

## Conference Paper

# Financial Technology: An Overview on Shariah and Legal Implication

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**Abstract.**

Technological progress affects many things and practices in today's life. In addition to the occurrence of the COVID-19 pandemic, it leads to a more open and almost comprehensive use of technology. This effect also occurs in the financial aspect. The emergence of various forms of technology-based transactions also has implications for legislation and sharia. This study was conducted qualitatively through the analysis of literature and legal sources from selected countries such as Malaysia and Indonesia. The study found that there is a law that has been drafted to regulate this aspect as well as a fatwa issued to lay the foundation for this transaction from a contractual point of view according to the Syariah perspective. However, further research still needs to be done considering that various forms of innovation involve transactions that have taken place and each of them requires clarification from a legal point of view as well as jurisprudence adaptation.

**Keywords:** financial technology, Shariah, legal, implication

## 1. INTRODUCTION

Advances in technology have affected many things in the affairs of society, including financial transactions. This influence has implications in the context of transactional methods and at the same time also affects the law and legislation. In understanding this development, it is necessary to understand the definition of 'Fintech' and what are the legal implications resulting from this transaction. This writing will analyse the definition of Fintech, the relevant terms of fintech, the development of fintech in selected countries and conclusion.

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## 1.1. What is Fintech?

“The term “FinTech,” which is the short form of the phrase financial technology, denotes companies or representatives of companies that combine financial services with modern, innovative technologies” [1]. Adam observed that “...the aid of technological innovations in the financial services industry (‘FinTech’) is disrupting banking, such that banks are being displaced, diminished and disintermediated by tech start-ups.” [2]. Lawyer Deloitte further remarked that “Financial technology is following the model of many start-ups in the services industry: one does not need to own a product or a service to improve it, or to build further services around it. For instance, Uber is the world’s largest taxi company and own no vehicles, fb is the world’s most popular media owner and creates no content, and Airbnb is the world’s largest accommodation provider and owns no real estate ”.

Courtney Gartmen categorised Fintech according to the types of transaction such as lending, payment, international money transfer, personal finance, equity financing, consumer banking and insurance. This categorisation also corroborates with the report by Mordor’s Intelligence as follows:

“Malaysia is home to one of the key Fintech sectors as more organizations and consumers prefer the digitized ways of delivering financial goods for their investment appraisal and payments through a broad array of FinTech platforms for various types of Financial goods. The paper provides a comprehensive background analysis of the Malaysian Fintech Market, including an economic evaluation, market overview, market size calculation for major sectors, and developing market trends. It also discusses market dynamics and key business profiles.. The Malaysia Fintech Market is Segmented By Service Proposition (Money Transfer and Payment, Savings and Investment, Digital Lending & Lending Investment, Online Insurance & Insurance Marketplaces, Other).The market sizing and forecasts have been done on the basis of transaction volume/revenue (USD million) [3].

## 2. METHODOLOGY

This study employs a descriptive analysis qualitative study method that involves data retrieval from a library and authorized website. This strategy was chosen since it is the most effective way to get literature highlights on legislative texts.

### 3. RESULTS AND DISCUSSIONS

#### 4.

##### 4.1. The Relevant Terms in Fintech Research

There are various related terms when addressing Fintech as listed by practitioner as follows:

“ (a) Disruptive Technology: technologies or products that challenge the industry as a whole by taking the place of the latest technology. This technology is a more advanced technology and forces industries and companies to change and adapt to avoid the risk of becoming irrelevant. Past examples are the existence of telephones, personal computers, emails and cellphones.

1. Fintech: An abbreviation for financial technology, this catch-all phrase refers to any innovation that harnesses the power of mobile technology, big data, and advanced analytics to drive change in the financial sector.
2. Cryptocurrency: In the same way that a nickel, dime, or quarter is also a coin, cryptocurrency is a category for any form of digital currency. Bitcoin, Ethereum, Ripple, and Litecoin are all examples of cryptocurrency. Cryptocurrency operates outside any government or traditional banking system and is exchanged using encrypted electronic transfers, making counterfeiting very difficult.
3. Bitcoin: Bitcoin, the original cryptocurrency that was created in 2008, is one of the most extensively utilized cryptocurrencies. A number of companies, including Microsoft, WordPress.com, Whole Foods, and Subway eateries, have already adopted it. It is anonymous, easy to send instantaneously, and has low transaction fees.
4. Blockchain: An open source, peer-to-peer technology that records all cryptocurrency transactions on the equivalent of a giant global spreadsheet. There is no spreadsheet “owner” and each time a new batch of transactions is encrypted by the network, it gets added to an unalterable online ledger (or chain) as a block. While Blockchain technology was initially developed for Bitcoin, it has many more applications, including:
  5. Payment and money transfers with an almost instant flow between payers and payees;
  6. Cybersecurity with reduced risk of hacking;

