HARMONIZING SHARI’AH RULINGS IN ISLAMIC FINANCE:
STRATEGIES AND CHALLENGES

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ABSTRACT

The main objective of this paper is to discuss the ways and challenges in harmonizing shari’ah rulings in Islamic finance industry. The issue of harmonization is pertinent to be resolved because of disagreements over certain shari’ah issues to certain extent has hindered industry’s robust growth in the global market. This paper critically reviews previous efforts and proposes a new harmonization framework at national and international levels. Apart from that, it also identifies the main challenges in harmonizing shari’ah rulings. The challenges identified are the absence of inclusive participation in issuing shari’ah standards, lack of regulatory support, discrepancy level of industry development between countries, differences of shari’ah governance framework and difficulty to win over all shari’ah scholars collectively. This paper will be valuable addition to the existing literature in the effort towards enhancing the governance of shari’ah matters in Islamic finance industry.

Keywords: Islamic Finance, Shari’ah governance, harmonization

INTRODUCTION

Compliance to the shari’ah (Islamic law) principles is the fundamental element of Islamic financial products. Products offered in Islamic financial institutions (IFIs) must be free from riba (interest), gharar (uncertainties) and maysir (gambling). This basic premise of Islamic finance paves the way for shari’ah scholars to play integral role in the industry. They are appointed as shari’ah committees in IFIs to ensure that the operations of IFIs are conducted in accordance with Islamic principles. Nazri Chik makes an interesting survey with regards to the current state of shari’ah advisory practices in the Sunni-dominant Muslim countries. He categorizes the leading shari’ah scholars into four main groups; (1) Saudis and Sudanese based-scholars such as Sheikh Abdullah Ibn Sulaiman al-Manea and Sheikh Abdel Rahman Ibn Saleh al-Atrim (2) the Gulf Co-operation Council (GCC) based-scholars such as Dr. Abdul Sattar Abu Ghuddah, Dr. Mohamed A. el-Gari and Nizam Yaquby (3) Darul Ulum, Pakistani based-scholars who are led by Taqi Uthmani and (4) Malaysian based-scholars such as Dr. Daud Bakar, Dr. Akram Laldin and Dr. Aznan Hasan (Nazri Chik, Personal communication, 19 March 2013). They are said to have adopted slightly different approaches and orientations in supervising the shari’ah aspect of their respective IFIs. Because of a few controversial rulings (i.e. bay’ al-inah), the Malaysian shari’ah scholars are perceived to be more ‘innovative’ and flexible as compared to the rest of the group (Shaharuddin et. al, 2012).
The different approaches in shari’ah interpretation have led to the divergence of shari’ah rulings in the industry. The scholars are often in disagreement when modifying the classical fiqh doctrines to meet the financial needs of current Muslims (Hasan, 2003). As a result, a contract can be recognized in one country but rejected in another. Although the juristic disagreement is acceptable from the fiqh perspective, its practice in the industry is thought to bring more disadvantages than benefits. It is felt that the lack of consistency in shari’ah rulings has created uncertainty and confusion among the industry players. For instance, due to unresolved fiqh issues of bay’ al-dayn (sale of debt), issuers and investors become confused about the legality of sukuk trading in the secondary market. If this fiqh disagreement remains, not only a cross-border instrument cannot be created, but the industry may also lose its stakeholders’ confidence and acceptance in the future.

In contrast, unvarying shari’ah rulings will arguably stimulate the growth of the industry. It will consolidate the interpretations of shari’ah and this will enable the industry to expedite its product development and reduce the risk of non-compliance. Industry practitioners have long advocated that the absence of globally accepted shari’ah standard is an intervening factor that impedes the strategic plan in positioning Islamic finance into the mainstream economy (Abbas Zaidi, 2008). Therefore, given the era of globalization in which Islamic financial institutions are operating, the idea of harmonizing shari’ah rulings has come to constitute an issue of concern mainly among the industry practitioners.

Since shari’ah interpretation is viewed as the underlying reason for the disagreement, harmonization refers to a process of determining certain rules and standard of interpretation which is to be used by the shari’ah experts (SC-OCIS, 2010). In other words, the harmonization from this point of view is more of refining the interpretation of the methodology used by the shari’ah scholars in solving modern financial problems. It is argued that by having an agreed method of interpretation, the consistency of shari’ah rulings can be achieved. This opinion is based on the assumption that there is causal effect between the inconsistency of rulings and undefined methodology (Masud, 2009). This paper critically reviews previous efforts and proposes a new harmonization framework at national and international levels. Besides, it also discusses some challenges which might be encountered by relevant authorities in pursuing the harmonization agenda.

