DEVELOPMENT OF ISLAMIC FINANCE AND ISLAMIC LAW OF MU'AMALAT IN THE 21ST CENTURY[i]

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In this paper, where applicable, the term "Islamic finance" is used to cover Islamic banking, Islamic finance and *takaful* (Islamic insurance).

When I was a law student in 1960's, Islamic law was not even offered as a law subject at universities in Malaya (subsequently Malaysia) and Singapore. Perhaps the only place where it was taught, in Arabic, in Malaya and Singapore then was at the Islamic College, Klang, near Kuala Lumpur. In the universities, when it was referred to or mentioned, it was out of academic interest and a matter of history. Its criminal law was thought as ancient, harsh or even "uncivilised" by the standard of the twentieth centuries. Shariah civil law was considered as an out of date law of the Muslims in the past millennium. "*Mu'amalat"* was just a name of a branch of the Shariah civil law. Even Muslim common law trained lawyers did not think it was relevant and applicable in the twentieth century, it having "been in the cold storage" for centuries.

Banks were looked upon as a "sinful place" meant for the rich non-Muslims, because it practiced *"riba"* which is prohibited by Islam. As a result, you do not find Muslim customers and Muslim employees in the banks in Malaysia then. At that time, no one, not even Muslims, ever thought that there would one day be such a thing as Islamic banking, Islamic finance and *takaful*, what more in the next two decades.

However, the unimaginable had happened. What had started as an attempt by pious Muslims to avoid committing a sin had over a period of three decades, developed into a multi-billion dollar business. Non-Muslims saw money in it and wanted a share of it. "Conventional" banks do not want to be left out. They opened "Islamic windows" or Islamic subsidiaries. Even countries where the word "Islam" was frowned upon and the word Shariah was almost unknown began to show interest in Islamic banking, Islamic finance and *takaful*. Indeed they vie to be the Islamic finance hub in their region.

As a result, Islamic banking and finance has become an increasingly important component of the international financial system. As of September 2012, there were more than 600 Islamic financial institutions operating in more than 75 countries across the globe. Global Islamic finance assets were estimated to reach USD 1.6 trillion by the end of 2012 and are projected to exceed USD 6.5 trillion in 2020. As of September 2012, there were 12 jurisdictions where Islamic finance had been categorized as having mainstream relevance, mainly due to large

Muslim populations and strong government support. Besides them, there are 25 other countries in which Islamic finance has a niche presence. These countries are offering various Islamic finance products and are constantly working to develop them further. Likewise, 18 other countries have been identified that have an interest in developing the Islamic finance industry and are actively engaged with regulators to enable incorporation and governance of Islamic banks in their jurisdictions (GIFF, 2012: 5). [iii]

One of the countries most responsible for the unprecedented expansion and popularity of the Islamic finance is Malaysia. Malaysia is the largest Islamic financial hub in the Asia-Pacific region and a role model, in terms of legal and Shariah infrastructure, for other countries aspiring to develop their own Islamic finance industry. By the end of 2011, Islamic financial assets in Malaysia stood at USD 272.5 billion (GIFF, 2012: 77). In 2012, Malaysia proudly hosted 21 Islamic banks (including 5 international Islamic banks), 17 *takaful* operators (including 1 international *takaful* operator and 4 re*takaful* operators), and 16 Islamic fund management companies licensed under the Capital Market and Services Act 2007 (Mohamad and Trakic, 2012: 23). In addition, Malaysia is the largest *sukuk* market in world with USD 107.0 billion of total *sukuk* outstanding or 71.6% of the global total market shares (GIFF 2012, 77). [iv]

We must bear in mind that Islamic banking, Islamic finance and *takaful* as we know them today are a modern invention based on traditional Islamic principles, combined at times. They were born in a world where the banking, financial and insurance systems which have now come to be known as the “conventional” systems, have been firmly established. Conventional banking, finance and insurance have developed over a few hundred years. New and newer products were invented and innovated to meet the ever-increasing and changing needs of the customers.[v]

Law too had developed 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, the whole structure of laws, substantive and procedural, had come into existence as we know them today.[vi]

There was no parallel development in the Islamic sector. As a result, the Islamic products are created in common law surrounding whether in their creation, documentation, implementation or settlement of disputes.

The focus in the beginning (and I would say until now) is with regard to making the products 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 of Malaysia as well as the Securities Commission of Malaysia to approve new products, within their respective jurisdictions. The idea behind it is to utilize the best available expertise, to ensure that the SAC is independent and transparent and, most important of all, to ensure consistency in the rulings.[vii]

But, producing a Shariah-compliant product is not the end of the matter. The implementation and the settlement of disputes will have to be Shariah-compliant too. Otherwise it is like having halal meat cooked in a "non-halal" way. The final product is "non-halal". Why bother to look for halal meat in the first place?

