

# From legalism to value-oriented Islamic finance practices

Islamic  
finance  
practices

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## Abstract

**Purpose** – This paper aims to provide analysis on the state of Islamic finance through critical appraisal on its current form and practices. This paper argues that the current form of Islamic finance practices is due to its legalistic approach and hence requires value-oriented reform. In this regard, Shari'ah governance system can be one of the mechanisms toward such reformation.

**Design/methodology/approach** – This paper uses case study research method and comparative studies of other's works to develop understanding on the extent of Islamic finance practices. The study utilizes descriptive, comparative and critical analysis approaches in extracting and analyzing the information.

**Findings** – The literature has indicated the growing frustration of scholars and proponents of Islamic economics on the failure of Islamic finance in addressing the real economic and ethical issues beyond the legal realm of Shari'ah compliance. Legalism leads to a narrow understanding and ignores certain dimensions of Islamic finance practices. Considering all factors and through critical observation, this paper argues that the current form of Islamic finance practices is due to its legalistic approach and hence requires value-oriented reform. At this juncture, the paper suggests that Shari'ah governance system can be one of the mechanisms toward such reformation.

**Originality/value** – This paper provides valuable discussion and fresh and recent information on Islamic finance practices, including Shari'ah governance practices of Islamic financial institutions (IFIs) through case studies. The study shares experience of Malaysia in developing its Islamic finance framework and practices from legalistic toward value-oriented approach.

**Keywords** Convergence, Islamic finance, Legalism, Value-oriented

**Paper type** Case study

## Introduction

Islamic finance has emerged as an alternative and competitor to the commonly used conventional banking system. Since its establishment, the system has been slowly adapted into the existing banking system and has proven its effectiveness and sustainability. Global Islamic banking asset with commercial banks will reach US\$1.8tn, representing 17 per cent average annual growth, and it is estimated that Islamic finance will be able to tip US\$6.5tn by the year 2020. Although witnessing the significant progress and positive development of Islamic finance, we must also not forget about the critiques and negative appraisal on its current implementation and practices. The literature has indicated the growing frustration of scholars and proponents of Islamic economics on the failure of Islamic finance in addressing the real economic and ethical issues beyond the legal realm of *Shari'ah* compliance. In fact, the imitation of many Islamic finance products and conventional services has resulted in making Islamic instruments seen as a sub-set of those available in conventional finance. Considering this valid concern, this paper hence attempts to provide an analysis on the



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direction and development of Islamic finance. Within the recent regulatory framework and infrastructure, this paper tries to generate an understanding and provide assessment on the extent of change and reform in Islamic finance practices.

It is important to note that this paper is not intended to question the method of Islamic jurisprudence in deriving certain legal rulings but rather to widen and enhance the framework of Islamic finance practices from a multi-dimensional approach. The author also recognizes and truly values the contributions of the past and present scholars and practitioners in the development of Islamic finance industry. Everything presented here is not new and actually derived from the works of pertinent scholars from various fields and expertise. Undeniably, they have made significant contributions in many forms that resulted in tremendous growth and fantastic achievement of Islamic finance. The author considers this paper as a preliminary thought to revisit the present Islamic finance practices and to advocate holistic reform to ensure its dynamicity and authenticity. As Islamic finance is multi-dimensional, its reform requires a holistic and balanced approach from both micro and macro perspectives.

To shed light on the topic, the author organizes the paper as follows. The next section discusses the state of Islamic finance practices between the aspiration and the reality. The third section explains the reform needed to improve the Islamic finance practices. This part criticizes the legalistic approach and advocates the value-oriented framework for reform in Islamic finance practices. The fourth section highlights challenges ahead and concludes the discussion.

### **Between aspiration and reality: convergence or divergence**

Without significant reform, Islamic finance may face difficulties and even may experience a systemic shock in the future. Strong statement made by Sheikh Saleh Kamel, the founder of Dallah al-Baraka Group on Islamic finance practices, in his acceptance speech for the Islamic Development Bank prize in Islamic Banking in 1997 should be an eye-opener to all. He said:

I would like to tell you, in all frankness, that if I were to start all over again, I would not choose the bank as a framework for the application of Islamic teachings in the field of economy and investment. I would look for another framework, which is fully in line with the *Shari'ah* principles regulating investment. This is due to the fact that we have not been satisfied with taking only the name of the bank but also its basic concept, namely, that it is a financial intermediary. So, we have not been able to find for our financial institutions a concept and a pattern, which goes beyond the issue of financial intermediary. This has led to the fact that the preferred investment patterns of Islamic banks have become a mix of a loan and an investment. It is a mix, which has most of the characteristics of a *riba*-based loan and the flaws of the Western capitalist system. It fails to highlight the features of Islamic investment based on risk-sharing and real investment. It does not recognize the guarantee of the capital or its return.

[Buiter and Rahbari \(2015\)](#) also express their concern on the existing Islamic finance practices and state the following:

What we need is the application of Islamic finance principles, in particular a strong preference for profit-loss and risk-sharing arrangements and a rejection of “*riba*” or interest-bearing debt instruments. I am not talking here about the sham *Shari'ah*-compliant instruments that flooded the market in the decade before the crisis; these were window-dressing, pseudo-Islamic financial instruments that were mathematically equivalent to conventional debt and mortgage

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contracts, but met the letter if not the spirit of *Shari'ah* law [...] I am talking about financial innovations that replace debt-type instruments with true profit-loss and risk-sharing arrangement.

In March 2009, the Vatican, in its official newspaper *L'Osservatore Romano*, stated: "the ethical principles on which Islamic finance is based may bring banks closer to their clients and to the true spirit which should mark every financial service" (World Bulletin, 2009). This official press statement seems to be a positive support to Islamic financial system by such influential religious institutions such as the Vatican. The faith-based ethical principles of Islamic finance attract many parties and bring hope to the current global financial system.

Contrary to its ideal assumption, Islamic finance in actual practice is more anxious on the legal and mechanistic aspect of *Shari'ah* compliance. Numerous studies have shown the tendencies of Islamic finance to imitate its conventional counterparts in many aspects and have started to lose its identity. A study by Belouafi *et al.* (2015) on 40 studies between 1983 and 2013 found a significant divergence between the theory and practice of Islamic finance. In other words, Islamic finance now is moving toward convergence with the conventional financial system rather than promoting its own identity. Convergence here means the development and practices of Islamic finance that steadily move toward having similarities and share common characteristics with its conventional counterparts. Islamic finance now operates more as a supplement to the conventional system rather than acting as a viable financial system that has its own identity. Hasan (2013) analyses some valid concerns over Islamic finance practices and summarizes them into several categories, and these include in the aspects of epistemology, model and framework, products and services, methodology, governance and socio-economic contribution (Table I).

All of these criticisms tend to conclude that Islamic finance practices are now to certain extent deviating from its original objectives or at least starting to lose its own identities. The critiques clearly highlight concerns of many scholars on Islamic finance practices, which are due to its legalistic approach. Preliminary findings show that legalism has shifted attention of IFIs away from the values and principles that represent the essence of Islam and reduce the concerns over excessive debt in the market practice.

