

# HARMONIZATION OF SHARIAH RULINGS IN ISLAMIC FINANCE: AN ANALYSIS

Rahmat Hakim\*

## Abstract

Pesatnya perkembangan ekonomi Islam diseluruh dunia dewasa ini cukup menggembirakan. Hal ini dapat. Hal ini terbukti dengan meningkatnya inovasi produk-produk perbankan Islam, institusi – institusi ekonomi Islam, baik dari segi lembaga pelaksana, regulator, dan juga lembaga-lembaga pendidikan ekonomi Islam. Namun, terdapat beberapa problem dalam proses perkembangan Ekonomi Islam meliputi perbedaan pendapat dalam *ijtihad* dan *fatwa* dalam penentuan hukum suatu kontrak yang pada akhirnya menimbulkan kontroversi diantara Negara-negara Muslim. Sehingga berdampak pada tersendatnya laju perkembangan Ekonomi Islam dunia secara umum. Penelitian ini bertujuan untuk memaparkan tentang upaya harmonisasi tentang *ijtihad* dalam penentuan hukum akad suatu produk yang dilakukan oleh beberapa Ekonom Islam guna mendapatkan suatu problem-solving mengenai perbedaan pendapat dalam penentuan hukum suatu produk atau akad. Berdasarkan hasil penelitian ini, institusi – institusi ekonomi Islam yang mempunyai fungsi sebagai regulator untuk lembaga-lembaga ekonomi Islam mempunyai peran yang signifikan dalam upaya harmonisasi, namun peneliti berkesimpulan bahwa harmonisasi akan sulit terwujud dikarenakan perbedaan tempat dan *madzhab* yang terdapat dalam Negara-negara Islam.

**Kata kunci:** Harmonization, Islamic Finance, Regulation.

---

\* Alumni Institut Studi Islam Darussalam Mahasiswa Master of Muamalat Administration (MMA), Departemen of Economics And Muamalat, University Sains Islam Malaysia (USIM), Nilai, Negeri Sembilan, Malaysia 78100.(akoeholic@gmail.com)

## Introduction

It is well-agreed among Islamic financial experts that the biggest challenge faced by the regulators of Islamic finance is harmonizing<sup>1</sup> these interpretations into a consistent and efficient regulatory framework that will ensure unimpeded Islamic financial intermediation amongst all. (Venardos, 2006)<sup>2</sup>, Habib Ahmed, 2006<sup>3</sup>, Kamran Nadri, 2007<sup>4</sup>, Ashraf Md Hashim, 2008<sup>5</sup>, Syafi’I Antonio, 2010).<sup>6</sup> Given, the rising global integration of the Islamic financial services industry, greater supervisory harmonization across national boundaries is essential.<sup>7</sup>

## Several Factors Caused to Harmonisation

There are several factors why the industry needs to be standardized or harmonized by shariah rulings in the first place. *First*, standards make control and regulation easy and manageable. A central bank regulating different shariah regimes will be ineffective, cumbersome and costly. *Second*, global market place has forced markets appetite for most financial products to converge into several products. Similarly, the global nature of Islamic finance industry entails appetite of customers to become less fragmented and diverse. *Third*, to contain a significant drawbacks from the previous strategy. In the case for Pakistan, for instance, in 1980’s it

---

<sup>1</sup> Harmonization in arabic term known as *tawfiq* which means to bring one thing (two or more different types of ideas) into harmony or agreement with another. Muhammad Amanullah, (2005), “Principles to be followed in partial harmonization between Islamic fiqh and Man Made law”, IIUM, pp. 5.

<sup>2</sup> Angelo M Venardos, (2006), *Islamic Banking and Finance in South-East Asia: Its Development and Future*, 2<sup>nd</sup> ed., (Singapore: World Scientific Publishing).

