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INTERFACE BETWEEN *SHARI'AH* AND CIVIL LAW IN ISLAMIC FINANCE: CURRENT PROBLEMS AND THE WAY FORWARD

By
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All great religions including Hinduism, Buddhism, Judaism, Christianity and Islam prohibit usury or interest taking. So much so, that in the early days, if a person of the Jewish faith charged interest, he/she could not stand as a witness in a Jewish Court. Similarly, a Roman Catholic who dealt in interest was denied the right to a Catholic burial. (see *Yahia Abdul Rahman: The Art of Islamic and Finance*). It was not until 1403 that departure from this prohibition became evident when, in Florence, Italy, Lorenzo Antonio di Ridolfi won the right to charge interest on loans. In 1545, Henry VIII uplifted the prohibition (*Glynn Davies, History of Money from Ancient Times to Present day*). However, towards the end of the twentieth century, while followers of other religions seemed to have accepted interest as an integral part of modern finance, a group of Muslims started to look for ways to introduce interest-free finance to serve their own needs in the modern world. They were driven by piety and not to "make money". Indeed, Islamic finance is not about "making money" but "earning money" by producing or doing something in exchange for it, in a fair and honest way. This is because Islamic finance is faith-based. What follows is interesting: the *prohibited* becomes *"conventional"* and the *permissible* becomes *"Islamic."* Because the word "Islamic" is attached to the interest-free finance, some people claim that it is "terrorism finance", used as a vehicle to promote world domination of Islam over other faiths or that it is designed to replace conventional finance!

However, bankers and others all over the world see it differently. They see money in it and are fighting to get a share of it. So much so that countries that have no love for, nor wish to be identified with, anything "Islamic", are vying to be the hub for Islamic finance.

That is because Islamic finance has developed by leaps and bounds over the last three decades. This development, however, is not without challenges, particularly, to produce products which comply with requirements of *shari'ah*, which are relevant to the modern day needs of the customers, which are not

less attractive than the conventional products, in the conventional financial and legal environment while ensuring that the purpose of Islamic finance, economics and *shari'ah* itself is not lost.

(In this paper, for the sake of convenience, I use the term “civil law” to refer to the law of the country other than Islamic law (s*hari’ah*) and the term “Islamic finance” to include Islamic banking and *takaful*.)

Islamic finance, as we know it today, is only about forty years old in Malaysia. Since Islamic finance had remained stagnant for centuries compared to its conventional counterpart, there is no alternative but to produce products similar to those conventional products in the market, minus the characteristics prohibited by Islam. Hence, we hear criticisms such as “they are conventional products by another name”, “it is just a matter of changing the word 'interest' to “profit'” and so on. Some *shari'ah* scholars complain that what is being done is to produce *shariah*-compliant products instead of *shariah*-based products.

Speaking for myself, (I am not a *shari'ah* scholar), I do not see anything wrong in producing products similar to conventional products, so long as they are *shariah*-compliant. Consider this illustration: A pious Muslim wants to enter into a transportation business. Do you expect him to sell horses, camels and donkeys because those were the means of transport sold by Muslim traders in Islamic history? Certainly not. Instead he would be selling cars, buses and lorries because those are the means of transport that the customers will buy now. What is important is that the product must be *shariah*-compliant and that the original purpose of Islamic finance, Islamic economics and the *shari'ah* itself is achieved. Does it make a difference from the *shari’ah* point of view whether you eat *roti arab*, *nasi lemak*, *char koey teow*, *chapati,* burger or hotdog so long as it is *halal*?

We now come to the law. With the development of conventional finance, civil law too had developed, through legislation and judgments of the courts to cope with the requirement of the industry. Company law, land law, contract law, bankruptcy law, laws governing financial institutions and insurance companies, rules regarding procedure had also developed at the same time. As a result, laws, substantive and procedural, had come into existence as we know them today. There was no parallel development in the Islamic sector.

It is under such environment that the Islamic finance was reborn in its modern form. Hence, the interface between the two cannot be avoided. Indeed from the moment a company is to be incorporated to do business in Islamic finance until the company is wound up, it is civil law that applies. It is the same with the business: from the creation of a product to its documentation, to resolution of disputes in court and enforcement of orders of the court, civil law applies. That is the reality.

