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PROHIBITING RIBA IN ISLAMIC FINANCE: Ethical and Legal Dimensions and the Role of Malaysia's Shariah Advisory Council

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History

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Abstract: One of the most critical issues in Islamic finance is the elimination of *riba* (usury), as Shariah prohibits it. Riba, defined as an unjust excess in financial transactions, is explicitly forbidden in the Quran and Hadith due to its exploitative nature. This study examines riba based on the fatwas issued by the Shariah Advisory Council (SAC) of Bank Negara Malaysia, the highest Shariah authority whose decisions are binding on financial institutions, courts, and arbitrators under the Central Bank Act 2009. Using a literature review methodology, this article highlights the strategic role of the SAC in prohibiting Riba and ensuring compliance with Shariah principles. The findings reveal that the prohibition of riba has profound ethical and legal implications, promoting fair and Sharia-compliant financial transactions. The implications of this research are significant for strengthening Islamic law and Islamic banking in Malaysia and Asia. By emphasizing the need for transparency and accountability in SAC decisions, this study offers valuable insights for policymakers, practitioners, and academics to integrate Shariah principles with modern financial needs to ensure justice and societal welfare.

Keywords: riba (usury), Shariah Advisory Council (SAC), islamic finance, Sharia compliance, ethical financial transactions

Abstrak: Salah satu isu terpenting dalam keuangan Islam adalah menghilangkan riba yang dilarang Syariah. Riba, kelebihan zalim dalam transaksi keuangan, secara tegas dilarang Al-Quran dan Hadis karena eksploitatif. Studi ini mengkaji riba berdasarkan fatwa Shariah Advisory Council (SAC) Bank Negara Malaysia, otoritas tertinggi syariah yang keputusannya mengikat lembaga keuangan, pengadilan, dan arbitrator, sesuai Central Bank of Malaysia Act 2009. Menggunakan kajian pustaka, artikel ini menyoroti peran strategis SAC dengan menegaskan keharaman riba dalam memastikan kepatuhan syariah. Temuan menunjukkan bahwa larangan riba memiliki implikasi etis dan hukum yang mendalam, mendorong transaksi keuangan yang adil dan sejalan dengan syariah. Implikasi riset ini penting bagi penguatan hukum Islam dan perbankan syariah di Malaysia dan Asia. Dengan menyoroti kebutuhan transparansi dan akuntabilitas dalam keputusan SAC, studi ini memberikan wawasan bagi pembuat kebijakan, praktisi, dan akademisi untuk mengintegrasikan prinsip syariah dengan kebutuhan keuangan modern guna menjamin keadilan dan kesejahteraan masyarakat.

Kata kunci: riba, Shariah Advisory Council (SAC), keuangan Islam, kepatuhan syariah, etika transaksi finansial.



A. Introduction

The discussion of financial institutions and the schemes they run is always interesting. Without realizing it, financial institutions have made a major contribution to the development of the country's economy and the development of the community's economy. One of the impacts resulting from banking operations is helping the government maintain state financial stability. However, this is not necessarily in accordance with existing Islamic economic laws. The law inherent in Shariah economics is that all forms of harm must be eliminated in every muamalah transaction. The issue often discussed concerns interest practiced in financial institutions, which is always associated with usury in Islamic law. In discussing Shariah economics, it has become absolute law that usury is a system in the economy that is prohibited by various authentic texts.¹

Islamic finance is recognized as significant in the mainstream, largely because of substantial Muslim populations and robust government backing. Additionally, 25 other nations have Islamic finance in a niche capacity. These countries provide various Islamic finance products and consistently strive to enhance their offerings. Likewise, 18 other nations have shown interest in advancing the Islamic finance sector and are actively collaborating with regulators to facilitate the creation and governance of Islamic banks within their jurisdictions.²

