

# **Roles of the Islamic Financial Institution in Combating Money Laundering: Legal and *Shari'ah* Perspectives**

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## **ABSTRACT**

*Money laundering is not a new phenomenon in Malaysia. It creates a negative impact on the economic growth as it facilitates crime and stimulates illegal activities. Money laundering also perpetuates crimes as they encourage the underlying criminal activity from which illicit proceeds are generated. It could not be denied that money launderers commonly use Islamic financial institution as a place to legitimate their ill-gotten gains through utilization of various financial instruments. It is really important to ensure that Islamic financial institution is protected from any potential abuse by money launderers to ensure that the public at large has confidence on the credibility of the Islamic financial institution. Government then introduced a few measures for the prevention of money laundering and one of it is Anti Money Laundering Act 2001 (the AMLA). The AMLA provides that financial institution has statutory duty towards the authority to report any suspicious transaction relating with money laundering. This paper therefore tries to explore the duty of Islamic financial institution<sup>1</sup> in combating money laundering with reference to the AMLA, Islamic perspective, relevant authorities and reported cases.*

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<sup>1</sup> Section 3 of the AMLA defines financial institution as an institution licensed under the Islamic Banking Act 1983, the Takaful Act 1984, The Banking and Financial Institutions Act 1989, The Insurance Act 1996 and the Money-Changing act 1998 or a person licensed under the Securities Industry Act 1983, the Securities Commission Act 1996 and the Futures Industry Act 1993 or an offshore financial institution (Labuan Offshore Financial Services Authority) Act 1996.

## 1.0 INTRODUCTION

Money laundering is the process by which criminals create the illusion that the money they are spending is actually theirs to spend<sup>2</sup>. Section 3 of the AMLA defines money laundering as the act of a person who engages, directly or indirectly in a transaction that involves proceeds of an unlawful activity, and who enquires, receives, possesses, disguises, transfers, converts exchanges, carries, disposes, uses, remove from or brings into Malaysia proceeds of any unlawful activity. In short, the term of money laundering involves three main activities namely the conversion of illegal cash into another asset, the concealment source of the illegally acquired proceeds and with the creation of the perception of legitimacy of source and ownership.

Money laundering process comprises of three main stages. The first stage is placement, which means illegal gains which introduce into the financial system. The illegal profits may derive from drug trafficking, prostitution rings, smuggling, illegal arms sale, kidnapping for ransom, bribery, computer-fraud schemes and smuggling of human beings and organs. Secondly, “layering” is the process of transferring illegitimate funds among various accounts so as to disguise the money trail such as purchase and sales of investment instruments or through multiple transfers of funds from different accounts around the world disguised as payments for goods or services. The last stage is integration ie to integrate the illegal proceeds back into the economy as legitimate funds through legitimate transactions such as business ventures, luxury assets, lending, financing and investing<sup>3</sup>.

It is a matter of vital important for every country as well as Malaysia to combat money laundering in preventing the criminals from utilising the existing financial instrument for their benefits. It could not be denied that money launderers may also use Islamic financial instrument to legitimate their illegal proceeds. Here, Islamic Financial Institution (IFI) has a duty to report any suspicious transaction to competent authority. If there is no effective mechanism in handling money laundering activities especially within the framework of IFI, we believe that it may affect the development of Islamic banking and also negate the public confidence. Hence, the aim of this paper is to provide an overview on the roles of IFI in combating money laundering through legal and shariah perspectives.

## 2.0 PREVENTIVE MEASURES OF MONEY LAUNDERING AND ITS RELATION WITH IFI

In International community, the Financial Action Task Force on Money Laundering (FATF) is an important inter-governmental body that develops and promotes policies to combat money laundering. The G-7 industrial group established the FATF as a global money-laundering watchdog, as a response over money laundering. In Malaysia, there are certain preventive measures that have been taken by the authorities and these include inter alia:-

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<sup>2</sup> Guy Stessens. (2000). *Money Laundering a New International Law Enforcement Model*. United Kingdom: Cambridge University Press. p. 82.

