

**SHARI'AH ADVISORY COUNCIL: A COMPARATIVE
ANALYSIS BETWEEN BANK NEGARA MALAYSIA
AND SECURITIES COMMISSION**

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AUTHOR DECLARATION

بِسْمِ اللَّهِ الرَّحْمَنِ الرَّحِيمِ

I hereby declare that the work in this academic project is my own except for quotations and summaries which have been duly acknowledged.

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ABSTRAK

Kajian ini merupakan kajian yang menggabungkan dua method penyelidikan yang asas iaitu kajian perpustakaan dan kajian lapangan. Kajian ini bertujuan untuk mengemukakan analisis perbandingan Majlis Penasihat Shari'ah di peringkat pernggubalan iaitu di Bank Negara Malaysia bagi industri perbankan Islam dan takaful dan di Suruhanjaya Sekuriti bagi industri pasaran modal Islam. Untuk memperolehi data, beberapa teknik kajian telah digunapakai iaitu penyelidikan dan pencarian maklumat di perpustakaan-perpustakaan terpilih dan internet dan temubual. Hasil kajian menunjukkan adanya persamaan karektor dan elemen yang terdapat pada kedua-dua Majlis tersebut. Dapatan dari hasil kajian ini menunjukkan perlunya kepada penyatuan di antara kedua-dua Majlis tersebut untuk membantu dalam perkembangan kewangan Islam di Malaysia.

ABSTRACT

This research project combines two research methodologies that are library-based research and field-work based research. It attempts to seek a comparative analysis of the *Shari'ah* Advisory Council in respect of Islamic banking and takaful industry and Islamic capital market industry. As such, the research has taken the experience of Bank Negara Malaysia and the Securities Commission accordingly. This research concludes that the councils share similarities in terms of certain characteristics and workability. Thus, there is a valuable need for unification between both councils to support the governance of Islamic financial growth in Malaysia.

ملخص البحث

هذا البحث يعتمد على الدراسة المكتبية والدراسة الميدانية. ويهدف هذا البحث إلى تقديم تحليل المقارنة بين مجلس الإستشارية الشرعية في مرحلة وضع المبادئ بالبنك الوطني الماليزي لمجال البنك الإسلامي والتكافل وبين مجلس الإستشارية الشرعية في "سوروهنجايا سيكوريبي" لمجال تسويق رأس المال الإسلامي. وتم جمع المعلومات في هذا البحث عن طريقة البحث عنها في المكتبات المعينة وشبكة الإنترنت والمقابلة الشخصية. وتشير نتيجة البحث إلى أهمية توحيد المجلسين لتحقيق الهدف في مساعدة تطوير المالية الإسلامية بماليزيا.