Shariah law is based on the Koran and hadith. The Koran is the top source of Islamic law. All of its verses have the status of *qath'iy al-wurud*, namely laws whose truth is certain and whose existence is believed. This is a general guideline for mankind to organize their lives related to worship and *muamalah*. One of the matters related to *muamalah* regulated in the Qur'an is the issue of buying, selling, and usury.³

Malaysia's successes reflect the extraordinary efforts of the Malaysian government, industry stakeholders, and the broader community to reach their current position. The robust and consistent growth of the Islamic finance sector suggests the presence of an effective regulatory framework, a well-executed Shariah system, and substantial government support. Malaysia has a distinctive dual financial system consisting of both conventional and Islamic institutions operating harmoniously. One of Malaysia's key innovations is the establishment of the Shariah Advisory Council (SAC), which serves as the top national authority for approving

¹ Asriadi Arifin Adi, Mukhtar Lutfi, and Nasrullah Bin Sapa, "RIBA DAN BUNGA PERSPEKTIF EKONOMI SYARIAH," *Moneta: Jurnal Manajemen & Keuangan Syariah* 1, no. 2 (May 1, 2023): 23–30, <https://doi.org/10.35905/moneta.v1i2.3488>.

² Bank Negara Malaysia, "Global Islamic Finance Forum Report" (Kuala Lumpur, 2012).

³ Rukman Abdul Rahman Said, Alimin Alimin, and Yamaluddin Yamaluddin, "Konsep Al-Qur'an Tentang Riba," *AL ASAS* 5, no. 2 (2020): 1–15.

Shariah products and determining the Shariah stance on issues that arise in court proceedings and arbitration.⁴

In the Islamic business concept, riba is an addition not accompanied by an exchange of compensation, as the Qur'an prohibits. The Qur'an has explained in detail the stages of prohibiting usury.⁵ The first stage describes the existence of negative elements in riba (QS. al-Rum [30]:39). It is followed by signaling the prohibition of usury by condemning the Jews who practiced usury (QS. al-Nisa'[4]:161). Next, the Qur'an explicitly forbids usury with the limitation of *adhāfan mudha'afan* (QS. Ali Imran[3]: 130), which is followed by the total prohibition of usury in its various forms (QS. al-Baqarah[2]:275 -281).

The role of financial institutions and their operational schemes remains a compelling topic of discussion, particularly in the context of their impact on economic development. Previous studies, such as Mohamad & Trakic (2012), have examined the Shariah Advisory Council's role in resolving disputes within Islamic banking in Malaysia, highlighting the regulatory framework supporting Islamic finance's growth.⁶ Additionally, Nyanyang (2020) research explores the Quranic prohibitions on usury (riba) and the stages leading to its total prohibition, emphasizing the importance of compliance with Islamic economic laws in financial transactions.⁷

Ahmad et al. studied the usury issue in short selling in Bursa Malaysia by combining it with the securities borrowing and lending mechanism using the *ijarah bi than* principle.⁸ Maksum examines Islamic legal opinions from Indonesia and Malaysia to outline how Islamic financial institutions must create products to avoid the practice of riba (usury) on unlawful debts and identifies two specific models for creating products that anticipate and avoid riba.⁹ Prabowo investigates the inadequate evidence of usury (riba) in the economies of five Asian countries and

⁴ Mohd Izzat Amsyar Mohd Arif et al., "Enhancing the Statutory Roles of the Shariah Advisory Council of Bank Negara Malaysia through Technological Advancement: A Way Forward," *KnE Social Sciences*, January 5, 2024, <https://doi.org/10.18502/kss.v8i21.14808>; Tun Abdul Hamid Mohamad and Adnan Trakic, "The Shari'ah Advisory Council's Role in Resolving Islamic Banking Disputes: A Model to Follow?," 2012, <https://research.monash.edu/en/publications/the-shariah-advisory-councils-role-in-resolving-islamic-banking-d>.

