

# TERRORIST FINANCING AND PERCEPTIONS ON ISLAMIC FINANCIAL INSTITUTIONS

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## **Abstract**

*The terrorist attacks of the United States (US) World Trade Center on September 11, 2001; Bali bombings in 2002 and 2005; London Bombing in 2005; and the Mumbai bombing in 2008 had left some very detrimental global perceptual impacts on the Muslims and Islamic financial institutions globally. As most of these attacks were carried out by some militant Islamicists, understandably there were a lot of public skepticism against the Muslims and the religion of Islam. In the United States of America (USA) for example, following the attacks on September 11, the US government enacted the USA PATRIOT Act, which is basically designed to prevent the use of the US financial system to help fund terrorism and other crimes. The enactment of the PATRIOT Act 2001 had accelerated the establishment of similar laws globally. In Malaysia particularly, the Anti Money Laundering and Anti-Terrorism Financing Act was introduced in 2001 and amended in 2007 to include more emphasis on the terrorist financing aspects. By virtue of these Acts, terrorist financing is a criminal offence. To date, most writings implicating Islamic financial institutions with terrorist financing are either written by Western authors or the articles are perceptual in nature. This conceptual paper reviews previous studies on this topic, examines related legislations, progresses to propose research strategies on how to counter these perceptual biases and highlights preventive mechanisms adopted by the Malaysian Islamic financial institutions in mitigating and detecting terrorists financing.*

**Keywords:** *terrorist financing; Anti-Money Laundering; Islamic Financial Institutions; perceptual study; public perception; perceptual impact*

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## Introduction

Following the September 11 attacks, there were a lot of anger and skepticisms among the public towards Muslims and the religion of Islam. Some were even quick to equate terrorism with Islam. One of the earlier efforts undertaken by the United States (US) government to diffuse public fear towards terrorism was the enactment of the Patriot Act in 2001. PATRIOT which stands for “Providing Appropriate Tools Required to Intercept and Obstruct Terrorism” is a law specifically established to prevent and deter individuals, groups of individuals or even corporations to use the US financial system to help fund terrorism and other forms of crimes. Since the Act was established, all countries wishing to deal with the US financial markets had to adopt a much heightened and strict financial regulations. One of the immediate actions taken by the US government when the Patriot Act was first established was the freezing of “oil money” from the US financial system. “Oil money” symbolises funds invested by some very rich Middle Eastern investors in financial institutions in the US. Due to the much strict requirements and procedures, new “oil money” investors were discouraged from placing their money in the US. Some researchers (e.g. Dusuki, 2008; Henry and Wilson, 2006) posited that the introduction of the Patriot Act in the US had indirectly spurred the development of the Islamic financial Institutions (IFIs) globally. The “oil money” investors started to divert their investment into these IFIs. The growth of the IFIs has been phenomenal. For example, in the 2007 Mc Kinsey report on *The World Islamic Banking Competitiveness* – it is stated that Islamic assets are expected to hit USD<sup>1</sup> trillion by 2010, with an average growth rate of 15%-20% per annum. Other IFIs’ products are also showing increasing trends. Table 1 depicts the other relevant statistics on IFIs.

Table 1: Quick Statistics of IFIs

Asset Types	Statistics
Islamic Assets Under Management	USD750 billion and expected to grow to USD1 trillion by 2010 (average rate of growth 15%-20% p.a.)
Islamic Mutual Funds	USD300 billion (average growth rate 23% p.a)
Takaful Contributions	USD7.2 billion (average growth rate 13% p.a)
Global Market Capitalisation of Dow Jones Islamic Index	USD10 trillion
Shari’ah Compliant Global Funds	680 funds
Global Outstanding Sukuk	USD107 billion (average growth rate 22%)
No of IFIs	More than 600 IFIs in the World

*Source: McKinsey The World Islamic Banking Competitiveness Report 2008*

This paper is divided into four main sections. Following this introductory note, Section Two describes the development of IFIs in Malaysia. Section Three reviews previous studies and write-ups on this topic and attempts to understand public’s perceptions in linking terrorist financing with IFIs. Section Four briefly elaborates on AMLATFA 2001 and explains how this Act is expected to influence the operations of the banking industry and in particular the IFIs in Malaysia. Although AMLATFA covers the legislations of

both money laundering and terrorist financing, this paper gives more focus on the latter (aspect of terrorist financing). Section Five proposes a collaborative research to enhance public understanding and to counter negative perceptions towards IFIs.

## **Development of Islamic Financial Institutions in Malaysia**

The development of IFIs in Malaysia was dated way back in 1983. Malaysia was then one of four countries<sup>1</sup> that initiated the establishment of Islamic banks. Supported by a well-developed financial system, what is unique about Malaysia is the fact that conventional and Islamic financial institutions exist side by side, interacting with one another. One of the government's earlier aspirations when setting up the IFIs was to play a leading role in serving the Muslim *Ummah* and to enhance the socio-economic development of the country.