<sup>3</sup> Habib Ahmed, (2006), “Islamic Law, Adaptability and Financial Development”, *Islamic Economic Studies*, Vol.13, No.2, (Jeddah : IRTI & IDB), pp.119-141

<sup>4</sup> Kamran Nadri, (2007), “A Critique of Islamic Banking and Finance: Harmonization of Fatawa (Islamic Opinions) and the Nature of Modern Economic Life”, Working paper presented at IIUM International Conference on Islamic Banking Finance (IICiBF), (Tehran: Department of Economics of Imam Sadiq University), pp.1-14

<sup>5</sup> Ashraf Md Hashim, (2008), “Comparative Analysis of Malaysian Practice Vs. GCC Preference”, working paper presented at Colloquium On Islamic Finance Shariah & Operational Issues In Implementing Contemporary Products Shariah Divergence & Harmonisation, (Islamic Banking and Finance Institute Malaysia), pp.1-34

<sup>6</sup> M. Syafi’I Antonio & Aam Slamet Rusydiana, (2010), “What is The Future Outlook of Shariah Harmonization”, *Jurnal Dialog Balitbang, Kementerian Agama RI*, No.70, Vol XXXIII, pp.1-6

<sup>7</sup> Heiko Hesse et al., (2008), “Trends and Challenges in Islamic Finance”, *Journal of World Economics*, Vol.9, No.2, pp.175-193

experienced a time when Islamic banking system was developed in. Hence the strategy developed today is aimed not to standardize each and every practice just for the sake of standardization only.<sup>8</sup>

The process of harmonization has to be comprehensive. Because in some jurisdictions certain transactions are considered shariah-compliant while in others they may not be accepted as so.<sup>9</sup> It is extremely difficult to adjudge as to which is the closest to shariah.<sup>10</sup>

Wafica Ali Ghoul stated that the benefit of harmonization actually will lead to many advantages to Islamic Financial Institutions (IFI's) as follows;<sup>11</sup>

- (1) The harmonization of both regulation and Shari'ah interpretation would facilitate the industry's growth
- (2) Time and cost savings, financial stability, greater transparency and consistency in financial reporting, as well as improved public confidence.
- (3) Harmonization would take the compliance burden off of product developers' shoulders. Another benefit is increasing cross-border marketability; currently a product that is considered to be compliant in Malaysia, which is reputed to be rather liberal, may be rejected by GCC scholars and/or customers.
- (4) That greater harmonization of practices among Islamic financial institutions would help the consolidation and further expansion of the industry.
- (5) The lack of harmonization also has been forcing Islamic banks to enter into derivatives transactions with international financial

---

<sup>8</sup> *Op.Cid*, M. Syafi'i Antonio, (2010), "What is The Future Outlook of Shariah Harmonization", pp.1-6

<sup>9</sup> This issue involves with the application of *Bay' Inah* in Islamic financial transaction and sukuk (Islamic bond) which become a controversy among scholars of its permissibility in Islamic legal rules over Islamic countries. See; Amir Shaharuddin, (2012), "The *Bay' al-Inah* Controversy in Malaysian Islamic Banking", *Journal of Arab Law Quarterly*, Leiden, pp.499-511. Compare; "DSN MUI: Ulama Mesir Haramkan Sukuk Karena Alasan Maslahat", [www.hidayatullah.com](http://www.hidayatullah.com). Accessed; ySunday, yJanuary y13, y2013, by8:39:06 PM.

<sup>10</sup> Rasul, Bilal, (n.d), "*Identifying the Main Regulatory Challenges for Islamic Finance*", Q-finance, <http://www.qfinance.com/regulation-best-practice/identifying-the-main-regulatory-challenges-for-islamic-finance?page=1>, taken on Monday, 7:36/11/21/2012.

<sup>11</sup> Wafica Ali Ghoul, "*The Standardization Debate in Islamic Finance: A Case Study*", working paper presented at 8<sup>th</sup> International Conference on Islamic Economics and Finance, Doha, Qatar 2011. pp.1-14.

institutions, in order to avoid the complexities of dealing with two Shari'ah boards if they were to deal with another Islamic bank.