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 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 that the parties, on the advice of their common law trained lawyers, to adopt English law as the law of choice and English and English court 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, European Parliament and Council Regulation No. 593/2008 of June 17, 2008 on the Law Applicable to Contractual Obligations (Rome I). 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 as an ingredient."* The Muslim replies, *"No problem. I respect your integrity."*

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."*[viii] Some States have even passed laws prohibiting application of Shariah.

So, there is a need to have a Shariah-compliant and Shariah-compatible law to cater for the Islamic finance industry. To meet the demands of modern complexity, while retaining its principles, Shariah will have to adapt and adopt from the currently dominant common law system which has more developed laws and procedures be it in companies' law, commercial law, bankruptcy law, civil procedure and others. In other words, Shariah has to develop. What we have seen in the short period of three decade is that Shariah had developed within itself and also by integrating with common law. In the latter case, it is now often referred to as harmonization.

Let us look at what has happened and is happening to Shariah as a result of the introduction and development of Islamic finance.

First, within the *Shariah* itself, we see the beginning of the disintegration of the *Mazhabs*. We know that one of the reasons that had led to the differences of opinions between the *mazhabs* was the geographical factor. For example, it was said that the earlier ruling of Imam Abu Hanifah that *"qamar"* refers only to alcoholic drink made from grapes and, therefore, in modern terminology, stout, whisky and beer are not, was made at a time when a particular hadith had not "reached" him in Kufah. Later when his students came to know of the hadith, they revised his ruling. Imam Syafi'e revised his fatwas after living in Egypt for a few years. On the other hand, Imam Malik spent all his life in Madinah. That explains some of his views. Now such a situation does not arise anymore. All information, whether on facts or law, is accessible to all no matter where they are, within minutes. Rulings made by a committee in the Middle East, Europe or elsewhere are known to other scholars everywhere in the world and vice versa. Scholars from different countries sit in the same committees all over the world. Transactions are not localized, like Imam Abu Hanifah selling cloth to a local customer in his shop in Kufah.

Secondly, the Shariah itself, especially *mu'amalat*, is developing in a way that had never happened before. Shariah has now come into direct contact with common law. To cater for modern international Islamic finance and to compete with its conventional counterpart, the Shariah can no longer look to its traditional source alone. This is because, while the development of conventional finance over the last few centuries was accompanied by the development in the law, especially common law, there was no parallel development in Islamic finance and the Shariah. So, Shariah will have to adopt laws and procedure from common law jurisdictions and even from its conventional counterpart. Good examples are the laws and rules that are now being used in Islamic finance. There are no ready-made equivalent of the Companies' Act, the Contracts Act, the National Land Code etc. So those laws are being used.

When the case goes to court, the Rules of Court are used. The Law Harmonisation Committee of the Central Bank of Malaysia of which I am Chairman

has identified only one provision of the Rules of Court that is contrary to Shariah i.e. regarding interest after judgment. We have already introduced a Shariah-compliant rule to cater for cases arising from Islamic finance. On the other hand, we are introducing the Shariah principle of wa'd into the Contracts Act to give legal recognition to the principle which is used widely in Islamic finance. Guiding Principles and Standards issued by the Islamic Financial Services Board (IFSB) and Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) dig deep into the archive of the conventional counterpart. It does not matter where the law or the rule comes from so long as it is not contrary to Shariah. When I was asked about a decade ago, "What is your definition of Islamic law?", my reply was "Any law that is not unislamic". I still hold the same view.

Without us realising it, actually there is a harmonistion of the laws going on. It is a two-way traffic, really. To me it does not matter the traffic from which direction is heavier so long as they don't collide with each other.

Thirdly, Shariah is moving into the legal main stream of the world. Common law lawyers are learning or getting advice on how to draft Shariah-compliant contracts. Shariah issues will continue to be litigated, argued and deliberated whether or not the courts rule on them eventually. Some courts may decline to rule on them but the fact that Shariah issues are litigated and argued before them, would make the subject familiar to them. In the end, I believe some lawyers and Judges in common law jurisdictions, indeed even in Japan, Korea, and Russia would become experts in it.

Fourthly, the Shariah, particularly *mu'amalat*, is going global. Non-Muslims in non-Muslim countries seek the advice of Muslim scholars who are experts in Islamic finance to launch an Islamic finance product. Non-Muslims have taken great interest to study the Shariah particularly pertaining to Islamic finance. Islamic economics and Islamic finance have become a popular subject in universities throughout the world. Thus, Shariah is no longer seen as an outdated medieval law meant for tribal desert dwellers. It is being studied and applied in billion-dollar international financial transactions in all the big cities in the world.