Before discussing further, it is important to note that caution and criticism are mostly welcomed and, in fact, warranted but not to baseless allegation and wrongful accusation. Constructive criticisms will surely contribute to the development of the Islamic finance industry. The unethical criticisms will lead the industry nowhere and, in fact, may infiltrate its development and negate the public confidence.

### **Legalism and its implication to Islamic finance practices**

A legalistic approach is workable and appropriate from the micro perspective. Islamic finance dimension on the other hand is not micro in character but rather multi-dimensional. IFIs should take into consideration both micro and macro perspectives in the implementation of Islamic finance. Failure to do so and even an act of neglecting these two dimensions may result certain significant implications. More importantly, legalism leads to narrow understanding and ignores certain dimensions of Islamic finance practices.

Balz (2008) summarizes the rationales of why legalism is not the ideal framework for Islamic finance practices. First, Islamic finance is part of a revival of Islamic religious

Themes	Remarks
<i>Shari'ah</i> arbitrage and failed to serve the objectives of Islamic law	The practice of Islamic finance opens the gate for <i>Shari'ah</i> arbitrage. Islamic in Islamic finance should relate to the social and economic ends of financial transactions rather than the contract mechanics through which ends are achieved (El-Gamal, 2006)
Excessive debt	The disproportionate percentage of debt-based instruments as compared to equity-based[1]
Lack of authenticity	Islamic finance remains very much wed to neo-classical economics and employs Keynesian economic model to prove that interest-free economic system is workable and superior to conventional finance (al-Attas, 2006)
Relying on legal fiction	"In developing a <i>fiqh muamalat</i> caution must therefore be exercised for it is all too easy, when creating and then relying on legal fiction, to fall into the pit of complacency and inadvertently developing a <i>fiqh hiyal</i> " ( <i>Arab Malaysian Finance Bhd v Taman Ihsan Jaya Sdn Bhd &amp; Ors (Koperasi Seri Kota Bukit Cheraka Bhd, third party)</i> [2008] 5 MLJ 631)
Lack of social dimension and poor record of corporate social responsibility	Lack of commitment of Islamic finance industry to support developmental agenda and corporate social responsibility (Asutay, 2007) "The doctrine of shareholders' value, which is the bedrock of capitalistic market, has been shown to be the basis of Islamic finance practices" (Sairally, 2007)
Islamic finance operates within neo-classical economics	"Islamic economics depends too much on neo-classical economics without questioning either the value-orientation of neo-classicalism or the possibility of treating Islamic values in such otherwise value-free models of economic behavior, pricing and allocation" (Choudhury, 1999) "Rather than being part of the Islamic political economy, Islamic finance has been pursuing policies away from the theoretical underpinnings and systemic understanding of Islamic economics and has located a surrogate financial framework in neo-classical economics" (Asutay, 2007) "Islamic economics is an empirical theory with 'neo-classical guise'" (Al-Attas, 2006)
Identical to the conventional banking	"The 'applied business model' of IBs is almost identical to the conventional interest-bearing one. It is neither a 'two-tier muḍarabah' nor a wakalah (agency) based model but rather a specially 'engineered' debt model. The framework adopted in the development of Islamic financial instruments has been to design products in such a way that these are almost equivalent in economic and risk characteristics to conventional debt instruments" (Belouafi <i>et al.</i> , 2015) The current practice of Islamic finance shares many common similarities with conventional finance (Siddiqi, 2007) Islamic finance is not any different from conventional banking except in name (Kuran, 2004) A borrower under conventional loan is far better off ( <i>Affin Bank Berhad v Zulkifli Abdullah-Perspective</i> [2006] 4 MLJ i)

**Table I.**  
Critiques on Islamic  
finance practices

(continued)

Table I.

Themes	Remarks
Bankers' Window-dresser	<i>Shari'ah</i> advisors as bankers' window-dressers and overstretching the rules of <i>Shari'ah</i> to provide easy <i>fatwa</i> for the new breed of banker (Kahf, 2004)
Over legalistic approach	<p>"From the legalistic perspective, it is argued that interest is haram for being unjust and exploitative. However these concerns are merely rhetorical, as the new institutions in question have become too cozy with their own exploitative environment about which they are mute. Islamic finance is delinked from the broader goals of development and poverty alleviation" (Farooq, 2007)</p> <p>Islamic finance is experiencing a "formalist deadlock" where the industry is more concerned with formal adherence to Islamic law instead of promoting Islamic ethical values (Balz, 2008)</p> <p>"The current trend reduces Islam and its <i>Shari'ah</i> to their legal dimension rather than seeing them within a greater civilizational framework" (Haneef, 2009)</p> <p>"<i>Shari'ah</i> scholars approach the issue from a microeconomic perspective, and reflect on how an Islamic bank, as a financial firm, should conduct its transactions according to <i>fiqh</i> rules; they do not see it in a macroeconomic terms, with Islamic banks, as financial intermediaries, meeting the financing needs of society" (Siddiqi, 2000)</p>

ethics and not Islamization of the law. Second, *Shari'ah* principles are applied as ethical principles and not as legal principles. Third, in Islamic finance, Islamic law no longer is applied by Islamic scholars but it is institutionalized. Fourth, in Islamic finance, the system of precedent marks a clear departure from how Islamic law was administered in the past, drawing on new forms of standardization. Finally, from a legal perspective, Islamic law is no longer perceived as "law" but as "risk". The author agrees with these views, as the current form of Islamic finance practices is dominantly influenced by this legalistic approach and has produced negative implications:

- *Mere Shari'ah compliance*: Islamic finance products are mere replication of conventional banking. Some of the products involve no real sale. Anwar (2002) observes that although the Islamic banks have successfully replaced the practice of interest with other modes such as *bay al-murabahah* and *al-bay bithaman ajil*, doubts regarding their permissibility still persist. This is because there are no substantial changes in financial objectives. Islamic banks in those contracts are not actually interested in real sale, but just to facilitate cash.
- *Shifts attention away from the values and principles*: Legalism shifts attention away from the values and principles that represent the essence of Islam. It also delinks Islamic finance from its purpose and spirit, which leads to overemphasizing on form over substance or ritual over the values and consciousness underlying those rituals.
- *Potential factor to unethical practice*: Legalistic approach can lead to unethical practice, as it ignores the broader issues related to the moral teachings of Islam. Through this legalistic approach, debt is not a problem as long as it is created by *Shari'ah*-compliant means (Ahmed, 2011b).

