A Study on the Shariah Decision Making Processes Adopted by the Shariah Committee in Malaysian Islamic Financial Institutions

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INTRODUCTION

In Malaysia, the supervisory authority on Shariah matters at the Central Bank is known as the Shariah Advisory Council (SAC) and at the respective bank, is the Shariah Committee (SC). These two bodies are conferred with the specific authority to decide issues of Shariah compliance in the Islamic banking. They must ensure that all Shariah related issues pertaining to the businesses of the bank are Shariah compliant. The bank has to consult the committee and to adopt all the resolutions decided by their respective committee. This is stated in section 28 of the IFSA which states that the IFIs must ensure that all its activities are compliant with the Shariah. Furthermore section 30(1) of the same Act provides that the IFIs must establish the Shariah Committee. For the SAC, sections 56 and 57 of the CBMA provide similar provision that is when the dispute arises, it must be brought to the arbitration panel or to the court and the ruling made by the SAC shall be binding on the IFIs.

The SC has been defined as a body established under a specific or general statute of an Islamic bank of a particular country with the main objective of ensuring that the operations of the bank are not violating any Shariah principles (Sudin, 1997). The committee comprises mainly of experts in Shariah or more specifically fiqh mu`amalat. The Shariah compliant issue is very significant to the business of the bank. It also contributes in terms of innovations resulting in products suitable for modern and prudent banking activities (Bakar, 2002).
As far as Shariah compliance is concerned, it is a mandatory requirement on the Islamic bank to ensure that its aim and operations, business, affairs and activities are in compliance with Shariah (s. 28(1) IFSA 2012). The Shariah Governance Framework 2010 also provides similar provision that it is its objective to provide comprehensive guidelines to the board, the Shariah Committee of the IFIs in discharging their responsibilities in relation to Shariah matters. The Shariah compliance is the core and essence of Islamic financial system. It is the expectation of the Bank Negara Malaysia on the IFIs to ensure that all business activities and operations are Shariah compliant. Hence, the Shariah review and the Shariah audit functions are formed and included in the shariah governance framework. This is a clear expectation on the SC members so that they may perform an oversight role on Shariah related matters to the institution’s business operations and activities. They are responsible and accountable for all their decisions, views and opinions related to Shariah matters (SGF, 2010). The compliance with Shariah rules and principles is the raison d’etre of the IFIs (IFSB, 2009)

In order to ensure that the expectation is fulfilled, the members of the SC must bethose who are equipped with not just general knowledge of Shariah or other disciplines, but more importantly have reached a specialized level of being learned and expert in FiqhMu`amalat (IFSB, 2009). The SC must consist at least of five scholars and the majority must hold the degree in Shariah and this must include the study in UsulFiqh or FiqhMuamalat. Other people may also be appointed but they must be the professionals in the field of law or finance so that they could assist further the deliberations of the Shariah related matters under discussion. However they must not form the majority of the Shariah Committee which, must not consist of less than five people.

The decisions of the SC which are made through the exercise of a collectiveijtihadis binding on the Islamic Financial Institutions and the court or arbitrator. This is stated in section 57 of the CBMA 2009 which states that “Any ruling made by the Syariah Advisory Council pursuant to a reference made under this Part shall be binding on the Islamic Financial Institutions...and the court or arbitrator making a reference under section 56” (Rusni, 2013, p. 12.). Furthermore sections 28 (5) and 29 (6) of the IFSA provide that any IFIs which fails to ensure Shariah compliance of its activities shall subject to a fine of RM25 million or imprisonment of not more than 8 years. Making a Shariah ruling binding and mandatory is important, otherwise the essential purpose of establishing the Shariah supervisory board is not achieved (Bakar, 2002).