Fifthly, Islamic finance has changed the methodology of giving fatwas and created a new breed of *ulama's*. Because of the complexity of the products, their similarity with the conventional products, the interlink with the law of the land which is usually common law based, knowledge of the Shariah alone is no longer sufficient for a Shariah opinion to be given. The difficulty is not to know the relevant verses of the Qur'an, hadiths or opinions of traditional *ulama'* on a principle of Shariah. What is more difficult is to understand the mechanism of the products in order to identify the Shariah issues, if any and apply the relevant Shariah principles. This is where inputs from people from the industry and other disciplines become necessary. As a result, individual *ulama's* are no longer suitable to make the decision anymore. Hence, the practice now is to have a committee consisting of a

number of scholars, even from different countries, aided by officers from other relevant disciplines. Decisions are made as decisions of the committee, instead of the individual. Of course a member may give his own opinion and may be quoted subsequently. But, it is the ruling of the committee that becomes the *fatwa*.

From my own observations, traditional *ulama's*, well versed only in Shariah are finding it difficult to understand the complex mechanism of modern Islamic finance. Indeed, it appears that proficiency in Arabic alone in quite inadequate nowadays. I also see a new breed of scholars, usually in their forties, who are proficient in English and Arabic, had attended universities where they studied Shariah in Arabic as well as post-graduate courses in Western universities, usually in English, and have a fair knowledge of conventional finance. They are the ones who are in great demand by the industry.

Sixthly, at the beginning of this process, the greatest hindrance was that those who knew common law did not know Islamic law and those who knew Islamic law did not know common law. This is because, traditionally, due to historical and social reasons, common law lawyers and the Islamic Scholars hardly came into contact with one another. In Malaysia, common law lawyers were either British or other non-Muslims. They were trained in England, spoke English and, even if they were not Englishmen (or British), they were very English in their way of life. On the other hand, the Islamic scholars were Malays, usually from the villages, who had pursued their Islamic education in Islamic schools and proceeded to Egypt or the Middle East to further their Islamic studies. The speak Arabic besides their mother-tongue, the Malay language. The two groups of people dressed differently, ate different food and differently, too. While the common law lawyers would frequent the club bars, the Islamic scholars would not enter a club or even a bank. So, one can expect the separation and the prejudice against each other, including, even against each other's profession and the laws that they dealt with.

But, with independence, things began to change. The sons and daughters of those Islamic scholars themselves had become common law lawyers but their attachment to, familiarity with and their basic knowledge of and even their love for, Islamic law remained. The Islamic scholars of their generation could also be their own relatives and friends. There was contact and mutual respect. These were the people who sat together to produce the Shariah-compliant laws mentioned earlier.

Seventhly, the wind of change is also blowing from the opposite direction. Every time I attended an Islamic banking or *takaful* conference or seminar anywhere in the world, I noticed that a large number of the participants including speakers, at time a large majority, were either whites or non-Muslims. Some of them could even be the descendants of those common law lawyers mentioned earlier but, unlike their forefathers, they are now discussing Islamic law, Islamic banking, Islamic finance and *takaful*. Indeed, many are already experts in the subjects. The East and the West seem to have met!

All these seem to have been brought about indirectly by the development of Islamic banking and Islamic finance. The 21st century could be the beginning of a new era for the development and application of Shariah, particularly *mu'amalat,* globally.[ix]

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NOTES

[i] This paper was written for the Nigerian Muslim Students Association (NAMLAS) Journal.
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[iii] Tun Abdul Hamid Mohamad and Dr. Adnan Trakic: The Shariah Advisory Council's role in resolving Islamic banking disputes in Malaysia: a model to follow? http://www.tunabdulhamid.my
[iv] Ibid. Spelling of Arabic words changed to suit the spelling used in rest of the article.
[v] Tun Abdul Hamid Mohamad: Interlink/interface between civil law system and shariah rules and principles and effective dispute resolution mechanism. http://www.tunabdulhamid.my
[vi] Ibid
[vii] For fuller discussion of the advantages of having a single SAC at national level, see: Tun Abdul Hamid Mohamad: Malaysia as an Islamic Finance Hub: Malaysian law as the law of reference and Malaysian courts as the forum for settlement of disputes. http://www.tunabdulhamid.my
[viii] Julio C. Colon, Choice of Law and Islamic Finance, TILJ.
[ix] This paper was prepared for publication in the Journal of the Nigeria Association of Muslim Law Students (Namlas National) namlasnationaleditorial@gmail.com