<sup>3</sup> Goerge J Kriz. *International Cooperation to Combat Money Laundering: The Nature and Role of Mutual Legal Assistance Treaties* (1993) 1 CLJ xxvi

## **2.1 Guidelines on Money Laundering and Know You Customer Policy**

Central Bank of Malaysia (CBM) has issued a directive known as “Guidelines on Money Laundering and Know You Customer Policy”. This guideline derived from one of the FATF forty recommendations. These “Forty Recommendations” are viewed as the leading framework of measures for combating money laundering and terrorist financing. All reporting institutions including IFI must comply with this CBM’s directive.

## **2.2 Asia Pacific Group on Money Laundering and NCC**

Malaysia joined the Asia Pacific Group on Money Laundering (APG) in 2000. Beside, there is also a committee at national level to combat money laundering consists of 13 ministries and government agencies known as NCC which has been set up in April 2000. The objective of this committee is to develop strategies, policies to prevent money laundering activities.

## **2.3 The Anti-Money Laundering Act 2001 (the AMLA)**

The Malaysian government took a step in combating money laundering by introducing the AMLA. The AMLA gives certain agencies authority to trace, seize and ultimately confiscate criminally derived wealth and enabling inter government exchange of information with counterparts in other countries. The amendments to the AMLA have been passed by the Parliament on 20<sup>th</sup> November 2003 and gazetted as law on 25<sup>th</sup> December 2003. This is the first amendment since the enforcement of the AMLA in 2001. The purpose of the amendment is to cover the element of terrorist financing in combating terrorism activities in Malaysia.

Before the amendment, the AMLA consisted only 92 sections with 2 schedules. The amendment inserted new provision in Part VIA which covers suppression of terrorism financing offences and freezing, seizure and forfeiture of terrorist property. Anti Money Laundering (Amendment) of Second Schedule Order 2003 provides the insertion of new predicate offences in Banking and Financial Institutions Act 1989, Betting Act 1953, Customs Act 1967, Explosives Act 1957, Futures Industry Act 1993, Kidnapping Act 1961, Penal Code and Securities Industry Act 1983<sup>4</sup>. This is to provide a comprehensive and integrated approach from various institutions in preventing money laundering activities.

### **2.3.1 Reporting Institutions**

CBM has set up the Financial Intelligence Unit (FIU) to carry out its functions as the competent authority<sup>5</sup>. The FIU conducts regular briefing sessions for reporting institutions’ compliance officers to clarify issues and resolve problems relating to the AMLA compliance.

Reporting institutions refer to financial Institution as an institution licensed under the

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<sup>4</sup> Section 2 (a) until (h) of the Anti Money Laundering (Amendment) of Second Schedule Order 2003.

<sup>5</sup> Section 7(1) of the AMLA.