Understanding the sources of Shariah:
Shariah is defined as the sum total of Islamic teaching and system, which was revealed to Prophet Muhammad s.a.w. recorded in the Qur’an as well as deducible from the Prophet’s divinely guided lifestyle called the sunnah (Akram, 2008). The Qur’an and the sunnah contain rules and regulations revealed byAllah s.w.t and these two are known as the primary sources of Islamic Law. Al-Quran, Sunnah and Ijma’ are transmitted proofs and their authority and binding force are independent of any rational justification (Kamali, 2004). Qiyas is another primary source but it is a rational proof because its validity is founded on an established hukm of the Qur’an ‘Sunnah or Ijma’ (Akram, 2006). The commonality of the illah in qiyas is matter of opinion and ijtihad(Kamali, 2004)The authority of these four sources is based on the Qur’anic verse which addresses the command to the Muslims to refer to these sources to find solutions for disputes or issues.Allah SWT says: “O you who believe! Obey Allah SWT and obey the Prophet (Muhammad), and those charged with authority among you. And if you differ over anything among yourselves, refer it to Allah SWT (Al-Quran) and the Prophet (Al-Sunnah).” (Surah al-Nisa’: 59). It is also based on the Allah SWT also says: “And whatever the Prophet has given you – take it; and what He has forbidden you (from doing) – refrain from it.” (Surah al-Hasyr: 7)(IBFIM, Internet)

The development of the Shariah also relies on other sources which are termed as the secondary sources. These sources are formulated by the scholars based on their deep understanding of the primary sources. These sources are needed because there are a lot of new cases which did not occur during the time of the Prophet s.a.w. and hence, new ijtihad is necessary in order to find the ruling. These sources are like qiyas, maslahah, istishtan, istishhab, saddzari'ah, 'urf, maqasidshar'Iyyah, siyasatshar’Iyyah and many more. The basis for these secondary sources is a hadith of the Prophet s.a.w. when he appointed Muaz as a judge in Yemen. The Prophet s.a.w. asked Muaz that what he would do to solve disputes while in Yemen. The Prophet s.a.w. said: “How will you judge when the occasion of deciding a case arises?” He replied; I shall judge in accordance with Allah’s Book. The Prophet PBUH then asked him, “What will you do if you do not find guidance in Allah’s Book? He replied: I will act in accordance with the Sunnah of the Prophet s.a.w. The Prophet PBUH asked him again, “What will you do if you do not find guidance in the Sunnah of the Prophet s.a.w.? He replied: I shall do my best to form an opinion and spare no pains. The Prophet s.a.w. then patted him on the breast and said: “Praise be to Allah s.w.t. who helped the Messenger of the Messenger of Allah swt to find a thing which pleases the Prophet s.a.w. (Nyazee, 2002)

Ijtihad means striving to the utmost to discover the law from the texts through all possible means of valid interpretation (Nyazee, 2002). Its validity is derived from divine revelation and hence is always in harmony with the Qur’an and the Sunnah (Kamali, 1991). The scholar who performs ijtihad must possess the appropriate qualification such as the knowledge of the sources of the Shariah, knowledge of Arabic and familiarity with the
prevailing customs of society, upright character, as well as the ability to formulate independent opinion and judgment (Kamali, 2006). As far as the modern transaction is concerned, the *ijtihad* is significant in order to extend the ruling to new cases that are not covered clearly by the Qur’an and the Sunnah. Therefore the function of the *mujtahid* to derive the new ruling for the new case from the general principles available in the Qur’an and the Sunnah. The *mujtahid* is therefore must open their minds to the current development and realities and to interpret the whole text in its totality by looking at the objectives of the Shariah in order to materialize its ultimate objectives in any particular issue. (Islamic Capital Market, 2009)

The exercise of *ijtihad* would be indirectly instrumental in bringing about disagreement amongst Muslim scholars (Bakar, 2002). In performing *ijtihad* in modern Islamic financial matters to find new rulings for new cases, there are three possible approaches adopted by the members of SC (Akram, 2008). In fact, these approaches occur to all rulings of Islamic law. The first approach is the rigidity and inflexibility in making Shariah decisions. This occurs due to the attitude of fanatism towards a particular school of law, views or scholars. Other reasons are the reliance on the literal meaning of the text of the Quran and hadith without referring to its objectives or maqasid, and due to the unnecessarily propagating the usage of the proof (blocking the means to evil) in disputed issues (Akram, 2008)