**How Can Harmonization be Accomplished?**

Efforts to harmonize the shari’ah rulings in the industry have been carried out at different levels by various organizations. In the United Arab Emirates (UAE), the task is conducted by a committee called lajnah al-tansiq (Coordinating Committee). Created on the basis of the industrial aspiration towards the harmonization of shari’ah rulings, the committee serves as a platform to bring together, or harmonize, different rulings issued by shari’ah boards in the country.
Organizations such as Accounting, Auditing for Islamic Financial Institutions (AAOIFI) in Bahrain also perform a similar function but at the international level. As the second Islamic economic institution established after the Islamic Development Bank (IDB), the AAOIFI is currently supported by 200 institutional members including the central banks, regulatory authorities, financial institutions, accounting and auditing firms from over 40 countries. Besides the shari’ah standards, the AAOIFI also prepares accounting, auditing, ethics and governance standards. As of 2012, 48 shari’ah standards have been produced by the AAOIFI as guidance on shari’ah permissibility in various economics and finance transactions. These include shari’ah rulings on trading in currencies, commercial papers, investment of sukuk, capital and investment protection.

However, similar to other international standard-setting bodies i.e. Basel Committee on Banking Supervision (BCBS), the AAOIFI does not have the statutory mandate. As an independent international organization, the AAOIFI does not have the authority to enforce its members to adopt its shari’ah standards. Thus, the adaptation to the shari’ah standards is made voluntarily and the AAOIFI will support the process by providing technical and knowledge support. To date, the AAOIFI shari’ah standards have been fully adopted in four countries namely Bahrain, Pakistan, Sudan and Syria. The regulators of these countries have agreed to make the standards as part of the mandatory requirement for their respective IFIs. Another major IFI which adopts the shari’ah standards holistically is the Islamic Development Bank Group itself (Nizam, 2012). However, the standards remain merely as source of reference in most jurisdictions elsewhere. The shari’ah boards in Malaysia, Indonesia Brunei, UAE, Jordan, Kuwait, Lebanon, Saudi Arabia and Qatar will refer to the AAOFI shari’ah standards but will not necessarily follow them. Generally, they will choose to implement the shari’ah standards only when the standards suit their national interest.

The different rates of implementation of the standards also constitute an issue faced by another standard-setting institution namely the Islamic Financial Services Board (IFSB). Established in 2003, the primary objective of the IFSB is to promote more uniform practices of good governance among IFIs. Unlike the AAOIFI, the IFSB focuses on the supervisory and regulatory issues where it aims to ensure IFIs to incorporate the best international practices and standards that are in line with Islamic principles. In a recent survey, the IFSB finds out that only 10.4 percent of their 11 standards were implemented. The result is based on a survey of 31 regulatory and supervisory authorities from 24 countries. In the survey, guidance to implement the standards and to have greater engagement with the IFIs have been identified as the key factors to increase the rate of adaptation (IFSB, 2013). Thus, both AAOIFI and IFSB face a similar challenge on how to transform the agreed practices into applicable standards. The success of both AAOIFI and IFSB is not only measured by creating prudential standards for Islamic banking, capital market and takaful.
operators but more importantly to ensure full, consistent and timely implementation.

To enhance and coordinate the initiative to develop a globally accepted financial product, the International Islamic Liquidity Management Corporation (IILM) was established in 2010. Indeed, the establishment of the IILM marks a response to the need for a cross-border instrument particularly in overcoming the liquidity problem faced by the industry. However, as revealed by its managing director Dr. Rifaat Karim, the absence of a uniform shari’ah interpretation has become a major hindrance in developing the desired instrument. Despite having its own shari’ah board, the IILM has to seek for endorsement from each jurisdiction before the instrument can be accepted (Karim, 2013). The problem demonstrates the extra cost of ensuring and seeking advice on shari’ah compliance. Subsequently, it further prompts more serious questions; why do the decisions of shari’ah boards of the international institutions such as the AAOIFI and IILM cannot be relied on? Why are there shari’ah boards which choose to deviate from the rulings?