⁵ Nyanyang Nyanyang, "Pemikiran Wahbah Al-Zuhaili Tentang Hukum Riba Dalam Transaksi Keuangan Pada Kitab Fiqih Islam Wa Adillatuhu," *Mutawasith: Jurnal Hukum Islam* 3, no. 2 (December 21, 2020): 172–85, <https://doi.org/10.47971/mjhi.v3i2.234>.

⁶ Mohamad and Trakic, "The Shari'ah Advisory Council's Role in Resolving Islamic Banking Disputes."

⁷ Nyanyang, "Pemikiran Wahbah Al-Zuhaili Tentang Hukum Riba Dalam Transaksi Keuangan Pada Kitab Fiqih Islam Wa Adillatuhu."

⁸ Azlin Alisa Ahmad et al., "Regulated Short Selling in Bursa Malaysia: Evaluating the Usury Issue," *International Journal of Advanced Research* 9, no. 01 (January 31, 2021): 991–98, <https://doi.org/10.21474/IJAR01/12380>.

⁹ Muhammad Maksum, "The Mechanism of Avoiding Riba in Islamic Financial Institutions: Experiences of Indonesia and Malaysia," *JURIS (Jurnal Ilmiah Syariah)* 22, no. 2 (December 15, 2023): 235, <https://doi.org/10.31958/juris.v22i2.6952>.

finds that higher interest rates are associated with greater difficulty in recovering from financial crises. At the same time, Shariah (proxied by direct investment) can boost the economy and increase economic resilience against financial crises.¹⁰

While these studies contribute significantly to understanding Islamic finance and its regulatory environment, they often focus primarily on the theoretical frameworks or specific case studies without addressing the practical challenges financial institutions face in implementing Shariah-compliant practices. This paper aims to fill this gap by exploring the operational implications of Shariah compliance in various financial institutions. It assesses not only the alignment of products with Islamic law but also the real-world challenges practitioners encounter in ensuring that their operations remain free from harm, as mandated by Shariah principles. This focus on the practical applications of Islamic finance distinguishes my work from previous research, providing a deeper insight into how financial institutions can better navigate the complexities of Shariah compliance while contributing to broader economic stability.

B. General Concept of Usury

Regarding language or etymology, usury is defined as addition, growth, excess, rent, and interest in money. Usury is referred to as additional or excess because there is additional or excess in usury transactions. Hereinafter referred to as rent or interest, some people perceive usury as a scheme like interest on money because money increases or reproduces. Based on a broader understanding/terminology, usury is an addition to a loan or exchange charged by one party to another party.¹¹ Riba is forbidden by Allah SWT and is even classified as one of the major sins. But the question is what is meant by usury. From a linguistic point of view, usury refers to the meaning of growing (fertile) and increasing.¹²

In general, *riba* can be divided into *riba al-fadl* and *riba al-nasi'ah*. *Riba al-fadl* is the excess of goods exchanged for other goods of the same type, such as the exchange of dates for dates or any *ribawi* item. While *riba al-nasi'ah* is the delay in the delivery of one of the goods (or both) in an exchange transaction between *ribawi* items of the same type or '*illah*.¹³ *Riba al-fadl* and *riba al-nasi'ah* belong to the category of *riba al-buyu'*.

However, there is another division of *riba* called *riba al-jahiliyyah*, which contains *riba al-card* and *riba al-day*, which is *riba* that occurs in debt transactions.¹⁴

¹⁰ Bambang Hadi Prabowo, Ema Sulisningrum, and Sri Harnani, "Financial Crisis and Usury in Digital Economic: Why Major Religion Prohibit Usury? Monetary Studies in Asia," *JBFEM* 4, no. 1 (May 26, 2021): 27–46, <https://doi.org/10.32770/jbfem.vol427-46>.

¹¹ Adi, Lutfi, and Sapa, "RIBA DAN BUNGA PERSPEKTIF EKONOMI SYARIAH."