What makes it difficult is that both *shari'ah* and civil law issues could and do arise in the same case. Neither the civil court nor the *shari'ah* court has the expertise to resolve both issues (not to mention jurisdictional conflicts in the case of Malaysia). (For discussion on the forum for resolution of such disputes, see my paper entitled "Interlink/ Interface Between Civil Law System and Shariah Rules and Principles and Effective Dispute Resolution Mechanism" presented at the Islamic Financial Services Industry Legal Forum 2009" (in September 2009) reported in The Law Review 2009 Vol. 3. (Sweet and Maxwell Asia)). Lawyers too are not in a position to assist.

To make matters worse, we have this dilemma. Generally speaking, those who know civil law do not know Islamic law. Those who know Islamic law do not know civil law and those who think they know both have never practised law. This is not Malaysia's dilemma alone. It is a global dilemma.

When I spoke at the conference that I had mentioned earlier in September 2009 and also at a subsequent *"Muzakarah Penasihat Syariah Kewangan Islam 2009 Kali Ke-4"* two months later, I thought that only defaulting customers would raise *shari'ah* issues in order to avoid payment. I could not imagine a financial institution, having offered what it claims to be a "*shari'ah*-compliant product" would turn around and say "Actually, the product is not *shari'ah*-compliant and therefore the contract is void." to avoid an obligation under the contract. I had even said that I would be very disappointed if any lawyer were to advise his/her client to put up such a defence.

I said so because I thought, in the case of a Muslim customer, to give an analogy, he should not go to a restaurant, order the food, eat it and when the bill comes, claims that the food is not *halal* and therefore he does not have to pay for it. He should satisfy himself from the very beginning whether the food is *hala*l or not. If he has any doubt he should inquire or simply do not order it. If the customer is a non-Muslim, then the issue does not arise at all. He does not even accept the religion of Islam in the first place, why should he be

concerned whether the food he is going to eat is *halal* or not. In the case of the financial institution, it offers a product which it claims to be *shari'ah*-compliant, which has been approved by its own *shari'ah* committee. It is highly immoral to do so and it should be estopped from claiming that the product is not *shari'ah*-compliant. Frankly, I could not then see a situation where a financial institution would be raising such a defence.

I was wrong. Something like that had in fact happened, not here, but in England. The case on point is the case of **Investment Dar Co KSCC v Blom Developments Bank Sal** (2009) EWHC 3545 (Ch). Without going into the details, the facts are as follows:

Bloom Developments Bank Sal (Bloom) which was incorporated in Lebanon placed US10 million (capital sum) with Investment Dar Co KSCC (TID), which was incorporated in Kuwait, under a *wakala* (agency) agreement. The agreement was governed by English law and provided that TID would invest the capital sum as agent of Blom in a *shari'ah*-compliant manner. The agreement further provided that at the end of the investment period TID had an obligation to pay to Blom the capital sum together with the anticipated agreed profit. TID failed to fulfill its obligation to pay to Blom the capital sum and the profit at the end of the investment period. As a result, Blom brought a summary judgment application in the High Court in England. The Master ordered TID to pay the capital sum but not the profit. TID appealed. At the appeal, TID's counsel argued, inter alia, that (I) TID was prohibited by its constitutional documents from entering into agreements which did not comply with *shari'ah*, (ii) the agreement did not comply with *shari'ah*. The Court held that TID's counsel had made an arguable case that the agreement did not comply with *shari'ah* and the agreement was therefore void.

It should be noted that TID has its own *Shari'ah* Committee of distinguished scholars who had satisfied themselves that the range of transactions undertaken by TID were *shari'ah*-compliant.

That case and cases in own courts made me think what we should do about it. Of course, we will have to prepare ourselves, meaning lawyers, judges, Islamic scholars, bankers and others to meet the situation. But, should we not go one step further I.e. whether we could and should take advantage of the situation by aspiring to make Malaysian law the governing law of cross border Islamic finance contracts and Malaysian courts and/or arbitrators the forum for settlement of Islamic financial disputes?