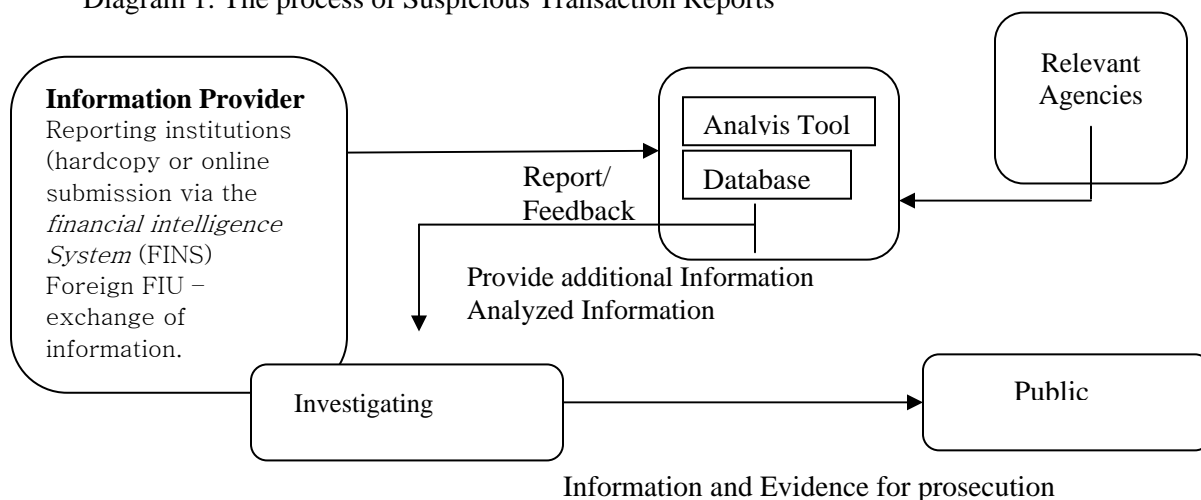
Islamic Banking Act 1983, the Takaful Act 1984, The Banking and Financial Institutions Act 1989, The Insurance Act 1996 and the Money-Changing act 1998 or a person licensed under the Securities Industry Act 1983, the Securities Commission Act 1996 and the Futures Industry Act 1993 or an offshore financial institution (Labuan Offshore Financial Services Authority) Act 1996 including Lembaga Tabung Haji, Development financial institutions, postal financial services and gaming houses.

### 2.3.2 Roles of Reporting Institutions vis a vis IFI

#### (a) Reporting of Suspicious Transactions

According to section 14 of the AMLA, banks or financial institutions have responsibility to report for any suspicious transactions to CBM. It provides for the FIU to collaborate with the relevant domestic regulatory, supervisory and enforcement agencies in intelligence gathering, analysis and dissemination. Within the enforcement framework, the FIU provides investigation support with more effective information sharing and intelligence analysis. The process of reporting, receiving, analyzing and disseminating financial intelligence on any suspicious transaction may be summarized as follow:

Diagram 1: The process of Suspicious Transaction Reports<sup>6</sup>



#### (b) Internal Policy

The AMLA requires a reporting institutions to adopt, develop and implement internal programs, policies, procedures and controls to guard against and detect an offence. Therefore, the reporting institution as well as its branches and subsidiaries shall implement compliance programs in and outside Malaysia. This internal policy should be comprehensive, credible and action-oriented aimed at enhancing CBM’s measures to combat money laundering.

For instance Bank Muamalat Malaysia Berhad, established some infrastructure focussed on the prevention and detection of illegal and laundering activities within the Bank. Therefore, the policy and procedures have been formalized and documented to guide all

<sup>6</sup> Financial Intelligence Unit (FIU) of Central Bank of Malaysia

employees and to inculcate awareness on money laundering. This policy includes inter alia, purpose of Anti Money Laundering policy and employees's responsibility either at branches level or head office of financial institutions.

**(b) Know Your Customer.**

IFI shall make reasonable efforts to determine the identity of all customers. There must be a standard operational procedure to enable IFI in identifying customers such as verifying by reliable means the identity, legal capacity, occupation or business purpose through the use of documents such as identity card, passport, birth certificate and driver's licence<sup>7</sup>.

**(c) Compliance officer**

IFI is required to establish and adopt clear anti-money laundering reporting lines. As such, IFI shall appoint an officer at management level who will be in charge of the internal procedures regarding anti money laundering<sup>8</sup>. An officer who in charge this internal procedures and reporting of suspicious transactions to FIU is known as a Compliance Officer<sup>9</sup>. The Compliance Officer will deal with the FIU of any matter pertaining to suspicious transactions as well as inculcating awareness to employees on the essence of anti money laundering programme.

**(d) Continuous Training**

IFI shall inculcate staff awareness on anti money laundering. Guidelines on Money Laundering and Know You Customer Policy issued by CBM requires financial institution to conduct continuous training to its employees either at branch or management level. Training module shall emphasize on procedures in facilitating the recognition, treatment and reporting of suspected money laundering activities<sup>10</sup>.

