2012-2013

HARMONIZING SHARIAH RULINGS IN ISLAMIC FINANCE: ISSUES, WAYS AND CHALLENGES

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Scholars in Residence in Islamic Finance

2012-2013

ACTIVITES REPORT

Introduction

This report is prepared for Oxford Centre for Islamic Studies (OCIS) and Malaysian Securities Commission (SC) which jointly collaborate in funding the fellowship of Scholar in Residence in Islamic Finance. I am greatly honoured and grateful to be selected as the first holder of this important initiative. During my presence in OCIS, I had seized the opportunity to participate in various academic activities held by the Centre. In my view, OCIS has succeeded in maintaining a good academic culture by consistently organizing Fellow Seminar and Centre Seminar every week during term time.

Despite diverse range of topics presented, discussions during the Fellow Seminar were always intriguing in terms of broadening the scope of analysis and perspectives. I remembered listening to enlightening presentations from Dr. Degang on China's international politics and Dr.Yusof on social inclusion in Turkey. Besides, presentation from Tan Sri Zarinah Anwar on corporate governance issues was also a thought-provoking one. In addition to that, I also benefited from attending series of talks given by renowned speakers during the Seminar Centre. The talks on economic of Middle Eastern theme were particularly relevant to my research topic. I also enjoy attending speeches during Special Seminar and OCIS graduate colloquium.

Academic environment and culture are not the only thing you can obtain while in OCIS. The Centre regularly organizes Centre Dinner, where you will experience the 'Oxford tradition'. The dinners are memorable not only because of the foods served but due to the settings and the invitees. Through the dinners, fellows have the opportunities to interact further with the invited guests whom normally are world leaders. The former secretary of ASEAN and the former prime minister of Bosnia are just to name a few. Being the SC-OCIS fellow also gives me the opportunity to attend the roundtable discussion in Islamic Finance held in Ditchley. The roundtable is unique because it gathers prominent practitioners, regulators and scholars and discuss the most critical issues faced by the industry. As a student in Islamic finance, the chance to meet and discuss personally with them is amazing.

The library of the Centre also has relatively good resources in Islamic finance. It has a number of recent publications in the area. Besides, scholarly articles in the area of Islamic finance can be reached via various database in the Bodleian library. Hence, the Centre is a good place to do extensive literature review. I am fortunate with the presence of Tan Sri Zarinah Anwar, the former chairman of Securities Commission of Malaysia at the Centre, whom I discussed at length about my research. It would be more helpful, however, if I could know experts from Oxford University who are conducting research in similar topic. The lack of surrounding experts in Islamic finance is the only limitation which I encountered. Therefore, I went to conferences in Exeter and Paris to seek for the relevant experts in the field. And in May 2013, I left the Centre early to conduct interviews in Malaysia and resume my research work at Securities Commission.

Below is the list of my publications and other academic activities while doing this fellowship:

Articles published:

Fatwa on Islamic Capital Market: A Comparative Study between Malaysia and GCC Countries, Research paper, International Shariah Research Academy (ISRA) (2012), Kuala Lumpur.

The Controversy of Bay' al-Inah in Malaysian Islamic Banking, Arab Law Quarterly 26(2012) 499-511, Brill Leiden.

Halal Issues in McDonald Malaysia: A Case Study, chapter in bookIntegrated Cases Study in *Muamalat*, Islamic Science University of Malaysia (2013).

The Improvement of Ar-Rahn (Islamic Pawn Broking) Product in Islamic Banking System, The Journal of Asian Social Science, vol. 9, no. 2, 2013.

MuhamadMuda, Amir Shaharuddin& Abdel Hakem, 2013. Profitability Determinant and the Impact of Global Financial Crisis: A Panel Data Analysis of Malaysian Islamic Bank, *Research Journal of Finance and Accounting*, vil. 4 no. 7, p. 121-130.

MuhamadMuda, Amir Shaharuddin& Abdel Hakem, 2013. Comparative Analysis of Profitability Determinants of Domestic and Foreign Islamic Banks in Malaysia, *International Journal of Economics and Financial Issues*, vol. 3 no. 3, p.559-569.

Amir Shaharuddin, *Is Bay' al-Tawarruq is a Better Alternative?* Unpublished.

Conference papers:

Harmonization Shariah Rulings In Islamic Finance, *Shariah Workshop* organized by Institute of Arab and Islamic Studies, University of Exeter, 17-18 April 2013.

Issues and Challenges in Harmonizing Fatwas in Islamic Finance, *Oxford International Islamic Banking and Finance Conference*, 2 May 2013.

Conference Attended

10th Annual Meeting, Islamic Financial Services Board (IFSB), SasanaKijang, Kuala Lumpur, 14-17 May 2013.

MuzakarahSyariah Nusantara, organized by International Shariah Research Academy, Fairmont Hotel, Singapore, 28-30 May 2013.

Presentations

*HarmonizingShariah Rulings in Islamic Finance: Issues, Ways and Challenges,*Fellow Seminar, Oxford Centre for Islamic Studies 29 November 2012 and 29 April 2013.

*HarmonizingShariah Rulings in Islamic Finance: Issues, Ways and Challenges,*Invited Speaker at Graduate School of Business, National University of Malaysia, 20 June 2013

*HarmonizingShariah Rulings in Islamic Finance: Issues, Ways and Challenges,*Islamic Capital Market Division, Securities Commission of Malaysia, 27 June 2013.

Research grants (Applications and Awards):

The Development of Islamic Wealth Management Framework, Ministry of Higher Education Grant, 2011-2013.

Ijtima'I and Tijari Based Financing Initiatives for Sustainable Healthcare Services, proposal submitted for Niche Research Grant Scheme of Ministry of Education Malaysia.

Conclusion

In conclusion, I really believe that the fellowshipis important in enhancing research in Islamic finance. I do hope that both OCIS and SC will continue to support this initiative.