Malaysia is at the forefront of Islamic finance and has the world's most vibrant and comprehensive Islamic financial system. As any other commercial financial institutions, the operations of IFIs are being supervised and regulated by the Central Bank of Malaysia (a.k.a. Bank Negara Malaysia)<sup>2</sup>. Today, there is a significant number of full-fledged Islamic banks in this country<sup>3</sup>. This includes several foreign owned IFIs<sup>4</sup>; and conventional institutions that have established Islamic subsidiaries. Today, Malaysia continues to progress and to build on the industry by inviting foreign financial institutions to establish international Islamic banking business and to conduct foreign currency business (Bank Negara website at <http://www.bnm.gov.my>). Presently, Malaysia's Islamic banking assets have reached USD65.6 billion with an average growth rate of 18-20% annually<sup>5</sup>. The report further noted that the Islamic banking assets at the end of the second quarter of this year, constitute close to 19 percent of the total banking assets. Total financing currently amounts to 118 billion ringgit which accounts for 20.1 percent of the total financing portfolio of the banking industry.

## **Perceptions on Muslims and Islamic Financial Institutions**

Public negative perceptions towards the religion of Islam and Muslims are not a myth. In fact, a 2006's post 9/11 poll conducted by the ABC News and the Washington Post presents clear documentary evidence which revealed that 46% of Americans expressed an unfavorable opinion of Islam. Describing the same survey, Ali, S. N & Syed A.R (2010) further noted the findings of the poll stated that six out of ten Americans believed that Islam was "prone to violent extremism"; and another 25% of those surveyed also admitted to "prejudicial feelings" against Muslims and Arabs. The negative perceptions had indeed double that of a similar survey conducted in 2002.

In their paper titled "Public Support for Civil Liberties Pre- and Post-9/11", Sullivan and Hendriks (2009) noted that whilst the American public was very intolerant of communists, socialists, and atheists in the 1950s and 1960s, the current intolerance is focused more on Muslim Americans and right-wing racists. The finding is very similar to a 2004 study by

Cornell University. It was found that the September 11 attack had created public fears towards terrorism and almost half of those polled proposed that the US government should curtail civil liberties for Muslim Americans.

The negative perception towards Muslims is not just confined to the US. A Pew Global Attitudes Project conducted in 13 countries including the US, Britain, Spain, France and Germany revealed that most respondents felt that Muslims are “violent and fanatical”<sup>6</sup>. Figure 1 summarises their opinions. In general, the respondents considered relations between Muslims and Westerners as “generally bad” after the September 11 terrorism.

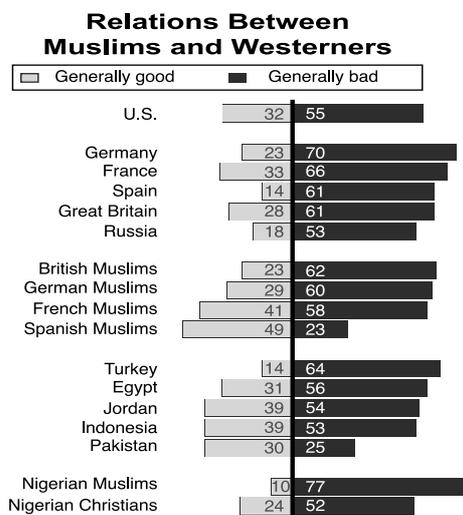


Figure 1: How Westerners and Muslims View Each Other  
(Source: Pew Global Attitude Project 2006)

Some studies (e.g. Weber, 2008 Levitt, 2003) had also viewed organisations such as non-profit organisations, philanthropy group and financial institutions as possible avenue of terrorist financing. In a later study, Schneider (2010) noted how the Al-Qaeda group had used the Al-Shamal Islamic Bank in Khartoum Sudan to transfer funds to various companies owned by Osama Bin Laden. Another renowned bank such as the Citibank was also implicated by the terrorist in their terrorist financing scheme. On a similar notation, Basile (2004) documented how the Al-Qaeda group successfully made small financial transfers using under-regulated Islamic banking networks throughout the world to move funds from one country to another. Similarly, Weiss (2005) found that terrorists seek increasingly more informal methods of earning and moving money. The financial support of terrorism involves both earning funds, through legal and illegal means, and the illicit movement of money to terrorist groups

A 2008 research conducted by the Financial Action Task Force (FATF) highlighted a trend by terrorism financiers of using the complex commercial arrangement of financial institutions to avoid money trail. Some other writings implicating Islamic financial

institutions with terrorist financing are perceptual in nature (e.g. Pieth, 2006; Drakos, K, 2004; Chen & Siems, 2004; Zagaris, 2004; Schneider, 2010). At the lower end, perception represents a simple process of interpreting and organising one's thought of the meaning of a concept. However, if left uncontrolled, perception may ultimately lead to unconscious prejudice and biases.