**(e) Record Keeping**

Section 17 of the AMLA requires reporting institution to maintain record for not less than 6 years. Reporting institution has to keep the records of all transactions involving both local and foreign customers. These include identity and address of both remitter and beneficiary, accounts affected, transaction type, identity of reporting bank, date, time, amount and treatment of multiple transfers.

**(f) Production of Documents**

Public Prosecutor if he is satisfied may authorize in writing an investigating officer in relation to any financial institution to inspect, take copies of books, record, reports

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<sup>7</sup> Section 16 (2) of the AMLA.

<sup>8</sup> Section 19 of the AMLA.

<sup>9</sup> At branch level, branch manager is a compliance officer and at head office, Senior Assistant Vice President of Operations Department is a compliance officer. See n.a. (2004). *Suara Muamalat*. 11<sup>th</sup> Edition. p. 19.

<sup>10</sup> Section 19 (2) of the AMLA.

belonging to the bank and to scrutinize share transactions or related affairs. The officer of any financial institution in charge shall furnish a copy of all the accounts, books, records, documents, relating to the person to whom a notice is issued<sup>11</sup>.

### **(g) Freezing Orders**

Section 44 (1) states that where an enforcement agency having the power to enforce the law under which a serious crime is committed or about to be committed, it may issue an order freezing any property of that person, wherever his property may be or in his possession, under his control or due from any source to him. In the context of financial institutions, they shall then freeze the accounts based on the order issued by the enforcement agency.

## **3.0 SHARIAH PERSPECTIVE**

Islam prohibits us to involve in any economic activities and services which are contradicted with the teaching of Islam such as money laundering activities. As Allah *Subhanahu Wataala* (SWT) says in *al-Quran surah al-Baqarah* verse 188: “*And do not eat up your property among yourselves unjustly and do not use it as bribe for the judges, with intent that you may eat up wrongfully and knowingly (even) a little of other people’s property.* The word unjustly in this verse refers to property incurred through illegal ways such as stealing, deceiving, smuggling, cheating and so on and so forth<sup>12</sup>. Money laundering involves proceeds of illegal activities and Islam does not recognize any property derived from such sources.

### **(a) Duty to Promote Good and to Forbid Wrong**

Basically, IFI has a duty not only required by statutory law such as the AMLA but as well as the decree of religion of Islam. Islam promotes its followers not only to do good things but also to forbid wrong such as criminal activities. This duty is put in the shoulder of an individual as well as institution or corporate body as Allah SWT says in *al-Quran surah al-Imran* verse 104:- *Let there arise from you a group of people inviting to all that is good, bringing together what is right and forbidding what is wrong, they are the ones to reach ultimate felicity*<sup>13</sup>. As such, IFI has responsibility to prevent or to combat money laundering activities which are clearly contradicted with the teachings of Islam.

Islamic banking principles prohibit the production of goods and services that contrary to the value of Islam and to avoid any illegal economic activities. The definition of Islamic banking business as banking business whose aims and operations do not involve any element which is not approved by the religion of Islam in section 2 of the Islamic Banking Act 1983 clearly provides that IFI should not involve in any financial activities which is forbidden.

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<sup>11</sup> Section 44 and 49 of the AMLA.

<sup>12</sup> Muhammad Taqiuddin Al Hilali and Muhammad Muhsin Khan. (1996). *The Noble Quran A summarized Version of At-Tabari, Al-Qurtubi, and Ibn Kathir with comments from Sahih Al-Bukhari*. Riyadh: Darussalam. p.49.

<sup>13</sup> Syed Vickar Ahameed. (1999). *Interpretation of the Meaning of the Glorious al-Quran*. English (trans). Kuala Lumpur: TR Group of Companies. p. 72.

## (b) Privacy Right

In Islam, any person includes IFI shall observe secrecy principles ie to keep the customer's data and identity as confidential. In contrast section 14 of the AMLA requires IFI to report for any suspicious transactions to competent authority and this may lead to the disclosure of customers' identity to third party without consent. In fact, section 20 states that the secrecy obligations overridden, which gives the power to CBM to investigate any information in customer's account. The issue is whether IFI is permitted in the eyes of shariah to do so?