Harmonizing *Shari'ah* Rulings in Islamic Finance: Issues, Ways and Challenges[1]

Dr. Amir Shaharuddin
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1.0 Introduction

Islamic finance has increasingly evolved to become a global alternative. Over the past 40 years, the industry has experienced tremendous growth. From being originally established to cater the need of retail banking, the industry is now expanding into other sectors such as in *takaful* (Islamic insurance), capital market and wealth management. With an average growth of 15-20 percent per year, Islamic finance is recognized as the fastest growing sector of finance with more than 300 institutions worldwide (Global Finance, 2012). The total assets managed by Islamic financial institutions (IFIs) are estimated to have reached USD1.6 trillion. Given the amount of oil wealth in much of the Muslim world and the persistent demand for *shari'ah*-compliant products, the industry is expected to continue its steady growth in the foreseeable future. One of the successful products created is *sukuk,* literally described as an Islamic investment instrument that mobilizes funds from institutional investors to support major development projects in the Middle East and East Asia. As at the end of 2012, the total global *sukuk* issuance stood at USD267.6 billion. The funds were invested to improve facilities in electricity, water, sanitation, and telecommunications as well as to build inter-urban roads and railway networks across the regions (Malaysian ICM, 2012).

[1] This paper was prepared during my fellowship as a Scholar in Residence in Islamic Finance at Oxford Centre for Islamic Studies (OCIS), jointly funded by Securities Commission (SC) of Malaysia and the OCIS. I am also greatly thankful to UniversitiSains Islam Malaysia (USIM) which grants me study-leave to complete this research.

Islamic finance industry is built upon the consciousness on the prohibition of *riba* in the Qur'an. Based on the model developed by Muslims economists in 1970's, IFIs are established to provide alternatives for Muslims in circumventing *riba* in their daily economic transactions. Hence, compliance to the *shari'ah* (Islamic law) principles becomes the fundamental element in all financial products offered. Interpreted as interest by the majority of contemporary *shari'ah* scholars, *riba* is avoided in the IFIs by promoting profit and loss-sharing principles (PLS). The PLS dictates that risk and reward should be jointly shared by contracting parties in any business pursuits. In order to gain economic reward, capital providers should bear certain amount of risks with entrepreneurs. The linking of the lawfulness of gain to risk-taking is based on two classical legal maxims which are derived from the *hadith* of the Prophet Muhammad (pubh). The legal maxims state that (1) *al-kharaj bi-dhaman* - gain comes with the liability for loss and (2) *al-ghunmu bi al-ghurmi* - gain is the result of risk-taking. Obviously, the PLS promotes a win-win concept and the idea that someone must lose at the expense of someone else's gain is contradictory with the Islamic teachings. On this understanding of risk sharing, capital guarantee and fixed returns as applied in the conventional investment instruments are rejected by the *shari'ah*.

The emphasis on *shari'ah* compliance paves the way for the *shari'ah* scholars to play integral role in the industry. In order to ensure that the operations of the IFIs are conducted in accordance with Islamic principles, *shari'ah* boards which comprise of experts in Islamic commercial transactions are set up. The Shari'ah Governance Framework issued by Bank Negara Malaysia (BNM) in 2011 illustrates the comprehensiveness of the duties of *shari'ah* boards in the country. The *shari'ah*

boards primarily exist to perform an oversight role and collectively make *ijtihad*[2] on all matters related to IFIs' operations. They are responsible in examining the new financial product structures and deciding on the extent to which the products comply with the rules described by the *shari'ah*. Besides, they are expected to monitor IFIs in carrying out the *shari'ah* review, audit, risk management and research. In general, these key roles are also performed by other *shari'ah* boards across the Islamic finance world.

NazriChik (2013) 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 IbnSulaiman al-Manea and Sheikh Abdel Rahman Ibn Saleh al-Atram (2) the Gulf Co-operation Council (GCC) based-scholars such as Dr. Abdul Sattar Abu Ghuddah, Dr. Mohamed A. el-Gari and NizamYaquby (3) DarulUlum, Pakistani based-scholars who are led by TaqiUthmani and (4) Malaysian based-scholars such as Dr. DaudBakar, Dr. AkramLaldin and Dr. AznanHasan. 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 satisfy the financial needs of current

[2] The endeavor of a Muslim scholar to derive a rule of divine law from the Qur'an and hadith to solve a contemporary problem.

Muslims. 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. 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. It should be noted however, that the discussions have mostly been held in conferences and forums with only a few working papers published in academic journals. During a conference in Bahrain, Shamshad Akhtar (2009), the former governor of State Bank of Pakistan has made an interesting note:

> "the diversity provided by different schools of thoughts in Islamic law on same issues at times creates confusion in the minds of the public, but if properly harmonized across the globe, the diversity can become a great strength for the industry".

The present research discusses the issues, ways and challenges in harmonizing the *shari'ah* rulings in Islamic finance. Focusing on the issue of *bay' al-dayn* as a case study, the research discusses how harmonization can be pursued for the betterment of the industry. The discussion begins with the clarification on the meaning of the two terms; harmonization and standardization. As they are always used interchangeably, the research will try to vindicate the concept of harmonization and shed light on what is actually needed by the industry and its stakeholders. Additionally, the research will explain on the suggestions made by leading *shari'ah* scholars and industry practitioners on ways of accomplishing harmonization objectives. The question on whether or not we need to create another international body for this purpose, or if we could leverage the function of the existing institutions will be elaborated. Besides, the research will also touch on the challenges that might be faced in the course of harmonizing the *shari'ah* rulings. The discussion is important for all parties involved to ensure a successful implementation of any relevant strategy.

The present research adapts the qualitative method where the content analysis, comparative and critical methods are employed. First, an extensive literature review has been conducted to examine the current state of knowledge in the subject. This includes the analysis of available reading materials in the topics of Islamic legal dispute (*khilaf*) and *fatwas* on the sale of debt. A special attention is also paid to the literature on the European Union (EU) experience in harmonizing their respective laws. After that, a series of semi-structured interviews are conducted with the *shari'ah* advisors, regulators and industry experts to seek in-depth information with regards to ways and challenges in harmonizing *shari'ah* rulings in Islamic finance.

2.0 What Does Harmonization of *Shari'ah* Rulings Mean?

Although the harmonization of *shari'ah* rulings in Islamic finance has increasingly become a popular topic, the issue of terminology has not received much attention. As indicated earlier, there are two terms which are regularly quoted when discussing the subject; harmonization and standardization. As the two terminologies connote rather distinctive meanings, regulators, industry practitioners and *shari'ah* scholars appear to be in disagreement when elaborating the issue. We shall discuss this ongoing dispute in the following section. However, it should first be noted that many of them do not have clear understanding of the meaning of harmonization itself. As a result, efforts towards harmonization agenda are still far from satisfactory. Hence, the aim of this section is to define the term harmonization and outline its scope and contribution.

