

**BANK NEGARA MALAYSIA**  
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OPTIMAL SHARIAH GOVERNANCE IN  
ISLAMIC FINANCE

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# 1. Introduction

- Shariah requires certainty in the terms of contracts; in fact uncertainty is a reason for the invalidity of contracts.
- Given the fact that there are no authoritative and globally accepted ready-reference shariah texts applicable at domestic or global levels on fiq muamalat, financial institutions and counterparties who enter into shariah-based or shariah-compliant contracts often face problems deciding on the shariah applicable to their contracts.

# 1. Introduction

- The lack of such ready reference sources can not only create uncertainty in the legal relations between parties but also act a disincentive to entering into such contracts.
- It could also frustrate the growth of Islamic banking and the development of Islamic finance domestically and globally.
- Hence, the need for domestic and global bodies for shariah governance is apparent.

## 2. Establishing an Effective Shariah Governance Framework

- Taking Malaysia as an example, in the early years of Islamic banking each Islamic bank was required to have a shariah advisory council.
- In addition there were shariah advisory councils set up at Bank Negara Malaysia, the Securities Commission, Bursa Malaysia and for the Takaful Operators.

## 2. Establishing an Effective Shariah Governance Framework

- The proliferation of shariah councils:
  1. gave rise to the possibility of differing or even conflicting views or rulings on the same issues being made by different councils;
  2. resulted in duplication of work;
  3. over-stretched scarce resources; and
  4. imperceptibly created situations of one-upmanship.

## 2. Establishing an Effective Shariah Governance Framework

- This situation was partly addressed in 2003 when Parliament amended the Central Bank of Malaysia Act to establish the [National] Shariah Advisory Council (SAC).
- The SAC “shall be the authority for the ascertainment of Islamic law for the purposes of Islamic banking business, takaful business, Islamic financial business, Islamic development financial business, or any other business which is based on Shariah principles and is supervised and regulated by the Bank”.

## 2. Establishing an Effective Shariah Governance Framework

- The various shariah advisory councils set up in the banks were turned into shariah advisory committees.
- By this single act a degree of certainty in the shariah relating to Islamic banking and financial transactions has been created. However, total integration has not yet been achieved. There are still shariah advisory councils functioning in the Securities Commission, Takaful Operators, Bursa Malaysia, etc.
- Ideally, all these bodies should be brought under one umbrella.

### 3. Different Modalities in Shariah Governance

- Modality means a prescribed method of procedure.
- This should not be an issue if it relates to procedural matters in shariah governance.
- The real problem would be when modalities encompass the form and content of shariah rulings.

### 3. Different Modalities in Shariah Governance

- There could be no single modality that would be suitable for all situations. The ultimate criterion should be that the modality adopted should adequately serve the purpose.
- One modality could be in the form of referral of current issues by relevant bodies for shariah rulings.

### 3. Different Modalities in Shariah Governance

- The referring body should ensure that the referral is complete with the full factual background of the matter set out concisely and the issues to be answered framed appropriately.
- Where a specific ruling or answer is required the matter or issue that is referred should also be specific and all relevant particulars should be given.
- There may be other modalities such as allowing interested parties or their representatives to appear before the Council to assist it to reach a decision or make a ruling.

## 4. Development of Shariah Governance Framework at Domestic and International Levels

- At the domestic level the development of a shariah governance framework would be relatively easy. Indeed many countries already have such framework.
- At the international level, however, the matter could become more protracted and even contentious.

# 4.1 SAC at the Domestic Level

- For domestic level, the Malaysian model (the BNM SAC) may be considered, but with some modifications.
- The overall function of the SAC has been set out earlier.
- The SAC consists of such members as may be appointed by the Minister of Finance, on the recommendation of the Bank, from amongst persons who have knowledge or experience or both in the Shariah and also –
  - banking;
  - finance;
  - law; or
  - any other related discipline.

## 4.1 SAC at the Domestic Level

- The Central Bank is required to consult the SAC on Shariah matters relating to Islamic banking business, takaful business, Islamic financial business, Islamic development financial business, or any other business which is based on Shariah principles and is supervised and regulated by the Bank.
- The Bank may issue written directives in relation to those businesses in accordance with the advice of the SAC.

## 4.1 SAC at the Domestic Level

- Where in any proceedings relating to Islamic banking business, takaful business, Islamic financial business, Islamic development financial business, or any other business which is based on Shariah principles and is supervised and regulated by the Bank before any court or arbitrator any question arises concerning a Shariah matter, the court or the arbitrator, as the case may be, may –

## 4.1 SAC at the Domestic Level

- (a) take into consideration any written directives that have been issued by the Bank; or
- (b) refer such question to the SAC for its ruling.

## 4.1 SAC at the Domestic Level

- Any ruling made by SAC pursuant to a reference made to it shall, for the purpose of the proceedings in respect of which the reference was made -
  - (a) if the reference was made by a court, be taken into consideration by the court in arriving at its decision; and
  - (b) if the reference was made by an arbitrator, be binding on the arbitrator.

# 4.1 SAC at the Domestic Level

- The rationale for this distinction in the binding effect of the rulings between an arbitral tribunal and the court is difficult to see. The rulings should be binding on both bodies.
- Recent cases in the courts have shown that the judges, who are not trained in the shariah, would benefit from, and should be held to be bound to apply, the rulings of the SAC.
- This would create certainty in the law.

## 4.2 SAC at the International Level

- There is no SAC at the International level for Islamic banking at present. But there is a dire need for such a body.
- The requirement for certainty in the applicable shariah is more pressing at this level as the transactions are cross-border. Different laws, including shariah, will be applicable in different countries. Issues will arise as to which law shall apply and hence the possibilities of conflict of laws situations arising are real.

## 4.2 SAC at the International Level

- Such issues must be addressed at the global level otherwise cross-border transactions could get mired in legal conflicts which would ultimately put a damper on transactions based on the shariah.

## 4.2 SAC at the International Level

- An International Shariah Advisory Council (ISAC) should be established.
- It may be modelled on the domestic councils which exist in many countries, but of course the logistics will be more elaborate and complex.
- But the real issue is not the establishment of the body itself but reaching agreement on its charter, i.e. its composition, role and the legal status to be accorded to its rulings.

## 4.2 SAC at the International Level

- The features of the ISAC should include:
- it should be accorded recognition by all acceding countries;
- its rulings should be made binding on all acceding countries and all international tribunals, courts and arbitral bodies, hearing cases involving the shariah;
- it should be open to any body or institution whatsoever to refer shariah issues to it and obtain rulings; where such requests come from non-acceding countries regulated fees or charges may be imposed.

## 4.2 SAC at the International Level

- An ISAC is an absolute necessity and is urgently needed.
- The development and growth of Islamic banking and finance must be supported by such a sound and reliable machinery for resolving legal issues that arise whether at the time that contracts are entered into or later when disputes arise.

## 4.2 SAC at the International Level

- The task of establishing an ISAC would not be easy; some might think that the hurdles and obstacles are too formidable.
- But those are no reasons to delay the process.
- There are precedents, e.g. IFSB, AAOIFI, etc.

## 4.2 SAC at the International Level

- This is one opportunity to demonstrate:
  - the universal nature of the shariah and that it is adaptable and can respond to the demands of global business transactions and that it is relevant to modern times;
  - that the global Muslim community can reach consensus where it is required; and
  - that Islamic banking and finance is ***the*** system of, and for, the future.

# End

- **Wallahu A'lam.**
- **Thank you. Wassalam.**
  
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