### **Problem of Harmonization**

The problem arises where the principles and procedures for specific contracts are not so easily found and therefore have to be derived from the *fatwas*, or interpretations of the shariah scholars. The *fatwas* which awarded on financial transactions differ amongst scholars and across jurisdictions, which produces the problem of pluralism in shariah interpretations. There are mainly five schools of thought in Islamic jurisprudence for example, Hanafi, Shafi'i, Hanbali, Maliki, and syiah Ibadi amongst others. Each school of thought has its own set of *muftis* (scholars) on Islamic financial issues which, more often than not, creates conflict and ambiguity in decisions on the veracity of a transaction in terms of its compliance with the shariah.<sup>12</sup> Put it simply, Since Islamic law itself is divided between different juristic schools of thought (*madzahib*), which provide guidance on the analytical reasoning (*ijtihad*) or interpretative analogy (*qiyas*) of the general principles of the shari'ah, there is no consensus (*ijma*) on the religious compliance of certain products and transaction structures.<sup>13</sup>

For instance, there are differences between the method in which Dubai and Malaysia deal with Shari'a compliance. However, there are distinct advantages in Malaysia's approach of having a centralized Shari'a approval structure, as opposed to Dubai's, which is based on each issuer having its own Shari'a Board. There problem is that the number of differing Shari'a interpretations that prevail in the Middle East; the conviction with which they are held; and the fact that it is a cross border regional market: all place the prospect for conformity of interpretation and regulatory administration beyond reach –at least for the present.<sup>14</sup>

An example in the case of Islamic Bond or *Sukuk* which particularly highlights the divergence in views of Islamic scholars. One of the most

---

<sup>12</sup> *Op.Cid*, Rasul, Bilal, (n.d.), "Identifying the Main Regulatory Challenges for Islamic Finance", taken on Monday, 7:36/11/21/2012.

<sup>13</sup> *Op.Cid*, Heiko Hesse et.al, (2008), "Trends and Challenges in Islamic Finance", pp.175-193

<sup>14</sup> *Op.Cid*, M. Syafi'I Antonio, (2010), "What is The Future Outlook of Shariah Harmonization", pp.1-6

popular Islamic financial instruments, the *sukuk* have questions looming over them. The renowned shariah scholar Sheikh Muhammad Taqi Usmani believes that the guarantee to pay back the invested capital in *sukuk* undermines the tenets of the shariah by compromising on the risk and profit or loss sharing philosophy. Further more, Sheikh Usmani contends that the investment must be consequential to the investor where profits and losses both have to be anticipated.<sup>15</sup>

The different jurisdictions which opposed by Islamic financial Institution caused to adopting different models with respect to Shariah governance. There are as follows;

1. Conventional approach: Regulators do not possess the remit or may, as a matter of stated policy, not regulate Shariah compliance directly; however, the regulators may require disclosure of material information to investors, which includes details of Shariah compliance. For example, in France, the compliance of the issue with Shariah rules does not fall within the remit of the AMF (France Monetary Authority). It is the responsibility of the issuers, with assistance from their advisers, to incorporate into the prospectus the relevant elements, including appropriate details of the Shariah board involved in the transaction, which provide the necessary information to enable investors to make an informed decision.
2. Shariah systems approach: Firms are required to have their own Shariah boards. The governance, function and operation of Shariah board decisions are regulated. For example, Dubai: see DFSA's Islamic Financial Business Module (ISF).
3. Centralized approach: There are firm based Shariah boards, and also a central Shariah board which assesses the compliance of financial products and institutions. The example of this method of supervision are Shariah Advisory Councils (SAC) in both of Securities Commission of Malaysia and Bank Negara Malaysia and National Shariah Board of Indonesia. (SAC) was established in May 1996 to advise the Commission on Shariah matters pertaining to the ICM.
4. Other: Approaches which have not been specifically identified in this report or hybrid versions of the previous models.

---

<sup>15</sup> *Op.Cid*, Rasul, Bilal, (n.d.), "Identifying the Main Regulatory Challenges for Islamic Finance"; taken on Monday, 7:36/11/21/2012.

