

# Fatwa on the Islamic Law Transaction and Its Role in the Islamic Finance Ecosystem

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## **Abstract**

*Fatwa holds a pivotal role in determining the guidance of Islamic society especially in Islamic finance ecosystem. Moreover, fatwa will render the direction for Islamic finance and then it will impact to the stakeholders of Islamic finance ecosystem such as regulator, Islamic finance institution, investor, and the market performance. This paper will discuss about the role of fatwa on the Islamic law transaction and its effect to Islamic finance performance. By adopting content analysis as the method of the study, this paper finds that firstly there has several fatwa having any dispute among the Islamic scholars and Islamic fatwa institution such as sukuk nature, bay al-inah, the nature of interest, bay al-dayn, and screening methodology adopted by several indices. Secondly, the different fatwa issued by Islamic scholars and Islamic fatwa institution influence the performance of Islamic finance product in the market which affect the stakeholders of Islamic finance industry.*

**Keywords:** *Fatwa, Islamic finance, Islamic scholar, Islamic fatwa institution*

## **A. INTRODUCTION**

Islamic Finance has been developing nowadays. It is exhibited by the high number of growth in some Islamic Finance sectors such as Islamic bank, sukuk and takaful industry. In Islamic banking industry, it experiences exponential development where it has 16% growth averagely per annum in 2010 to 2014. By having this number of growth, Islamic bank increases its market size from USD 490 billion to USD 882 billion. It makes Islamic banks grows barely two times in four years only. Moreover, GCC contribute 34% of the total asset in Islamic banks where ASEAN country like Malaysia, Indonesia, Brunei Darussalam and Thailand has 13% in their contribution to Islamic banking asset in the world (Ernest and Young, 2016).

In terms of sukuk market, upward momentum is also experienced by the value of sukuk issuance since 2009 to 2014. After suffering crisis in 2008, the value of sukuk issuance increase 56% reaching USD 38 billion in 2009 which is previously only USD 24.2 billion in one year before. Moreover, sukuk market grows gradually which reaches USD 138 billion as a value of sukuk issuance in 2013 (IIFM, 2017). In the takaful market, the development of this industry is really delightful. The growth of takaful industry is quiet significant which reaches USD 20 billion in 2013. Previously in 2006, the value of takaful asset is only USD 5 billion. It connotes that the asset grows four times in less than ten years (IFSB, 2015).

The current development of Islamic finance can not be separated to the role of Islamic scholars. In the individual role, Islamic scholars usually render their view to lighten the muslim society. In addition, Islamic scholars also embody in Islamic fatwa institution which will perform *ijtihad* to solve the problem faced by the ummah. In order to guide Islamic finance institution, Islamic scholars transform to be shariah advisor that create many guidance to the industry such as Shariah Advisory Council (SAC) in the national level and Shariah Committee (SC) in company level in Malaysian context. Not only producing guidance to the industry, Islamic scholars also develop the industry by issuing fatwa which will bind the market players. It aims to promote and expand the industry in many financial sectors needed by the ummah.

However, the fatwa issued by Islamic scholars often have different point of view that makes the society confused. The difference between Islamic scholars fatwa is due to the foundation used to produce the fatwa. One of the example is fatwa pertaining

about impermissibility *bai bithaman ajil* in Islamic finance transaction where the most Islamic scholars in the world refuse it except Malaysia (Laldin, Khir, & Parid, 2012). This different opinion among Islamic scholars are able to affect the market performance. It can be seen from the number of sukuk issued by the market player while Accounting and Auditing Organization for Islamic Financial Institution (AAOIFI) issued fatwa about the sukuk which was considered as shariah non-compliance. The screening methodology applied by the industry was considered not to comply to shariah that makes more than one hundred company were delisted. Therefore, the fatwa issuance by Islamic scholars in the Islamic finance industry will directly affect the stakeholder of Islamic finance ecosystem such as regulator, investor, company and other market player in the industry.

To discuss it further, this paper will portray the issue of fatwa produced by Islamic scholars which influence the Islamic finance ecosystem. In this paper explanation, it consists of five parts which first is introduction and the meaning of the fatwa becomes the second part. In the third and fourth part will shed light about the difference and the impact on fatwa respectively where the last part will delineate the conclusion and the recommendation of this paper.

## **B. THE MEANING OF FATWA**

In Islam, fatwa has special place due to its power to determine whether muslim society are able to perform certain activity or not. In terms of definition, fatwa is a legal opinion issued by certain Islamic scholars who are eligible to have certain degree of knowledge and virtue about Islam. Their legal opinion will be used to solve the problem faced by ummah (Laldin et al., 2012). Moreover, it is also applied as the final decision from Islamic perspective to deal with any unresolved issue Islamic society. Mehmood (2015) adds that fatwa will be issued when there are some issues which are very important to ummah in terms of economics, social, personal and public interest. Moreover, different conditions of the society are able to have different legal opinions from the Islamic scholar (Mehmood, 2015). Thus, fatwa can depend on the circumstances of the society as well as the region. In addition, fatwa is also guidance for the government to determine the important decision to its people (Lindsey, 2012). For example is in determining the truth belief. In Islamic countries such as Indonesia, Malaysia, and Egypt, this particular decision can create unity among the muslim society as well as avoid and prevent from deviant beliefs which can exist in the muslim community. By issuing fatwa, it can be used also as a foundation to enact legal framework of law (Zulkifli & Hassan, 2014).