The advocators seem to be confused over the term harmonization as opposed to standardization. For most of them, the harmonization of *shari'ah* rulings means to create a sole authority such as the Supreme *Shari'ah* Board in the Islamic finance industry. Ignoring the regional and national differences, the Supreme*Shari'ah* Board will adopt the 'one-size-fits-all' approach in which its resolutions will become applicable to every institution. It will eliminate the need of *shari'ah* board at every single IFI and thus, reducing the problem of lacking a number of *shari'ah* scholars. Since IFIs are not required to maintain their *shari'ah* boards at institutional level and to become the point of reference at all times, the global *shari'ah* body will reduce the time and cost in developing new financial products. The global *shari'ah* body will 'harmonize' the diverse *shari'ah* interpretation into one standard version and this will make the market fairer, more efficient and more transparent (Ghoul, 2008). Given the

diverse *shari'ah* governance models adopted by IFIs worldwide, in which different institutions have different governance models by which they set, measure, and monitor their compliance, such 'standardization' process is contended to be the key towards transition, from niche to mainstream position of Islamic finance (KPMG 2006).

The successful international harmonization of laws in the Western world has proven that the standardization is possible. In the West, efforts to harmonize law across nations can be traced back to the early 19th century (Faria, 2009). The setting up of the International Institute for the Unification of Private Law (UNIDROIT) marked the beginning of these efforts, although they were largely conducted in academic discourse during the initial stage. Similar to Islamic finance, the main driving force behind the harmonization efforts is to enhance legal certainty and predictability. The establishment of supra-national institutions such as the European Union (EU) makes the harmonization process become much more systematic. In order to create a single market, the EU commences the process of harmonizing standards for goods and services throughout its 27 member states. In a full harmonization process, the EU standards will substitute the diverse national rules, and member states are obliged to implement them. This is done by issuing Directives which impose obligations on states. Apart from the finance and banking industry, the full harmonization is carried out on the aspect of the insurance of motor vehicle, cosmetics, fertilizer, transportation and telecommunication. However, there are also areas where minimum harmonization is adopted. The EU sets the minimum standards and member states are free to choose more stringent measures (McMohan, 2009).

Thus, from the EU perspective, harmonization is usually referred to a legislative process whereby various pieces of legislation are either brought together in one document, or are at least coordinated (Faure, 2000). The process eventually leads to the unification of law. Several questions arise, however- should Islamic finance adopt the same model? Is the ultimate aim of harmonization of *shari'ah* rulings able to create a single market like the EU does? If the answer is yes, the harmonization of *shari'ah* rulings would indicate that different legal systems, in which IFIs are present, are to be combined. It appears that the level of harmonization discussed by experts in Islamic finance does not reach a point where the conversion and unification of *shari'ah* rulings are envisioned. At this point in time, perhaps the unification is not needed. Rather, the diversity of legal opinions is still thought necessary by many parties. This is due to the understanding of the reasons as to why differences in *shari'ah* rulings exist. Unlike the EU laws, the diversity of *shari'ah* rulings in Islamic finance stems from the different approaches in interpreting the divine or scripture law. *Shari'ah* scholars who are advising IFIs are seen as interpreters of Allah's speech and Prophet Muhammad's *hadith* to Muslim bankers who do not understand the more intricate aspects of the revelation. The notion of interpretation implies that it will be almost impossible to 'standardize' human thinking and reasoning.

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. However, the argument raises some basic questions. Is it true that the diversity of *shari'ah* rulings is due to the inexistence of a defined methodology? What is the current methodology adopted by the *shari'ah* scholars, then? To what extent is the discussion at the IFIs level conducted before rulings are issued? While the investigation of the issues is beyond the scope of this research, the examination on the Islamic jurisprudence literature, however, reveals a different account.

Despite the fact that Muslim jurists have developed extensive hermeneutic science which is exemplified in Islamic legal theory (*usul a-fiqh*) and Islamic legal maxims (*qawa'idfiqhiyyah*), differences in *fiqh* still exist. In theory, both bodies of knowledge should provide formulae for *shari'ah* scholars in interpreting the divine sources and should be able to assign them into 'harmonized' rulings. However, the predictable result of the *shari'ah* interpretation is seldom accomplished because there is always some kind of tension between an approach to legal interpretation that aims to satisfy the demand of practicality, with an approach that strives to maintain consistency with an overarching prescriptive hermeneutic (Jackson, 2002). Perhaps, this explains why it is so difficult to predict a jurist's response to an unprecedented question, even assuming his perfect mastery of *usul al-fiqh* and *qawa'idfiqhiyyah*. On this argument, the refined interpretation method is believed to bring little benefit in harmonizing the *shari'ah* rulings.

Islamic finance is undoubtedly a dynamic industry where evolutions and changes continue to take place. In this capacity, modern *shari'ah* scholars have to give more practical considerations when deducing new rulings for Islamic finance, as compared to family law matters. A rising number of discussions among contemporary *shari'ah* scholars, recently on *maslahah* (public interest) and *maqasid al-shari'ah* (objective of Islamic law) clearly suggest this phenomenon. Due to the perceived thought that Islamic finance has deviated from its original objectives, discussions regarding the two principles have increasingly received wider attention. Given the emphasis on the practical aspect in deducing new rulings, the disconnection between *fiqh*and*usul al-fiqh* would be more apparent. As practical considerations vary depending on country jurisdictions and market localities, *shari'ah* boards will be likely to issue different rulings despite their mastery on new methods of interpretation.

It goes without saying that the theory of interpretation developed by the classical jurists is insignificant. In *usul al-fiqh*, there is discussion on *al-ta'arrudwa al-tarjih* (conflict in preference). In dealing with diverse rulings, the past jurists had outlined four possible steps that could be taken. The first is to combine the different rulings. The combination is possible, particularly when the jurists could find a meeting point between the different views. There are different rulings which can be combined and applied in a harmonious way. However, sometimes different *fiqh* rules cannot simply be reconcilable. In such a situation, the jurists will resort to *tarjih* –which is to prefer one rule to another. Then, if the *tarjih* is not possible (due to strong justification of each rule), the jurists would choose *naskh* (abrogation). However, the *naskh* can only take place with clear injunction from the Qur'an or hadith of the Prophet (pbuh). Finally, in the event in which neither of the steps mentioned is able to solve the

differences, the jurists would settle for *tawqif* by which no position is taken until further investigation is conducted. The steps are meant to be a helpful guide for *shari'ah* scholars in dealing with juristic disagreement. However, as rightly observed by Kamali, the formulae seem unable to solve the diversity of *shari'ah* rulings in which the Islamic finance industry is facing. In the first place, discussions on harmonization will not be raised should the above theory succeed in reconciling the disagreement among the *shari'ah* boards (SC-OCIS, 2010).