¹² Muhammad Ikhlas Rosele et al., "Hadith Riba dalam Kitab 'Umdah Al-Ahkam: Analisis Perspektif Fiqh," *Jurnal 'Ulwan* 3, no. 1 (January 18, 2019): 11–19.

¹³ Salem Ali Salem Al-Qahtani, "Perspectives on Saudi Arabian Secondary Social Studies--Part 1," *Canadian Social Studies* 32, no. 2 (1998): 58–60.

¹⁴ Hamadah, "Kajian Lengkap Sirah Nabawiyah " 1998

Riba al-qard is riba that occurs when a debt contract is signed, and the debtor must pay more than the debt he received at settlement. While *riba al-day* refers to usury that occurs after the debt contract is signed, when the debtor is unable to pay the debt at the promised time, the creditor doubles the amount of the debt.¹⁵ *Riba al-dayn* also happens in deferred sales transactions.

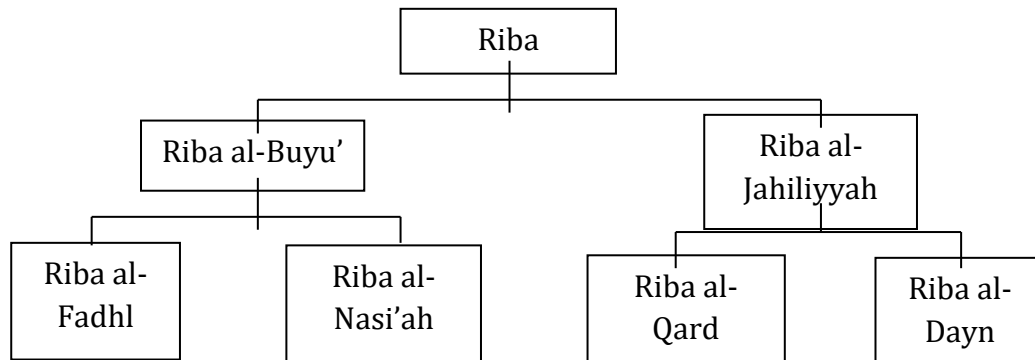


Figure 1. Types of Riba in Islam.

1. *Riba al-Fadhl*

Riba Al-Fadl means the exchange of goods whose value is unequal. It alienates the unequal exchange of values, which is contrary to the principles of Islamic justice and is prohibited.¹⁶

2. *Riba an-Nasi'ah*

Riba al-nasi'ah, which means late payment.¹⁷ *Riba an-nasi'ah*, according to Sayid Sabiq, is an addition that must be taken back by the person providing the loan in return for delaying payment. According to Hanafiah scholars, *riba an-nasi'ah* is a form of barter buying and selling in which there is no excess, but the reward or price is given at the end. *Riba an-nasi'ah* is haram according to the Qur'an and fiqh. *Riba an-nasi'ah* is also known as *riba jahiliyyah*. This is motivated by the habit of *jahiliyyah* people who carry out the habit of giving a loan to someone, and when it is due, they offer it to be extended or not so that this usury breeds. Nowadays, *riba an-nasi'ah* in financial or banking institutions is a money lending model where the repayment is paid in installments with monthly or annual interest such as 5%, 10%, and so on. Practices like this clearly show *riba an-nasi'ah*, which is a sin.

¹⁵ Rosele et al., "HADITH RIBA DALAM KITAB 'UMDAH AL-AHKAM."

¹⁶ Muhammad Surya Badali and Muhammad Faris Athaya, "Pembelajaran Hukum Riba Dalam Islam," *Religion: Jurnal Agama, Sosial, Dan Budaya* 2, no. 4 (October 23, 2023): 1146-52, <https://doi.org/10.55606/religion.v1i4.545>.

¹⁷ Badali and Athaya.