The second approach is the excessive flexibility or *al-tasahul*in making Shariah decisions. It is due to the excessive utilization of the principle of *maslahah* and *darurah*. It is also due to the excessive application of the mode of facility (*tathab‘* al-rukhas) and taking the easiest view of the *mazhab* (*al-tashfi`hayn al-mazahib*) in solving problems. This approach is not quite correct because as far as choosing the different views provided by the schools of Islamic thought, the method should be by looking for the strongest view and not the easiest as the strongest view is the best view to be followed. Finding legal device (*al-tahayut al-fiqhiyyah*) in order to justify certain rulings is also a type of excessive flexibility. IbnQuyyim elaborated that it is not allowed for scholars to engage the *haram* and *makruh* actions as legal devices. (Akram, 2008, p. 63)

Finally is moderate approach in arriving at Shariah decisions. Islam emphasizes on the importance of moderation (*wasatiyyah*) in everything. It means that the scholars shall investigate the issues and arrive at a decision without compromising the fundamentals of the Shariah. Imam al-Shatibi said: A vice mufti is the one who provides moderate and practical solutions for the public and will not burden them with unnecessary burdens (*al-shiddah*) and will not also be inclined towards excessive flexibility (up to the point of compromising Shariah principles). (Akram, 2008, p. 65)

**The Shariah Decision Making Process Practiced by IFIs:**

Before a meeting is conducted by the SC, a proper presentation of request for decisions on Shariah-related matters must be prepared in the form of proposal papers which must clearly state the purpose of the paper. It must contain all the necessary details which adequately prepared and subsequently be presented to the SC by the officers in charge. Where appropriate, other relevant organs of governance shall also be provided with a copy of the proposal papers. All papers for presentation shall be submitted to the secretary of the SC for onwards distribution to members of the SC not later than one week prior to the SC’s meeting. Any paper submitted after the cut-off time shall be presented to the SC only upon approval of the Chairman (IFSB, 2009)

The SC should determine a quorum for its meeting as appropriate, based on the total number of members sitting on its panel. For example, a SC comprising five members may set its quorum as three. In the event the SC includes professionals, such as lawyers, accountants or economists who have some knowledge of Shariah but are not particularly trained in that discipline, as members of the SC, the quorum set should ensure that they would not dilute the value of decisions made by the SC on Shariah-related matters. Although those professionals are treated as equal to the other members sitting on the SC, they should not vote on Shariahmatters. Preferably, professionals such as lawyers, accountants and bankers can still be called in to advise the SC during meetings, but they should not actually be part of the composition of the SC. Members who are unable to attend but have valid reasons shall be recorded as “Absent with Apology”, whilst absenteeism without valid reason shall be treated as “Absent without Apology”, and the minutes shall be recorded as such. (IFSB, 2009)

The Operation Procedures for the SC by the IFSB states about the frequency of meetings and attendance. It provides that the meetings shall be held regularly in order to ensure that the SC is kept sufficiently in touch with the business of the IFIs. The regular meeting is necessary so that the operations of the IFI are not adversely affected because of the difficulty in securing the SC’s approval for policy and decision. According to the SGF 2010, by having the regular meeting, the SC is kept sufficiently in touch with the business of the IFI (SGF, 2010). The regularity requirement of the meeting means that the meetings of the SC shall be held at least once in every two (2) months (IFSB, 2009 and SGF 2010).

The SC member is expected to contribute and allocate adequate time and efforts to discharge his duties effectively. The SC member must attend at least 75% of the SC meetings held in each financial year. Where necessary, the participation of the SC can be facilitated by means of video or telephone conferencing. Finally, it states that the number of SC meetings held in the year, as well as the attendance of every SC member shall be disclosed in the IFI’s annual report (IFSB, 2009 and SGF 2010).
The minimum quorum of a SC meeting shall be two-thirds with majority of attending members must be members with Shariah background. If there is difference of opinions among the member of the SC, the decisions shall be made on the basis of two-third of the members present, with majority of the two-third votes shall be members with Shariah background (IFSB, 2009 and SGF 2010). This requirement suits the nature of the duty because most of the issues involved in banking and finance are commercial and financial in character, such as contracts and related matters such as formation of contract, termination of contract, elements affecting a contract such as fraud, misrepresentation, duress or rights and liabilities arising from a contract (Bakar, 2002).