Ali, S.N & Syed A.R (2010) in his recent research article entitled "Post 9/11 Perceptions of Islamic Finance" focused on three sources of data: review of mainstream media in the US, survey of Islamic finance industry professionals and an examination of Islamic finance media professionals globally. The review of US mainstream media revealed very few articles linking Islamic finance with terrorism and only 12% of the media maintained a negative tone. Most Islamic financial professionals considered the 9/11 event as a "blessing in disguise" as it marked the resurgence of Islamic finance which brought closer scrutiny of the industry. The Global Islamic finance media professionals perceived a negative impact and most were not happy with the way the industry handled media attention. Efforts to counter negative global media perception should therefore be heightened. One of the best ways to negate negative perceptions is to educate the public and to increase their awareness of the actual situation by giving facts and figures of actual practices<sup>7</sup>.

## **Laws to Counter Terrorism Financing**

Based on the backdrop of the various perceptions listed in the previous section, the current section reviews the Malaysian legislations pertaining to terrorist financing and hopes to establish if the public perceptions could be countered by giving actual facts on what is being practiced by IFIs to mitigate terrorist financing. The passing of the USA Patriot Act 2001 had quickly made its footing globally and today, many governments of other countries have established or are establishing similar laws. In Malaysia, the legislation governing terrorist financing is covered under the Anti-Money Laundering and Anti-Terrorist Financing Act (AMLATFA, 2001). The Act specifies terrorist financing as "the act of providing financial support, either through a legitimate or illegitimate source, to terrorists or terrorist organisations to enable them to carry out terrorist acts". Although it is expected that most of these funds originate from some forms of criminal activities, some of the monies may have been derived from legitimate sources (e.g. funds raised by non-profit organisations and public donations).

As a market leader in Islamic finance, Malaysia views negative public perceptions very seriously. In ensuring effective implementation of AMLATFA, the National Co-ordination Committee (NCC) to Counter Money Laundering and Terrorism Financing was established by the government. The NCC is in turn entrusted to ensure that all national efforts are aligned with other regional and international practices. Currently, the NCC membership comprises fifteen (the numbers may have increased) Federal Ministries and Government agencies: (i) Anti-Corruption Agency; (ii) Attorney-General's Chambers; (iii) Central Bank; (iv) Companies Commission of Malaysia; (v) Immigration Department of Malaysia; (vi) Inland Revenue Board; (vii) Labuan Offshore Financial Services Authority; (viii) Ministry

of Finance; (ix) Ministry of Foreign Affairs; (x) Ministry of Internal Security; (xi) Ministry of Domestic Trade and Consumer Affairs; (xii) Registrar of Societies; (xiii) Royal Malaysian Customs; (xiv) Royal Malaysia Police and (xv) Securities Commission. The Central Bank of Malaysia, through the Financial Intelligence Unit (FIU) is responsible for supervising and regulating the Anti-Money Laundering and Counter Financing of Terrorism (AML/CFT) compliance of all the financial institutions in this country<sup>8</sup>.

Four specific sections of the Malaysian Penal Code (hence, implicating criminal offence) are dedicated to terrorism financing offences. They are Section 130N – Providing or collecting property for terrorist acts; Section 130O – Providing services for terrorist purposes; Section 130P – Arranging for retention or control of terrorist property and Section 130Q – Dealing with terrorist property<sup>9</sup>. AMLATFA 2001 is indeed a very powerful legislation. The Act covers “any serious offence, foreign serious offence or unlawful activity whether committed before or after the commencement date”. In addition to its retrospective application, AMLATFA also supersedes several other legislations in this country. Upon conviction, the AMLATFA offenders have to pay a hefty fine plus imprisonment.

How does the law affect the IFIs? In Malaysia, the AML/CFT programme is implemented on an incremental basis. The first group of Reporting Institutions (RIs) is the banks (including Islamic banks) which form the largest component of the financial system. The next group of RIs still fall within the definition of financial institutions such as the insurance and Takaful industries, offshore entities, capital market intermediaries, development financial institutions and money changers. A 2004 Amendment to AMLATFA had redefined Reporting Institutions to also include the Designated Non-Financial Businesses and Professions (DNFBPs) sector. In Malaysia, DNFBPs comprise accountants, lawyers, real estate agents, company secretaries and casinos. Effective 2007, dealers of precious metals and precious stones had been added. Hence, if the RIs are suspicious of their clients' transactions (for possible money laundering or terrorist financing), they must immediately report their suspicion to the FIU at the Central Bank of Malaysia by giving details such as the person conducting the transaction; information of the account holder or his/her beneficiary; details of the transaction; and description of the suspicious transactions<sup>10</sup>.