Therefore, in my view the best definition to describe the harmonization in the current context is '*a process of minimizing major differences among shari'ah boards and to promote mutual respect among them*'. Thus, harmonization does not mean seeking a sole authority in issuing *shari'ah* rulings; rather it allows a diversity of legal opinions. Harmonization neither intends to close the 'gate' of *ijtihad* nor to permit total disparity which will result in the lack of authority. The primary aim of harmonization is to minimize major differences as much as possible between the *shari'ah* boards (Laldin, 2013). This could be achieved by promoting cross-border discussions to seek for the best solution for the industry. By invoking mutual respect, the harmonization effort stresses the importance of (1) a reciprocal relationship between all *shari'ah* boards in Muslim countries, (2) to promote the notion of agree to disagree, (3) to resolve disagreement through debate, not open criticism and (4) to inspire the willingness to reverse ruling and accept changes over time.

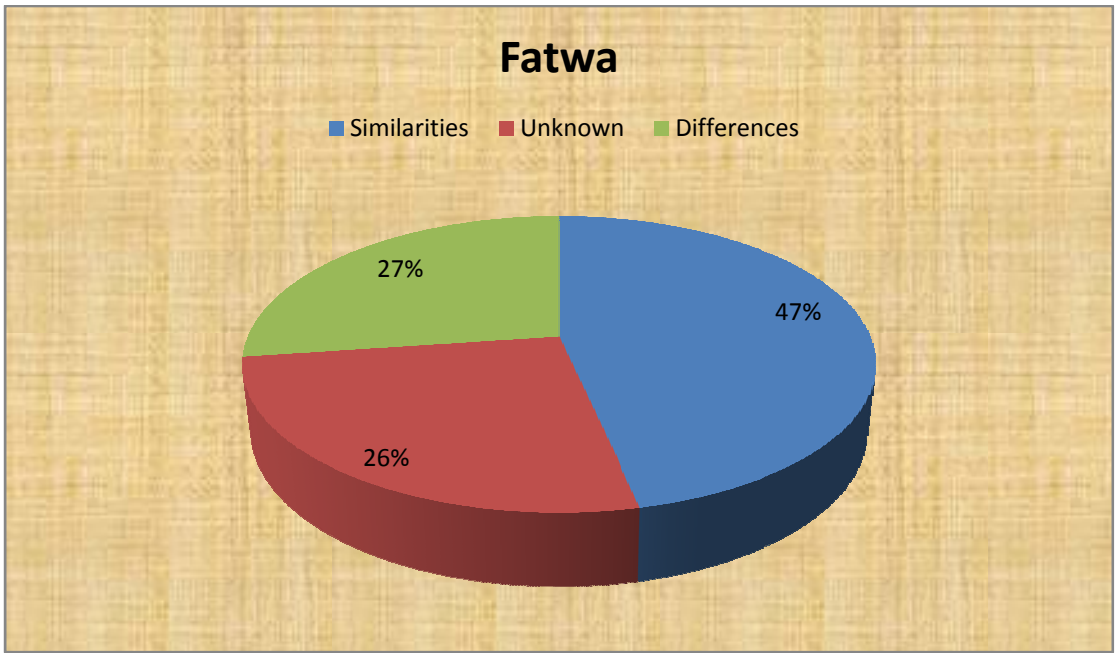
We will now turn our discussion to answer an important question before any harmonization measures are to commence; is there a significant difference between *shari'ah* rulings issued in Islamic finance all over the world? Finding the answer to

the question is vital for one reason. If the differences occur within a few and minor *fiqh* issues only, the harmonization efforts will not be very complicated as one might think. Once the *shari'ah* scholars have reached an agreement on the issues, the Islamic finance industry will then have a harmonized *shari'ah* practice. On the contrary, if the differences involve major *fiqh* disputes, a systematic plan needs to be strategized and implemented. To the best of my knowledge, the answer to the question is not straightforward. Most of the *shari'ah* personnel (who work in the *shari'ah* department) of Malaysian Islamic banks deny the fact that differences among *shari'ah* boards around the globe are significant. It has been claimed that the differences are only particularly noticeable in some controversial contracts, such as *bay' al-inah* and *bay' al-dayn* (Arshad, 2013).

In improving the corporate governance framework of IFIs, Grais and Pellegrino have surveyed 6000 *fatwas* and found that only 10 percent of them are conflicting (Grais& Pellegrino, 2006). However, their finding is debatable as they do not explain specifically the sources and the conflicting *fatwas* surveyed. Laldin*et. al.* (2011) and Shaharuddin*et. al.* (2012) have attempted to add to the literature in this subject, by comparing Malaysian *fatwas* with their GCC counterparts in the Islamic banking area and the Islamic capital market. They come to a significant disparity between the two leading authorities, whereby the differences in Islamic banking and Islamic capital market *fatwas* are prevalent at 31 percent and 25 percent, respectively. Since the present research focuses on the Islamic capital market issue, the work of Shaharuddin*et. al.* (2012) deserves our attention.

The researchers compare and analyze *fatwas* pertaining to 13 contracts which are commonly used as the underlying basis for Islamic capital market operations and instruments. The contracts studied include*musyarakahmutanaqisah* (diminishing partnership), *bay' al-dayn* (sale of debt), *bay' al-inah* (sale and buy back), *bay' al-ma'dum* (sale of non-existent object), *bay' al-wafa'* (redemptive sale), *bay' al-muzayadah* (auction sale), *bay' al-'urbun* (down payment sale), *bay' bimayanqatibihi al-si'r* (sale of undefined price), *da' wata'ajjal* (rebate for early settlement), also *ujrah* (fee) for guarantee. By examining the *fatwas* of 6 leading institutions[3], they have found that there exist major differences between certain *fatwas* issued by the Malaysian and the GCC *shari'ah* scholars. Figure 1 below shows the findings of the study.

Figure 1: Overall Percentage of the Similarities and Differences between Malaysia's and Middle East's *Shari'ah* Resolutions in the Islamic Capital Market.