Unresolved issue may exist because of any complexity situation and different thoughts happening in the society. With having complicated structure of law, regulation and the way of thinking can obscure what is actually allowed and what is not. For example is about *riba*. In the modern world, *riba* is acceptable where most of the muslims perform *riba* in their financial activity such as investing their money in the conventional money market, depositing their money in conventional bank and borrowing money from conventional institution. Furthermore, those activities are recently perceived as common things which are allowed and it does not violate the existing legal law in the most Islamic countries. On the other hand, fatwa has a function to make it clear then straighten inappropriate thought in the muslim community.

Uniquely, fatwa has a nature that is not binding to the people asking fatwa to address their problem (Laldin et al., 2012). Non-bindingness of the fatwa does not mean that a muslim can freely ignore it. It exhibits that a muslim can follow other legal opinion issued by the eligible Islamic scholars in certain issue. It was also practiced by Imam Syafie when he visited the Imam Malik's student. At that time, Imam Syafi'i was appointed by the students to be imam in the congregational prayer. Actually, the students already prepared to pray *qunut* in the *shalatul subh*. Surprisingly, Imam Syafi'i did not perform it even though his opinion said that *qunut* is encouraged to be performed in *shalatul subh*. Imam Syafi'i respects to Imam Malik's thought which is part of his *ijtihad* where in *ijtihad* there is no wrong decision as long as the process of *ijtihad* follows all provisions prescribed to shariah. This nature of fatwa is actually practiced in the daily activity among muslim society. However, it is different from the reality while it is practiced in the institutional level especially in Islamic finance industry.

In the industrial level, fatwa issued by the legal authority in certain region. It connotes that fatwa will bind the institution inside the region or industry especially in Islamic finance (Laldin et al., 2012). It is showed by AAOIFI's statement whereas fatwa issued by AAOIFI has to be followed by Islamic finance institution regardless it will

satisfy the company management to yield more return or not. Moreover, AAOIFI emphasizes that if there is any Islamic institution which rejects the fatwa due to any reason, that condition must be delivered to the general assembly of AAOIFI. Not only in AAOIFI which is mainly practiced in middle east countries, Islamic financial institution in Indonesia also has to follow Indonesian Ulama Assembly or *Majelis Ulama Indonesia* (MUI) in determining the financial transaction aligned with shariah. MUI has Shariah National Board or *Dewan Syariah Nasional* (DSN) which will produce fatwa relating to Islamic finance issue as well as give the recommendation for the better economic condition (Barlinti & Dewi, 2012). In addition, the bindingness of the fatwa issued by DSN is already enacted in the Indonesian law. The main point of the regulation is that central bank will enact some regulation in Islamic bank and finance based on the fatwa issued by DSN. Notwithstanding DSN is not government institution, this institution also standardize the shariah compliance indicator in the Islamic finance industry. Those situation makes DSN is very powerful to manage Islamic finance industry in Indonesia.

To develop as well as keep the Islamic finance industry aligned to shariah, Malaysia has also the fatwa commission to enlighten unresolved issue namely Shariah Advisory Council (SAC) which is under Bank Negara Malaysia. Beside SAC, fatwa is issued by Security Commission (SC) which will only regulate and bind capital market industry. The function of SAC and SC in Malaysia remains the same as another fatwa institution in the Islamic finance industry which is to enact some regulation or fatwa regarding to the development of Islamic finance industry aligned with shariah (Hamza, 2013).

The bindingness of fatwa may create assurance in terms of financial transaction among Islamic finance stakeholders. Then, the adopted regulation will make the industry operation clear and will not create a confusion to the stakeholders in the Islamic finance industry. Due to that assurance, the Islamic finance industry will be more stable that may directly influence to Islamic finance growth and development based on shariah law.

### **C. FATWA DISTICTION IN ISLAMIC FINANCE**

Distinction of fatwa may happen among the fatwa institution in Islamic finance area. The popular dissenting opinion among Islamic scholar happened in 2008 while Shaikh Taqi Usmani as The President of AAOIFI argue the practice of sukuk industry at that time. In the beginning of his opinion, Shaikh Taqi Uthmani emphasizes that sukuk is one of the Islamic finance instrument to finance economic activity, securing the stream of capital to have a good liquidity. Moreover, sukuk can be utilized to equitable distribution of wealth where the investors are able to earn profit from invested funds to the company. The advantages mentioned above become the purpose of Islamic economic system which exerts to establish justice and welfare in economic society (Usmani, 2008).

Shaikh Taqi Usmani then shows that the practice of sukuk is mimicking to the bond which is conventionally performed. The background of his idea is because sukuk has three element which is strongly similar to the application of conventional bond. First is assigning the statment mentioning that if there has any excess return in the sukuk more than agreed return, it will be given to the management as an incentive of good performance. However, he also acknowledge that the incentive in the business partnership is allowed by shariah based on the profit sharing. It is based on the declaration of Ibn'Abbas, Ibn Sirin and Ibn Qudama who conclude that excess return is lawful because it does not have any legal impediment which prohibit it. This argument is also strenghtened by Ibrahim al-Nakhha'i and Hammad who consider that practice is *makruh* (undesirable). Even though there has several Islamic sholars from Shafi'i and Maliki school saying that the incentive sholud be on the determined basis and it is treated as fee rather than fully incentive. That argument aims to ascertain the fee which will be received by the broker when it is able to outperform the return based on business activity.