Pre-product approval process:

According to the SGF 2010, pre-product approval process involves namely the issuance of Shariah decisions, product structuring or design processes backed by comprehensive Shariah research, vetting of contracts and agreements as well as compliance checks before the product is offered to the customers. It includes the procedures that need to take place at the product design or at the development stage. This occurs before the product is offered to the customers. There shall be a formal and transparent procedure for issuance of Shariah decisions which are well documented and approved by the board and SC. An IFI should ensure that the pre-product approval process includes, among others, a review of the concept, structure, term sheet, documentations, policies and procedures, pamphlets, brochures and advertising materials. The documents shall be approved by the SC of the IFI. (SGF, 2010, p. 40)

At the product design/development stage, an IIFS would want to ensure that its Shariah Governance System covers the relevant ex-ante processes, namely (i) issuance of Shariah pronouncements/resolutions, and (ii) compliance checks, before the product is offered to the customers. Hence, prior to establishing or engaging its SC, an IIFS should be fully aware of its options, which include the appointment of a reputable and credible SC, the support of the SC by appointing an ISCU or an individual Shariah officer, whereby the SC shall be able to mandate and delegate some of its functions to the ISCU; and lastly for the SC to have at least three members, possibly trained in different schools of jurisprudence, have a mix of members with different lengths of experience, and where appropriate, comprise of different nationalities. In addition to their Shariah expertise, members of the SC should possess some exposure in the areas of commerce or finance – for example, in retail banking, Takaful undertaking or capital market products (IFSB, 2009)

Product approval process:

The Shariah non-compliance may occur during the product development process that could originate from improper structuring of products, lack of internal research in understanding the appropriate Shariah concepts, and misrepresentation of the product at issuance or marketing stage of the product. The IFI must acknowledge that managing a Shariah-based institution has to be a continuous process, and it requires the IFI to have in place adequate and appropriate measures and controls, including risk-mitigating instruments that could address or mitigate Shariah non-compliance instances (SGF, 2010).

Therefore, the IFI is expected to refer all Shariah issues related to its end-to-end product development design and process to the SC. The requirement for an advice or a decision must be made in a comprehensive manner for effective deliberation by the SC. This will include explaining the process involved, documents used and other necessary information. All new products shall be certified by the SC and must be backed by the relevant fiqh literature, evidence and reasoning. There shall be rigorous deliberation process among the SC as well as detailed scrutiny of the legal contracts and other documents relevant to the products or transactions (SGF, 2010).

The interpretation of the Shariah rules and principles based on the discipline of Fiqh al-Muamalat is a matter of the professional judgment of members of a SC. Therefore, as far as possible, the members of a SC should seek to reach a consensus in arriving at a decision of the board. Only when consensus cannot be achieved within a reasonable period of time should any decision be taken on the basis of a simple majority. At the same time, members of the SC should be consistent in the opinions that they provide in serving on the SCs of different IIFS. Consistency in this respect is related to competence and independence, as mentioned above, and also is a matter of professional ethics (IFSB, 2009)

There are several steps that can be adopted by members of the SC in order to appear more consistent in their decisions. In countries where there is a central authority issuing the Shariah pronouncements/resolutions, the SC at the IFIs is usually required to follow and adopt such Shariah pronouncements/resolutions as are issued by that central Shariah authority. In jurisdictions where there is no such body, it is recommended that the Shariah board follows and adopts the Shariah pronouncements/resolutions issued by internationally recognised bodies that issue authoritative opinions on Shariah matters. If that is not possible – for example, where no such internationally recognised body has come up with an authoritative opinion on the product to be offered by the IIFS – the SC should exercise its best efforts in documenting and publishing the Shariah pronouncements/resolutions issued by the SC and/or its members so that they can be openly assessed by the industry’s stakeholders (subject to the appropriate observance of confidentiality) (IFSB, 2009).
Post product approval:
Post-product approval process involves monitoring product implementation to ensure compliance with Shariah principles, identifying the area of potential Shariah non-compliance risks and proposing the relevant actions to the management. Ex-post considerations that should be observed at the product offering stage – that is, after the product has been offered to the customers and transactions have been carried out. An IFI must ensure that post-product approval in its Shariah governance framework also includes internal Shariah review and Shariah governance reporting. Without such follow-up, the IFI would not be able to monitor the consistency of its Shariah compliance and effectively manage any Shariah non-compliance risks that may arise over time (SGF, 2010).