Perhaps, examining the process of which the international shari’ah standards or rulings are made could shed light on how to accomplish the harmonization goal. This is because the success in reaching an agreement on the standard implementation through joint and voluntary measures depends on two factors; (1) inclusive participation in the standard-setting process and (2) gaining political support at the highest level. For any standards to be accepted, members or potential users should be involved in the standard preparation process including forming the working group and research team, reviewing the exposure draft as well as bringing the draft to the attention of their respective constituents. The fair balance of representatives from various jurisdictions will ensure that their specific circumstances are taken care of. The representatives will have equal chance to voice out their concerns and regulatory constraints. This inclusive participation can only work if the standard-setting body is supported by a close network. The standard-setting institution would serve as a platform for cooperation and the sharing of experience between the shari’ah boards around the globe (Siddiqi, 2004).

Does Islamic finance have any specific institution to handle shari’ah issues? Do we need to set up another international institution for the harmonization purpose? Or could we maximize the potential of existing institutions such as the AAOIFI and the International Islamic Fiqh Academy? The International Islamic Fiqh Academy or widely known as Majma’ Fiqh Islami based on Jeddah was established in 1981 as a platform to discuss contemporary issues faced by the Muslim ummah. Under the auspices of 57 Organizations for Islamic Conference (OIC) members, the organisation comprises of 43 scholars who come from various backgrounds i.e. fiqh, theology, Qur’an and hadith and who represent different countries. Since its inception, the Majma’ Fiqh Islami has organised more than 20 series of round-table discussions and many other conferences on diverse contemporary issues including
on economics, health, medicine, faith, politic and law. From the meetings, the scholars have issued multiple resolutions to demonstrate their views which serve as guidelines for Muslims. Although economics and finance have increasingly become regular topics of discussion in their meeting, the scope of Majma’ Fiqh Islami remains diverse. Many of their members are not specialized in fiqh muamalat (Islamic commercial transaction) and thus are less qualified to issue ijtihad in Islamic finance matters.

Therefore, the AAOIFI is thought to have better capacity to lead the harmonization pursuit. However, as mentioned earlier, the close network and continuing support from all shari’ah boards are essential. The latter requires a sound shari’ah governance framework to be developed in each jurisdiction. The centralized model of shari’ah governance framework which consists of an over-arching shari’ah board at the national level followed by the shari’ah committees at the individual IFI level is appropriate to be adopted in many parts of the world where Islamic finance is actively employed. To date, the shari’ah governance framework has successfully been implemented in Pakistan, Sudan and Malaysia. It could facilitate the harmonization of shari’ah rulings at the national level.

For instance, in Malaysia, the National Shari’ah Advisory Council (NSAC) of both Central Bank and Securities Commission acts as the highest authority in the process. The individual shari’ah boards of IFIs in the country are encouraged to make their own ijtihad to augment the innovation in the industry. However, if the ijtihad raises differences in the applications, the NSAC will harmonize them. A case in point is the issue of rebate or ibra’. Since ibra’ is considered as a benevolent contract from shari’ah point of view, its application in facilitating early financing settlement is solely upon IFIs’ discretion. In Islamic banking practices, customers who wish to repay their debt earlier than the stipulated period will be likely to pay in full amount.

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Upon default, customers will also have to pay in full because IFIs will claim based on the total financing given. In both cases, the ibra’ will not be granted automatically. The practice however contradicts that of the conventional banks. As loan becomes the basis of conventional mortgage, the rebate will obligatorily be given by banks to customers upon early settlement and default. Customers who compare the practices will tend to label the Islamic banks as inconsiderate.

Furthermore, prior to 2012, the practice of ibra’ in the local Islamic banks was not unified. There were shari’ah boards which are compelled to execute ibra’ and others tend to leave the matter to the discretion of banks’ management. Therefore, to improve the matter, the Central Bank of Malaysia (BNM) has issued guidelines on ibra’. The Guidelines have obliged Islamic banks to grant ibra’
to customers who make early settlement and in the case of default. Although the Guidelines may be seen as a deviation from the original ruling on *ibra‘*, its enforcement on the Islamic banking institutions is considered valid by the National Shari‘ah Advisory Council (NSAC) of the Central Bank of Malaysia. The NSAC agrees to impose on Islamic banks the incorporation of a clause on the undertaking to provide *ibra‘* to customers on the basis of *maslahah* (public interest). According to the NSAC, the inclusion of the mandatory *ibra‘* clause will not only safeguard the interest of customers but also ensure the competitiveness of the Islamic banking industry as a whole (BNM, 2012).