Finally, the shariah council concludes that there is not prohibited to have incentive from outperforming business activity as long as it is based on actual return yielded inside the business process. Unfortunately, the incentive given by the sukuk holders to the management is from interest basis rather than from business activity or working asset in sukuk. This particular condition makes the incentive becomes unlawful based on shariah which is really similar to conventional model (Usmani, 2008). Due to that reason, sukuk is considered as not shariah compliance in application by Shaikh Taqi Usmani.

Second is the guarantee from the managers which promise to cover the low return experienced by sukuk holders while the sukuk is underperform. The covering process will use a loan from the management funds which will be redeemed by following actual profit which may outperform at maturity. If the operation of sukuk is like bond scheme, thus the scheme is the same as loan based on conventional paradigm. In this view, Shaikh Taqi Usmani opines that the scheme does not comply to shariah. The third concept of sukuk which Shaikh Taqi Usmani disapprove is the binding promise by the manager that sukuk will be redeemed at the day of maturity based on the face value price (Usmani, 2008). This concept is viewed as not in accordance to shariah. Because in the shariah partnership, there is no guarantee that one of the party involved in the business transaction will acquire the asset back in the face value price. It also sheds light that the manager as *mudarib* or *wakil* does not perform themselves as the truly *mudarib* or *wakil* in the business activity if there is any guarantee to return capital back. At the end, It clearly portrays that the operation of sukuk does not truly explain the spirit of Islamic finance which is based on risk-sharing and profit-sharing.

Another dispute among Islamic scholars which relates to Islamic finance issues is experienced between Shaikh-al-Azhar Muhammad Sayyid Tantawi and Sheikh Yusuf Al Qardawi (Gamal, 2004). The different view among the two ulama emerge when Shaikh publish the new fatwa in *Al-Ahram*, the semi-official newspaper, about the rule of interest which is said as shariah compliance in banking operation practice. *Majma' al-Buthuh al-Islamiah*, a research institute led by Shaikh Tantawi opines that the people engaging as customers in the bank have to be treated as *rabbul mal* who invests his money in the bank based on profit sharing contract. Due to that reason, the customers entitle to gain profit sharing from the banking operation. This particular idea comes up because *Majma' al-Buthuh al-Islamiah* views from the liquidity management of the banking operation. Then, the profit generated by the customers can be from interest which is obtained by the bank.

Moreover, Shaikh Tantawi cites the opinion of Abdul-Wahhab Khallaf and Ali Al-Khafif arguing that any business activity such as partnership contract is able to determine the pre-specific amount of return which will benefit to the parties involved in the contract. Moreover, it is also not considered as *riba* because it is not harm and it gives advantages to another party (Gamal, 2004). Afterwards, that Islamic scholars add that no fatwa concludes that *mudarabah* contract will void while the pre-determined profit is utilized inside the contract. This idea is based on the Islamic law which only consider *mudarabah* contract as a partnership business activity based on profit sharing and risk sharing regardless whether it is based on pre-determined profit or not (the fatwa of pre-specified profit was issued in 2002).

Hence, it indirectly emphasizes that the banking customer approves *mudarabah* contract in based on silent agreement. Not only in the banking operation, paying interest in government bond (*shahadah al-istithmar*) is also not considered as *riba* (Utami, 2006). In this term, bond certificate is reflected as saving activity whereas many people are encouraged to perform it at that time. Shaikh Tantawi takes the argument from Yasr Suwaylem and Sheikh Abdul Azim Barakat, both of them are from Maliki and Hambali School respectively, owning certificate in conventional bond accords to *mudarabah* which the bondholders deserve to earn return from their investment.

To respond fatwa of Shaikh Tantawi, Shaikh Yusuf Al-Qardawi has different idea with him. In his opinion, Shaikh Al-Qardawi firstly states that the position of customers' money in the banks is as entrusted good which the bank has to guarantee it (*wadi'ah yad amanah*) rather than treat it as a loan to the bank. Bank is also not assumed as the poor financial institution which needs money deposited by the customers to perform its business. (Utami, 2006). Afterwards, Shaikh Al-Qardawi argues, in the *mudarabah* and *muzaraah* contract which is based on profit and risk-sharing, pre-determined profit is exactly not allowed in shariah. Islamic bank as *mudarib* is prohibited to conduct double contracts in one transaction such as to be *wakil*.

Shaikh Al-Qardawi claims that *riba* is excess value regardless it is double or only small additional value. On the other hand, giving more money when returning a loan is encouraged based on existing hadith. This activity is basically accorded by the generosity of the borrower as an appreciation to the kindness of the lender. He also states that the intention of arguing *riba* is strongly indicated that the main intention is to be opposition. The different opinion had by the Islamic scholar may not perform to look for the truth which is part of ethic in conducting *ijtihad* (Utami, 2006). Afterwards, Shaikh Al-Qardawi criticizes Shaikh Thantawi to have wrong justification to define emergency condition. that there is wrong definition about the meaning of emergency perceived by Shaikh

Thantawi and He also apprehend that deposit money is not to take Islamic. Hence, both activities are totally different.