That may sound like a dream to many people. But, let us examine our position. Malaysia is already the hub for Islamic finance and that we intend to strengthen this position. We are the biggest issuer of *sukuk* and have been so for more than a decade. We are recognized world-wide as a forerunner in Islamic finance. Why not include the two newly mentioned aspirations in the program? Make it a holistic approach.

In this respect, I think we have eight factors in our favour. First, whatever our own views about it, Malaysia, in the eyes of the world, is a Muslim country. To Muslims from other countries and to many non-Muslims who have visited Malaysia, Malaysia is a model modern Muslim country. Some even say that Putrajaya could be the Cordoba of the third millennium. Whatever it may be, why not use those factors to our advantage? Other countries, including those that do not even want to be associated with Islam and have no love for anything Islamic, are trying hard to be the center for Islamic finance. Why not Malaysia?

Secondly, our government is committed to make Malaysia the hub for Islamic finance. It has spent millions of Ringgits establishing centers for learning and research on Islamic finance and promoting Malaysia as a centre for Islamic finance. I believe, if properly advised, it would also be prepared to spend on and support this aspiration, which, after all, is part of its aspiration to be the leading or undisputed hub for Islamic finance.

Thirdly, we have an advantage over England in that we have more Islamic scholars who already are or who could be trained to be experts in Islamic finance. Bear in mind that we have many people, though they may be quite young now, who are proficient in both Arabic and English who are also trained in law and *shari'ah*, the two ingredients to be experts in Islamic finance. They are our potentials in this respect. Besides, we already have a number of lawyers, may be one or two judges, who are quite familiar with Islamic finance. Many younger lawyers have a good grounding in *shari'ah* as well. They have the potential to specialise in Islamic finance, provided they do not fall into the category of “an *ummah* of lost opportunity”, to quote Sheikh Nizam Yaa'kubi.

Fourthly, we already have a central body (now two), i.e. the *Shari'ah* Advisory Council (“SAC”) of Bank Negara and of the Securities Commission, to make *shari’ah* rulings on Islamic finance. Common law lawyers may not like the

idea. But the SAC promotes consistency in the rulings, to me an important ingredient in the development of Islamic finance for the simple reason that the law must be certain. The Central Bank of Malaysia Act 2009 and recent amendments to the Capital Markets and Services Act 2007 further reinforces the importance of these respective SAC's rulings in this regard. If, according to the *shari'ah*, a contract is void on ground of *gharar* (uncertainty), is it not worse if the law itself is uncertain? And, here, we are not dealing with common law which the common law judges themselves have sufficient knowledge of their own or, they can look up the law in the face of conflicting submissions by counsel, to decide an issue. Here, we are dealing with a religious law which in most cases, both the lawyers "assisting the court" and the judges themselves (with respect) know very little about, if at all. Muslims would not want the *shari'ah* to be interpreted and determined by non-experts, what more if they are non-Muslims. Modern Islamic banking was born out the desire by Muslims to avoid committing a sin and to abide by the injunctions of the *Qur'an* and *Sunnah* of the Prophet. The last thing Muslims would want to see is that their religious law, which is binding on them, which determines whether they are *shari'ah* abiding or not, whether they are committing a sin or not, being determined by common law lawyers and judges, with little or no knowledge of the *shari'ah*, both Muslims and non-Muslims. Imagine a non-Muslim Judge determining what is *haram* and sinful for a Muslim to do. That is what it amounts to.

I am prepared to be blamed for proposing the establishment on the SAC of Bank Negara in 2002. But, let me tell you that at almost every seminar and conference on Islamic finance that I attended, at home and abroad, I hear more praises than disapproval of the establishment of the SAC. They consider it as a plus factor for Malaysia. This is what Yahiya Abdul Rahman said in the same book at page 79:

> "This approach *(the Malaysian approach - added)* saves a lot of confusion and conflicts within different Shari'aa Boards. The involvement of the Central Bank adds credence and weight to the rulings. In addition, because the Shari'aa Board is operated and supervised by the Central Bank, there is no potential for conflict of interest, because the individual banks are not paying their own hand-picked scholars for their services."

Fifthly, unlike other Muslim countries, be they Arab countries or Indonesia, we already have the common law and the common law system in place and working comparatively well. This supplement is important whether at the stage of drafting the documents, at the trial and in the final stage of enforcement of judgments.