3. *Riba Qardh*

Riba Qardli is all forms of debt and receivable practices that include there is a profit motive (*syarth naf'an*) which returns only to the debt lender (*muqaridl*) or at the same time to the debtor (*muqtaridl*). In substance, *riba qardl* is included in the usury faddli category because the profit required in *riba qardl* is a form of addition or interest on one of the *ribawi* commodities.¹⁸ *Riba qardh* means *usury qardh* when additions and time consequences bind a debt and receivables contract. For example, Person A lends money to Person B, amounting to 2 million for 10 months. Person B must return to Person A at the agreed time with an additional 10%.¹⁹

4. *Riba Al-Dayn*

Interest is earned on lending money to another party (or interest paid on borrowing money from another party). This interest (*riba*) appears in debts (*duyun*—plural of *dayn*) as a percentage or a fixed amount added to the principal amount of debt (*asl al-dayn*). It is the most commonplace and most debated type of interest. In general, *riba al-dayn* is any excess or additional benefit charged or paid as a consideration in a lending/borrowing transaction. Sharia strictly prohibits all types and sources of *riba*, including *riba al-dayn*. An example of *riba al-dayn* is a transaction in which one party pays \$12,000 after one year for an amount of \$10,000 received today. *Riba al-dayn* may take many forms, including money, some benefit or service (rendered in association with a lending transaction), and so on.²⁰

C. The Role and Duties of the Shariah Advisory Council at Bank Negara Malaysia

The Shariah Advisory Council (SAC) of Bank Negara Malaysia, established in 1997, serves as the highest authority on Islamic finance matters in Malaysia. Bank Negara Malaysia, or The Central Bank of Malaysia Act (CBMA), establishes a more comprehensive legal framework for regulating the Shariah Advisory Council (SAC) compared to previous statutes, significantly enhancing its legal status and authority as the highest body for determining Islamic law in Islamic finance. Under the CBMA, the rulings of the SAC are binding on courts and arbitrators, eliminating the

¹⁸ Ipandang Ipandang and Andi Askar, "Konsep riba dalam fiqh dan al-qur'an : Studi komparasi," *Ekspose: Jurnal Penelitian Hukum dan Pendidikan* 19, no. 2 (December 29, 2020): 1080–90, <https://doi.org/10.30863/ekspose.v19i2.1143>.

¹⁹ Tatik Nurhasanah, "Mengenal Riba Dalam Etika Ekonomi Islam," *J-MAS (Jurnal Manajemen Dan Sains)* 8, no. 1 (April 29, 2023): 164–69, <https://doi.org/10.33087/jmas.v8i1.940>.

²⁰ Fincyclopedia, "Riba Al-Duyun," *Fincyclopedia* (blog), accessed January 10, 2024, <https://fincyclopedia.net/islamic-finance/r/riba-al-duyun>.

discretionary power courts previously held in deciding whether to follow SAC rulings.²¹

The Central Bank of Malaysia Act 2009 provides a comprehensive legal framework for the Shariah Advisory Council (SAC), binding its decisions on Islamic Financial Institutions (IFIs), courts, and arbitrators. However, the immunity granted to the SAC from legal action should be reconsidered and subjected to judicial scrutiny to support the development of IFIs in Malaysia. This immunity may lead to potential abuse of power, posing risks to the interests of customer stakeholders within the Islamic finance sector.²²

The Shariah Advisory Council (SAC) serves as a cornerstone in resolving Islamic banking disputes by providing binding determinations on Shariah issues referred by civil courts and arbitrators. This legal mandate ensures uniformity and reliability in interpreting Shariah principles within Malaysia's financial system. The SAC's dual role in addressing civil and Shariah law disputes highlights its critical role in bridging legal frameworks to strengthen Islamic finance systems.²³

Between 2009 and 2018, 7 out of 8 Islamic financial cases in Malaysia were referred to the Shariah Advisory Council (SAC) to resolve Shariah issues, primarily involving contract principles. This highlights the SAC's pivotal role in ensuring compliance with Islamic law. The single exception, where referral was not required, underscores the comprehensive yet selective application of the SAC's mandate, demonstrating its effectiveness in addressing Shariah complexities within Malaysia's legal framework.²⁴