## 7. Cloud storage that greatly reduces the risk of compromised data [4]

This new paradigm as Adam highlighted is due to a change in the way customer doing things. It requires 'a frictionless experience at a least cost.' The emerging of block chain technologies and digital currencies, 'the issuance of money and finance are being separated.' [2] There are about 563,000,000 research as at 12<sup>th</sup> of October 2018 in Google search engine. The research covers various perspectives and jurisdictions. In addressing the new development in Fintech, Prof Walker listed the needs for the legal corpus in these areas:

1. Digital information and digital law;
2. Rights of digital, asset and claim;
3. Digital identity, implementation and liability;
4. Digital Risk and Governance;
5. Public and Private law related to digital;
6. Dispute resolution process in digital.

Some legal implication arising from Fintech transaction also discovered which include the recognition on the validity of the transaction, tax implication, the identity of contracting parties, subject matter of the contract, the digital signature and ownership issue.

## 4.2. Current Development in Selected Countries

### 4.2.1. Malaysia

Electronic payments and online banking has contributed to the development of Fintech in Malaysia. Fintech become an important and interesting topic taken into consideration of the rapid development in the advancement of technology [5]. It has its own challenges toward consumers' attitudes in accepting the new way of dealing with banking system. In Malaysia, there is an increasing interest in the utilisation of Blockchain technology and smart contracts. The Central Bank of Malaysia issued the Financial Technology Regulatory Sandbox Framework on the 18<sup>th</sup> of October 2016 [6]. The financial technology regulatory sandbox aims to facilitate fintech innovation while improving customer value, efficiency, and risk management in financial institutions. The sandbox provides a live testing environment with specific parameters and timeframes. To manage risks, the sandbox incorporates appropriate safeguards. However, it cannot be used to bypass

existing regulations. If a proposed product or solution is not suitable for the sandbox, the Bank offers guidance through an “Informal Steer” to align with laws and regulations. When evaluating applications, the Bank considers potential benefits, risks, and the integrity of participants. It also limits the number of participants to ensure adequate guidance and oversight.

With all the hype surrounding digital tokens, smart contracts and other solutions in the space of FinTech that are enabled through blockchain technology, the potential avenues and pitfalls of applying blockchain technology to the Malaysian political, social and economic landscape has caught the attention of many resulting in a call for regulation.

In Malaysia, the law that addressing the issue of cryptocurrency is stated in Policy Document on Cryptocurrency titled Anti-Money Laundering and Counter Financing of Terrorism (AML/CFT)- Digital Currencies (Sector 6).

*“This document is applicable to reporting institutions carrying on the following activities as listed in Paragraph 25 of the First Schedule to the AMLA: (a) activities carried out by any person who provides any or any combination of the following services: (i) exchanging digital currency for money; (ii) exchanging money for digital currency; or (iii) exchanging one digital currency for another digital currency, whether in the course of carrying on a digital currency exchange business or otherwise.”*

This clause indicates that Malaysia regards the transaction in digital currency as risky transaction as it might involve non-legal activities. This Policy Document is based on the definition made by the Financial Action Task Force (FATF) in the released report entitled “Virtual Currencies- Key definitions and Potential AM/CFT Risks.”

