



# **TOWARDS CONSISTENT SHARIAH INTERPRETATIONS IN THE CONTEXT OF EUROPEAN FINANCIAL MARKETS**

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## SHARIAH INTERPRETATIONS: AN OVERVIEW



- Islamic Jurisprudence, or *fiqh*, is the jurists' understanding of the sources of the law which are given or revealed.
- Unlike any other legal systems, *fiqh* is guided by a set of principles which are Revealed and Divine (i.e. Shariah).
- All in all, Islamic jurisprudence is the result of inter-play between principles which are Divine and legal rulings which are of jurists' interpretation. It is the manifestation of the intended rulings and laws of Allah which are constructed by qualified jurists.



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- Is Islamic jurisprudence principle or rule based? The answer is that Islamic jurisprudence consists of both principle(s) and rule(s) as Islamic jurisprudence is void if it lacks any supporting principles.



## TABLE OF COMPARISON BETWEEN SHARIAH PRINCIPLES AND ISLAMIC JURISPRUDENCE RULINGS

| Shariah Principles/Divine                     | Fiqh Rulings/Human   |
|---|--|
| 1. Prohibition of <i>Riba</i> (Interest)      | 1. <i>Riba</i> takes place in cash or in kind.   |
| 2. Prohibition of <i>Gharar</i> (Uncertainty) | 2. <i>Gharar</i> in unilateral contract ( <i>tabar'uat</i> ) is tolerable  |
| 3. Delivery of the subject matter             | 3. Delivery could be actual or constructive  |
| 4. Possession of the subject matter           | 4. While some jurists disallow a sale of an asset prior to its possession, some would allow this except for some identified goods. |



## ISLAMIC JURISPRUDENCE VIS-À-VIS ENGLISH COMMON LAW AND EUROPEAN CIVIL LAW



- Common law is a case-law orientation which is based on inductive approach. A number of cases decided by the court may ‘create’ a principle of law which shall be upheld by the lower court unless a “distinguishing” or “obiter dicta” can be established. In short, common law is a rule-based which may develop into principles of law. Thus, law report is very critical in common law-based judiciary.
- Civil law, on another hand, is based on principles of law from the very beginning. Thus, it is deductive in approach. Statutes and textbooks are relatively more important than cases decided by the court. In short, it is of principle-based and known as jurists’ law.



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- Islamic law, ironically speaking, combines these two approaches as it starts from Divine principles but allow the jurists to interpret the principles. Guided by the broad methodologies of these principles, the Muslim jurists are allowed to opine on matters of law.



## ILLUSTRATION OF BOTH INDUCTIVE AND DEDUCTIVE APPROACHES IN ISLAMIC LAW



- The Shariah principles prohibit '*riba*' be it taking or paying. The Shariah principles also disallow any transaction that may trigger the 'ratio decidendi' or *riba* prohibition such as rescheduling the sale tenor for an increase in the selling price. The jurists simply deduce these rulings from the existing Divine Texts (i.e. principle-based).
- Issue: Can a defaulter in *Murabahah* Sale (the buyer) restructure this transaction through an *ijarah* mechanism i.e. the buyer will sell the asset to the seller/financier at a price which is equivalent to the outstanding *murabahah* sale price to set-off against the debt of *murabahah*. Thereafter, the seller/financier will lease back the same asset to the buyer/customer according to new terms of period, lease payment and option to purchase or *wa'd* to sell.



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- Issues to be considered:
  - a) Will this lead to sell and buy-back under the prohibited 'inah sale?
  - b) Will this ruling be different if the clause of restructuring has been incorporated in the agreement under "Event of Default"?
  - c) Would the '*wa'd*' to sell the asset back to the seller/financier be problematic?
  - d) Would the increase of payment be viewed as similar to increase of payment in rescheduling arrangement?



## IMPACT OF INTERNATIONALISATION ON SHARIAH



- Essentially, internationalisation of products and services means that products are being offered outside the origin of the products i.e. cross border transactions.
- Impact of internationalisation:
  - a) risk management
  - b) different regulatory framework and requirement.
  - c) Shariah interpretations/Shariah board composition
  - d) Shariah techniques of risk management – both market and currency risk.
- Impact on Shariah
  - a) Fatwa construction and Shariah standards being applied e.g. Islamic REITs, Islamic ETF, etc,
  - b) Shariah risk management tools.
  - c) Shariah governance from regulators' perspective.



## CAN SHARIAH INTERPRETATIONS BE HARMONISED?

- For all intents and purposes, Shariah interpretations are dynamic and open to many juristic interpretations.
- *Ijma'* or Muslim jurists consensus is the only legal form of agreement by all jurists. However, it is rather difficult if not impossible to achieve.
- Harmonisation of various interpretations could be achieved through:
  - a) Standards being agreed by most of the jurists and/or regulators.
  - b) “Mutual respect” approach.
  - c) One common board for one single jurisdiction or across jurisdictions.
- What needs to be done to achieve harmonisation?
  - a) Thorough discussion based on quality research papers.
  - b) Policy direction by certain jurisdictions.
  - c) Reference to any standard, if any.



## IS THERE A NEED FOR A “SUPREME BOARD” TO ACT FOR THE GLOBAL INDUSTRY?



- There are exponents and opponents to this proposal.
- Personally speaking, there should not be a “Supreme Board” in Islamic finance industry. A global standard setting body is “quite” sufficient to govern the industry. The “Supreme Board” could be relevant for a country/jurisdiction but not for the global industry.
- Advantages and disadvantages of a “Supreme Board”
  - a) Innovation
  - b) Standardisation
  - c) Cost
  - d) Certainty of law
  - e) Market practice



## MANAGING INCREASINGLY COMPLEX PRODUCTS WITHIN A CONSISTENT SHARIAH FRAMEWORK



- Innovation of products needs “freedom” to propose new features of product to suit both the “demand and supply” of Islamic finance industry.
- Shariah Standards and established fatwas may provide some parameter or framework to deal with this innovative and sophisticated products. However, some exception based on a valid legal arguments may be considered.
  - a) Selling an asset without its possession.
  - b) Substitution of *salam* asset.
  - c) Sale of receivables for an asset.
- What needs to be done is to provide a “self-explanatory fatwa on new innovative products to avoid confusion and misperception”.



## DEVELOPING A BASE OF EUROPEAN SHARIAH SCHOLARS



- Shariah Scholars who are well versed with both Islamic commercial transactions and modern finance are few in the industry.
- The need to develop more scholars in many parts of the world is a *bona-fide* need.
- An ideal scholar is someone who is not only knowledgeable in Shariah issues but also in regulatory issues of a certain jurisdiction. Thus, the need for the “local scholars” to address their locality needs.
- Also, the local scholars may be more appealing to their own community.
- A cross border scholar is still the ultimate design.



## SHOULD EVERY BANK CONTINUE TO HAVE ITS OWN SHARIAH BOARD?



- There is no standard answer to this question?
- A bank can use its own Shariah board or it may use the national Shariah board (if any) or it may outsource the Shariah compliance duties to a consulting company to manage the compliance requirement.
- The stakeholders of the bank may decide in the best interest of the bank and perhaps the “timing” and “regulation” factors.



## EXPLORING THE ROLE OF REGULATORS IN THE HARMONISATION PROCESS



- Bank Negara of Malaysia.
- Bank Indonesia and Council of Islamic Scholars.
- Central Bank of Bahrain.
- DIFC.
- Central Bank of Sudan.
- FSA, United Kingdom.
- MAS, Singapore.
- EU Central Banks?



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