To address concerns over the Shariah compliance of certain products approved by the Shariah Advisory Council (SAC), a model of *istinbat* (legal reasoning) methodology is proposed. This methodology aims to enhance the SAC's decision-making process by providing a structured framework for issuing Sharia-compliant resolutions in Islamic banking. By incorporating a more robust legal reasoning approach, the SAC can ensure greater consistency, transparency, and

²¹ Mohammad Azam Hussain, Rusni Hassan, and Aznan Hasan, "Analysis on the Development of Legislations Governing Shariah Advisory Council of Bank Negara Malaysia," *Jurnal Syariah* 23, no. 2 (May 1, 2015): 325–42, <https://doi.org/10.22452/js.vol23no2.6>.

²² Nuarrual Hilal Md. Dahlan et al., "The Shariah Advisory Council in the Malaysian Islamic Financial Institutions: Features and Legal Issues," *J. for Global Business Advancement* 9, no. 3 (2016): 284, <https://doi.org/10.1504/JGBA.2016.076718>.

²³ T. Abdul, Hamidah Mohamad, and A. Trakic, "The Shariah Advisory Council's Role in Resolving Islamic Banking Disputes in Malaysia: A Model to Follow?," 2012, <https://www.semanticscholar.org/paper/THE-SHAR%C3%94%C3%91AH-ADVISORY-COUNCIL'S-ROLE-IN-RESOLVING-A-Abdul-Mohamad/8afe6b1bec8ee569676a605f03cdb45ac159780a>.

²⁴ Sharifah Athirah Wan Idrus, Mat Noor Mat Zain, and Mohd Al-Adib Samuri, "Shariah Advisory Council as a Judiciary Judgment in Dispute Bai' Inah Contract in Civil Court in Malaysia," *International Journal of Law, Government and Communication*, July 11, 2019, 206–23, <https://doi.org/10.35631/ijlgc.4150021>.

alignment with Islamic principles, ultimately strengthening its role in maintaining the integrity of Malaysia's Islamic finance sector.²⁵

Technological advancements can significantly enhance the statutory roles of the Shariah Advisory Council (SAC) of Bank Negara Malaysia by optimizing its governance system and strengthening its legal obligations. Leveraging digital technologies, the SAC can streamline Shariah resolution processes, standardize rulings, and improve its internal policies to ensure consistency and efficiency. Additionally, positioning the SAC as a public reference authority through digital platforms can enhance transparency and accessibility, solidifying its role as a cornerstone of Shariah governance in Islamic finance.²⁶

D. Riba in the Fatwas and Legal Opinions of the Shariah Advisory Council

According to Sayyid Sabiq, the word *riba* means *al-ziyadah* (additional). The referred addition is an addition to the capital, whether it is little or a lot.²⁷ The prohibition of *riba* is strictly mentioned in the Qur'an. Allah SWT has also provided a detailed explanation about *riba* and its impact in several surahs and verses, including surah Al Baqarah, verse 275.²⁸ Islam strictly prohibits usury both in the Koran and hadith, with the main aim of guarding against exploitation and unfair hoarding of wealth, which can seriously harm the financial interests of other people.²⁹

From a terminological point of view, scholars explain the meaning of *riba*. The Hanafiyyah explains usury as a surplus from an exchange stipulated in advance by one of the parties who made the contract. Malikiyyah states it is every type of *riba*, and this definition is general. The Syafi'iyah, on the other hand, explains usury as a specific exchange contract whose similarity is unknown according to the Shariah framework when the contract is signed or when there is a delay in the exchange of goods. The Hanabilah group explains that *riba* is a form of surplus on goods or delay, especially goods that have been explained by Shariah about their prohibition (if one of them is more or is exchanged with a deferment) either in *nas* or *qiyas*.³⁰

²⁵ Fathullah Al Haq Muhamad Asni and Jasni Sulong, "The Model of Istinbat by the Shariah Advisory Council of Central Bank of Malaysia," *International Journal of Academic Research in Business and Social Sciences* 8, no. 1 (February 1, 2018): Pages 12-23, <https://doi.org/10.6007/IJARBS/v8-i1/3778>.