Besides Shaikh Yusuf Al Qardawi, there has some institution and certain Islamic finance scholars who also argues to the fatwa of Shaikh Tantawi about legalizing interest in the financial practice. The first comes from Islamic Fiqh Insititute of Qatar (IFI) in 2003 which conclude the mechanism of generating profit from the relationship between depositors and the bank are not allowed if it is sased on specific fixed return. The reason behind it is because that activity violates the essence of *mudarabah*. Silent partnership will also void if one of the party determine the known profit in the beginning of the transaction process. One of Islamic scholar namely El-Gamar also stipulates that Shaikh Tantawi should consider the banking operation as a whole which the way the bank generates money is fully not shariah compliance due to the investment process mainly based on usury that is prohibited by Islam (Utami, 2006).

#### **D. FATWA DISTICTION IN ISLAMIC FINANCIAL INSTITUTION**

The different opinion does not only happen among the Islamic scholars but also in Islamic financial institution. It can be seen from the different views and adopted regulation in Islamic finance industry. The fatwa distinction mainly occur to determine the permissibility of the product. For instance, it is in Islamic bank, the first is about *bay al-inah*. In the Malaysian fatwa view, *bay al-inah* is not prohibited. It align to Imam Shafi'i school that define *bay al-inah* as permissible based on his book *Al-Umm*. Imam Syafi'i shows that if there has a person selling an asset to the buyer in the lower price, the buyer should not be prevented to the same goods in the future. This understanding is also supported by Imam Subki allows *bay al-inah* transaction. (Bank Negara Malaysia, 2010). Moreover, Malaysia adapts *bay al-inah* contract to be implemented in certain product such as *bay bithaman ajil* which is viewed as not permissible transaction by *Majma Al fiqh Al Islami, Kuwait Finance House* and other fatwa financial institutions (Laldin et al., 2012). The reason of the refusal of this fatwa is justified by the conclusion of Imam Syafi'i who not allow *bay bithaman ajil* in pre-determined agreement before during the transaction. Then, Shaikh Al-Qardawi opining that *bay al-inah* is allowed if there is no pre-existing agreement to repurchase the goods sold previously. On the other hand, non Malaysian fatwa institutions actually allow the *bay al-inah* if there is not stated rigid agreement practiced by *bay bithaman ajil* such as in Malaysia that does not comply to the nature of *bay al inah* which only "halalize" *riba* based on many Islamic scholars opinion.

The second is *hibah* (gift). Originally Rasulullah Saw encourage his ummah to perform *hibah* that accord to "...exchange gifts (among you) and you will love each other". In Islamic bank, *hibah* is usually practiced in *wadi'ah yad dhamamah* contract where the bank will give *hibah* to the customers depositing their money in the bank (BNM, 2010). The gift is actually aimed to reward the customers due to their generosity to give Islamic bank's opportunity to utilize money in the business activity. In several countries such as Malaysia and Indonesia, giving *hibah* to the customers have become a custom to be practiced.

To respond this issue, the jurist from *Dallah Al-Barakah*, one of Islamic bank player in Middle East, proposes some requirement to perform *hibah*. The gift is not allowed to be promised as pre-determined agreement and the customer has no right to ask *hibah* from Islamic bank as well. Furthermore, *hibah* distribution has to be taken from the Islamic bank's profit that is agreed by the customers and the latter is Islamic bank has to make acceptable regulation based on shariah law while Islamic bank wants to announce *hibah* to the customer (Laldin et al., 2012).

From another view, Kuwait Finance House and Dubai Islamic Bank suggest not to perform *hibah* due to some reasons. That two institution opine, in performing *hibah*, one of the contracting party practically bears the obligation to reward the customers as *hibah*. Then by giving *hibah* will violate the spirit of Islamic finance which is based on risk-sharing and and profit-sharing which is also stated by the legal maxim in Islamic law *al ghurmi bil ghurm* which similarly means that there is no return without a risk. However, the existance of *hibah* basically may benefit to Islamic bank to keep the competitiveness of Islamic bank in the banking industry.

Not only in banking industry, in the Islamic capital market, the fatwa distinction also exists. there has several issues that remain debatable. *Bay al-dayn* (sale of debt) becomes one of the issues debated by Islamic scholar. SC claims *bay al-dayn* as one of the contracts which will develop Islamic capital market in Malaysia and create more

*masalahah* in the market (SC, 2016). The application of *bay al-dayn* is already practiced in sukuk or Islamic bond. The popular example that is usually provided by the Islamic scholar is Khazanah Islamic benchmark bond which has three paths in issuing sukuk. Firstly, the securitization of the sukuk will adopt *bay al-dayn* where it is based on sell and buy back. The first owner of sukuk will ensure that the sukuk will be bought back. Secondly, the debt certificate (*shahadat al-dayn*) will be issued. This kind of certificate will be held by the sukuk holders as the evidence to have sukuk. Then, trading the debt of certificate will be the latter process. It makes the sukuk holders able to buy and sell of debt activity in the secondary market by using *bay al-dayn* (Shaharuddin et al., 2012).