Sixthly, our courts are functioning reasonably well in terms of efficiency and speed in the disposal of cases. The computerization project is showing positive results. The Judiciary's integrity has improved over the last few years. What we have to improve is the quality of judges and lawyers too.

Seventhly, Malaysian lawyers and Judges speak English, our laws and judgments of our superior courts are written in English.

Eighthly, we have the infrastructure, our streets and hotels are free from suicide bombing (so far), our costs of living is comparatively cheap and we have summer throughout the year. All these factors are conducive to foreign lawyers coming to do litigation here.

So, I think we have the right ingredients to compete with England or any other country to be the country whose law would be the governing law in cross border Islamic finance contracts.

However, first of all, our lawyers and judges should stop thinking that they are inferior to the English lawyers and judges, at least in this area. At the same time, they should educate themselves in this area. That is essential. The same goes for the Islamic scholars, bankers, auditors, judges and everyone involved in Islamic finance. For appointment as judges, we should also be looking for people with knowledge and experience in Islamic and conventional finance.

Secondly, everybody involved, including lawyers and bankers, should think and act positively. They should think of the bigger gains to share if Malaysia succeeds in this aspiration. They should all work to build and not to destroy Malaysia position in Islamic finance, for a short term gain.

Thirdly, we have to update our laws which are in use and relevant to Islamic finance transactions and make them *shari'ah*-compliant where they are not. More than three decades have passed since we first introduced Islamic finance in Malaysia. With no experience in the documentation of the

transactions and not being an Islamic scholar, I do not know which laws that are being used in Islamic finance transactions are *shari'ah*-compliant and which are not. At conferences I used to hear *shari'ah* scholars complaining in general terms such as “we should introduce the *shariah* in full” to make Islamic finance transactions fully Islamic. However, nothing happens after that.

The question is: Who is going to *buat kerja* (do the work)? The problem is that this is not something that one person, e.g. a common law lawyer or a *shari’ah* scholar is able to work alone. There has to be a combination of the relevant expertise and an organization, institution or department to put them together to do the work. So, at three different conferences in 2003 and 2005 I had made my suggestions about it. Unfortunately, no one took up the idea. However, two days ago, the Deputy Governor of Bank Negara had announced the establishment of a committee for the purpose, pre-empting what I had wanted to say here (as you can find in the paper that has been circulated to you) and forcing me to amend my paper. Further more, I have been asked to chair the committee, the “punishment” one usually gets for talking too much!

Ladies and gentlemen,

Since I have been asked to chair that committee, I am taking this opportunity to appeal to practising lawyers, Islamic scholars, auditors, Islamic finance operators, academicians, universities, lawyers' associations, NGOs indeed everybody, to make their contributions. Let us all work together to produce the first model *shari'a*h-compliant laws for Islamic finance in the world. Let us together build Islamic finance in Malaysia and be the number one in the world. If we succeed, I believe, many of you will benefit too. Stop thinking of one client or one BBA case. Think of the multi-million dollar contracts and cases that would come to Malaysia and that some of them may end up with you.

Off hand, I think a few things could be done straight away. First, the Rules of the High Court 1980 and other Rules of Courts. The provisions regarding interest should be replaced with the *ta'widh* and *gharamah* (penalty and compensation) which have been approved by the SAC. Provision regarding i*bra'* (rebate) as approved by the council recently may be made. The other issue that we may have to look into is *Wa’d*: whether it should be made contractually binding and how? We may have to look at the National Land

Code particularly regarding possible alternatives to the creation of charges in securing the rights of Islamic banks as they provide financing based on *musyarakah mutanaqisah* (diminishing partnership). Partnership law is also worth studying as contracts based on *musyarakah* and *mudharabah* principles become common place, and so on.

I am sure that many of you, whether in the course of drafting a document or in your post-graduate research or whatever, would have come across laws which are used in Islamic finance transactions which you think are not *shari'ah*-compliant. Please give your suggestions and make your contributions. (My email address is at the end of the paper). Let us be proud of our contributions for Islamic finance and for Malaysia. We may be rewarded even in this world itself.

Thank you.