

The Need for Shariah-Compliant Law of Choice for Islamic Finance Transactions

*Tun Abdul Hamid Mohamad**

Islamic banking, Islamic finance and *takaful* (“Islamic finance”) in its modern form was born in late twentieth century out of the desire of pious Muslims to try to avoid committing a sin in their financial transactions. We should not lose sight of that intention otherwise Islamic finance could lose its direction, get corrupted or even hijacked.

That calls for:

- (1) the product itself has to be Shariah-compliant;
- (2) the implementation has to be Shariah-compliant;
- (3) the settlement of disputes has to be Shariah compliant.

In other words, it should be Shariah-compliant from beginning to end. There is no point buying *halal* meat if you add wine in the cooking.

The focus in the beginning (and I would say until now) is with regard to (1) i.e. the product should be Shariah-compliant. This is done through collaboration of the industry players, lawyers, auditors, Shariah scholars and others. In most countries, for that purpose a Shariah Committee is established at each financial institution.

In Malaysia, we have that arrangement too. But, we have gone further. In 1997, we established the Shariah Advisory Council (“SAC”) at the Central Bank to approve new products. The idea behind it is to utilise the best available expertise, to ensure that the SAC is independent and transparent and, most important of all, to ensure consistency in the rulings.

I will not repeat the advantages that we foresaw in in all these moves. (Please refer to my website: www.tunabdulhamid.my)

With regard to (2), the lawyers who draft the contracts are mostly common law trained lawyers. Common law precedents are readily available. All that the lawyers have to do is change, delete or add some clauses which, in their

* Former Chief Justice of Malaysia and Chairman of Law Harmonising Committee, Central Bank of Malaysia. This article is an edited version of a paper presented at the Global Islamic Finance Forum 2012 (GIFF 2012), held in Kuala Lumpur on September 19–20, 2012. E-mail: tunabduhamid@gmail.com; website: <http://www.tunabdulhamid.my>.

opinion would make the contract Shariah-compliant. The language of the contracts, especially cross-border contracts, is English. The legal system in common law based countries is more up to date. No country offers a modern complete set of Shariah-compliant laws for it to be adopted as the law of choice. Courts in some common law countries are highly regarded. So, it is quite natural for the parties, on the advice of their common law trained lawyers, to adopt English law as the law of choice and English and English courts as the forum for settlement of disputes.

Everyone knows that the English law applicable is not completely Shariah-compliant. Everyone knows that English lawyers and judges are not trained in Shariah. Everyone knows that most of them are, at least, indifferent towards Shariah. It is further complicated by the application of the Rome Convention on the Law Applicable to Contractual Obligations of 1980 and Rome I Regulation.¹ Yet, Muslims who started off by wanting to be Shariah-compliant have voluntarily chosen non-Shariah-compliant law and courts which do not and cannot apply the Shariah. How do you expect such courts to give judgment in accordance with Shariah?

We are just like a Muslim who takes the trouble to go and buy *halal* meat, then go to a non-*halal* restaurant and ask the chef to cook it. The chef is an honest man. He says, “*My cooking is not halal. I use wine and lard.*” The Muslim replies, “*No problem. I trust your integrity.*” That is how smart we are.

To choose the United States law as the law of choice is no better. “*There is concern by U.S. scholars that a choice of law that necessitates looking into Shariah law will run afoul of the First Amendment prohibition of state endorsement of a particular religion.*”² Some States have even passed laws prohibiting application of Shariah.

Bearing all that in mind, to me it is ironical for Muslims who created modern Islamic finance to make it Shariah-compliant in order to avoid committing a sin, to choose laws that are not Shariah-compliant and which (in those countries) cannot and will not be made Shariah-compliant and to choose courts and judges who do not and will not apply the Shariah.

So, there is a need to have Shariah-compliant laws to be the law of choice for Islamic financial transactions and to have courts which will be and are able to apply the Shariah in such cases. We cannot expect those countries referred or in a similar position, to do it. After all, Islamic finance is not their “baby”. It is our “baby”. So, it is our responsibility to provide Shariah-compliant laws to be the law of choice and to provide a suitable forum for settlement

1 European Parliament and Council Regulation No. 593/2008 of June 17, 2008 on the Law Applicable to Contractual Obligations (Rome I).

2 Julio C Colon, “Choice of Law and Islamic Finance”, TILJ.

of disputes. We have lost three decades. So we have to start immediately and seriously.

How do we go about it?