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GLOSSARY

Terminologies used throughout the book

<i>Ahwal Sakhsiyyah</i>	Islamic personal law
<i>Asnaf</i>	group of peoples that deserve zakat
<i>Bai Bithaman 'Ajil</i>	deferred payment sale
<i>Bai' dayn</i>	sell of debt
<i>Bai' ma'dum</i>	buying and selling something that exist
<i>Bai' muzayadah</i>	sale by auction
<i>Bai' wafa</i>	sale with a right in the seller to repurchase the property by refunding the purchase price
<i>Daman / Kafala</i>	suretyship
<i>Dha' wa ta'ajal</i>	creditor writing off part of the debt when the debtor settles the balance of his debt earlier
<i>Fiqh</i>	substantive law
<i>Fatwa</i>	decree or religious edict from a qualified scholar
<i>Gharar</i>	elements of uncertainty and cheating
<i>Ghalat</i>	error in perception
<i>Hibah</i>	gift inter-vivos
<i>Hukm</i>	legal text
<i>Ibadat</i>	Islamic rules of ritual worship
<i>'Ibra</i>	surrendering rights and claims
<i>Ijarah</i>	asset leasing
<i>Ijarah thumma al-bai'</i>	leasing with an option to buy
<i>Ijtihad</i>	reasoning by qualified scholars to obtain legal rulings from the sources of the <i>Shari'ah</i>
<i>Iqta</i>	government award
<i>Inter alia</i>	among others
<i>Jinayat</i>	Islamic criminal law
<i>Istisna</i>	manufacture
<i>Maisir</i>	gambling
<i>Muamalat</i>	Islamic transaction law
<i>Mu'awadhat maliyyah</i>	exchange contract
<i>Mudarabah</i>	partnership
<i>Murabahah</i>	mark-up sale
<i>Musyarakah</i>	partnership
<i>Musharakah mutanaqisah</i>	diminishing partnership
<i>Maslahah rajihah</i>	tangible deeds
<i>Qabadh</i>	possession
<i>Qard hasan</i>	benevolent loan
<i>Qat'i</i>	clear-cut and decisive
<i>Qur'an</i>	holy book of Islam
<i>Raison d'etre</i>	the purpose of something to exist
<i>Riba</i>	usury
<i>Sadd zari'ah</i>	blocking the mean to evil
<i>Shari'ah</i>	Islamic law
<i>Suftajah</i>	financial notes
<i>Sunnah</i>	practice of Rasulullah

<i>Ta'widh</i>	compensation
<i>Ujrah</i>	rental or fees for usage of labour and benefits
<i>'Umum balwa</i>	unfavourable widespread situation
<i>'Urbun</i>	earnest money, down payment
<i>Usul Fiqh</i>	recognized methodology of deriving legal ruling
<i>Wadiah</i>	guaranteed deposit
<i>Waqf</i>	religious property
<i>Zakat</i>	religious alms
<i>Zanni</i>	not clear-cut

TRANSLITERATION

1. Alphabet

<u>Arabic</u>	<u>Latin</u>	<u>Example</u>	<u>Transliteration</u>
ء	'	النساء	An-Nisā'
ب	B	بدري	Badri
ت	T	تفكّر	Tafakkur
ث	Th	مباحث	Mabāhith
ج	J	جیلانی	Jālānī
ح	ḥ	حديد	Hadīd
خ	Kh	خليل	Khalīl
د	D	داعي	Dā'i
ذ	Dz	ذكر	Dzikh
ر	R	رابطة	Rābiṭah
ز	Z	زكیر	Zakīr
س	S	سيد	Said
ش	Sy	شيخ	Syeikh
ص	ṣ	صبر	Sabr
ض	ḍ	ضعيف	Dai'f
ط	ṭ	الطور	At-Tur
ظ	ẓ	عظيم	'Azīm
ع	'	عمّان	'Ammān
غ	Gh	غافر	Ghāfir
ف	F	فتح الله	Fethullah
ق	Q	القسطون	Al-Qāsitūn
ك	K	كثير	Kathīr
ل	L	لم	Lam
م	M	مسلم	Muslim
ن	N	نطفة	Nutfah
و	W	وجودية	Wujūdiah

هـ	H	هريرة	Hurayrah
ي	Y	يوسف	Yūsuf

2. Short Vowel

<u>Arabic Vocal</u>	<u>Latin Vocal</u>	<u>Example</u>	<u>Transliteration</u>
-----	A	أمر	Amr
-----	I	عاصم	‘Aṣim
-----	U	صبر	Sabr

3. Long Vocal

<u>Arabic Vocal</u>	<u>Latin Vocal</u>	<u>Example</u>	<u>Transliteration</u>
ا	Ā	مذاكرة	Muzākarah
و	Ū	المتقون	Al-Muttaqūn
ي	Ī	علمين	‘Ālamīn

4. Diphthong

<u>Arabic Vocal</u>	<u>Latin Vocal</u>	<u>Example</u>	<u>Transliteration</u>
و	Ww	منورة	Munawwarah
ي	Yy	تيمية	Taimiyyah
ي	Iyy	البخاري	Al-Bukhāriyy