The issuance of this Policy however does not indicate that the Bank recognised this transaction. This is reiterated by the Bank in the Policy Document as follows:

*“...digital currencies are not recognised as legal tender in Malaysia. Members of the public are therefore advised to undertake the necessary due diligence and assessment of risks involved in dealing in digital currencies or with entities providing services associated with digital currencies.” (Para 1.5 of the Policy Document)*

Malaysia “promoting greater transparency” in dealing with digital currencies in order to “protect the integrity of the financial system and strengthen incentives to prevent their abuse of illegal activities (Para 1.4 of Policy Document)”

*” Therefore, it is clearly stated in the Policy Document that “any person offering services to exchange digital currencies either from or to fiat money, or from or to another digital currency is subject to obligations under the Anti-Money Laundering,*

*Anti-Terrorism Financing and Proceeds of Unlawful Activities Act 2001 (AMLA) as a reporting institution pursuant to First Schedule of AMLA (Para 1.4 of Policy Document.”*

The development in Malaysia shown the variety of market players involved such as Jirnexu, MyCash Online, Capital Bay, PitchIN, MHub are the major companies operating in Malaysia Fintech Market. The new regulation recognising some regulatory changes Ignited Fintech Adoption also was introduced. In 2022, National Bank of Malaysia (BNM) awarded digital banking licenses to Boost-RHB, GXS Bank-KUOK Brothers, AEON-MoneyLion and KAF Consortium [7].

Malaysia's cryptocurrency laws are dubious; they are not as benevolent as those in Singapore and Japan, but they are comparable to those in India. Legislators and enforcement agencies disagree on the subject. The Malaysian cryptocurrency regulation was the first to go into force in January 2019. The Securities Commission (SC) of Malaysia has recently drafted stricter and more direct regulations regarding cryptocurrency. The Capital Markets and Services (Prescription of Securities) (Digital Currency and Digital Token) rule categorizes digital currencies, tokens, and crypto-assets as Securities and places them under the Securities Commission's jurisdiction. Order 2019, To operate in the nation, exchanges must submit an application for a license from the authority. Only upon compliance with the regulatory requirements will the exchange be granted a license. The exchange needs to:-

1. Submit investment documentation of \$1.2 million paid-up capital to the Central Bank of Malaysia (Bank Negara) for approval.
2. Record and maintain the details of the participants and the transactions within the regulatory framework.
3. Comply with the AML-CTF rules and also the approach applied to ensure the monetary safety of the customers.
4. A work plan determining to collect data about their customers, their activities etc..

Based on the above, Malaysia set a strict regulations for exchanges in crypto currencies. Currently there are 3 registered recognized Digital Asset exchangers which are Luno Malaysia Sdn. Bhd., SINERGY Technologies (M) Sdn. Bhd. and Tokenize Technology (M) Sdn. Bhd. (Capital Markets and Services (Prescription of Securities) (Digital Currency and Digital Token) Order, 2019).

On 233rd and 234th Shariah Advisory council of Security Commisison meeting had discussed the following issues:

1. Whether Digital Assets can be recognised as *mal* (asset) from Shariah perspective;
2. Whether Digital Assets can be classified as currency or *urudh* (goods); and

### 3. How to determine the *Shariah* status of a digital token.

SAC in a series of its meetings had discussed issues in relation to Digital Assets from *Shariah* perspective. The discussions on Digital Assets in the SAC meetings are limited to Digital Assets that are regulated by the SC. The SAC had, at its 233rd meeting held on 29 June 2020 and its 234th meeting held on 20 July 2020, resolved the following:

#### (A) Digital Currency

Digital currency is recognised as *mal* from *Shariah* perspective. The SAC had viewed digital currency from two scopes, as follows:

##### (1) Digital currency that is based on technology without any underlying

Digital currency in this form is categorised as '*urudh* and it is not a currency from *Shariah* perspective. Such digital currency is not categorised as *ribawi* items. Therefore, the trading of such digital currency is not subject to the principle of *bai' al-sarf* (currency exchange).

##### (2) Digital currency that is backed by *ribawi* items

###### (i) Digital currency that is backed by gold, silver and currency

If a digital currency is backed by *ribawi* items comprising gold, silver and currency, it is categorised as a currency from *Shariah* perspective. Hence, the trading of such digital currency is subject to the principle of *bai' al-sarf*.

###### (ii) Digital currency that is backed by *ribawi* items other than gold, silver and currency

If a digital currency is backed by *ribawi* items other than gold, silver and currency, it is categorised as *amwal ribawiyah* (*ribawi* items). Therefore, the trading of such digital currency is subject to the *Shariah* requirements of *ribawi* items.