According to Jamal Abbas Zaidi, to harmonize the shariah standards have to delineate the possible arguments that may be put forward by citing the view of market leaders and regulators. By the view of both of them, the possible counter arguments by Shari'a scholars will be founded.<sup>16</sup>

Market leaders and legislators argued that harmonization of Shari'a standards will reduce transaction costs to the industry and to the regulators, helps the formation of efficient regulatory oversight, enhances the process of Shari'a compliance, and contributes to confidence and growth in the industry. Moreover, the lack of uniformity of standards for "Islamic banking" practices across Islamic countries caused to difficult to develop prudential regulatory standards across the Islamic banking institutions over Islamic countries.

In contrast, Shari'a scholars have a different opinion on harmonization of Shari'a standards, as follows;<sup>17</sup>

- 1) The standardization of Shari'a may become against the fundamental premise of *Ijtihad* which has existed for centuries. Because, if the rules become standard, and imposed by legal authorities, then *Ijtihad* cannot be applied anymore. This will eventually damage the vary reason that we are able to apply *Shari'a* in all times and places, that is, *Ijtihad* is the main reason why Shari'a is dynamic and is able to be applied in different circumstances.
- 2) There are different schools of thought in *Shari'a* (especially in *fiqh mua'amalat*) and these schools of thought differ in their opinions each other, although there are agreement on most important Shari'a issues. To standardize Shari'a rulings may mean the precedence of one school of thought over the other, which cannot be universally acceptable.<sup>18</sup>

---

<sup>16</sup> Jamal Abbas Zaidi, (2012), "Shari'a Harmonization, Regulation and Supervision", Islamic International Rating Agency, Working paper presented at: AAOIFI-World Bank Islamic Banking and Finance Conference 10-11 November, Manama, Bahrain, pp. 2

<sup>17</sup> *Ibid*, Jamal Abbas Zaidi, pp. 3

<sup>18</sup> See the diagram of Agreement and Disagreement in Islamic financial rules in the last page.

## How to Harmonize?

Some of scholars suggest that knowing *riba* in the contemporary times should be important to underpinning foundations of the modern political economy. Such as A rightful understanding of the circumstances and special social and economic problems helped the former jurists in centuries ago to bring up a grouping of harmonized ideas under a consensual term, named *riba*. Thus, finding a better definition of *riba* is the most urgent appeal of the abstracter branch of Islamic banking and finance.<sup>19</sup> While other scholars promote the alternative method to harmonize it, through Islamic financing based on *Muqarada* and *Musharaka* principles to replace *ba'i 'Inah* and *ba'i Dayn* which is unacceptable among several jurists.<sup>20</sup>

The rest, argued that harmonizing the regulation, may be possible through doing consensus in the *fatwas* by the centralization of the shariah rulings in a central Islamic authority such as the Islamic Fiqh Academy of the Organisation of the Islamic Conference (OIC), which is recognized by a large majority of scholars. The pursuit should be toward uniform regulatory frameworks based on principles and standards designed by universally accepted organizations such as the Islamic Financial Services Board (IFSB), the Accounting and Auditing Organization of Islamic Financial Institutions (AAOIFI), the General Council for Islamic Banking and Finance Institutions (GCIBFI), and also the Islamic International Rating Agency (IIRA).<sup>21</sup>

Harmonization due to taking place at the national and international levels. The need to have a 'global Shari'ah body' will be entrusted to harmonize 'diverse bodies of knowledge to one standard version'.

---

<sup>19</sup> *Op.Cid*, Kamran Nadri, (2007), "A Critique of Islamic Banking and Finance: Harmonization of *Fatawa* (Islamic Opinions) and the Nature of Modern Economic Life", pp.1-14

<sup>20</sup> Saiful Azhar Rosly & Mahmood M.Sanusi, (1999), "The Application Of *Bay' Al-'Inah* And *Bay' Al-Dayn* In Malaysian Islamic Bonds: An Islamic Analysis", International Journal of Islamic Financial Services, Vol.1 No.2, (India: International Institute of Islamic Business and Finance (IIBF)).pp.1-16

<sup>21</sup> *Op.Cid*, Heiko Hesse et al., (2008), "Trends and Challenges in Islamic Finance", pp. 175-193. see also; Rasul, Bilal, (n.d.), "Identifying the Main Regulatory Challenges for Islamic Finance", Q-finance, <http://www.qfinance.com/regulation-best-practice/identifying-the-main-regulatory-challenges-for-islamic-finance?page=1>, taken on Monday, 7:36/11/21/2012.