5. Exemption

5.1. Arabic letter ء (hamzah) found at the beginning of a word is transliterated to the letter “a” not to ‘, example:

<u>Example</u>	<u>Transliterated</u>
أحمد	Ahmad

ABBREVIATIONS

AAOIFI	Accounting and Auditing Organization for Islamic Financial Institutions
AGM	Annual General Meeting
BIMB	Bank Islam Malaysia Berhad
BNM	Bank Negara Malaysia
FSMP	Financial Sector Master Plan
GII	Government Investment Issue
HLIB	Hong Leong Islamic Bank
IB	Islamic banking
IBS	Islamic Banking Scheme
ICM	Islamic capital market
IMMM	Islamic Interbank Money Market
PBUH	peace be upon him
p.	page
pp.	pages
n.a	no author
SAC	Shari'ah Advisory Council
SAW	salla Allah 'alayh wa sallam
SC	Securities Commission
SPTF	Skim Perbankan Tanpa Faedah
UAE	United Arab Emirates
vol	volume

CHAPTER 1

INTRODUCTION

1.1 Introduction

Shari'ah compliance is the essence of an Islamic bank operation. It is a mandatory requirement to every Islamic bank to establish *Shari'ah* Advisory Council (hereinafter SAC). SAC plays a crucial role and responsibility to ensure the Islamic bank complies strictly with the principles of *Shari'ah* in its operations. The scope of *Shari'ah* compliance is not simply confined to the concepts of Islamic banking or theoretical aspects alone, but the entire spectrum of the Islamic bank operations. This means the underlying concept of the products, structures, term sheets, documentations, accounting and operational procedures must comply with *Shari'ah*. The existence of a complete *Shari'ah* framework for the Islamic banking and financial system is very important to ensure the existence of one set of opinion in matters related to *Shari'ah* so that it would increase the public confidence and enhance the capital market development. This is due to the fact that SAC and *Shari'ah* Committee form an integral part of *Shari'ah* framework in Islamic banking and finance.¹ The role and function of Muslim scholars, and particularly of the *Shari'ah* advisory, in both the development and the enhancement of Islamic banking and finance are worthy of examination. Their contribution has been a great spur to the success of Islamic banking, not only in winning the confidence of shareholders and the public, but also in innovations resulting in products suitable for modern and prudent banking activities.²

This chapter will deal with general concepts of SAC in terms of its literal and functional meaning, types and differences of SAC in terms its of terminology, establishment, composition and roles it seek to address.

1.2 General Concepts of SAC

1.2.1 Literal Meaning

Generally speaking, Islamic laws and rules are known as *Shari'ah*. Literally, the word *Shari'ah* means 'a course to the watering place', 'a resort of drinkers' or 'the clear straight path'.³ In abstract sense, *Shari'ah* is a metaphysical reality known through the *Qur'an* and the *Sunnah*.⁴ *Shari'ah* is a divine revealed law. It starts from given of self-evident premises which constitute the sources of Islamic law.⁵ According to Muslim jurists, *Shari'ah* is defined as 'the rules which are ordained by Allah for His servants by sending His Messenger'.⁶

Many jurists have used the terms *Shari'ah* and *Din* (religion) interchangeably. The *Shari'ah*, like religion consists of belief, both moral and juristic. Therefore, the expressions such as '*Shari'ah* of Islam' and 'Religion of Islam' are of equal and similar meaning. In short, both terms connote a complete systematic way of life to which a believer must adhere.