Regarding to this practice, *Dallah al-Barakah*, *Majma fiqh al-Islami*, and AAOIFI have different opinion. They agree that sale of debt is not allowed due to *gharar* issue which exist inside the contract and it may create *riba*. In addition, if the price of the sukuk is based on discounted price, it will create *riba* as well due to the first price and the final price of sukuk at the end of period will be different. Hence, the sukuk price has to have the same price at par value. If that condition can not be fulfilled, the transaction will be *riba* due to any additional value in the sukuk price (Mohd Noor, 2009).

SC has different consideration to the existing issue in sale of debt especially about *gharar*. This view is supported by Maliki school stating that the main risk of sale of debt is to ensure the exchange of debt itself to be a property (*ayn*) (Shamsiah & Nor Fahimah, 2013). Furthermore, Security Commission in Malaysia finally allows the transaction with considering that in the capital market, exist which is guaranteed by clearing house (third party) (Sifat & Mohamad, 2016). Thus, the issue of *gharar* is already fixed. Moreover, the Security Commission also makes limitation to perform the contract where the debt has to be confirmed, it can not be sold before it is received and it must be paid in cash to avoid sale of debt for debt (*al-kali bi al-kali*) (Shaharuddin et al., 2012).

In addition, the different screening process also occurs between capital market such as Kuala Lumpur Stock Exchange Syariah Index (KLSE SI), Financial Times Stock Market (FTSE), Standard & Poor (S&P), and Dow Jones Islamic Market (DJIM) due to different consideration to issue a fatwa in Islamic financial market. Originally there is no totally shariah compliance company in the world that is listed in the capital market due to many condition such as economic system used nowadays. However, several countries are trying to select shariah company by adopting negotiable shariah compliance criterion proposed by Islamic scholars. This screening process functions as an effort to minimize the non Islamic element in economic system including *riba*, *gharah* and *maysir* (Adam & Bakar, 2014). Hence, the shariah screening process also attempts to manage the company more shariah onwards by improving the screening requirement gradually.

In term of comparing shariah screening in the listed company in capital market, Malaysian's shariah screening process was known as the most liberal before it is revised in November 2013. In Malaysian's screening process, quantitative and qualitative measurement are applied. In the qualitative measurement, the screening process will identify the nature of the company which must not mainly perform in non shariah activity like based on *riba*, selling alcohol, gambling, broadcasting and entertaining, conventional financial service, hotels, insurance, media (except newspaper), pork-related product, bars, tobacco, trading gold and silver and weapon and defence (Pok, 2012). After screening the nature of the company, there has any assessment to test the society perception to the company. If the perception is acceptable by the society, the company can be labelled as shariah compliance. Conversely, the company will not pass the screening process if the society's perception is not acceptable by the society.

In the quantitative screening process, there has revised screening criterion which is applied before and after November 2013. Before the revised criterion, Kuala Lumpur Stock Exchange Shariah Index (KLSE SI) adopts income approach as the screening process. The income approach consists of prohibited income from non *halal* source which must be not beyond 5%. Then, 10% is utilized as the benchmark of income coming from *umum balwa* source like interest income from fixed deposit. Furthermore, 20% and 25% benchmark are used to rental income where the building is utilized to non shariah activity such as gambling and applied activities that consider as *masalahah* like hotel and resort operation (Pok, 2012). Notwithstanding KLSE SI applies income approach, there is no financial ratio approach performed by the KLSE SI at that time which is different from other indices.

By adopting liquidity ratio, interest ratio, debt ratio and non-permissible income ratio approach, there has a difference amongst Dow Jones Islamic Market Indices

(DJIM), Standard & Poor (S&P) and Financial Times Stock Exchange (FTSE) where the first two of the indices apply market capitalization as the denominator and the last one indices applies total asset as the denominator. Moreover, in terms of debt and interest ratio, there has no difference. Afterwards the difference appears in liquidity ratio where DJIM uses 33% benchmark to assess the liquidity ratio which is not allowed to beyond that number where S&P and FTSE utilize 49% and 50% benchmark respectively. The later is 5% benchmark utilized by FTSE and S&P which allows companies to earn non *halal* income.

The rationale behind the benchmark is that Islam views the more illiquid of the asset, the better performance will the company have. Because in Islam, fixed asset will generate money from the transaction based on real sector in the economic system. In term of debt ratio, the consideration basically is from the hadith while Abu Baqr wants to donate more than one-third of his wealth, then Rasulullah Saw said that donating his wealth more than one-third is too much (Derigs & Marzban, 2008). For the non *halal* benchmark, Al-Qur'an and hadith do not mention it but the benchmark comes from the Islamic jurist's *ijtihad*. Actually, the difference in the screening process comes from some consideration made by shariah committee in every screening institution. shariah committee will obligate to keep the listed stock the market which comply to shariah.