- *Relying on legalism will not free Islamic finance from crisis and difficulties: A comparative study on 34 IFIs and 34 conventional banks in 16 countries affirms the finding that there is no significant difference in terms of the effect of the financial crisis on the soundness of Islamic finance and Conventional banking system (Bourkhis and Nabi, 2013). Islamic banking industry is not entirely crisis-proof, and financial crisis does have an impact on the Islamic banking performance (Hidayat and Abduh, 2011).*

Lack of concern toward excessive debt in Islamic finance practices is a good example to illustrate the legalism and its implication. Debt created through sale-based debt instruments is permissible. There may not be any issues arising in using debt from a legal perspective, as appropriate *Shari'ah*-compliant instruments can be used to create it. Debt can be created through *murabahah* (cost-plus or mark-up sale), *bai-muajjal* (price-deferred sale), *istisna/salaam* (object deferred sale or pre-paid sale) and *ijarah* (leasing).

However, the ethics derived from the Prophetic traditions indicate the Muslims should strive to keep the levels of debt to a minimum. A key obstacle to recovery, growth and prosperity in the advanced economies is too much debt and too little equity in the economy (Buiter and Rahbari, 2015). If IFIs are concerned only on *Shari'ah*-compliant and profit-making objectives and neglect the issue of higher indebtedness among individuals, then they contribute to immorality (Ahmed, 2011a)[2].

### **Toward reformation of Islamic finance: from legalism to value-oriented Islamic finance practices**

Study by Hasan (2011) found that there are two categories of scholars. The “conservative” scholars view the legitimacy of Islamic financial products and services to be based on the legal and mechanistic aspects of *Shari'ah*. The products and services are classified as lawful and *Shari'ah*-compliant or *Shari'ah*-based if they meet the conditions of a valid *muamalat* transaction after going through the ordinary process of *usul al fiqh*. On the other hand, the “pragmatic” scholars admit that Islamic finance should not confine their function by solely emphasizing on the *fiqh* aspect. The “pragmatic” scholars acknowledged that Islamic financial products and services should not only be valid and lawful and must fulfil the spirit of *maqasid Shari'ah* but also must be ethical and uphold the Islamic values. This indicates that some scholars acknowledge the limit and shortcomings of the legalistic approach and advocate the value-oriented Islamic finance practices.

Ibn al-Qayyim made a brilliant explanation on the conceptual meaning of *Shari'ah*. He said:

Everything that lapses out from justice into injustice, and from mercy into its opposite, and from *maslahah* to *mafsadah*, and from wisdom into the frivolous, does not belong to *Shari'ah*, even if it is inducted into it by interpretation.

The explanation given by Ibn al-Qayyim clearly indicates that there is a need to go beyond the legalistic arguments. Jurisprudence, wisdom, values, ethics and morality play crucial roles in the interpretation of *Shari'ah*. The practices of Islamic finance, therefore, must consider all of these principles in its business and operations to make it in line with the higher objectives of *Shari'ah*. The following illustrates and summarizes the framework for value-oriented Islamic finance practices, which consist of four

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principles, namely, tenet-bound, principle-bound, real economy linked and society service.

- (1) *Tenet-bound*: Fundamentals tenets derived from *Shari'ah*.
- (2) *Principles-bound*: Concept is grounded on ethics and values.
- (3) *Real economy linked*: These are asset-backed transactions with investments in real, durable assets.
- (4) *Society service*: This is serving communities, not markets.

The idea to reform Islamic finance practices through value-oriented approach is not new. The basis of value-oriented approach can be found directly from the foundational text of *al-Quran* and *al-Sunnah* and through the principles derived from the texts. Understanding of the text using the faculty of mind and rationality within the Islamic parameters also justifies the need for value-oriented Islamic finance practices. Nyazee (2000), in his article entitled “the Third Mode of Ijtihad: A Value Oriented Jurisprudence”, has already discussed the idea to use values in the context of *maqasid al-Shari'ah*. Farooq (2011) also discusses in detail the basis of value-oriented approach. He explains and elaborates several texts of *al-Quran* and *al-Sunnah* pertaining to value orientation and summarizes his arguments into 13 main essential values:

- (1) fundamental human dignity;
- (2) justice;
- (3) equality;
- (4) freedom;
- (5) universal moral values;
- (6) humanity;
- (7) *Shura* (representation and participation);
- (8) rule of law;
- (9) seeking common ground for mutual good;
- (10) rejection of violence as normal;
- (11) non-judgmental;
- (12) substance over form; and
- (13) embracing life-experience as part of the collective learning curve.

On top of the textual understanding, history has also proven that the legalistic approach could not solve all problems in the society. Moral enforcement supports and complements the legal mechanism to protect the interests and rights of individuals. For instance, in the past, Islamic societies had institutions that oversaw the ethical and morals issues related to economic affairs. Kamali (2008) affirms this fact and states that the practices of previous Islamic communities recognized the roles of courts to deal with the legal issues, and the market controller (*muhtasib*) was authorized to intervene and stop immoral and unethical practices. In the absence of *hisbah* institution in the context of modern finance, Ahmed (2011a) views that the role to oversee ethics and morals issues can be taken up by the regulators.

Value-oriented Islamic finance practices consider *maqasid al-Shari'ah* as not only philosophical but also as benchmark or indicators. Failure to meet the higher objectives of *Shari'ah* will be the indicator for IFIs to revisit and review their practices. [Kahf \(2006\)](#) indicates that fulfilling *maqasid* at the transaction level would involve satisfying the objectives, principles and values underscored in the Islamic laws of transactions. IFIs should observe *maqasid* in their corporate objectives and policies and also use them to verify compliance to true Islamic principles. The permissibility of a transaction will not only depend on the pillars of a valid contract but also on the outcome or consequences of the transactions ([Ahmed, 2011a](#)).

Ethics is an inherent element in value-oriented Islamic finance practices. [Reinhart \(1983\)](#) views that Islamic law is not just a law, but inheres ethics, as both constitute “a call to righteous action in conformity with the guidance of Revelation”. [Abtani \(2007\)](#) affirms this position where he states that Islamic law cannot be separated from its moral, ethical and religious principles; otherwise, its rules will be useless. At this point, the practices of Islamic finance should reflect the ethical principles. As an example, the prohibition of *riba* should be understood as not merely legal prohibition due to excess charge on a sum loaned but as a moral prohibition of exploitation in financial transactions ([Fazlurrahman, 1985](#)).

Another important element of value-oriented approach is civilizational dimension. [Siddiqi \(1981\)](#) views that civilizational-oriented dimension is concerned with the social justice and therefore closely related with human well-being such as poverty, underdevelopment, illiteracy, inequalities and the level of health and education. [Chapra \(1979\)](#) adds this list to include the fulfillment of basic needs such as food, clothing, shelter, medical care and education; equitable distribution of income and wealth; equality of opportunity to all; sustainable growth and stability; and individual freedom, social cohesion and moral excellence.

#### Tawhidic paradigm

Although majority of the Islamic economists or Muslim jurists agree on the concept of *Tawhid* as one of the philosophical pillars of Islamic economic, it is observed that little is written or discussed on the *Tawhid* epistemological methodology. [Choudhury and Hoque \(2004\)](#) discuss this very fundamental topic and explain Islamic epistemology of *Tawhid*. This *Tawhidic* paradigm provides foundation of Islamic faith, and, therefore, Islamic finance framework, which is faith-based, also emanates from this concept. Allah says in *al-Quran*:

Men who celebrate the praises of Allah standing, sitting, and lying down on their sides, and contemplate the wonders of creation in the heavens and the earth, (with the thought): Our Lord! Not for naught Hast thou created all this! Glory to Thee! Give us Salvation from the penalty of the Fire (3: 191).

