different from cash.”
- ii. Some *Mālikī* and *Shāfi‘ī* scholars have reported that when the sale of debt is permitted, it may be conducted at any price agreed upon by the parties. Thus, debt may be sold for a higher or a lower amount, provided mutual consent exists.

Taqi Usmani responded to this argument by clarifying that the opinions of *Mālikī* and *Shāfi‘ī* scholars apply only when all legal conditions are fulfilled. He illustrated this with an example: when someone says the sale of gold is permissible, it does not imply permissibility while violating the rules of *ribā*. Rather, it means the sale is allowed as long as all conditions are met—such as the requirement that *ribawī* items of the same kind must be exchanged in equal amounts. This is the context behind the example cited by *Mālikī* scholars. *Shāfi‘ī* scholars, on the other hand, provided an example involving the sale of debt for a different kind—such as selling livestock for money on a deferred basis. They did not explicitly mention the requirement of equal amounts, as it is considered self-evident. Some scholars also reference the case of “pay in advance and get a discount”, based on the story of *Banī An-Naḍīr*, who were expelled from Madinah while some residents remained indebted to them.

Eastern scholars responded by noting that the majority of scholars disallowed the practice of “pay in advance and get a discount”. This view is supported by prominent figures such as Abdullah bin Umar, Zaid bin Thābit, and others. Additionally, some scholars argue that the story of *Banī An-Naḍīr* is *Da‘if* (weak) and cannot be authenticated. Those who permitted “pay in advance and get a discount” restricted it to transactions between the debtor and creditor. If a third party is involved, the ruling changes, and none of the scholars have allowed it in such cases. Therefore, a promissory note discount cannot be analogized to this situation. The creditor, as the owner of the debt, may waive part of it, but a third party purchasing the debt is effectively buying cash owed by the debtor—an act akin to selling money for money at a premium.

Resolution No. 64 of the IIFA states:

The discount of a deferred debt to accelerate its repayment, whether at the request of the creditor or of the debtor (pay less but ahead of time), is permissible in Shariah and does not fall within *Ribā* if not based on a prior agreement and as long as the relationship between the creditor and the debtor are bilateral. If a third party is involved between them, the discount is not permissible, subject to the *Shari‘ah* ruling regarding the discount of trading instruments.

Disallowing the sale of deferred debt: The IIFA also prohibited the sale of a deferred debt by a non-debtor. It states:

It is not allowed to sell a deferred debt by the non-debtor for immediate cash, of its type or otherwise, because this results in *Ribā*. According to Ibn Anas, it is not permissible to sell it for deferred cash (regardless of the debt form) because it is similar to selling the debt for a debt which is strictly prohibited in *Shari‘ah*, even if the debt is the result of a loan or a deferred sale.

(Ibn Anas, 1985, p. 672; IIFA, 1998)

These applications have been subject to differing opinions. Scholars from the Eastern Arab world generally consider such practices to conflict with the Hadith of Abdullah bin Umar (as previously mentioned). In contrast, scholars from Malaysia permit the sale of debt to a third party, citing the views of certain *Mālikī* and *Shāfi‘ī* scholars (IIFA, 1998).

Informant 9 responded to a question posed by the researcher regarding the challenges faced by the bank in liquidity management. He identified the sale of debt as one of the key issues. He stated:

There is a problem due to a difference of opinion because, in Malaysia, the sale of debt is practiced, while it is disallowed in the East of the Arab world due to arguments made by the scholars there.

(Informant 9, personal communication, November 30, 2019)

The sale of debt is a tool developed for traded financial instruments such as promissory notes and debt certificates, primarily for liquidity management. However, upon closer examination of the structure adopted by Bank Islam Malaysia, it appears to involve the sale of debt for an immediate cash payment. This practice is not permissible, as it does not meet the requirements of a valid sale under *Shari'ah* (IIFA, 1998). Malaysian scholars responsible for *Shari'ah* supervision in Islamic banks argue that this form of debt sale does not constitute *ribā* for two main reasons: First, debt certificates issued for securitized debt differ from money and are not subject to the rules of *ṣarf*, which require equality in amounts and immediate exchange. Therefore, exchanging securities for cash is distinct from exchanging cash for cash, as the certificates represent a right to claim and possess different characteristics (Zakariya, 2007). Second, - These debt certificates arise from sale contracts commonly used in Islamic banking, such as *murābahah*, *bai' bithamān ājil*, *ijārah*, *istisnā'*, and others. As such, the debt represents goods sold under these contracts, implying that it may be sold at a premium or discount, similar to the goods themselves (Boudjemia, 2023).

The first argument lacks rigor, as debt certificates are essentially tools for documenting the existence of debt. They refer to debt and money, and discounting promissory notes in this manner is impermissible, as it equates to selling money for money with a discount and deferment (As-Subhī, 2022). The second argument is also weak, particularly in the claim that “the debt represents goods sold”. In reality, debt and goods are distinct: debt is the deferred price of the goods, which is money (Boudjemia, 2023; Zakariya, 2007).