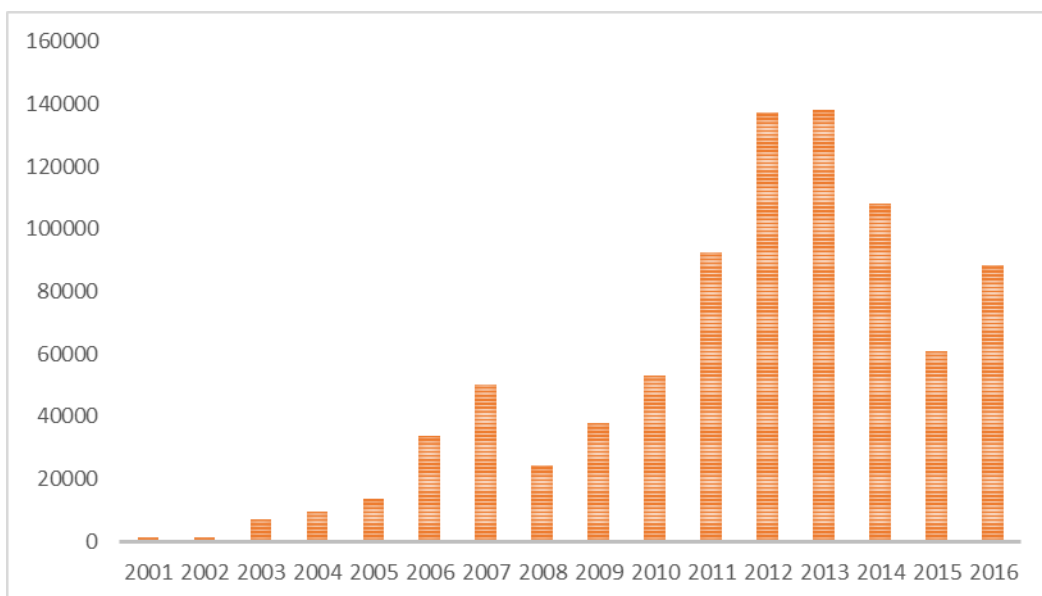
Furthermore, the improvement of the screening process which is already labelled as the most liberal shariah screening in the world, Security Commission where the shariah committee is inside the organization changes the screening process in 2013 which seems more strict than before (Security Commission, 2013). In the change of shariah screening process, Security Commission applies 5% benchmark to income from non halal source such as from conventional bank and insurance, gambling, pork, liquor, tobacco and etcetera. Then, 20% benchmark is utilized to income from the business activity that consist of hotel, resort operation and stockbroking business. Besides income approach, ratio financial benchmark screening is also applied by Security Commission which comprise two benchmarks. First is cash over total asset ration which must not be beyond 33%. The consideration of that benchmark is that fixed asset in Islamic perspective is the kind of asset that will generate money. It means, Islam encourage the productivity of the asset itself. Second is debt over total asset. In this ratio, the benchmark is 33% which means that the total debt had by the company must be not exceed from that benchmark. However, the company may exceed that benchmark if the source of debt comes from shariah compliance transaction. Thus, ratio 33% benchmark is only applicable for the debt which has a source from conventional perspective. Moreover in term of the qualitative screening process, it remains unchanged (Kasi & Muhammad, 2016).

To sum up, the difference fatwa in Islamic institution comes from the different interpretation among the Islamic scholarS. It indicates that Islamic scholars play pivotal role to determine the shariah compliance in the Islamic finance industry. Moreover, shariah committee will also screen the listed company listing in capital market regularly to assess the quantitative and qualitative measurement. Due to the importance of screening process in Islamic finance industry, shariah committee has to manage it properly as well as impove the screening process to safeguard the trust of the Islamic finance stakeholders which will affect the performance of the Islamic finance players. In addition, the fatwa given by shariah committee will also influence the society as the party involving in Islamic economic's system that engage in the Islamic finance industry.

#### **E. THE IMPACT OF FATWA**

The shariah issue in Islamic finance becomes an important thing where many people really concern about it. For instance is from the investor perspective. An investor has the preference to invest his money in certain investment product. Mostly in Islamic finance industry which is considered as ethical industry, some of the investor prefers to put his money in Islamic finance because of the shariah issue. It means that there has several investor which is religious who do not only invest to earn money but also has to shariah compliance. This kind of investor mainly comes from middle east who is rich investor owning a lot of money (Pok, 2012). Hence, investor as a part of society, the fatwa will affect the investor interest as well. On the other hand, the company and the regulator who are the part of the society in Islamic financial ecosystem will also adjust to the fatwa announced by the authority to be better in offering Islamic finance products and services.