This verse provides fundamental principle of governance where everything created by Allah has a purpose, and human being is created to be the world's vicegerent. By putting a trust to mankind as a vicegerent, Allah plays actively roles to monitor and involve in every affair of human being, and He is aware and knowing everything all the times. Allah says in *al-Quran*:



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O my son! If it be (anything) equal to the weight of a grain of mustard seed, and though it be in a rock, or in the heavens or on the earth, Allah will bring it forth. Verily, Allah is Subtle, Well-Aware (31:16).

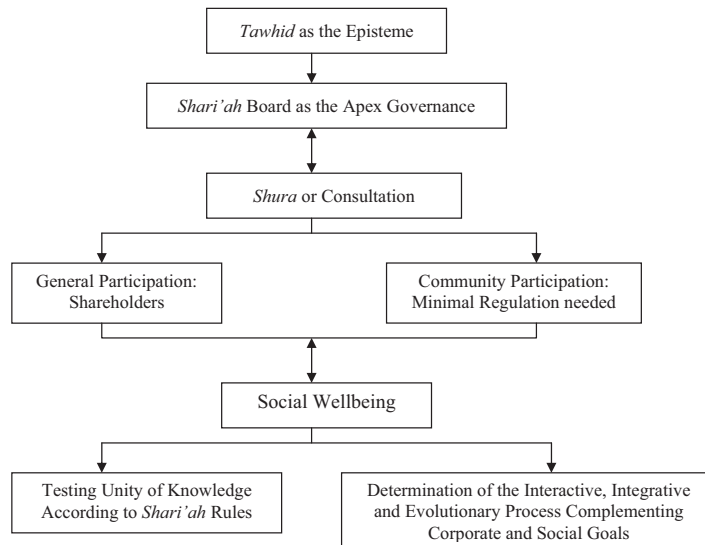
As Allah knows everything and all mankind is answerable to Him, the principle of *Tawhid* lays down a foundation for Islamic finance.

The concept of *Tawhid* denotes vertical dimension of Islam, whereby man's life on earth in its entirety relates eternally to God. Although unity depicts the vertical dimension, equilibrium denotes the horizontal dimension of Islam by which it is a binding moral commitment of every individual, institution, corporation or any kind of entities to uphold a delicate balance in all aspects of lives. The axiom of free will then propagate the concept of natural freedom within certain limitation, whereby it emphasizes on the element of balancing between the "individual freedom" and "collective freedom". Finally, the concept of "*amanah*" or responsibility complements the Islamic ethical axioms in which the natural freedom that derived from the free will axiom must be exercised with full responsibility as a vicegerent and trustee of God (Naqvi, 1981).

In term of governance, according to Choudhury, an Islamic corporation such as Islamic bank is a legal entity where the principals and proportionate of the firm's shares owned by the shareholders are based on equity participation and profit sharing ratios. Meanwhile, governance of corporation deals with legal and organizational structures that control the internal governance of a firm with an objective to define and attain an objective criterion by way of understanding the relations between variables supported by policies, programs and strategic coalition (Choudhury and Hoque, 2004). At this point, there are four principles and instruments governing Islamic governance, i.e. extension of *Tawhid* unity of knowledge via interactive, integrative and evolutionary process to the interacting environing factors, the principle of justice, the principle of productive engagement of resources in social and the principle of economic activities and recursive intention amongst the above stages. This concept of corporate governance is further illustrated and summarized by Choudhury and Hoque (2004) in Figure 1.

Figure 1 shows that the Islamic corporate governance approach is premised on the *Tawhid* epistemological model, whereby the functional roles of corporation are working via the *Shari'ah* rules. The principle of *Tawhid* derives important concept of vicegerency (*khilafah*) and justice or equilibrium (*al-adl wa al-Ihsan*). The stakeholders as vicegerent of Allah have fiduciary duty to uphold the principle of distributive justice via the *Shuratic* process. The constituent of *Shura* provides widest possible participation of the stakeholders in the affairs of the company such as Islamic banks.

There are two main institutions involved in the above process of corporate governance, namely, the *Shari'ah* board and the constituent of *shura's* groups of participants, i.e. all the stakeholders. In determining the scope of *Shari'ah*, the institution of *Shari'ah* board comes into a picture and plays a crucial role to ensure that all processes are in line with the *Shari'ah* principles. In addition, the shareholders also play a big role as active participants and conscious stakeholders in the process of decision-making and policy framework by considering the interest of all direct and indirect stakeholders rather than maximizing their profit alone. The other stakeholders including community should also play their roles to provide mutual cooperation to protect the interest as a whole and to stimulate the social well-being function for social welfare. All of these processes are centered toward fulfilling the ultimate objective of



**Figure 1.**  
Tawhidic-based  
corporate governance

**Source:** Choudhury and Hoque (2004)

Islamic corporate governance of complementing the private and social goals via upholding the principle distributive justice (Choudhury, and Hoque, 2004).

#### *Ethical dimension derived from Tawhidic paradigm*

In Islam, the word ethic is synonym with the term *adab* and *khuluq*. These two terms denote good behavior or a standard of conduct to be observed in social interactions or the set of moral principles that distinguish right from wrong. In the holy *al-Quran*, the term *khuluq* can be found in *Surah al-Qalam* Verse 4, as Allah says: “And surely you (Prophet Muhammad) have the best form of morals”, and in *surah al-Shu'ara*, Verse 137: “There is no other than *khuluq* of the ancient”. Apart from these, the Prophetic *hadith* had also made reference to ethics and morality where Aishah reported that that “the *Khuluq* (Morals) of the Prophet was based upon the Qur’an”, and the Prophet says that “I have come to complete the code of moral conduct” (Muslim).

In deconstructing the Islamic ethical principles within the realm of economy, Naqvi (1981) advocates four important axioms that specifically reflect its relevancy in determining the rules of economic behavior in a society. The axioms of unity, equilibrium, free will and responsibility are the basis for deriving a set of ethical system and principles that would be appropriate to nurture and guide the economic behavior from the Islamic point of view. These divine formulated axioms provide very useful guidelines in identifying and recognizing legitimate ethical principles in an economy.