Source: Shaharuddin*et.al* (2012).

[3] Malaysian Securities Commission National Syariah Council, International Islamic Fiqh Academy, Kuwait Finance House, AAOIFI, Dallah al-Barakah and Dubai Islamic Bank.

As indicated in the study, only 48 percent of the *fatwas* issued are similar across Malaysia and GCC jurisdictions. The differences have been recorded at 25 percent. However, with a large percentage of unknown *fatwas*- or *fatwas* which are not yet discussed or issued- there is possibility that the differences of the percentage will be bigger.

In the following section, we will explore into the modern juristic disagreement on *bay' al-dayn* (sale of debt). The issue of *bay' al-dayn* catches our attention here because the contract is critical, not only to develop a secondary market for *sukuk*but also to create liquidity instruments for the industry at large. As a case study, the discussion aims to highlight the different approaches of interpretation and reasoning adopted by two opposing groups of *shari'ah* scholars. The apprehension of this issue will be beneficial in our plan to develop a harmonization framework and anticipate the challenges which might be faced by relevant parties.

3.0 Juristic Disagreement on *Bay al-Dayn*

One of the yet-to-be-resolved *fiqh* issues in Islamic finance is that of *bay' al-dayn*. *Bay' al-dayn*is defined as the exchange between payable rights upon a person with cash. Its application towards enhancing the efficiency of*sukuk* market has been disputed by modern *shari'ah* scholars. Generally, most *shari'ah* advisors either from the GCC or other parts of the Muslim world allow *sukuk* to be traded in the secondary market. However, they disagree on the issue of permitting *sukuk* trading at discounted prices and at premium. As the underlying contracts of *sukuk* differ, the one in contention is *sukuk* created based on sale-based contract such as *murabahah* and

tawwaruq[4]. Unlike equity-based (i.e*mudarabah*) *sukuk* which represents the undivided ownership of the underlying asset, the sale-based *sukuk* constitutes the right to claim the deferred payments (receivables). The issue arises when *sukuk holders* intend to sell the right to other investors before its maturity. For a better understanding of the issue, let us examine the structure of commodity *murabahahsukuk* of TDM Berhad, as illustrated in diagram 1 below.

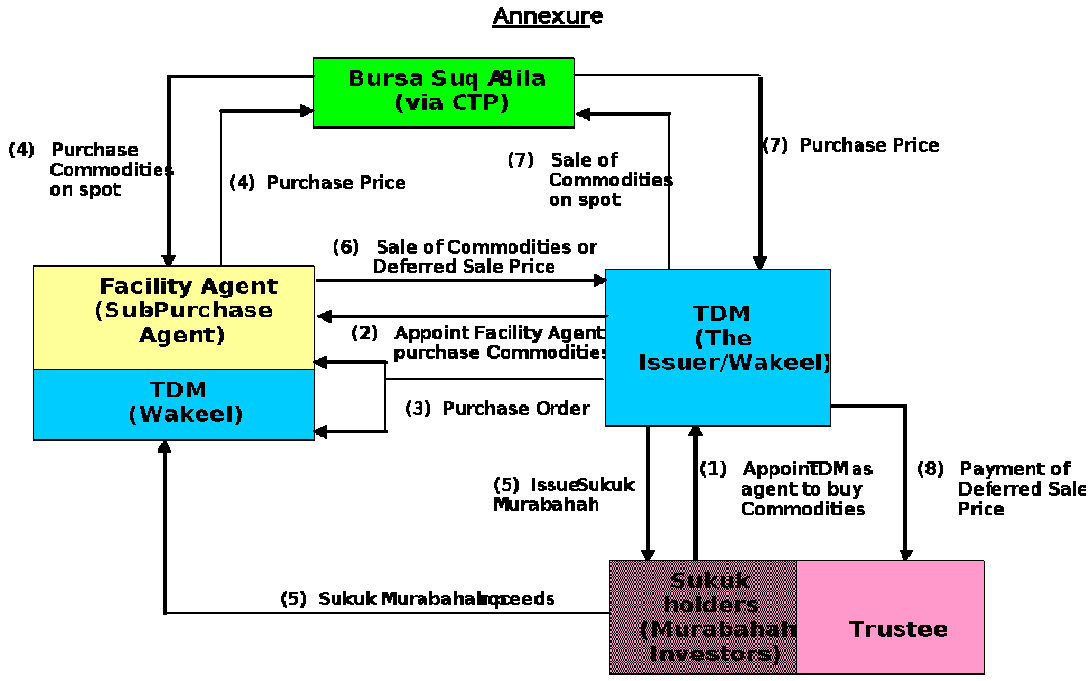


Diagram 1: The Structure of TDM Commodity MurabahahSukuk

When investors invest their money in the *sukuk*, they will automatically appoint an issuer (TDM) as their agent to purchase certain commodities. TDM will then appoint a sub-agent to execute the deal. The sub-agent will purchase the commodities from the vendor in Bursa Suq al-Sila'- a market place created by the Malaysian authority to facilitate the commodity trading. The purchase price is paid on spot and which is equivalent to the principal amount contributed by the *sukuk* holders. Subsequently,

[4]*Sukuk* created on based equity contracts such as *mudarabah* and *musyarakah* are viewed as tradable unanimously by modern jurists as they represent undivided ownership of underlying asset.

TDM as the issuer will purchase the commodities from the *sukuk* holders on deferred payment. The selling price will be paid in installments and will be made of principal plus profit. The TDM shall sell the commodities to Bursa Suq al-Sila' for cash. By entering the sale contract, *sukuk holders* will be entitled to receive the deferred sale price until the *sukuk's* maturity. It is the deferred sale price in which the sale of debt is referred to. When in need of liquidity, can the *sukuk*(which represents receivables derived from sale of commodities) be sold in the secondary market? If yes, can the *sukuk* holders sell them at premium or discount?