Islam respects privacy rights and considers privacy right as essential. Any information received must be kept as a trust and no person is allowed to disclose it without the owner's consent<sup>14</sup>. Islam guarantees privacy right to every individual as Allah says in *al-Quran surah al-Hujurat* verse 12: *O ye who believe! avoid suspicion as much (as possible), for suspicion in some cases is a sin, and do not spy on each other, do not speak ill of each other behind their backs, would any of you like to eat the flesh of his dead brother? No! You would hate it but fear Allah, for Allah is often-returning, most Merciful*<sup>15</sup>.

However, the above principle of privacy right is not absolute and there is an exception. For instance we may refer to the permissibility of disclosing information by witness in the court. This exception is laid down in *al-Quran surah al-Baqarah* verse 283 as Allah SWT says: *..do not conceal testimony, for whoever conceals it, his heart is stained with sin, and Allah knows all that you do*<sup>16</sup>.

In addition, there is a job of its nature which require of exposing information such as doctor, judges, police, investigator and religious enforcement officer<sup>17</sup>. Here, IFI's officer especially its compliance officer is also allowed to disclose information and report to competent authority of any suspicious transaction involving money laundering. The nature of its job scope requires him to suspect, investigate and disclose of information on any suspicious transaction. It is his duty to prevent any suspicious criminal to legitimate his illegal proceeds through utilization of Islamic financial instrument. Moreover, principle of *maslahah* or public interest may also be invoked in permitting such disclosure made by any IFI's personnel.

## 4.0 CASES

In Malaysia, there are several prosecutions for the offence of money laundering under section 4 (1) of the AMLA and all of these cases involve financial institutions as a mean to legitimate illegal money. From facts of the cases below, it is observed that financial institution may identify any suspicious transaction of its customer and further assists the

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<sup>14</sup> Syarif bin Adwal bin Idris. (1997). *Khitman Al-Sir wa Ifshauhu fi Fiqh Islami*. Jordan: Darul Nafais. p.15-16.

<sup>15</sup> *Supra note* 13. p. 655.

<sup>16</sup> *Supra note* 13. p. 55.

<sup>17</sup> The meaning *for suspicion in some cases is a sin* in this verse verifies that not all suspicion is prohibited. See Muhammad Ali al-Sabuni. (1980) *Safwatu al-Tafasir. Dar al-Kitab al-Islamiah. p. 230*

competent authority in preventing money laundering activities. This paper briefly explains four selected cases as follows:-

**(a) *Public Prosecutor v Dr. Hamimah*<sup>18</sup>**

This is the first case where the accused has been charged with section 4 (1) of the AMLA and if upon conviction he may be fined not exceeding RM5 million or jailed term not exceeding five years or both. Dr Hamimah, 55 years is a former director of Safire Pharmaceutical (Malaysia) Sdn. Bhd. She was charged under the AMLA involving a sum of RM37.062 million at Kuala Lumpur Sessions Court. She faces seven charges of receiving money being proceeds from unlawful activities overseas. Dr Hamimah is accused of receiving RM2.2 million through her daughter's account with RHB Bank on June 9 2002. She is also alleged to have received RM6.7 million through account of Azam Rahmat Sdn. Bhd. where the accused is a director, also at the same bank between June 3 and 9 2003. She also faced a charge of receiving RM4.7 million through the account of One Oscar Sdn. Bhd. at Bank Bumiputra Commerce Bank Berhad. Dr Hamimah is also alleged to receive a total of RM4.7 million via the accounts of Megbridge Sdn. Bhd., D'Oscar Builders Sdn. Bhd. and Meridien Tenggara Sdn. Bhd. between 4 and 6 June 2003 and RM9 million through the account of Desa Ikhlas Sdn. Bhd. at the same bank between 6 and 10 June 2003. The case is still pending.