The need for greater plurality of approaches to widen the scope of knowledge and the type of scholars taking part in this discussion so that it encompasses the full scope of intellectual depth that one finds in Islamic scholarship.

In the other hand, While adapting the body of Islamic commercial law is the prerogative of the jurists, this effort also involving the Islamic legal infrastructure which is the cooperation of political leaders, by facilitating the legal fraternity as well as the law making and administration bodies of Muslim countries to grow Islamic finance industry.<sup>22</sup>

### **The Role Of Islamic Regulators In Harmonization**

At least, there are three organizations have been spearheading the effort to set standards followed by Islamic financial institutions (IFI's), namely the Islamic Financial Services Board (IFSB) and the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), as well as the International Islamic Financial Market (IIFM).

#### **1. The Role of IFSB**

Eventough IFSB<sup>23</sup> does not have any legal enforcement powers, but it hopes that the production of high quality standards will lead to their adoption and also these adoption can help Jurisdictions to mitigate systemic risk which threatens their financial stability. The Steps followed by IFSB in creating standards, are as follows;<sup>24</sup>

**Step 1:** a draft of a new standard is prepared through a joint effort by a team of participants from regulatory authorities and market players

**Step 2:** the Islamic Development Bank mandates that IFSB should forward the draft to the IDB's Shari'ah committee for approval.

**Step 3:** an exposure draft is issued by IFSB's technical committee, giving the public a period of between three to six months to comment through public hearings and educational workshops held by IFSB,

---

<sup>22</sup> *Op.Cid*, Habib Ahmed, (2006), "Islamic Law, Adaptability and Financial Development", pp.119-141

<sup>23</sup> was established in 2003 in Kuala Lumpur, Malaysia; it is an international organization which has been issuing standards for the effective supervision and regulation of IFI's.

<sup>24</sup> *Ibid*, Wafica Ali Ghoul, "The Standardization Debate in Islamic Finance...pp.1-14

**Step 4:** IFSB revises the exposure draft in light of what are usually constructive comments received both from regulatory authorities and the public.

**Step 5:** IFSB trains users of financial industry standards to make them comfortable to implement new standards through a program called “Facilitating the Implementation of IFSB Standards”.

## 2. The Role of AAOIFI

The role of AAOIFI<sup>25</sup> is doing screening in Islamic financial products, “product by product” to verify Shari’ah-compliance, and also expanding beyond that of being a mere standard setter to playing a more active role in ensuring the Shari’ah compliance of the products that Islamic financial institutions offer. The AAOIFI’s standards have been made mandatory for Islamic financial institutions in Bahrain, Dubai International Financial Centre, Jordan, Sudan, Syria and Qatar. AAOIFI standards have been incorporated into national guidelines and are adhered to by AAOIFI member institutions in other countries, including Indonesia, Lebanon, Malaysia, Saudi Arabia and the United Arab Emirates. However, the compliance of member institutions can only be enforced or fully monitored if AAOIFI standards are mandated at country level and then enforced by domestic regulators.<sup>26</sup>

## 3. The Role of IIFM

The role of International Islamic Financial Market (IIFM)<sup>27</sup> is stepping up its efforts to pave the way for harmonization or standardization of rules and practices for the sector, because the divergence in opinion between Shari’ah scholars over Islamic financial products has caused concern in the market. The IIFM also working on global rules for Shari’ah-compliant structured products to make them

---

<sup>25</sup> is an independent international organization based in Bahrain, which is supported by central banks, IFI’s, and other participants from the global Islamic banking and finance industry. It has been working on a set of international standards on accounting, auditing, corporate governance, ethics, and Shari’ah-compliance; its principles are followed by the majority of IFI’s.