First, we should forget any idea of having one common set of laws for all countries offering Islamic finance, to apply. That will not happen and it is not practical. There is no such thing even in conventional finance. So, any country that feels obliged to do it or, at least, is interested to do it and has the know-how, should do it. Piety is not the only driving force now. It is business. The country that succeeds to provide such laws to be the law of choice and such forum for settlement of disputes may be the one that succeeds to become the holistic hub of Islamic finance.

Let me give you a glimpse of what we are doing in Malaysia.

I have mentioned about the establishment of the SAC at national level.

In 2004, we went further. By law, we made it a requirement for the courts and the arbitrators to refer Shariah issues to the SAC for a ruling. We realise that our courts and arbitrators do not have expertise in Shariah nor in Islamic finance, at least not yet. We want to avoid Shariah issues being determined by non-experts, what more by non-Muslim judges. Shariah is faith based.

In 2009 we went even further. The law was amended to make the rulings of the SAC binding on the courts and the arbitrators.

We are getting references from the court and the arbitrators steadily now. It means that, even though the provision is challenged by those who try to find an excuse to avoid paying their debts, the system is working. (My question to them is: Is not paying one's debt Shariah-compliant?) In answering the questions posed by the court, the SAC is very careful in ensuring that it only states the Shariah principle and not to make any decision of facts or to make a decision by applying the principle to the facts of the case. That is a matter for the court. Parties are also given the right to be heard, i.e. they are allowed to put in their experts' opinions in writing or even orally, in the case of the latter, if the SAC so decides.

In 2010 the Law Harmonising Committee was established. Its main function is to identify specific provisions of law which are used in Islamic finance that are not Shariah-compliant, with the help of the SAC, ascertain the Shariah position and recommend suggestions to the Government to make the necessary amendments. In this exercise, we will also introduce Shariah principles used in Islamic finance e.g. *wa'd* into our law and also harmonise laws that may hinder the development of Islamic finance to make them more Islamic-finance friendly.

How do we do it?

We take the practical approach based on my so-called “definition” of Islamic law: *Any law that is not un-Islamic is Islamic*. So, we focus on the laws that are applicable in Islamic finance, identify the provisions which, in our opinion, are contrary to Shariah and work on them, meaning we will put up a paper for the determination of the Shariah Advisory Council for the determination of the Shariah issue and put a draft bill to be forwarded to the relevant Ministry and the Attorney General. This is perhaps the first time that the Committee, the Ministries, The Attorney General’s Chambers, the academicians, researchers from ISRA, Shariah scholars, common law lawyers, industry people, AIBIM are all working together.

What have we done?

So far, we have reviewed 19 issues in relation to 17 laws in Malaysia including the National Land Code 1965, the Contracts Act 1950 and the Rules of Court. Out of that, seven issues have been identified as requiring legislative amendments to facilitate Islamic financial transactions, eight issues do not require any change to the law and four issues are still under review. The provision regarding penalty for late payment of judgment debt came into force on August 1, 2012. It is a slow process, no doubt, but we are doing our best.

But, taking care of the law is not all. Lawyers and judges must also educate themselves so that they have adequate knowledge of Islamic finance and Shariah to handle or deal with those cases. Lawyers should realise that there is a big business waiting for those with the required expertise. They should prepare themselves to grab the opportunity.

Regarding judges, I urge judges, on their own, to start reading on the subject and the judiciary to conduct courses, at least to selected judges, on the subject. Speaking from experience, judges only listen to submissions of counsel, who are partisan and may be equally ignorant on the subject, and then decide. It could be a case of two blind men pulling the third blind man to the opposite direction. In the end the stronger “puller” wins. Or, since judges only listen to lawyers, who themselves may not know much and the judge’s opinion becomes (case) law, at least until it is set aside by a higher court, there is the danger that judges will end up thinking that they know everything when, in fact, they don’t even know what they don’t know.

I think, if a country is serious about offering Shariah-compliant financial products, it should strive to ensure that its laws in so far as they are applicable to Islamic finance, are Shariah-compliant. This applies to all countries in the world. They should modify their own laws, at least in so far as they are applicable to Islamic finance, to make them Shariah-compliant. They can adopt the provisions in other countries that have done it: after all the principles

should be the same. They should also prepare their judges, lawyers, arbitrators and their courts to handle such cases.

At the end of the day, I believe that the country that offers the best Shariah-compliant laws besides an efficient, incorruptible and respected judicial system and is able to apply the Shariah, where required, will be the popular forum for issuance of Islamic finance products and for settlement of disputes arising therefrom.

Thank you.