Shari'ah law is essentially revealed by Allah and therefore divine. In a verse in *Qur'an*,⁷ the Prophet Mohammad (SAW) was asked by Allah to follow the path given by Allah. Both the *Qur'an* and the *Sunnah* are the *Shari'ah*, as they are divine in character. They represent the *Shari'ah* because *Shari'ah* law is the divine law in its essence, whereas *fiqh* (the substantive law) represents the understanding of Muslim jurists of the divine law.⁸

Shari'ah comprises the spiritual as well as material domains including the individual, social and collective aspects of human life. It can be categorised into four main parts, which are *Ibadat* (relates to worship), *Muamalat* (relates to transactions), *Ahwal Shakhshiyyah* (relates to family matters) and *Jinayat* (relates to crimes, offences and punishments).⁹

Essentially, *Shari'ah* is immutable and absolute, but not rigid; it is unchanging in its requirements, but not too tight in procedures and practices. It has a great degree of elasticity and flexibility. In short, it is adaptable to different situations and circumstances while its rules are adaptable and suitable to all times and environments.¹⁰

'Advisory' is an adjective word from 'advice'. It is used concurrently with words committee, panel or board. It means a group of people whose purpose is to give advice.¹¹

Whereas the word 'council' have various meaning that is to say; a group of people who are elected to control a town, a group of people who are elected or chosen to give advice or make decisions.¹² Looking at the purpose of this project paper, the second definition is arguably the preferable one.

One may say that in Islamic legal methodology, all rulings are originated from the *Shari'ah*, of which the primary sources are the *Qur'an* and the *Sunnah*. It should be noted that most of the provisions in these primary sources are in terms of general requirements. This is principally true with regard to commerce and financial transactions. Thus, these primary sources need deeper understanding and application to more in-depth, real-life situations. In the process of interpreting and applying the sources, an *ijtihad* occurs. In this process, the *Shari'ah* advisers look at the needs of the industry and put them in the light of rulings in the primary sources of Islamic law, i.e. the *Qur'an* and the *Sunnah*. If the rulings in the primary texts are clear-cut and decisive (*qat'i*), they will apply the rulings as they are. On the other hand, if the rulings are not clear-cut (*zanni*), they will apply further interpretation according to a recognised methodology (*usul al-fiqh*), to come to the appropriate 'new' rulings for the matters lay before them. Generally, this is how *fatwas* for new products and instruments are deduced, through the practice of *ijtihad*. From the exercise of *ijtihad*, the jurists come to a legal decision of *hukm*.¹³

1.2.2 Functional Meaning

There is no specific definition of SAC in the relevant contemporary literature. An SAC is 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 *Shari'ah* principles.¹⁴ The *Shari'ah* compliance is the very essence of an Islamic bank and its banking business. Thus, the *raison d'etre* and role of *Shari'ah* advisers acting as a supervisory council are crucial, because the responsibility to ensure *Shari'ah* compliance is vested upon these advisers. The efforts of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) to introduce standards or minimum requirements for the establishment and functioning of the SAC represent a major achievement in this direction.¹⁵ The AAOIFI¹⁶ give the following definition:

"A *Shari'ah* supervisory board is an independent body of specialised jurists in *fiqh al-muamalat* (Islamic commercial jurisprudence). However, the *Shari'ah* supervisory board may include a member other than those specialised in *fiqh al-muamalat* but who should be an expert in the field of Islamic financial institutions and with the knowledge of *fiqh al-muamalat*. The *Shari'ah* supervisory board is entrusted with the duty of directing, reviewing and supervising the activities of the Islamic financial institution in order to ensure that they are in compliance with Islamic *Shari'ah* Rules and Principles. The *fatwas* and rulings of the *Shari'ah* supervisory board shall be binding on the Islamic financial institution".