Furthermore, the study identified numerous noteworthy conclusions regarding the challenges faced by SSBs in introducing Islamic banking services and products in Malaysia, as follows:

- i. A critical challenge is the lack of effective institutional regulation and governance in Islamic financial institutions. Addressing this requires more coordinated efforts among the relevant authorities responsible for *Shari'ah* governance. The lack of coordination among collective *ijtihād* bodies—both domestically and internationally—combined with the absence of unified religious authorities in Islamic countries, has widened the gap between *fatwās*, leading to public confusion. Although *Shari'ah* supervision standards issued by international bodies such as AAOIFI and the Islamic Financial Services Board (IFSB) are not legally binding on IFIs in Malaysia, they have nonetheless improved the quality of financial statements and reporting practices. *Fatwās* issued by the National Fatwa Council of Malaysia, while also not legally binding, significantly influence Islamic financial practices;
- ii. The study supports the opinion that organized *tawarruq*, as practiced by KFH Malaysia, should be prohibited when used as a substitute for *īnah* (a sale and buyback arrangement) involving crude palm oil. This conclusion is based on the structure of the transaction, which involves selling a commodity “that is not gold or silver” from global commodity markets to the party engaging in *tawarruq* at a deferred price, with a condition attached to the contract that the bank must follow;
- iii. The research concludes that the resolution of the IIFA, which rejects the permissibility of debt sale, carries greater jurisprudential weight. This legal verdict is favored by certain jurists, particularly in jurisdictions where Islamic banking windows are permitted. The study supports the view that selling debt may be permissible under specific conditions, provided it aligns with the principles of Islamic finance. However, such permissibility must strictly adhere to all conditions relevant to this type of sale.

- iv. Innovative financial instruments must be designed and implemented in strict accordance with the principles and standards of Islamic finance. This ensures that the resulting financial solutions are both efficient and fully *Shari'ah*-compliant; and
- v. It is essential to prepare for the accelerating pace of globalization and advancements in information and communications technology. This can be achieved by developing self-defensive mechanisms to withstand global competition. Operational and legal challenges affecting Islamic banks require focused attention. Future research should incorporate more case studies and real-world examples to illustrate day-to-day practices. Additionally, rigorous statistical analysis is recommended to identify specific challenges and formulate appropriate responses.

## Conclusion

The principal finding of this study is the identification and evaluation of key challenges to *Shari'ah* compliance in Islamic financial institutions, particularly the lack of effective government regulation and governance standards. The study addressed institutional, methodological, operational, and emerging challenges faced by SSBs in Malaysian banks and proposed practical solutions related to their roles, functions, and responsibilities. Specifically, key findings can be summarized as follows: Identification of institutional, operational, administrative, and methodological challenges related to the roles and responsibilities of SSBs in Malaysian Islamic banks, evaluation of the roles and practices of SSBs and the obstacles they encounter, and proposal of solutions to these challenges through the development of Islamic financing tools and products, enhancement of *Shari'ah* supervision mechanisms, and emphasis on Islamic financial engineering.

The key practical recommendation of this study is that innovative financial tools should be designed and implemented in strict adherence to the principles and standards of Islamic finance, thereby ensuring effective and fully *Shari'ah*-compliant financial solutions. The most significant policy implications are as follows: enhancing coordination between SSBs in Malaysian banks and the supervisory authority at the Central Bank of Malaysia, broadening engagement with other Sunni jurisprudential schools, rather than limiting decisions exclusively to the *Shafi'i* school, expanding *Shari'ah* board membership to include experts in finance, accounting, insurance, and management, alongside scholars specialized in Islamic jurisprudence and its foundational principles, and strengthening *Shari'ah* supervision frameworks and legal structures to ensure the proper implementation of rulings and uphold the integrity of Islamic banking practices.

This study recommends that future research address a broader range of emerging jurisprudential issues in Islamic banking, as well as the governance of SSB roles and the development of their mechanisms and oversight practices. It also suggests evaluating the extent to which *Shari'ah* boards adhere to *fatwas* based on collective *ijtihad*, and assessing the impact of such adherence on the performance of Islamic financial institutions and their products. Additionally, the study emphasizes the potential of artificial intelligence in supporting *Shari'ah* board decision-making and data analysis to enhance institutional capabilities and align with contemporary developments. The study also recommends the development of control standards within Malaysian Islamic banks, particularly for internal *Shari'ah* audits, to reinforce the governance of SSBs. Another key recommendation is the establishment of a governance system that incorporates multiple oversight standards with sufficient flexibility to strengthen the roles and responsibilities of SSBs in Malaysian banks.

In addition, future research is encouraged to explore the following topics: restructuring *Shari'ah* supervision in Islamic banks in response to globalization challenges, smart *Shari'ah* control: leveraging artificial intelligence to enhance *Shari'ah* compliance, developing a unified international model of *Shari'ah* control: vision and obstacles: vision and obstacles, and *Shari'ah* supervision amid the digital transformation of Islamic banking services.

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