For good risk management and progressive verification of product viability, an IIFS would want to ensure that its Shariah Governance System covers the relevant ex-post processes – namely, internal Shariah review and Shariah governance reporting. Without such follow-up, the IIFS would not be able to monitor the consistency of its Shariah compliance and effectively manage any Shariah compliance risk that may arise over time. Hence, an IIFS should be fully aware of the possibility of, among other things:
_ ensuring that the SC is more focused, with more time spent on each assignment and conflicts of interest adequately managed, which may imply that its members should not serve more than a limited number of clients;
_ hiring and nurturing young members of the SC with promising potential to expand the talent pool in the profession; and
_ engaging other professionals, such as lawyers, accountants and economists, to assist and advise the SC, especially on legal and financial issues (IFSB, 2009).

From time to time, members of the SC should participate in various seminars, workshops and meetings of scholars specialised in Fiqh al-Muamalat to present and debate existing and new Shariah pronouncements and resolutions. In fact, members of the SC should also consider participating in other similar events on banking and finance, Takaful, capital market, etc. which may be outside their Shariah domains, in order to expand their knowledge and understanding of developments in the IFSI (IFSB 2009).

Members of the SC must also expect to answer questions from shareholders and the public in a general assembly or similar forum. For better recording and dissemination of information, it would be helpful if they were to produce in the annual reports a section on Shariah compliance by the IIFS and Shariah pronouncements/resolutions issued by the SC and/or its members, including clarifying the process of how the SC reached its decisions (IFSB 2009).

The IIFS ensure that the SC adopts a specified process for changing, amending or revising any Shariah pronouncements/resolutions issued by it. Appropriate and timely disclosure shall be made to shareholders and/or the public whenever the SC and/or its members depart from or revise any of its Shariah pronouncements/resolutions (IFSB 2009).

Furthermore, there is a review process to ensure the Shariah compliance of the bank. The Shariah review function refers to regular assessment on Shariah compliance in the activities and operations of the IFI by qualified Shariah officers, with the objective of ensuring that the activities and operations carried out by the IFI do not contravene with the Shariah (SGF, 2010).

Apart from these, there exists audit process on the Shariah compliance matters of the bank. Section 37 and 38 of the IFSA provides the appointment of person by institution or Bank to conduct audit on Shariah compliance. The person or institution appointed shall have the duties and functions that may be specified by the Bank and shall submit a report to the Bank on the audit carried out. The Shariah audit is the periodical assessment conducted from time to time, to provide an independent assessment and objective assurance designed to add value and improve the degree of compliance in relation to the IFI’s business operations, with the main objective of ensuring a sound and effective internal control system for Shariah compliance (SGF, 2010).

Conclusion:
The new ruling issued by the SC must be forwarded to the Bank Negara of Malaysia for approval. At the Central Bank, there exist the Department of Islamic Banking and Takaful which scrutinizes the ruling or product from Shariah perspectives. The representatives of SC will be required to attend the meeting to deliberate further the ruling or product in front of the SAC members in the Bank Negara. The approval or disapproval of the SC ruling will be then decided by the SAC. The SAC will deliberate the issue thoroughly. In fact, the SAC functions as the advisor on Shariah issues to the Bank Negara. It is believed that similar procedures and guidelines applicable to the SC are also applicable to the SAC. It is also believed that the members of the SAC also have different approaches as far as the methodologies are concerned.

REFERENCES

Shariah Governance Framework (SGF), 2010.