**(b) *Public Prosecutor v Gan Kiat Bend*<sup>19</sup>**

This case involves a land broker in Kuala Lumpur. Gan Kiat Bend was charged in Kuala Lumpur Sessions Court for accepting illegal money in a sum of RM2 million from Syed Ahmad Faudzi Syed Abu Bakar a land broker through Standard Chartered Bank in January 2004. He was charged under section 4(1) of the AMLA and the case is still pending.

**(c) *Public Prosecutor v Ismail Husin*<sup>20</sup>**

This case involves a land broker age 53 from Perlis. Ismail Hussin was charged in Kuala Lumpur Sessions Court on 3 May 2005 for accepting and using illegal money in a sum of RM2.85 million through 11 cheques of Standard Chartered Bank and a telegraphic transfer from the bank to his wife's Bank Bumiputra Commerce account. The accused received the money which is derived from illegal activities of fraud and forgery of land certificate. The judge fixed bail at RM150,000 in one surety and directed that all his travel documents be kept with the court. The case is still pending.

**(d) *Public Prosecutor v Abdul Khalid Hamid*<sup>21</sup>**

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<sup>18</sup> n.a. (24 April 2004). "Doktor Di Tuduh Terima RM37 juta hasil Aktiviti Haram". Utusan Malaysia. <http://www.utusan.com.my/utusan/archive>.

<sup>19</sup> Rokiah Abdullah. (5 February 2005). "Broker Tanah Dituduh Ubah Wang RM2 juta". Utusan Malaysia. <http://www.utusan.com/utusan/archive>.

<sup>20</sup> Rokiah Abdullah. (3 Mei 2005). "Broker Hadapi 12 tuduhan perubahan Wang Haram". Utusan Malaysia. <http://www.utusan.com/utusan/archive>.

<sup>21</sup> Suwarni Mokhtar. (19 December 2005). "Peragut Mewah' Guna Wang Haram Dihukum Penjara Tiga Tahun". Utusan Malaysia. <http://www.utusan.com/utusan/archive>. see also Amizul Ahmad Tarmizi. (10



Abdul Khalid Hamid was found guilty under section 4(1) of the AMLA. He was charged of using illegal money in a sum of RM65,761.09 between July 2002 to July 2004. The money which is derived from various illegal activities is used for installment and deposit for buying a house in Bukit Rimau, Shah Alam, Proton Perdana V6 and Mercedes Benz. Judge Suraya Othman. This is the first conviction under the AMLA since its enforcement on 15 January 2001.

## 5.0 CONCLUSION

Malaysia has taken serious efforts in combating money laundering by introducing the AMLA and issuing the Guidelines on Money Laundering and Know Your Customer Policy issued by Central Bank of Malaysia. The need for an effective legal mechanism especially within the financial institution's framework through an integrated approach to prevent money laundering is the very essence in ensuring the public confidence on the economic and political stability.

Reporting institution as defined under the AMLA plays very important roles in term of reporting, internal policy, compliance officer, record keeping, freezing orders and know your customer policy. These functions are statutory requirements to all reporting institutions including IFI. In fact, IFI has further duty to prevent money laundering activities as promoted by religion of Islam. Shariah views that statutory duty under the AMLA upon reporting institutions as commendable and in line with the spirit of Islam.

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## Statutes

- The Islamic Banking Act 1983
- The Takaful Act 1984
- The Banking and Financial Institutions Act 1989
- The Insurance Act 1996
- The Money-Changing act 1998
- The Securities Industry Act 1983
- The Securities Commission Act 1996
- The Offshore financial institution (Labuan Offshore Financial Services Authority) Act 1996
- The Anti Money Laundering (Amendment) of Second Schedule Order 2003

## Cases

- Public Prosecutor v Dr. Hamimah*
- Public Prosecutor v Gan Kiat Bend*
- Public Prosecutor v Ismail Husin*
- Public Prosecutor v Abdul Khalid Hamid*