The issue of this sale of debt had been discussed by the classical jurists. It is known as a contract whereby a creditor sells his/her payable right upon the debtor himself or to a third party. There are many forms of sale of debt which had been elaborated in the classical *fiqh* texts. It may consist of the sale of outstanding debt to the debtor himself or to a third party; and in both cases the sale may conclude either in the form of cash or deferred payment (IBFIM, n.d). In general, the majority of classical jurists allowed the practice of selling debt to the same debtor with immediate payment and in equivalent amount (IbnQudamah, 1988). According to the classical jurists, the practice does not trigger any *shari'ah* issue. On the contrary, based on the hadith *bay' al-kali bi al-kali*, the jurists were in agreement to prohibit the exchange of debt for debt. The main reasons behind the prohibition were due to *gharar* (uncertainty) and *riba*. The classical jurists were of the opinion that either object or price of a sale contract, but not both counter-values, can be postponed to a future date (IbnRushd, 1996). Since the buyer is neither certain about the delivery of the debt (as object matter) nor the seller is guaranteed to receive payment, *bay' al-kali bi al-kali* is prohibited to prevent hazardous risks and *gharar* (uncertainties) in the transaction.

On the same argument pertaining to *gharar*, the classical jurists were in dispute in deciding on the legality of selling debt to a third party. The Hanafis, Hanbalis and Zahiris are reported to have prohibited the contract (Zuhaily, 2003). According to the Hanafis, debt isconsidered as *mal al-hukmi*(immaterial asset) in which there is no guarantee of its existence until the receipt (*qabd*) is obtained. Therefore, as long as the creditor does not receive the re-payment, he/she has no right to sell the debts to others. They only allowed the sale of debt to the same debtor in view that the delivery in such case was certain. It should be noted however, that IbnAbidin had mentioned an exception to the rule; '*....unless creditor is certain about the receipt i.e. he become the agent in collecting the debt himself*' (IbnAbidin, 1994). The exception of the rule again shows that the main concern rests with the non-delivery of the debt. Al-Kasani had reasoned clearly in his book:

> "Sale of debt to third party and purchase of it (debt) is prohibited, as if a person said to other; I sell debt in which a person (*fulan*) owed me to you with certain amount, or he said; I purchase this thing from you with debt which is owed by a person on me. This is because whatever on the *zimmah* (right) of a person will not necessarily be able to deliver. And the ability to deliver is a condition for a contract to be legally binding...(al-Kasani, 1998).

The Malikis permit the sale of debt to a third party under certain conditions among others; i) immediate payment for the purchase, ii) the debt is confirmed, iii) presence of the debtor during the sale. It is obvious that these conditions are imposed to ensure that the right of the debt purchaser is protected and to avoid any sale of debt before possession (*qabd*) (al-Dasuqi). As for Shafi'is jurists, the majority of them prohibited the contract altogether. Jurists such as al-Rafi'i subscribed to the rule on the view that debts are something that cannot be certain to be delivered. However, there was a group of Shafi'is jurists such as al-Subki who permitted the sale of debt to a third

party (al-Sharbini, 2000). This group refuted the thought that all debts are equal in delivery risk. For them, debt can be classified into *mustaqir* (certain) and *ghairmustaqir* (uncertain). Since the delivery of certain debt can almost be guaranteed, its sale to a third party is deemed permissible. Ibn al Qayyim of the Hanbalis, on the other hand, allowed the sale of debt to a third party with different justification. For him, the sale is simply permitted because there is no clear evidence from the verse of Qur'an, Sunnah, or any documented consensus (*ijma'*) which prohibits it.

Understanding the context of which sale of debt was conducted during the medieval period is vital, to comprehend why the classical jurists were debating about this. In the past, debts were created and sold in unregulated market. There was no regulatory body that monitored the deals 'agreed' between creditors and borrowers. For this reason, there is valid justification for jurists to impose a stringent rule before the debts can be transferred to other parties. Besides, it is noteworthy to mention that the classical debate on the sale of debt either to the debtor or third party did not touch on the pricing issue. The reason being is because the sale of debt had been discussed under the sub-topic of 'objects of sale' which does not meet the criteria of possession and deliverable conditions. Since the focus of discussions is to emphasize on the two conditions, none of the classical jurists explained whether the debts can be sold and purchased at discount or at premium. The most relevant rule to this issues was discussed, related with *da' wata'ajjal*. It refers to an agreement to reduce debt to facilitate early settlement. It could be initiated either by a creditor or a debtor. The jurists disagree in determining its legal ruling. The majority of the classical jurists prohibit the *da' wata'ajjal* because they consider it analogous to *ribaal-nasi'ah.*

According to the jurists, as increase in the borrowed principal for the exchange of delayed repayment in*ribaal-nasi'ah* is unanimously prohibited, so is the discount of debt for early settlement in *da' wata'ajjal*. Furthermore, it was reported in one of the *hadiths* that the Prophet Muhammad (pbuh) had disapproved of such transactions (Sunan al-Kubra, al-Baihaqi).

However, the majority of contemporary jurists view that the *da' wata'ajjal* is permissible. They differentiate between *da' wata'ajjal* which is agreed in advance and the one which is not. According to them, *da' wata'ajjal* is legally permitted if the debtor and the creditor do not stipulate it as a prior condition. If both parties agree that they would make debt deduction for early repayment, the transaction would be rendered forbidden. This view was held by members of the International Fiqh Academy of the OIC that passed a resolution in this matter in its seventh roundtable forum in Jeddah on May 1992.

The Middle East *shari'ah* scholars allow *murabahah* and *tawarruqsukuk* to be traded in the secondary market. Despite the issue of *gharar* in its future delivery, the *sukuk* is permitted to be sold to other investors for liquidity purpose. The main basis for the approval is due to the understanding that *sukuk* trading is conducted in a regulated market. The rights of all contracting parties (i.e. issuers and sukuk holders) are well documented and regulated by the financial authority. This makes the delivery of the *sukuk* almost certain and qualified to be recognized as certain debt (*daynmustaqir*). To add, the*murabahah* and *tawarruqsukuk* are treated as having similar characteristics of currency or money. Since money in Islam has no intrinsic value, they view that the *sukuk* cannot be transacted at premium or discount otherwise the transaction will be

tantamount to *riba*. According to them, the *sukuk*can only be transferred at par value (Obaidullah, 2007).

Meanwhile, the Malaysian *shari'ah* scholars have upheld a different opinion by permitting *murabahah* and *tawarruqsukuk* trading either at a discount or premium to par. Contrary to the Middle East *shari'ah* scholars who treat *sukuk* as money, the Malaysian *shari'ah* scholars recognize *sukuk* as valuable financial papers which have their own legal status (SC, 2009). For Malaysian *shari'ah* scholars, *murabahah* and *tawwaruqsukuk* represent the rights to claim on deferred payments which are documented in *wathiqahdayn*. According to them, such financial rights have their own monetary value but are not comparable to money. This is because the *wathiqahdayn* itself is not accepted as medium of exchange in the common market (Ngadimon, 2013). The interpretation is a departure from the Middle East *shari'ah* scholars' view on the *bay' al-dayn* issue. Since the *murabahah* and *tawwaruqsukuk* are not treated as money, *riba* does not take place, when they are trading at a price which is different from the original price.