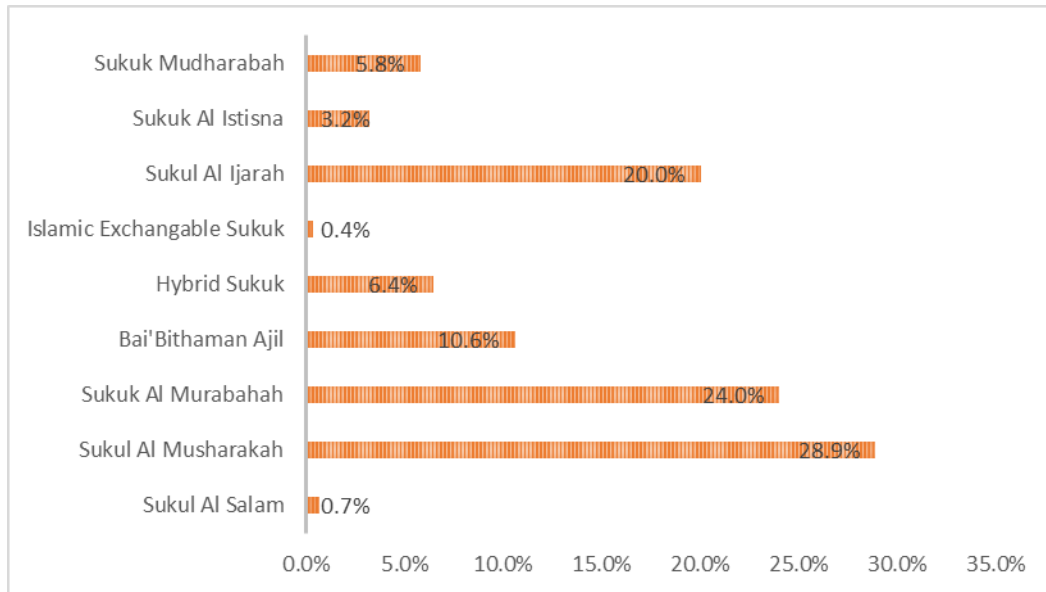
In 2008, the Islamic capital market faces the big challenge while the issuance of sukuk at that time decrease two times compared previous year. Based on the figure below, it can be seen that the number of sukuk issuance in 2008 drop significantly from USD 50 billion to USD 24.3 billion. The fall of sukuk issuance make shock the Islamic financial market due to the good performance experienced by Islamic finance in the prior period especially in sukuk market which is rising previously. This phenomenon occurs due to many factors. First is global economics condition which experiences financial crisis in the center of financial market which happens in US and Europe. The crisis makes the cost of borrowing money increase significantly. Moreover, this particular condition make the global financial market face uncertainty and high volatility that panics amongst the market players. This circumstance influence the sukuk market that makes the sukuk issuance fall at that time. Specifically, GCC and Malaysia experience deep fall in sukuk issuance which reach 55% and 59% respectively. Second is recommendation issued by AAOIFI (Hijazi, 2009) where render the warning to the investor not to engage in sukuk is considered as not shariah compliance which is also portrayed by Shaikh Taqi Uthmani.



**Figure 1. The Sukuk Issuance from 2001 to 2016 in million**  
*Source : IIFM (2017)*

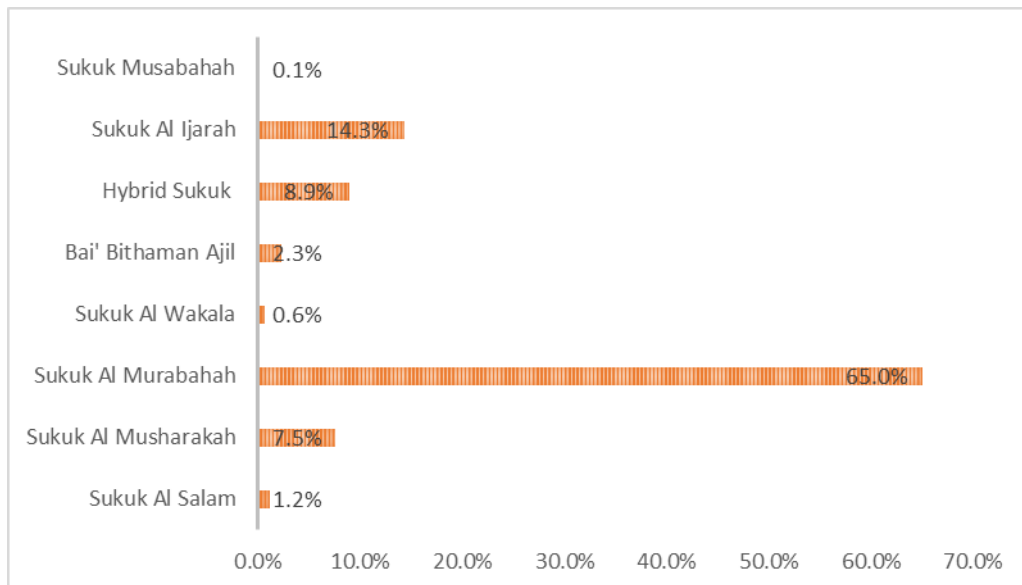
The recommendation of AAOIFI comprises of six points where sukuk which is tradable has to be fully owned by sukuk holder. In this first point, the ownership's transfer to the manager must be proven by certain related evidences. Second point is sukuk which is tradeable must not represent the debt and the third point is impermissibility of the manager to offer the loan for sukuk holders in covering the loss when the sukuk is falling. Impermissibility to the sukuk's manager to purchase back sukuk based on the nominal value at the end of the period becomes the fourth point. Conversely in the fifth point, in the lease based sukuk, purchasing sukuk at the end of the period at nominal value is permissible by AAOIFI. The latter, shariah committee is advised not to limit its role in issuing fatwa regarding the shariah rule of sukuk (AAOIFI, 2008). This suggestion also indicate that the main duty of shariah committee has to ensure that sukuk structure and its operation must comply to shariah.