Another construct of ethics to legitimize the ideal Islamic economic behavior refers to the principle of *adl* (justice), *amanah* (trust) and *ihsan* (benevolence). Based on the ethical axioms of unity, equilibrium, free will and responsibility, Islamic ethics must at least have three important characteristics, namely, the criterion of *adl* (justice), *amanah* (trust) and *ihsan* (benevolence) (Beekun and Badawi, 2005). The first feature of ethics in Islam

requires all individuals to behave justly to all. The managers, for instance, shall treat equally the employees without discrimination. The concept of *amanah* then further characterizes Islamic ethics by considering an individual as a vicegerent of God, and he is accountable to Him in which requires him to be responsible in whatever he does. Finally, the concept of *Ihsan* represents the core and most important element of Islamic ethics. Unlike justice, which is mandatory, *Ihsan* denotes what is above and beyond mandatory. In this regard, *Ihsan* requires extra caution, effort and good intention where the individual performs good deeds with the realization that Allah is watching him at all times. The criterion of *ihsan* then expects all stakeholders in IFIs regardless of shareholders, managers, board of directors and employees to observe the set of Islamic ethical principles, which is divinely revealed and clearly stipulated in *al-Quran* and *al-Sunnah*.

#### *Shari'ah governance as a mechanism of value-oriented reformation*

There are various models and approaches in implementing *Shari'ah* governance, namely, two-tier “centralized model” with a *Shari'ah* Advisory Council (SAC) at the level of the central bank and individual *Shari'ah* committees at the market level in each IFI, “centralized model” with a *Shari'ah* Advisory Council at the central bank only and “non-centralized model” with *Shari'ah* committees at the financial institution level only. The “two-tier centralized model” with an SAC at the Bank Negara Malaysia (BNM) and *Shari'ah* Committee (SC) at individual IFIs as practiced in Malaysia is considered the most preferred model for *Shari'ah* governance practices.

The BNM has initiated comprehensive *Shari'ah* governance framework from regulatory and non-regulatory aspects. The BNM has issued several guidelines on *Shari'ah* governance and these include the Guidelines on the Disclosure of Reports and Financial Statements of Islamic Banks, the Guidelines on the Governance of *Shari'ah* Committee for the IFIs and the *Shari'ah* Governance Framework (SGF). The SGF incorporates the standards of best practice governance for *Shari'ah* committee in terms of independence, competency, transparency, well-defined operating procedures, sound ethics and code of conduct, confidentiality and clear mandate and responsibility.

In Malaysia, the Islamic Financial Services Act 2013 (IFSA) tends to be the catalyst for *Shari'ah* governance practices in Malaysia. *Shari'ah* governance system has undergone a tremendous change with the enforcement of the IFSA. The IFSA grants the BNM with the necessary regulatory and supervisory oversight powers to fulfill its broad mandate within a more complex and interconnected environment, including introducing more comprehensive consumer protection regime and providing clear demarcation between conventional and Islamic finance. The IFSA provides a clearer and more comprehensive set of provisions for IFIs. The BNM has wide-ranging powers to issue directives and guidelines, which are binding upon every director, officer or *Shari'ah* committee member of the institution.

Looking at the overall transformation in Islamic finance industry in Malaysia, including its legal reform, it is concluded that Malaysia is trying to provide a comprehensive framework that is fully consistent with *Shari'ah* and to promote real demarcation between Islamic finance practices and conventional financial system. Not only that, current Islamic finance transformation in Malaysia seems to shift the next level of Islamic banking business transcending beyond financial intermediation and to include real economic sector participation. This is in line with the proposed *Tawhidic*

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paradigm and ethical dimension of value-oriented Islamic practices. The internalization of Islamic ethical principles based on *Tawhidic* paradigm such as *adl* (justice), *amanah* (trust) and *ihsan* (benevolence) is part of the Islamic finance orientations. This clearly explains the vision of the Malaysian regulator, policy makers and other stakeholders to realize the value proposition of Islamic finance through end-to-end *Shari'ah* compliance framework. The transformation toward value-oriented orientation can be seen through various initiatives and developments in different aspects of Islamic finance practices, and these include law revision, professional liabilities, roles of the *Shari'ah* board, *Shari'ah* reporting, *Shari'ah* research and development, compulsory training, *Shari'ah* parameters, consumer protection and product innovation.

#### *Law revision to support Shari'ah governance*

Islamic finance is not only about the prohibition of *riba* but also goes beyond it. It shall embrace and internalize the principle of Islamic ethics. In this regard, the entire process of any Islamic finance transaction shall not only be *Shari'ah* compliant but must be embedded with the element of ethics. For instance, despite the Contracts Act 1950 that provides a basis for contractual obligations, there are laws related to ethics in contracts such as the Trade Description Act 2011 (Act730), the Trade Description (Certification and Marking of Halal), Ordinance 2011 and the Consumer Protection Act 1999 (Act 599).

As a continuous effort to overcome impediments to efficiently conduct Islamic finance, the Law Harmonization Committee Report formulated several recommendations to resolve issues in Islamic finance. With the findings from several consultations and studies, the Committee proposed a few recommendations to improve the Islamic finance regulatory framework by providing legal certainty of *Shari'ah* contracts enforcement, to be responsive and sensitive to implement legislative changes, to develop human capital through producing highly qualified legal talent and commercially experienced judiciary and to create a supportive and reputable dispute resolution environment for adjudication and dispute settlement at national and international levels.

The Committee also introduced several new legal provisions in court such as rules on imposition of late payment charges on judgment debts, to allow better access to Islamic financing for consumers through recommended amendments to reserve land legislations at all states, to facilitate Islamic financing involving landed property through recognition of Islamic finance in the National Land Code 1965 and to amend the Companies Act 1965 to facilitate the effort to offer globally accepted *Shari'ah*-compliant product structures for the Islamic money market.

#### *Professional liabilities*

The IFSA requires every IFI, its director, CEO, senior officer or member of a *Shari'ah* committee at all times to comply with *Shari'ah* and the BNM standards applicable to such person. A failure to comply with the standards issued, including guidelines or standards, is an offence and may carry a maximum penalty of eight years of imprisonment or a fine of RM 25m or both. In this regard, the board and management are expected to have reasonable understanding on the principles of the *Shari'ah* and its broad application in Islamic finance, whereas the *Shari'ah* Committee is expected to have sufficient knowledge on finance in general, and Islamic finance in particular. Not only that, the SC members may be disqualified if they failed to attend 75 per cent of the

*Shari'ah* Committee meetings in a year without reasonable excuse[3]. *Shari'ah* governance requirements under the IFSA and the SGF expect greater responsibility to IFIs, particularly to those who involve in policy-making decision and issuing *Shari'ah* rulings. This high expectation is translated by looking at potential exposure to board or directors, management, officers and even *Shari'ah* committee members with heavy penalties including imprisonment.

#### *The Shari'ah Committee members as the board of directors*

The *Shari'ah* governance framework in some jurisdictions forbids the *Shari'ah* board members to be appointed as directors of IFIs. This restriction is perhaps intended to clarify the role of the *Shari'ah* board members, which is supervisory and advisory in nature. Similarly, in the case of directors, they cannot be appointed as *Shari'ah* board members, even if they are qualified.

Situation is different in Malaysia, whereby the SC members can be appointed as board of directors. The practice shows that many IFIs appointed the Chairman of the SC to be the board of directors, subject that they meet the necessary qualifications. The SC member who at the same time holds position as independent non-executive director plays significant roles to advise IFIs and to educate the board of directors on *Shari'ah* matters. This practice leads to mutual cooperation and grants the opportunity for the SC to learn and understand the overall operations and policy of IFIs. The board of directors also can interact and engage with the SC member to learn more about *Shari'ah* aspects of Islamic finance.