The approach taken by AAOIFI with regard to setting specific qualifications for the *Shari'ah* advisers is appropriate. The requirement to have expertise in Islamic commercial law (*fiqh muamalat*) suits the nature of the duty. This is simply because most, if not all, 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. Issues also

relate to different transactions in Islamic commercial law such as deposit (*wadi'ah*), investment (*mudarabah* and *musharakah*), credit sale or deferred payment sale (*bai' bithaman ajil*), mark-up sale (*murabahah*) and suretyship (*daman/kafala*).¹⁷

It has been observed, however, that in early stages of Islamic banking and finance, many of the *Shari'ah* advisers were not qualified in Islamic commercial proper. On the contrary, they were individuals who enjoyed a good reputation in their society. In other words, they were scholars in whom the society accepted and recognized as reputable though they were not academically trained in Islamic commercial law and related disciplines. However, when Islamic banks started to grow rapidly in the modern financial environment, a need for specialized jurists in Islamic commercial law was felt, as they are deemed to be more able to apply *Shari'ah* rules and principles to modern and actual cases in the banking.¹⁸

The AAOIFI standard also permits the appointment of one person not qualified in *fiqh muamalat* to serve on the *Shari'ah* supervisory board. This is a sensible provision, so as to allow practitioners and experts on law and economics to interact with the *Shari'ah* jurists in deliberating any *Shari'ah* issues facing Islamic financial institutions. However, these experts need to have certain degree of knowledge of Islamic commercial law. Otherwise, the appointment cannot be made, as this would defeat the purpose of having interaction and mutual consultation between them and the *Shari'ah* scholar.¹⁹

Ideally, a *Shari'ah* adviser must be knowledgeable in *Shari'ah* issues as well as law and economics, because such issues in many cases are overlapping. Some financial institutions tend to rectify such shortcomings by having experts on law and economics as invited members may not have full freedom to voice out their opinion and perspective since they are not full members of the board. Proper appointment of one such expert as a full member of the *Shari'ah* board, as advocated by AAOIFI would ensure their objectivity and freedom of expression during the meeting and deliberation, because all then would have equal standing.²⁰

In another definition states that an SAC is 'A group of *Shari'ah* expert who's responsible to monitor and supervise the operations of Islamic financial institution in order to ensure that it not contravene with *Shari'ah* principles'.²¹

Shari'ah advisory roles are vital in Islamic banks. They are very different from conventional banks. A conventional bank may have its legal adviser or business adviser; however these advisers are different from Islamic banks' *Shari'ah* advisers. It is because the management of the conventional bank is not bound to take any advice given by their legal and business adviser; whereas Islamic banks' management are obliged to adhere to the decision made by their *Shari'ah* advisers when the product proposed or any operational issues defined contradict with the *Shari'ah* principle.²²

1.3 Types and Differences of SAC

1.3.1 Terminology

The terminology of SAC differs in the sense of the official name to be used and banks that conform to certain terminology. Various *Shari'ah* bodies co-existed and are governed under the separate legal framework. An Islamic bank is required under the Islamic Banking Act 1983 [Act 276] to establish a '*Shari'ah* Advisory Body', while a takaful operator needed to set up a '*Shari'ah* Supervisory Council' as stipulated under the Takaful Act 1984 [Act 312]. The Islamic Banking Scheme (IBS) banks under the Banking and Financial Institutions Act 1989 [Act 372] are required to appoint a *Shari'ah* consultant, while financial institutions under the Development Financial Institutions Act 2002 [Act 618] appointed *Shari'ah* bodies on their own initiatives.²³ These SAC established at financial institutions operated by banks, takaful operators and development financial institutions.

There is also the National *Shari'ah* Advisory Council on Islamic Banking and Takaful that was established on 1 May 1997. The Council is regulated under section 16B of Central Bank of Malaysia Act 1958 (Revised 1994) [Act 519], to be argued that it established at national level and governed under Bank Negara Malaysia (hereinafter BNM) as the highest *Shari'ah* authority on Islamic banking (hereinafter IB) and Takaful.²⁴ The other SAC also established in the like manner that is SAC of Securities Commission (hereinafter SC) advising the related issues on Islamic capital market (hereinafter ICM) in Malaysia.²⁵ It is submitted that both SACs will be dealt with in further chapter of this project paper.