The discussion on *ibra‘* here highlights two important points. First, it demonstrates how harmonization of shari‘ah rulings can be implemented at the national level by having a unified model of shari‘ah governance framework. Secondly, the Guideline on *ibra‘* addresses the issue of mutual respect among shari‘ah scholars in the industry. This is particularly true when we look into the response of shari‘ah advisors of foreign Islamic banks i.e. Kuwait Finance House and al-Rajhi Bank which operate in Malaysia. What is their response to the Guideline? It is known that the Gulf and Saudi based-shari‘ah scholars refuse to recognize the *ibra‘* as an obligatory contract.

They agree with the AAOIFI standard which dictates that the contract is to maintain its benevolence concept. For them, the change from benevolence to obligatory concept is against the established rules found in the classical *fiqh*.

Nevertheless, with regards to the BNM’s resolution on *ibra‘*, both shari‘ah boards of Kuwait Finance House and al-Rajhi bank in Malaysia respect the decision (Mohd Arif Arshad, Personal communication, 27 March 2013). They abide by the resolution on the basis that it is issued by the authority (*’ulul amri*) for the sake of the Islamic banking industry as a whole (Suhaimi Yahya, Personal communication, 21 March 2013).

It is obvious that the regulatory body plays a crucial role in the harmonization process. At the international level, the need for such strong backing from the highest regulatory authority is much more evident. Perhaps, the experience of the conventional standard setting institution can be learnt in this respect. For instance, Basel’s strength lies in its capacity as a rule-making body. Although the adaptation to the Basel rules is voluntary, the Basel Committee on Banking Supervision (BCBS) itself is supported by the G-20, a group of finance ministers and central bank governors of 20 major economies (IFSB, 2013). Having such commitment from the highest-level regulatory bodies, the standards issued by the BCBS are implemented widely across the participating countries. The same criteria contribute to the success of the International Organization of Securities Commissions (IOSCO) in promoting high standards of regulation in securities and future markets among its members from over 100 different countries.

Thus far, we have suggested the harmonization of shari‘ah rulings to commence at the national level first. This requires each country to establish
a sound shari’ah governance framework. Depending on the needs and suitability, a country may adopt either centralized or decentralized shari’ah governance models. The harmonization in the centralized model is accomplished when the national shari’ah board resolves the different rulings issued by shari’ah committees at the IFI level. For countries which adopt a decentralized model such as in Kuwait, Qatar, UAE and Bahrain, there is a need to set up a coordinating committee to perform similar function of the national shari’ah board. After the different shari’ah rulings are harmonized at the national level, then the harmonization process can be elevated to the international level. However, based on experiences of several organizations surveyed such as AAOIFI, IFSB and IILM, we find out that the previous efforts in harmonizing the shari’ah rulings at the international level lack (1) inclusive participation and (2) support from the high level regulatory authority.

Diagram 1 summarizes our previous discussion regarding the framework on how to accomplish the harmonization of shari’ah rulings in Islamic finance.

### Challenges of Harmonization

At present, efforts to harmonize shari’ah rulings in the industry are merely done at academic discourse level. A number of seminars, conferences and roundtable discussions have been organized by various parties on harmonization and related issues. Some of them are held annually such as the International Shari’ah Scholars Forum (ISSF), AAOIFI and Dallah al-Barakah shari’ah conferences. However, for the purpose of our discussion, we shall focus on Muzakarah Nusantara organized by the International Shari’ah Research Academy for Islamic Finance (ISRA). The Muzakarah Nusantara serves as a platform for shari’ah scholars from Malaysia, Indonesia, Brunei, Singapore and Thailand to exchange views and discuss fatwas in Islamic finance.

Since its inception in 2007, seven meetings have been held successfully in different participating countries. Every year, the secretariat will choose the most critical issue faced by the industry and invite researchers who are mainly shari’ah advisors from different countries in the region to present related working papers. The selected issues will be debated based on research conducted by the invited speakers. At the end of the meeting, the participant will issue resolutions and document them. The resolutions could be considered as agreed opinions formulated by shari’ah scholars of the South-East Asian region. For instance, in 2010, they decided to
recognize *hiyal* (legal stratagem) as one of the methods in deducing new rulings. According to them, the *hiyal* practised in the industry is acceptable from the *shari’ah* point of view and is regarded as *makharrij* (legal exit) in finding the industry-oriented solution. In order to avoid any misuse of the concept, the scholars have imposed certain parameters and guidelines (Khir et al., 2010). In 2011, participants of the *Muzakarah* agreed to accept the application of *ijarah mausufah fi dhimmah* as an underlying contract in Islamic financial products.