²⁶ Mohd Izzat Amsyar Mohd Arif et al., "Enhancing the Statutory Roles of the Shariah Advisory Council of Bank Negara Malaysia through Technological Advancement: A Way Forward," *KnE Social Sciences*, January 5, 2024, <https://doi.org/10.18502/kss.v8i21.14808>.

²⁷ Said, Alimin, and Yamaluddin, "Konsep Al-Qur'ân Tentang Riba."

²⁸ Syaharani Cahyani Pramesti et al., "Analisis Riba Dan Bunga Bank Dalam Perspektif Islam: Konsep Bunga Dan Prinsip Ekonomi Islam Dalam Perbankan Syariah," *JURNAL ILMIAH EKONOMI DAN MANAJEMEN* 2, no. 3 (March 23, 2024): 179-85, <https://doi.org/10.61722/jiem.v2i3.1115>.

²⁹ Moh Syifa'ul Hisan, "Riba Dan Bunga Dalam Kontrak Syariah," *Syariat: Jurnal Studi Al-Qur'an Dan Hukum* 5, no. 02 (November 1, 2019): 255-70, <https://doi.org/10.32699/syariat.v5i02.1196>.

³⁰ Rosele et al., "HADITH RIBA DALAM KITAB 'UMDAH AL-AHKAM."

According to Ibn Qoyyim, usury is divided into two types, namely clear usury and obscure usury. Firstly, usury is clear and prohibited because of its own circumstances, namely usury *nasi'ah* (usury that occurs) due to delays in debt payments. Usury *nasi'ah* is permitted in emergency (forced) situations. Second is vague usury, disguised for other reasons, namely usury *fadh'l*. *Riba* occurs due to additions to the sale and purchase of similar objects. Usury *fadh'l* is prohibited because it prevents usury *nasi'ah* from arising. So, in this context, it is preventive.³¹

Muhammad Rasyid Ridha divides two kinds of things that are forbidden in religion. First, it is forbidden because of its substance, which has ingredients. It is not forbidden just because of an emergency. For example, *riba nasi'ah*. Secondly, It is prohibited due to other circumstances, such as *riba fadh'l*, which is prohibited so as not to be a way or reason for the occurrence of *riba nasi'ah*. *Riba nasi'ah* data is allowed due to an emergency or need.³²

In Islam, implementing usury is a major sin because it is taking advantage of usury, and the law is haram. Islamic usury law strongly emphasizes that usury is haram (forbidden). These are the ethical and moral principles of this religion.³³ Allah has permitted buying and selling and prohibited usury. Whoever has received a warning from his Lord (concerning usury), then he stops so that what he has obtained first becomes his and his business (is up to) Allah. Whoever repeats (usury transactions), those are the inhabitants of hell. They will abide therein forever.

The author has observed from the aforementioned cases that in Tan Sri Abdul Khalid's situation (August 21, 2009), Rohana J initiated an inquiry with the SAC regarding whether a ruling had been issued on the status of the BBA agreement. However, the first significant reference emerged in the middle of 2011, originating from arbitrators. Notably, the letter referring was signed by the former Chief Judge of Malaya. As this was the inaugural reference, it is rather concise, and the questions and responses are in English. For the sake of the record, we should include it here:

Can an arbitrator impose an interest charge in an award for late payment against a judgment debtor licensed under the Islamic Banking Act 1983? Interest is prohibited in Shariah. Consequently, imposing an interest charge in an award given to an institution licensed under the Islamic Banking Act 1983 is strictly forbidden from a Shariah standpoint. However, to acknowledge the loss suffered by the judgment creditor due to late payments and to discourage delays by the judgment debtor, the Shariah Advisory Council of Bank Negara Malaysia (SAC) has determined that:

The court may impose late payment charges on judgment debts in Islamic banking and *takaful* cases, utilizing the *ta'widh* (compensation) and *gharamah*

³¹ Ipanang and Askar, "Konsep *riba* dalam fiqh dan al-qur'an."