#### *Shari'ah non-compliance report*

The IFSA and the SGF put strict conditions on IFIs in terms of statutory reporting. To complement this, the BNM has issued *Shari'ah* non-compliance reporting guidelines. IFIs are required to immediately notify the BNM and its SC of any non-*Shari'ah* compliant activities and immediately cease from carrying on such business, affair or activity. The IFIs are required, within 30 days, to submit to the regulator a plan on the rectification of the non-compliance as provided in Section 28(3)(c).

The BNM utilizes an integrated system known as the Operational Risk Integrated Online Network (ORION) for guidance on treatment of *Shari'ah*-non-compliant items. ORION is the BNM regulatory reporting system and processes. This system enables efficient reporting and supervision. Through this system, the BNM can easily monitor and supervise any *Shari'ah* non-compliance cases in IFIs. It is reported that since its effective date, the BNM received more than 100 submissions from IFIs for *Shari'ah* non-compliance reporting, and less than 21 per cent are actual *Shari'ah* non-compliance. The amount of actual loss due to this non-compliance is also significant. Generally, any money obtained by *Shari'ah* non-compliance sources will be channeled to charity or returned to the rightful customers. This is the framework for the treatment of *Shari'ah* non-compliance income as part of purification processes for any IFIs in Malaysia. The nature of non-compliance factors refers to operational issues, inadequacy of documentation and internal procedure.

#### *Shari'ah research and scholars' activism*

The International *Shari'ah* Research Academy for Islamic Finance (ISRA) and various Institutions of Higher Learning in Malaysia have been at the forefront in improving the *Shari'ah* governance-related matters, including research and development. The Islamic

Finance Development Indicator acknowledges the ISRA as the top contributor of *Shari'ah* research, and, in 2014, the ISRA won IFN Service Providers Poll as the Best Islamic Research Firm. The overall performance of *Shari'ah* research in Malaysia is also commendable. Malaysia scored 211 points, representing 31 per cent of the total research papers on Islamic finance in the world, far ahead of any jurisdictions that offer Islamic financial products and services.

The establishment of the Association of *Shari'ah* Advisors initiated by members of *Shari'ah* scholars further stimulates the degree of professionalism and talent development in Islamic finance. With 159 qualified *Shari'ah* scholars in Islamic finance in Malaysia (13 per cent female, 13 per cent non-Malaysian and 12 per cent non-*Shari'ah* background scholars), Malaysia is ready to offer its *Shari'ah* talent and meet the demand of the industry[4]. The level of awareness in the grass roots of Islamic finance is also increasing, whereby *Shari'ah* scholars are now actively engaging the communities and civil society entities. To complement this, the mass media also have been very supportive by producing and publishing news, documentary, talk show and information on Islamic finance even during prime-time hours.

#### *Compulsory training for Shari'ah scholars*

The BNM also makes it compulsory for all *Shari'ah* committee members to attend the *Shari'ah* Leaders Education program, a specialized and tailored module for *Shari'ah* committee, organized by the International Centre for Leadership in Finance (ICLIF) and Governance Centre. This program aims at broadening the perspective of *Shari'ah* scholars and enhancing their knowledge on the different operational dynamics of Islamic finance practices. All *Shari'ah* scholars are required to complete this program. Completion of the program will be one of the requirements for the reappointment and renewal of *Shari'ah* committee members.

The initiative by the BNM clearly shows its commitment to improve the overall *Shari'ah* governance practices. It is important for *Shari'ah* scholars not only to understand and possess substantive knowledge of *Shari'ah* but also modern economics and finance. The integrated knowledge of *Shari'ah* and modern economics and finance will help the scholars to understand the overall principles and operations of Islamic finance from both micro and macro perspectives, and this can nurture their pragmatic and dynamic worldview.

#### *The right of Shari'ah committee to issue more stringent rulings than the SAC*

The Central Bank of Malaysia Act 2009 clarifies the status of *Shari'ah* ruling issued by the SAC in the event it contradicts with *Shari'ah* pronouncement of the SC at individual IFIs. The *Shari'ah* rulings of the SAC shall prevail and have binding force over the *Shari'ah* resolutions of the SC. This is to resolve any potential disputes and conflicts on *Shari'ah* rulings issued by both the SAC and the SC.

Although the *Shari'ah* committee of IFIs is bound to follow the resolutions made by the SAC, the SGF grants the right to the SC to come up with *Shari'ah* opinions, which are more stringent than the SAC. In the event that the SAC has approved certain Islamic financial products, the SC is allowed to come up with different rulings if they think it is appropriate and has valid justification. This grants the freedom and opportunity for the SC to set high standard and value-oriented Islamic finance practices.

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### *Professional indemnity takaful*

Another interesting development of *Shari'ah* governance in Malaysia refers to professional indemnity takaful for *Shari'ah* committee or *Shari'ah* advisory council members. As the only legislation of its kind in the world at this point of time, the IFSA makes *Shari'ah* scholars legally accountable and liable for their duties, as any *Shari'ah* committee members may be jailed or fined if they fail to comply. This serious legal implication triggers the need of having professional indemnity Takaful for *Shari'ah* scholars, as in the case of advocate and solicitor or medical practitioners. Professional indemnity takaful is designed to professionals who provide advisory services. It protects the professionals against legal claims for damages arising from breaches of duty. *Shari'ah* committee is not immune from legal protection, and they may be sued in the court of law. The need for this professional indemnity takaful will further influence the level of professionalism of *Shari'ah* scholars.

### *Shari'ah parameters and guidelines*

While acknowledging the advantages and viability of Islamic finance, the International Monetary Fund (IMF) has reminded IFIs and highlighted the need to tighten rules and comply with standards and regulations more consistently (Vizcaino, 2015). This strong message from the IMF indicates that Islamic finance must seriously consider the adoption standards for the purpose of consistency and to ensure financial stability. Considering this, for the purpose of uniformity and consistency, the BNM has issued several *Shari'ah* parameters and guidelines to IFIs as guidance and reference to promote harmonization and standardization of Islamic finance practices[5]. These standards incorporate value-oriented aspects of Islamic finance practices and put certain requirements to ensure that each financial transaction is genuine and valid. Section 28(6) of the IFSA makes the standards binding to all IFIs, failure of which may lead to a penalty that carries eight years of imprisonment or a fine of RM 25m or both.

### *Promoting equity-based Islamic financial products*

*Shari'ah* governance framework also aims to promote value-oriented Islamic finance practices through promoting equity-based Islamic financial products. Although the existing debt-based products are still in practice, the initiative to promote genuine equity-based transactions is considered as one of the efforts to provide a clear demarcation of Islamic finance and conventional financial system. In this regard, IFIs are expected to introduce a new structure of *mudharabah* investment account, which reflects the actual characteristics of investment.