#### (B) Digital Token

Digital token is recognised as *mal* under the category of '*urudh* from *Shariah* perspective.

In determining the *Shariah* status of a digital token, the following matters must be fulfilled:

(i) The proceeds raised from the issuance of the digital token must be utilised for *Shariah*-compliant purposes;

(ii) The rights and benefits attached to the digital token must be *Shariah*-compliant; and

(iii) In the event that the utilisation of proceeds under item (i) and the entitlement of rights and benefits under item (ii) above are for mixed activities of *Shariah* compliant and *Shariah* non-compliant purposes, the existing SAC resolution on utilisation of

sukuk proceeds and the business activities benchmark under the Shariah screening methodology for listed companies on Bursa Malaysia are applicable.

If a digital token is backed by ribawi items, the trading of such digital token is subject to the Shariah requirements for trading of ribawi items.

This resolution is not applicable to any Digital Assets which are outside the jurisdiction of SC.

The SAC has also resolved that investment and trading of Digital Assets that fulfil the above requirements and which are traded on Digital Asset Exchange (DAX) registered with SC are permissible.

The pandemic situation has increased the usage of Fintech. Report stated that the Malaysian government's Movement Control Order (MCO) acted as a catalyst by helping to "add 3 million new mobile banking service subscribers last year as well as pushed e-wallet usage and adoption to new highs. Merchants were quick to embrace the trend, with over 400,000 new businesses registering for QR code payment acceptance, a 164% jump from the 2020." In June 2020, Bank Negara Malaysia (BNM) issued a new policy framework on electronic know-your-customer (eKYC) to facilitate digital onboarding. The details purpose of this Policy Document as follows:

*"This policy document sets out the minimum requirements and standards that a financial institution, as defined in paragraph 5.2, must observe in implementing e-KYC for the identification and verification of individuals. The requirements outlined in this policy document are aimed at- (i) enabling safe and secure application of e-KYC technology in the financial sector; (ii) facilitating the Bank's continued ability to carry out effective supervisory oversight over financial institutions; and (iii) ensuring effective Anti-Money Laundering and Counter Financing of Terrorism (AML/CFT) control measures. (S.1.3 of eKYC)"*

#### **4.2.2. Indonesia**

According to Bank of Indonesia Circulation No. 16/06/Dkom, bitcoin is not accepted as legal tender in the nation. Additionally, Luqman Nurhisham examined the maqasid element of analysis, which refers to the goal of shariah as the preservation of people's rights, particularly as it relates to the preservation of wealth. He said that the use of this medium of exchange in the transaction could hurt the parties to the agreement because of the issue of uncertainty and the production of money without clear oversight. According to his opinion, the government has the power to issue currency. This is the aspect of maslahah in the economic structure that a nation ought to maintain.



In order to support banking organizations as they work to ensure that more Indonesians have access to financial services, the Indonesian government created a National Strategy for Financial Inclusion in 2016. Following this, the Financial Services Authority (OJK) recently revealed that more modern financial technology legislation were also under development and intended to encourage financial inclusion. [8].

Many financial institutions are adopting financial technology-based efforts to improve financial inclusion for people who are unbanked, partly as a result of the government's push. Most notably, through digital financial services, which are described as a variety of financial services accessed and delivered via digital channels, such as payments, credit, savings, remittances, and insurance.

There are many prospect for the development of fintech in Indonesia. Indonesian fintech regulators, Bank Indonesia (BI) and OJK have addressed three types of services, namely electronic money, peer to peer lending and payment services. At the same time, an opportunity lies in the high number of mobile phone ownership. Around 60 million unbanked people in Indonesia own mobile phones [9], which presents a massive opportunity for fintech services to penetrate through mobile phones [10].

## 5. CONCLUSION AND RECOMMENDATION

The development of financial technology (Fintech) as described as 'disruptive technology', is in fact a development that is difficult to curb. Each country must be prepared to face and provide appropriate infrastructure to address the aspects that are expected to cause harm. This development has its own merits, however more fundamental aspects need to be addressed and may need to be reinterpreted to recognize this ongoing evolution.

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