³² Sabila Zahra, "RIBA DALAM PANDANGAN ISLAM," accessed January 10, 2025, https://www.academia.edu/107976009/RIBA_DALAM_PANDANGAN_ISLAM.

³³ Badali and Athaya, "Pembelajaran Hukum *Riba* Dalam Islam."

(penalty) mechanisms. *Ta'widh* is defined as compensation for actual losses that can be recognized as income by the judgment creditor. *Gharamah* refers to a penalty imposed as a deterrent against late payment by the debtor and should not be considered as income for the judgment creditor. The SAC believes that this decision also applies to arbitration. However, the aforementioned ruling is strictly from a Shariah perspective. The complete resolution can be found in Appendix 1 for reference.

Can late payment charges be applied to periods before and after the award? Late payment charges (as outlined in our response to question 1) on the awarded amount can only be applied to the period following the award. What is the applicable rate for these late payment charges? The SAC has ruled that the rate for late payment charges on judgment debts shall be determined according to the rates specified in the court rules.

In the context of arbitration, the rate may be defined by the rules that govern arbitration. Additionally, the late payment charge on judgment debts should not be compounded. Shortly thereafter, the first reference came from the Muamalat Division of the High Court in Kuala Lumpur, made by Judge Mohd Zawawi J, whose judgments have been mentioned in this paper. He inquired whether the rate of *ta'widh* could be predetermined or agreed upon by the contracting parties in an agreement without any evidence of the loss incurred by the bank. The SAC responded as follows:

It is not permissible for the parties involved in a contract to set or agree upon the rate of *ta'widh* in advance based on mutual consent. However, the parties to a contract may agree on a rate established by the relevant authority. In Islamic banking, this authority refers to Bank Negara Malaysia.

Ta'widh denotes compensation for actual losses. Given the challenges in determining the exact amount of these losses and the necessity for consistency within the industry, Bank Negara Malaysia will set the rate for actual losses. The applicable rate for determining actual losses is the daily overnight Islamic interbank rate published on the Islamic Interbank Money Market (iimm.bnm.gov.my) as of the judgment date, calculated monthly on a daily rest basis. Guidance on the imposition of *ta'widh* can be found in the Imposition of Fees and Charges on Financial Products and Services included herein.

This confirms that in Islamic banking in Malaysia, *ta'widh* is used as an alternative to prohibited interest-based late payment penalties. However, applying a fixed rate for *ta'widh*, instead of reflecting the actual loss incurred, remains a subject of debate from a Sharīa perspective. In line with the recommendations of the SAC, Ishak's research suggests that Islamic banks should only claim the actual loss incurred due to late payments, with any remaining amount being allocated for

charitable purposes. This approach would ensure compliance with Shariah law and promote ethical financial practices in the sector.³⁴

E. Conclusion

Riba, defined as an unjust addition or advantage in financial transactions, is strictly prohibited in Islam as outlined in the Quran and Hadith. It includes practices such as riba al-fadl, riba al-nasi'ah, and riba al-jahiliyyah, commonly equated with interest in modern finance, making interest charges impermissible in Islamic banking. The Shariah Advisory Council (SAC) of Bank Negara Malaysia plays a critical role in preventing riba by issuing binding fatwas and ensuring adherence to Shariah principles under the Central Bank Act 2009. Through its authoritative guidance, the SAC promotes ethical financial practices, strengthens compliance, and supports the development of a just and Shariah-compliant Islamic finance system.

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