<sup>26</sup> *Ibid*, Wafica Ali Ghouli, “*The Standardization Debate in Islamic Finance....*” pp.1-14

<sup>27</sup> is the leading Islamic finance standard-setting body based in Manama, Bahrain, it was formed by several central banks to resolve issues such as the divergence in opinion between Shari’ah scholars; it is considered to be a platform that aims to serve and benefit all industry stakeholders.

acceptable across borders as banks start selling more derivatives. IIFM's efforts reportedly include developing a common template for hedging instruments such as currency swaps.<sup>28</sup>

## Conclusion

The rising global integration of the Islamic financial services industry, greater supervisory harmonization across national boundaries is essential. Therefore, the process of harmonization has to be comprehensive. Because in some jurisdictions certain transactions are considered shariah-compliant while in others they may not be accepted as so.

In the conclusion, I agree with the last opinion of scholars, which conducting harmonization of regulation through centralizing the shariah rulings in acceptant sentral outhority such OIC, IFSB, AAOIFI and so on. Because, simply say that concensus is one method of the earliest scholars done to make the oneness of regulation in any matters, in terms of seek the problem-solving of Muslim ummah. *Wallahu A'lam*.

## References

- Ahmed, Habib, (2006), "*Islamic Law, Adaptability and Financial Development*", Islamic Economic Studies, Vol.13, No.2, (Jeddah : IRTI & IDB).
- Ali Ghoul, Wafica, "*The Standardization Debate in Islamic Finance: A Case Study*", working paper presented at 8<sup>th</sup> International Conference on Islamic Economics and Finance, Doha, Qatar 2011.
- Amanullah, Muhammad, (2005), *Principles to be followed in partial harmonization between Islamic fiqh and Man Made law*, IIUM.
- Hashim, Ashraf Md, (2008), "*Comparative Analysis of Malaysian Practice Vs. GCC Preference*", working paper presented at Colloquium On Islamic Finance Shariah & Operational Issues In Implementing Contemporary Products Shariah Divergence & Harmonisation, (Islamic Banking and Finance Institute Malaysia).
- Nadri, Kamran, (2007), "*A Critique of Islamic Banking and Finance: Harmonization of Fatawa (Islamic Opinions) and the Nature of Modern*

---

<sup>28</sup> *Ibid*, Wafica Ali Ghoul, "*The Standardization Debate in Islamic Finance....*" pp.1-14

- Economic Life*”, Working paper presented at IIUM International Conference on Islamic Banking Finance (IICiBF), (Tehran: Department of Economics of Imam Sadiq University).
- Rasul, Bilal, (n.d.), “*Identifying the Main Regulatory Challenges for Islamic Finance*”, Q-finance, <http://www.qfinance.com/regulation-best-practice/identifying-the-main-regulatory-challenges-for-islamic-finance?page=1>, taken on Monday, 7:36/11/21/2012.
- Rosly, Saiful Azhar & Sanusi, Mahmood M., (1999), “*The Application Of Bay’ Al’Inah And Bay’ Al-Dayn In Malaysian Islamic Bonds: An Islamic Analysis*”, International Journal of Islamic Financial Services, Vol.1 No.2, (India: International Institute of Islamic Business and Finance (IIIBF)).
- Venardos, Angelo M., (2006), *Islamic Banking and Finance in South-East Asia: Its Development and Future*, 2<sup>nd</sup> .ed., (Singapore: World Scientific Publishing).
- Heiko Hesse et.al., (2008), “Trends and Challenges in Islamic Finance”, Journal of World Economics, Vol.9, No.2.
- Zaidi, Jamal Abbas (2012), “Shari’a Harmonization, Regulation and Supervision”, Islamic International Rating Agency, Working paper presented at: AAOIFI-World Bank Islamic Banking and Finance Conference, Manama, Bahrain.
- Shaharuddin, Amir, (2012), “The Bay’ al-Inah Controversy in Malaysian Islamic Banking”, Journal of Arab Law Quarterly, Leide.