It is argued that the terminology being used by financial institutions is different from one to another. In Malaysian commercial banks perspectives, for example in AmIslamic Bank,²⁶ Bank Muamalat,²⁷ Bank Rakyat,²⁸ Affin Bank,²⁹ HSBC Bank,³⁰ Kuwait Finance House (Malaysia) Bhd³¹ and RHB Group,³² SAC is also known as *Shari'ah* Committee. Bank Islam Malaysia Berhad employed the terminology of *Shari'ah* Supervisory Council.³³ Whereas Hong Leong Islamic Bank³⁴ names it as

Shari'ah Advisory Committee and EON Bank³⁵ names it as *Shari'ah* Advisors. Tabung Haji which is also part of financial institutions names its SAC as Investment Panel.³⁶

The research also observed several examples from Islamic Banks abroad, for example in Abu Dhabi Islamic Bank (ADIB)³⁷ and Kuwait Finance House (Saudi Arabia),³⁸ it is known as *Fatwa* and *Shari'ah* Supervisory Board. Meezan Bank³⁹ in Pakistan names it as *Shari'ah* Advisors. Al-Baraka Islamic Bank of Bahrain⁴⁰ names it as *Shari'ah* Board. Jordan Islamic Bank⁴¹ named it as *Shari'ah* Supervisory Committee.

1.3.2 Establishment and Composition

This section attempts to look into the differences of practices in Malaysia with reference to the Act 276 and other Islamic countries.

The AAOIFI standard on the appointment of the members of the *Shari'ah* supervisory board requires the authority to appoint them must be vested in the annual general meeting (AGM) of all shareholders of the institution. The reason for this is to ensure that the members of the *Shari'ah* board upon their appointment would be free from any undue influence by the management board because the latter does not have the authority to appoint or to dismiss them. Having said that, however, it is acceptable for the management board to propose the names of prospective members of the *Shari'ah* board to the AGM for deliberation and endorsement.⁴²

The setting up of a SAC varies from one country to another country. In some countries, the requirement to establish a SAC is stated in the law governing the operations of all Islamic banks. In Malaysia, Section 3(5) of the Act 276 provides that Bank Negara Malaysia (BNM) shall not recommend the grant of a licence, and the Minister shall not grant a licence, unless he is satisfied:

- (a) that the aims and operations of the banking business which it is desired to carry on will not involve any element which is not approved by the religion of Islam;
- and

- (b) that there is, in the article of association of the bank concerned, provision for the establishment of a Syariah advisory body to advise the bank on the operations of its banking business in order to ensure that they do not involve any element which is not approved by the religion of Islam.

For examples, Bank Islam Malaysia Berhad's (BIMB) Memorandum of Association prefaces that "nothing in this Memorandum contained shall empower the company to carry on any business or do anything involving any element which is not approved by the religion of Islam". Accordingly, Article 3 of BIMB's Article of Association stipulates that "A Religious Supervisory Council whose members would be made up of Muslim religious scholars in the country, shall be established to advise the company on the operation of its banking business in order to ensure that they do not involve any element which is not approved by the Religion of Islam".⁴³

Statement of Corporate Governance of Bank Muamalat states that The *Shari'ah* Committee was established in accordance with the requirements of Act 276 as well as the Bank's Articles of Association, which prescribe the setting up of a *Shari'ah* body to ensure that the Bank conducts its affairs in accordance with the *Shari'ah* Principles.⁴⁴

Malaysian banks differ from their composition. A few examples are as follow:

- i. Three members⁴⁵ of *Shari'ah* Committee of AmIslamic Bank.
- ii. Four members⁴⁶ of *Shari'ah* committee of Bank Muamalat.
- iii. Five members⁴⁷ of *Shari'ah* Committee of Bank Rakyat.
- iv. Four members⁴⁸ of *Shari'ah* Committee of Affin Bank.
- v. Three members⁴⁹ of *Shari'ah* Committee of HSBC Bank.
- vi. Six members⁵⁰ of *Shari'ah* Committee of Kuwait Finance House (Malaysia) Bhd.

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