The Malaysian version of *shari'ah* interpretation on *bay' al-dayn* has enabled its *sukuk* market to record remarkable growth. It is reported that more than 70 percent of global *sukuk* in the first half of 2012 were issued in the country (SC). The *sukuk* contributes approximately 51 percent of Malaysia's Gross Domestic Product (GDP). The country has an active secondary market which augments the depth and liquidity of the *sukuk* market. In contrast, the development of the *sukuk* market in the GCC records relatively a slower phase. Despite obtaining huge capital, the lack of secondary trading has discouraged a new issuance of *sukuk* especially after the global

economics recession because the investors are concerned about the illiquidity issue (Arabian Business, 2009). Nonetheless, as far as the issue of *bay' al-dayn* is concerned, the scenario has changed recently. In response to the global financial crisis which has affected some of the IFIs in the region, there is a move towards embarking into more discussions about creating liquidity instruments. The GCC *shari'ah* scholars had re-visited their rulings and agreed to allow the trading of hybrid *sukuk* which comprises of predominantly tangible assets and receivables.

As correctly pointed out by Siddiqui, the debate on the sale of debt demonstrates the tension between two approaches adopted by modern *shari'ah* scholars in solving financial issues. Malaysian *shari'ah* scholars can be said to give priority to the efficiency of production and creation of wealth to the *sukuk* market. Meanwhile, the Middle East scholars appear to shed light on fair dealing and justice in the transaction (Siddiqui, 2004). Can the two rulings be harmonized? Or should the differences be maintained for the sake of innovation and industry growth?

4.0 Views on Harmonization of *Shari'ah* Rulings in Islamic Finance

As noted earlier, due to the unclear apprehension of the term harmonization, contemporary *shari'ah* scholars and industry practitioners have adopted two opposing viewpoints with regard to the efforts in harmonizing *shari'ah* rulings in Islamic finance. There are advocators and critics of the agenda. Market leaders and regulators are those who repeatedly express their support towards the harmonization efforts (Jamal, 2008). This group believes that the existence of defined *shari'ah* standards will provide certainty in the *shari'ah* interpretation when solving contemporary *fiqh*

issues in Islamic finance. For regulators, such certainty is crucial in order to formulate prudential regulatory framework, which becomes a pre-condition for the industry's sustainable growth. The absence of prudential regulations will expose the IFIs into systemic instability which eventually leads to industry failure (SC-OCIS 2010). Meanwhile, for the practitioners, harmonized *shari'ah* rulings will bring clarity on the permitted and prohibited transactions across all jurisdictions. This will assist them to create cross-border instruments in tapping into larger international market. Hence, the progressive harmonization of *shari'ah* rulings in this respect is viewed by the market leaders and regulators as the driver towards greater integration of Islamic finance with the mainstream economic system (Zeti, 2007).

Besides, the harmonization of *shari'ah* rulings is important to maintain stakeholders' confidence. This is because the lack of uniformity has led to a perception that the *shari'ah* interpretations in the industry are poorly regulated. The pronouncement of Sheikh TaqiUsmani, the chairman of the *Shari'ah* Board of Accounting Auditing Organization for Islamic Financial Institutions (AAOIFI) in November 2007 is a good example to demonstrate the problem. TaqiUsmani had sent shockwave throughout the industry by declaring that 85 percent of *sukuk* issued in GCC countries are non-*shari'ah* compliant. He was of the opinion that the equity-based *sukuk* of *mudarabah* and *musharakah* mirrors the conventional bonds in the way that they offer fixed and guaranteed returns to investors. '*For current sukuk, risk is not shared and reward is not shared according to the actual venture of proceeds. About 85 percent of sukuk are structured this way*', he told the Reuters (Arabian Business, 2007). The pronouncement had affected the industry where the number of *sukuk* issuance was reduced in 2008. Following the pronouncement, the new issuers are forced to revisit

their *sukuk* structure (KFH, 2010). Although the pronouncement might be seen as a corrective measure undertaken by the AAOIFI, it did raise some serious questions about the *shari'ah*-compliant status of the previous *sukuk* issued and the capability of their *shari'ah* advisory members. Therefore, the harmonization of *shari'ah* rulings among the religious authorities is hoped to be able to prevent such conflicting opinions and legal chaos.

The former secretary general of AAOIFI, NedalAlchaar puts forth his view that the harmonization is important to prevent *shari'ah* arbitrage in the industry (Alchaar, 2010). According to him, the *shari'ah* arbitrage could occur when a particular rule is preferred over another merely because of personal *shari'ah* boards' inclination, not based on valid *shari'ah* justifications. The difference of *shari'ah* governance systems across IFIs worldwide makes the argument possible. In reality, there are IFIs which adhere to appropriate *shari'ah* governance framework where their *shari'ah* boards monitor all aspects of *shari'ah* compliance throughout the financial products' lifecycle. However, there are also IFIs which are not properly supervised. The incident of Goldman Schahs' *sukuk* program worth $2 billion in 2011 is an example of the problem. At least three of the eight scholars quoted in Goldman's provisional prospectus as endorsing the transaction said they had never even seen the document. This, understandably, had flagged up one of the major pitfalls in the current *shari'ah* governance system (Mcbain, 2012). The absence of a unified standard of *shari'ah* governance particularly in terms of the guideline on *shari'ah* interpretation, board appointment, composition, qualification and etc. exposes the IFIs into significant *shari'ah* risks. Hence, it is strongly argued that the existence of *shari'ah* standards

will protect the industry from any misuse and violation of *shari'ah* principles by irresponsible party.