Section 2 of the IFSA defines investment account as an account for the purposes of investment, including for the provision of finance, on terms that there is no express or implied obligation to repay the money in full and with profits-sharing or both the profits-or-losses-sharing features with or without any return. This provision not only classifies Islamic deposit as principal guaranteed and investment as non-principal guaranteed but also requires IFIs to facilitate proper priority of payments upon liquidation. The BNM has issued Transition Policy for the purpose of flexibility and to grant more times to enhance its operational capacity to meet the requirement. This Transition Policy allowed IFIs to continue and accept Islamic deposits on current account, deposit account, saving account or other similar accounts under any *Shari'ah* contract, including investment deposit products until June 30, 2015. By July 1, 2015, all

IFIs must separate all of its investment deposits products either into Islamic deposits or investments accounts.

#### *Consumer protection*

One of the main objectives of the *Shari'ah* governance is to provide a greater certainty and build public trust in the system and the enforcement for sustainable growth and development of Islamic finance industry. Through the *Shari'ah* governance framework, ethical business conducts are strengthened and, at the same time, the interest of consumers are legally protected. The element of consumerism embedded in the *Shari'ah* governance framework is expected to set a new benchmark for Islamic finance practices in the market.

Element of consumerism can be seen through additional liabilities of the Board of Directors (BOD) with due regard to interest of depositors, investment account holders and takaful participants. The IFSA and the SGF add further liabilities to the BOD to have due regards not only shareholder but also depositors, investment account holders or takaful participants. At this point, the BOD has the duties to act in the best interests of the IFIs and, at the same time, to act in the best interests of customers.

### **Case studies: toward value-oriented Islamic finance practices in Malaysia**

#### *Case study I: migration to tawarruq*

Instead of introducing and empowering *mudharabah* to portray the true spirit of investment, IFIs on the other hand are now migrating to *tawarruq*[6]. Most of IFIs have introduced various *tawarruq* products, including *tawarruq* term deposit-i and *tawarruq* deposit for current account and saving account. *Tawarruq* deposit instruments particularly term deposit-i share common similarities with the interest bearing fixed deposit in conventional. It provides fixed return to customers, which are derived through trading of *Shari'ah*-compliant commodities as the underlying asset. *Tawarruq* now can operate on both the asset and liabilities side of the Islamic bank balance sheet.

In general, *tawarruq* at the first place is allowed for liquidity purpose, and some *Shari'ah* scholars regard it as being still preferable to conventional personal finance principles (Housby, 2011). With reference to the recent development, most of IFIs now use *tawarruq* in almost all of their products on both assets and liabilities sides. This position affirms concern of numerous scholars on the prevailing practice of *tawarruq*.

The IFSA requirement on the separation of Islamic deposit and investment account can be considered as parts of the value-oriented Islamic finance practices initiative. The practice nevertheless shows that IFIs on the other hand are now migrating to *tawarruq*. To support the initiative of the BNM to promote equity-based products, the Malaysian Government backed the Investment Account Platform with an initial start-up fund for RM 150m. Lembaga Tabung Haji also allocated RM 200m for the establishment of the *Shari'ah*-compliant Restricted Investment Account. By looking at the current development, Bank Islam Malaysia Berhad is the first IFI that introduced new investment account products, namely, *Waheed* Investment Account, Special Investment Account and *al Awfar* Account products. These investment account products are structured under the principles of *Mudharabah* and *wakalah*. It is expected that more IFIs will introduce their new investment account products this year.



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*Case Study II: al-Bay Bithaman Ajil financing*

Muslim Consumer Association of Malaysia (PPIM) reported that they have received more than 4,000 reports from consumers between 2003 and 2012 of their dissatisfaction with IFIs. Most of the complaints refer to *al-Bay Bithaman Ajil* home financing. The PPIM claimed that the IFIs have abused the word “Islam” for the purpose of profit maximization without taking into consideration the ethical aspects of doing business (Yusop, 2012). In fact, there are many cases where the customers need to pay the whole amount of selling price to IFIs even when the construction project was clearly abandoned.

The weaknesses of the *al-Bay Bithaman Ajil* products can be illustrated in numerous court cases. In the case of *Affin Bank Berhad v. Zulkifli Abdullah-Perspective* [2006] 4 MLJ i, the learned judge in his obiter wrote that:

[...] all the more shocking when it is further realized that a borrower under conventional loan is far better off. The consequence of a default under the *al-Bay Bithaman Ajil* facility proved to be far more burdensome upon the unfortunate and bewildered defaulter.

The judge in the case of *Arab Malaysian Finance Bhd v. Taman Ihsan Jaya Sdn Bhd & Ors (Koperasi Seri Kota Bukit Cheraka Bhd, third party)* [2008] 5 MLJ 631[7] also reminded IFIs to observe the principle of omniscient, where he asserted that:

In developing a *fiqh muamalat* caution must therefore be exercised for it is all too easy, when creating and then relying on legal fiction, to fall into the pit of complacency and inadvertently developing a *fiqh hiyal*.

After reviewing the practices of *al-Bay Bithaman Ajil* and considering its *Shari'ah* and legal risk, the National *Shari'ah* Advisory Council issued resolutions on *bay al-'inah* (the underlying concept for *al-Bay Bithaman Ajil* is *bay al-Inah*) to rectify its flawed implementation in the market. This resolution detailed out the requirements of a valid sale transaction for *bay al-Inah* by imposing strict conditions. The resolutions laid down numerous requirements for IFIs to comply in which the elements of legal tricks in the transactions were removed. IFIs are no longer allowed to simply offer *al-Bay Bithaman Ajil*, and these strict requirements have led IFIs to offer different financing products.

*Case study III: ta'widh or compensation for late payment*

The case of *MK Associates Sdn Bhd v. Bank Islam Malaysia Bhd* [2015] 6 CLJ provides another interesting observation. This case involves issue and dispute on *ta'widh* or compensation for late payment. The BNM issued guidelines on *taw'idh* in 2012, whereby the amount that may be compensated to IFIs must be based on the actual loss incurred because of default, and this is only relevant in the sale-based financing facilities, including *al-Qard* (benevolent loan).

In this case, the plaintiff, MK Associates Sdn Bhd, defaulted in the installments of *al-Bay Bithaman Ajil*. The defendant, Bank Islam Malaysia Bhd, claimed the outstanding balance of the facility together with *ta'widh* or compensation for late payment in the amount of RM 10, 384 and 262.88 for the period of January 2000 to June 2012. The plaintiff contended that the defendant was not entitled to charge *ta'widh*, as it was not part of the terms agreed upon at the time the agreements were signed. The defendant on the other hand claimed that it has rights to do so pursuant to the BNM's letter dated December 10, 1998 and the *Shari'ah* Advisory Council Resolution in 1998.