**Figure 2. Domestic Sukuk Issuance from 2001-2008**  
 Source : IIFM (2017)

In addition, sukuk structure issued by utilizing *bay bithaman ajil* is recently lower in the domestic market which is only exist in Malaysia. It affects by many consideration like shariah issue especially about *bai al-inah* which no one of shariah scholar or Islamic fatwa institution are accepted outside Malaysia. This shariah issue becomes sensitive issue



**Figure 3. Domestic Sukuk Issuance from 2013- 2016**  
 Source : IIFM (2017)

Among the Islamic scholars due to any wide difference amongst them. Furthermore, the use of *bay bithaman ajil* as the sukuk structure will not able to attract the investors especially from GCC countries who wants to invest in Malaysian capital market. In this circumstance, the different opinion amongst the Islamic scholar in the fatwa issued is able to influence the market performance in Malaysia which is evidenced

by the figure attached above where eventually *bai bithaman ajil* sukuk structure is reduced gradually. Based on the figure 2. and 3, it shows that the percentage of sukuk structure based on *bay bithaman ajil* lower from 11% to 2% in the 2001-2008 period and 2013-July 2014 respectively in the domestic market. It also portrays from the value of sukuk issuance which has USD 11.2 billion and 3.8 billion in each period. This condition can also be interpreted that it has any movement from the use of *bay bithaman ajil* to other structures which are more shariah compliance amongst the Islamic scholars point of view and more attractive to the investors as well (IIFM, 2017).

In terms of revised screening process performed by Malaysian Security Commission, it has impacted the stock market in KLSI. As a result, after officially adopting the new screening process then applying it, 158 companies were delisted from the shariah index due to they can not fulfill the new shariah screening requirement conducted by Security Commission at that time. Furthermore, Industrial company product becomes the most affected sector which has 56 company non shariah compliance company after screened. This number is followed by trading service and consumer production company which is 30 and 18 companies while the leftover comes from properties, technology companies and etcetera. In addition, delisted company from the index after applying the new shariah screening makes the performance lower. It portrays the decrease in the negative return earned by delisted companies (Sakti & Barom, 2014). Afterwards, the price of the stock becomes lower due to market reaction which view the delisted stock is not better than before. The market reaction basically represent the public perception in the market that more appreciate to the stock which is categorized as shariah compliance stock. From the investors perspective, the delisted stock makes them do not have more choices to invest their money in the shairah compliance company. Hence, they have to think smartly to determine their decision in making portfolio of investment which will gain a good return to them. Eventually, in the new shariah screening process produced by the Security Commission, it is part of *ijtihad* done by that institution to improve the shariah screening process in Malaysia which affects economically in the society.

## F. CONCLUSION AND RECOMMENDATION

Fatwa is not legally binding in the society. But, when it relates to Islamic finance institution, it becomes binding to the Islamic finance ecosystem. Moreover, the fatwa influence many aspects like regulation, performance, perception and the market player itself. In term of regulation, fatwa issued by Islamic scholar will make several rules that have to be followed by involved Islamic institution such as in the screening process. Based on the evidence explained previously, the dispute in the fatwa makes the difference regulation amongst the indices. Hence, there has different degree of the shariah compliance applied by Islamic institution where the most tolerable screening process may be labelled as liberal screening process. Eventually, this perception can create a bad perception amongst the investors. The perception of the investors also one of the reason to lower sukuk issuance based on *bay bithaman ajil* structure. It indicates that the domestic market is trying to attract more investor which will create more acceptance of the product amongst the market player. Moreover, the lowering *bai bithaman ajil* sukuk structure is also a way of unity not to use the structure which is not recognized in the financial market internationally.

In term of the performance, fatwa issued by Islamic scholar or institution also directly influence to the market performance especially shariah compliance product and company. The direct effect of the fatwa issuance can be seen from the new method of screening process in Malaysia when it is practiced which makes 158 companies delisted from the index. Then, the effect does not stop at that point, the fall in the performance is experienced by the delisted company by earning lower return and reducing in the stock price. It makes the market player investing their money in the delisted company will be loss and the from the investors point of view, they will have less choices while they want to make portfolio in the market. Moreover, the index will own less shariah compliance company that may make the investors less attractive to invest their money.

Eventually, the fatwa directly affects the society in the Islamic finance ecosystem. Thus, the improvement of fatwa issuance has to be proposed to create more *maslahah* amongst the member of Islamic finance ecosystem. The suggestion which emerges is that Islamic scholar must have deep discussion to examine the existing or current shariah issue. It is necessary to intensify the coordination amongst the scholar around the world especially several fatwa which is considered as controversial fatwa in

other shariah scholars perspective. Not only finishing the problem which may appear, the coordination must intend to develop Islamic finance not to only come with mimicking product but also appers with the new insight to create Islamic finance more Islamic in the society. Moreover, the deep discussion amongst Islamic scholar also considered as an effort to keep the stability of the market and promote Islamic finance as well. Hopefully, this coordination forum can be conducted regularly for the highest intention which is to seek the truth because of Allah that will benefit to the society.

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