However, the majority of the contemporary *shari'ah* scholars appear to disagree with the idea of standardizing *shari'ah* rulings. They prefer to maintain the diversity of Islamic legal opinions in this respect. The main argument is that the diversity of legal opinion in Islamic finance occurs within the scope of legitimate interpretation of non-definitive matters (Laldin, 2013). For instance, it is argued that the *shari'ah* scholars do not dispute over the prohibition of *riba* but disagree as to what extent a particular financial product resembles *riba*, and vice versa. While Allah has clearly declared the prohibition of *riba* in the Qur'an, He does not prescribe the actual action of how it should be avoided. Thus, the *shari'ah* boards of IFIs interpret the non-self-evident legal texts of the Qur'an and the Sunnah and review their relevance in the context of modern financial transactions. The practice is absolutely permitted from *shari'ah* point of view. As the interpretation often deduces new *shari'ah* rulings, the exercises are classified as collective *ijtihad* (*ijtihadjama'i*). In the course of producing these new rulings, disagreement among the *shari'ah* scholars is inevitable. This is due to the nature of Islamic law itself that recognizes the division of definite (*qat'i*) and speculative (*zanni*) evidence in which the latter necessitates the diversity of scholarly opinions.

Based on the understanding of the *ijtihad* concept, disagreement among the *shari'ah* boards happens within the notion of right versus right situation (Elgari, 2010). The rulings are thought to be equal because they are supported by valid proof and evidence. Regardless of the country origin, there is no *shari'ah* board which is

superior to another. As stipulated in an Islamic legal maxim, '*al-ijtihad la yanqidu bi al-ijtihad* – a rule made by a jurist (*ijtihad*) shall not be nullified by another *ijtihad*. This mutual respect between the *shari'ah* boards forms the basis of harmonization. However, another sets of questions promptly emerge; is this a reality in the Islamic finance industry? What is the level of mutual respect and understanding among the *shari'ah* boards across Muslim countries? Do the *shari'ah* boards of the GCC respect and acknowledge the opposing opinions held by others outside their region, and vice versa? We shall explain the answers when we discuss ways to carry out the harmonization agenda. At this juncture, however, it is important to note that the majority of *shari'ah* scholars opine that the diversity of *shari'ah* rulings in Islamic finance industry should be maintained because at least it has provided some wonderful cases of study in examining *fiqh* advancement in the modern time (Vogel, 2011).

Additionally, being confined in one *shari'ah* opinion is deemed contradictory to the once-prevalent practice of past Muslim scholars (Taha, 2013). The history of early formation of *madhhab* (Islamic schools of law) demonstrated that diversity of legal opinion was always appreciated and conducted in harmony. The norm of which Islamic legal traditions are developed is in opposition to the idea of standardization. It was reported that the Abbasid Caliph Abu Ja'far al-Mansur (re. 754-775) had once tried to standardize the conflicting and divergent *shari'ah* verdicts issued by judges during his reign. The Caliph had asked Imam Malik's permission to use his *al-Muwatta'*, a compendium of the sunnah of the Prophet as known and practiced in Medina as the law of Abbasid kingdom. Imam Malik disagreed with the Caliph and said;

> *'O Commander of the faithful! Do not do that. Because the people have received various reports, heard several statements, and transmitted these accounts. Each community is acting upon the information they have received. They are practicing and dealing with others in their mutual differences accordingly. Dissuading the people from what they are practicing would put them to hardship. Leave the people alone with their practices. Let the people in each city choose what they prefer' (Mas'ud, 2009).*

Malik's refusal however, is argued to have occurred in a different context. In that period of time, the Sunnah was scattered across Muslim provinces, following the migration of Companions from Hijaz to Iraq, Syria and Yemen. The network of communication during the early period of *madhab* formation almost did not exist. Due to diverse geographical location and limited means of transportation, Muslim jurists could barely meet each other to discuss *fiqh* issues and exchange arguments. Therefore, Malik was reluctant to make his *al-Muwatta'* a standard book in governing the law of Abassid empire because he knew that his work was not comprehensiveness enough. As the *shari'ah* doctrine was developing, there was a possibility that he did not include important *hadiths* and explain the contradictory rulings issued by other prominent jurists of his time (Mustafa, 2013). However, given the modern information technology of our time, the scenario is totally different. All imminent *shari'ah* scholars in Islamic finance can be gathered on one platform to discuss and argue on a particular topic and possibly come out with one resolution. Currently, there are several international institutions which are set up for such purpose. The International Islamic Fiqh Academy based in Jeddah is one of them.

5.0 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, 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 they 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, the calls for some 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 auniform*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 our 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 participatory 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.

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' FiqhIslami* 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' FiqhIslami* 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' FiqhIslami* remains diverse. Many of their members are not specialized in

fiqhmuamalat (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. 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. They abide by the resolution on the basis that it is issued by the authority (*'ululamri*) for the sake of the Islamic banking industry as a whole (Yahya and Arshad, 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 the (1) inclusive participatory and (2) support from the high level regulatory authority. Diagram 2 below summarizes our previous discussion regarding the framework on how to accomplish the harmonization of *shari'ah* rulings in Islamic finance.

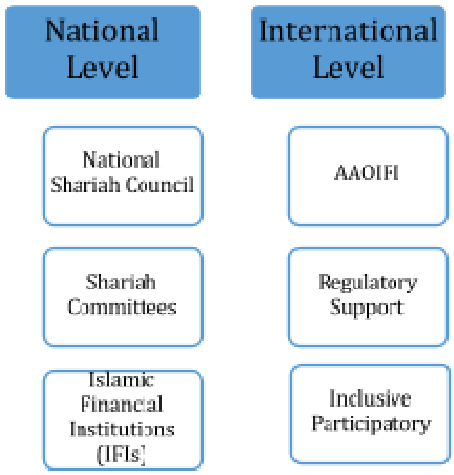


Diagram 2: Framework of Harmonization of *Shari'ah* Rulings in Islamic Finance

6.0 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, 2010). In 2011, participants of the *Muzakarah* agreed to accept the application of *ijarahmausufah 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, *shari'ah* scholars need to accept others' opinion although they might have their own justification 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 egoism 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 AAOIFI, we hope that it can champion the 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 objective intended.

7.0 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. Focusing on the issue of *bay' al-dayn* as a case study, the present research discusses issues, ways and challenges in harmonizing the *shari'ah* rulings. The Middle East and Malaysian *shari'ah* scholars differ in determining the legality of the *murabahah* and *tawwaruqsukuk* trading in the secondary market. Although both groups of scholars approve the transaction, the former restricts the sale to be done at par value whereas the latter allows the *sukuk* to be sold either at discount and premium prices. The disagreement arguably limits the potential of the sale-based *sukuk* to tap into larger international market.

It is found that 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 research 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 participatory 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.

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