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After giving due consideration of all factors and arguments, the learned judge made decision in favor of the plaintiff, and *ta'widh* was not relevant in this case. The court held that the plaintiff must know the imposition of *ta'widh* so that consent would be valid. The plaintiff in this case did not know the term *ta'widh*, as at the time the agreements were entered into in 1998, it was not practiced by IFIs. The learned judge opined that *ta'widh* was only introduced after the SAC's resolution in 1998 and the said resolution was only effective on January 1, 1999. It is unfair for the imposition of *ta'widh* where the agreements are silent on it, and, therefore, it shall be applicable only on or after January 1, 1999.

The above cases raised a valid question for us to ponder. Is there a material difference between Islamic and conventional financial products? The courts insisted that there must be a conscious effort by IFIs through valid instruments to make the transaction into a true and formal sale, which is acceptable under the *Shari'ah* principles. The case of *MK Associates Sdn Bhd v. Bank Islam Malaysia Bhd* [2015] 6 CLJ further illustrates the actual Islamic finance practices. *Ta'widh* of more than RM 10m upon the defaulted customer indirectly indicates that Islamic finance shares common similarities with conventional. Excessive compensation for late payment in Islamic finance mirrors the imposition of late penalty payment in the form of interest in conventional.

To facilitate the best practice of *ta'widh*, the BNM issued Guidelines on Late Payment Charges for Islamic Banking Institution. The Guidelines specifies in details the application of late payment charges for all Islamic financial products and services, as well as to enhance product transparency and disclosure requirements. The Guidelines requires board of directors and SC undertakings to ensure that they are satisfied with the controls that are put in place to determine and monitor the late payment charges. For the purpose of monitoring and recording of *ta'widh*, IFIs are required to put in place appropriate information system to ensure accurate computation and record keeping.

### **Concluding remarks**

Based on the foregoing discussion, there are some valid and legitimate concerns on the current practices and trends of Islamic finance. In simple words, “ask our heart” whether the recent Islamic finance practices have fulfilled the real higher objectives of *Shari'ah*. Over utilization of debt-based financing with all of its controversial issues is a good example. It brings little difference to the present system and creates negative perception to Islam itself. This raises a valid question for us to ponder, is Islamic finance real or truly Islamic?

Considering all factors and through critical observation, this paper argues that the current form of Islamic finance practices is due to its over legalistic approach and hence requires value-oriented reform. The value-oriented reform here means internalization of *Tawhidic* paradigm and ethical dimension in every aspect of Islamic finance practices. At this juncture, this paper suggests that transformation of *Shari'ah* governance system and framework can be one of the mechanisms toward the desired value-oriented reformation. Various initiatives and efforts, including legal reform in Islamic finance practices in Malaysia, illustrate this real transformation. To be realistic, we cannot expect that this transformation will happen overnight or within a short period of time, but we do hope that it will be going upward and accelerated direction toward real value-oriented reformation Islamic finance practices.

It is important to critically evaluate the performance of Islamic financial institutions against their foundational base and, at the same time, to maintain its positive development. The existing practices of Islamic finance so far have not established a distinct identity or to draw a clear demarcation line with conventional banks. More importantly, with the current practices, Islamic finance is surely not immune to the crisis. As the crisis is not the outcome of sudden practices, Islamic finance must learn from the history and take lesson from previous[8] financial crisis. We do not want to hear that the only lesson that Islamic finance has learned is that it never learns.

## Notes

1. According to the International Association of Islamic Banks, debt-based financing covered more than 80 percent of investments made by Islamic banks worldwide, and the Islamic Development Bank has so far not used equity-based financing in its financial business, except in a few small projects (Dar and Presley, 2000). Another study found that mark-up transactions represent 80-95 per cent of all investments by IFIs worldwide (Warde, 2000).
2. (Al-Shubaily, 2011, p. 2) found that PLS modes of financing on the asset side of 12 Saudi banks constitute no more than 3 per cent of the total assets of these institutions. Chong and Ming-Hua (2009) stated that 0.5 per cent of Islamic bank financing is based on the PLS modes of *mu\_darabah* and *musharakah* financing and on the liability side, *mu\_darabah* deposits, account for 70 per cent of total Islamic deposits.
3. The attendance record of the SC members must be disclosed in the IFI's Annual Report.
4. The total number of *Shari'ah* scholars reached 952, representing 652 IFIs in 46 countries; 75 percent of these *Shari'ah* scholars are located within the top ten countries by asset size and 41 percent are within the GCC region and 26 per cent in South East Asia. Malaysia has the largest numbers of *Shari'ah* scholars, 203, followed by Bangladesh, 173, Indonesia, 131, Kuwait, 70, Saudi Arabia, 68, Sudan, 60, Bahrain, 60 and UAE, 57 (ISRA, 2015).
5. The AAOIFI also has issued 93 standards and guidelines, including 25 accounting standards, 5 auditing standards, 7 governance standards, 54 *Shari'ah* standards and 2 codes of ethics. In addition, the IFSB has issued 24 Standards, Guiding Principles and Technical Note for the Islamic financial services industry in the aspects of capital adequacy requirements, risk management, governance, disclosure and supervisory review processes.
6. Interestingly, in the case of Islamic finance in Oman, prohibition of *tawarruq* practices has successfully resulted in product innovation such as interbank *wakalah* to meet the needs of short-term liquidity for IFIs. This means that sometimes closing the door through regulatory directive to certain practice may lead to innovation and creativity.
7. Dispute on *al-Bay Bithaman Ajil* seems to be never ending story. The recent case of *Low Chin Meng v. CIMB Islamic Bank* [2015] 5 CLJ 324 also highlighted the same issue, i.e. its validity and legality of *al-Bay Bithaman Ajil*.

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#### About the author

Dr Zulkifli Bin Hasan is an Associate Professor at the Faculty of *Shari'ah* and Law, Universiti Sains Islam Malaysia. As an academic, he has published numerous articles and books and presented many papers in various conferences both locally and abroad. He has vast experiences in Islamic finance industry as an advocate and solicitor, in-house legal advisor, SC Member, committee member of the Association of *Shari'ah* Advisors, including researcher for the Hawkamah, the Institute for Corporate Governance, Dubai International Financial Centre. In 2009, he assisted the Task Force on Corporate Governance in Islamic financial institutions to develop corporate governance guidelines for IFIs in the Middle East and North Africa (MENA) and the Task Force on Environmental, Social and Governance to specifically introduce the S&P/Hawkamah Pan Arab ESG Index for listed companies in 11 MENA markets. He represented Malaysia in the prestigious Young Muslim Intellectuals in Southeast Asia Programme in Japan organized by Japan Foundation 2013, and, in 2014, he was selected as a recipient of a grant to conduct scholarly research at Fordham University, New York, USA by the J. William Fulbright Foreign Scholarship Board through the Fulbright US-ASEAN Visiting Scholars Initiative. Dr Zulkifli is also involved in the Malaysian Syariah Index project as one of the panel of experts. His book entitled *Shari'ah Governance in Islamic Bank* published by the Edinburgh University Press won the MAPIM Best Publication in the category of social science in 2013. Zulkifli Bin Hasan can be contacted at: [zul361977@yahoo.com](mailto:zul361977@yahoo.com)

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