As indicated earlier on, the FIU was established in 2001 within the Central Bank of Malaysia to support an effective implementation of AMLATFA. Basically, FIU represents the central agency which receives Suspicious Transaction Reports (STR) from various reporting agencies. FIU then reports and disseminate financial intelligence to the appropriate law enforcement agencies for investigation into suspected criminal activities.

In a nutshell, it could be seen that the legislations to counter terrorist financing in Malaysia are fairly comprehensive. Financial institutions are also expected to create a position of an Anti Money Laundering (AML) officer within their banking organisations. The AML officer is responsible to monitor the AMLATFA compliance by the banks. For an Islamic financial institution in particular, there's another layer of management governance, the Shari'ah Advisory Council (SAC) that must be established. This is the result of the passing of the Central Bank of Malaysia Act 2009 which has allowed the central bank to

establish a National Shari'ah Council, "the high sole authority to be referred by the civil courts in dealing with Islamic banking and finance cases in Malaysia.

## **Moving Forward**

It could be concluded that perceptions linking Islamic financial institutions with terrorist financing do exist. However their presence has not deterred the development of the Islamic finance industry. In fact it was evidenced that the industry has grown much stronger and the prospect of IFIs to flourish further is very encouraging (Nazim Ali, 2010). Existing legislations governing financial institutions in Malaysia, especially those related to terrorist financing are in place and are in support of the country's and other global initiatives. The banking industry is one of the most stringent and protected industries in Malaysia. In addition to AMLATFA, IFIs are also governed by the Banking and Financial Institutions Act (BAFIA 1989) and the Islamic Banking Act 1983 (Amended 2009).

To counter these negative perceptions, deliberate efforts must be shown and taken to educate the public. It is important, for example, that the Central Bank of Malaysia, Conventional banks, Islamic financial institutions, Financial Intelligence Unit, Royal Malaysia Police, Securities Commissions and others conduct collaborative research to explain the mechanisms used by these institutions to detect, investigate and prevent terrorist financing within the IFIs' financial system. Based on recent interviews with various agencies including the Financial Intelligence Unit (FIU) of the Central Bank of Malaysia, the Royal Malaysia Police and a few Islamic financial institutions, the author was informed of ways (some are electronically done through computerised system) used by banks to detect suspicious transactions which might implicate terrorist financing.

## **Notes**

- <sup>1</sup> The other three countries were Iran, Pakistan and Sudan
- <sup>2</sup> Banking and Financial Institutions Act 1989 (BAFIA), Islamic Banking Act 1983
- <sup>3</sup> See Appendix 1 for details
- <sup>4</sup> See Appendix 2 for details
- <sup>5</sup> McKinsey *The World Islamic Banking Competitiveness Report 2008*
- <sup>6</sup> PEW Global Attitude Project 2006
- <sup>7</sup> Example of such practice is the Anti-Money Laundering and Counter Financing of terrorism (AML/CFT) Regime set up by The Central Bank of Malaysia
- <sup>8</sup> AMLATFA 2001 – Part III Financial Intelligence, Section 7 Functions of the competent authority. (1) The Minister of Finance may, by order published in the *Gazette*, appoint a person to be the competent authority and such person shall have all the functions conferred on the competent authority by this Act. (2) The competent authority may authorise any of its officers or any other person to perform any or all its functions or render such assistance in the performance of its functions under this Act as it may specify.

<sup>9</sup> Anti-Money Laundering Act 2003

<sup>10</sup> Anti-Money Laundering and Counter Financing of Terrorism by Financial Intelligence Unit, the Central Bank of Malaysia

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<http://www.bnm.my/microsites/financial>

## **Appendixes**

### **Appendix 1**

List of Malaysia's Islamic Banks

- Affin Islamic Bank Berhad
- Alliance Islamic Bank Berhad
- AmIslamic Bank Berhad
- Bank Islam Malaysia Berhad
- Bank Muamalat Malaysia Berhad
- CIMB Islamic Bank Berhad
- EONCAP Islamic Bank Berhad
- Hong Leong Islamic Bank Berhad
- Maybank Islamic Berhad
- Public Islamic Bank Berhad
- RHB Islamic Bank Berhad
- Bank Kerjasama Rakyat Malaysia

### **Appendix 2**

List of Foreign Own Islamic Bank in Malaysia

- Al Rajhi Banking & Investment Corporation (Malaysia) Berhad
- Asian Finance Bank Berhad
- HSBC Amanah Malaysia Berhad
- Kuwait Finance House (Malaysia) Berhad
- OCBC Al-Amin Bank Berhad
- Standard Chartered Saadiq Berhad