However, the *Muzakarah*’s resolutions are not binding. *Shari’ah* advisors in the region are not obliged to adhere to the decisions in their respective financial institutions. Without the binding mandate, the issues discussed in the *Muzakarah* merely become an academic exercise. There is no doubt about the importance of such *Muzakarah* to broaden the perspective of *shari’ah* advisors on various application issues. They could benefit from different industrial exposures and the sharing of experiences across the region. However, the *Muzakarah* will have little impact in shaping the future of the industry if the resolutions are left to be implemented voluntarily. Thus, it is timely to obtain regulatory support so that the resolutions will be enforceable. The initiative will not only distinguish the *Muzakarah* from any other conferences but more importantly will expedite the process of harmonization.

Nevertheless, the difficulty to implement the resolutions or even to come to a consensus is anticipated. This is due to the fact that the industry between Muslim countries is experiencing different stages of development. For instance, Malaysia and Brunei greatly vary in terms of market size and market development. The former is more advanced in developing its capital and money market instruments. Due to this factor, the discussion among Malaysian *shari’ah* scholars tend to be more complicated as compared to their Bruneians counterparts. Perhaps, there are certain rulings which are not suitable in Brunei but are more applicable in Malaysia. The *Muzakarah’s* participants should keep these differences in view to achieve harmonization.

The harmonization of *shari’ah* rulings requires openness and tolerance. In order to harmonize these rulings, *shari’ah* scholars need to accept others’ opinion although they might have their own justifications to defend or reject certain contracts. They need to acquire compromise and negotiating skills. However, based on previous experiences in conferences, some prominent *shari’ah* scholars appear to be hesitant to engage themselves in open dialogues and discussions. They are very confident with their opinions and unfortunately, become unwilling to listen to contradicting views. Thus, to bring together these *shari’ah* scholars alone is already a big challenge. All *shari’ah* scholars have to get rid of their personal egos and instead, are willing to instill readiness to revise *fatwa* and rulings.

Previous harmonization efforts are less effective due to the fact that they were conducted in disharmony. Various institutions such as AAOIFI, Islamic Research Training Institute (IRTI), ISRA and Dallah al-Barakah carry out their
harmonization initiatives in isolation. It is about time that the efforts are synchronized and future plan strategized systematically. In order to realize the collaboration, the need for strong leadership is evident. What we mean by leadership here is both institutional and individual leaderships. For the institutional leadership, we have identified the AAIOFI to have the capability to lead this important task. By referring to the AAIOFI, we hope that it can champion future initiatives to harmonize shari’ah rulings in the industry. As for the individual leadership, a respectable and knowledgeable shari’ah scholar should lead the task-force committee to accomplish the intended objective.

CONCLUSION

The harmonization of shari’ah rulings has become a regular topic of discussion in the Islamic finance industry. This is because the diverging shari’ah rulings hinders the development of cross-border instruments and thus, impedes the plan to place Islamic finance in the mainstream economy. Despite the increasing popularity of the topic, the term harmonization is not clearly defined by previous researchers. As a result, many are confused with any effort for standardization. Some of the proponents advocate the need to set up a Supreme Shari’ah Board which will adopt the “one-size fit all” approach in issuing shari’ah rulings in the industry. The idea, however, is rejected by most shari’ah advisors. They still believe in the importance of maintaining a diversity of opinions. Hence, harmonization in this chapter is defined as a process of minimizing major differences and invoking mutual respect among shari’ah advisors. Hence, harmonization is meant to seek the best practical solution, create minimum requirement standard and to be conducted within the notion of agree to disagree.

The harmonization of shari’ah rulings is accomplished at two levels; domestic and international. For the domestic level, the national shari’ah council will play the decisive role in solving the disagreement between shari’ah committees. Previous initiatives in harmonizing shari’ah rulings at the international level have been found to lack the inclusive participation and support from the regulatory body. Hence, the two factors should be taken into consideration to improve future strategies. In addition to that, challenges such as differences in the development stages between countries which influence the level of fiqh discussion should be looked into. It is hoped that the harmonization of shari’ah rulings in Islamic finance will succeed to improve the consistency and predictability in the shari’ah interpretation.
REFERENCES


