

The Role of *Shari'ah* Advisors in the Development of Islamic Securities

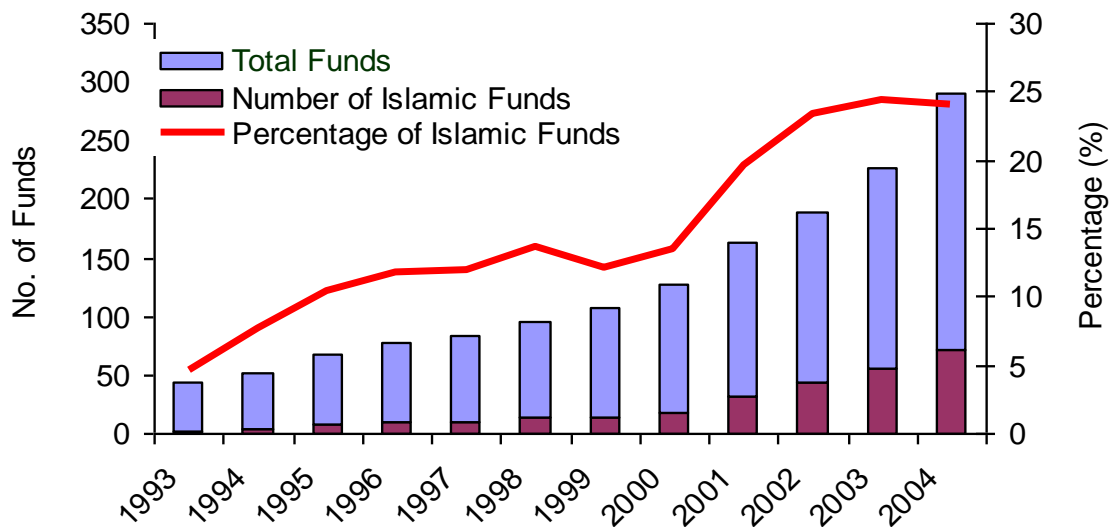
Dr. Mohamad Akram Laldin

Introduction

Islam is a comprehensive way of life, which strikes the balance between the spiritual and the material need of human being. One of the important aspects in human life is the need for a comprehensive system in order to govern their life and to ensure all the needs are catered adequately including the material needs such as the financial management. This aspect of life is closely related to the fast growing industry in the world nowadays, which is the Islamic financial services industry. At present, more than two hundred and fifty Islamic financial institutions are operating worldwide and Islamic banking is estimated to be managing funds of up to the value of US\$ 400 billion. The annual growth of Islamic financial institutions has been estimated at 15% worldwide over the past 10 years and is expected to accelerate in the near future.¹

One of the important sources of financing in the Islamic financial services is the fund generated from the Capital Market. In Malaysia, over the last decade, the Islamic Capital Market has seen significant growth and efforts to further strengthen this area of funding are ongoing. The creation of Islamic Money Market and Capital Market is no doubt a landmark development in the area of Islamic finance in Malaysia. A wide range of instruments was developed to facilitate the effective management of liquidity and funding by the Islamic financial institutions. This has facilitated the smooth flow of funds in the Islamic financial system. The development of the bond market in Malaysia is very encouraging in which it now accounts for 81% of GDP, the Islamic private debt securities account for about 44% of the total outstanding amount of private debt securities in the market, while the monthly traded volume of the Islamic money

market is now about RM30 to RM40 billion. The money market also effectively serves as a channel for the conduct of liquidity operations by Bank Negara Malaysia as part of its monetary policy. The Government of Malaysia has been supportive in the development of ICM. In 2001, the Minister of Finance launched the Capital Market Master Plan and one of the six strategic initiatives in the plan was to establish Malaysia as an international centre for Islamic Capital Market activities. The following chart illustrates the number and percentage of Islamic funds out of the total funds from 1993 to 2004.



In the development of any capital market, one of its main thrust is *Shari'ah* Compliance. Similarly, in Malaysia, this aspect has been seriously taken into consideration, as there is a special body to overlook the matter, which comes under the purview of the Securities Commission of Malaysia. In order to ensure the Islamicity of a particular product the Securities commission has required that all products should be examined and endorsed by the *Shari'ah* advisors. Therefore, *Shari'ah* advisor can be considered as the backbone of the industry without which the compliance aspect might be at stake. This paper intend to explore the role of the *Shari'ah* advisor in the development of Islamic securities

and it will begin by looking at the definition of *Shari'ah* advisory and then examine the specific role of *Shari'ah* advisors particularly in the development of Islamic Capital Market. The paper will also highlight the different approaches in *Shari'ah* advisory and finally will explore the challenges in *Shari'ah* supervision particularly in the development of Islamic securities. It is hoped that this paper will benefit the writer and met the expectation of the organizer.

Definition:

Shari'ah advisors are generally people who are entrusted to ensure the compliance aspects of particular products and instruments used in the Islamic Finance industry which broadly includes banking, capital market and *takaful*. Several definitions can be quoted in defining *Shari'ah* advisors. Among these definitions are the modified definitions from the definition of *Shari'ah* Supervisory Board in the AAOIFI standard which can be articulated as follows:

Shari'ah advisors are specialized jurists particularly in *Fiqh Muamalah* and Islamic Finance entrusted with the duty of directing, reviewing and supervising the activities related to Islamic finance in order to ensure that they are in compliance with *Shari'ah* rules and principles. The views of the *Shari'ah* advisor shall be binding in the specific area of supervision.²

The above definition indicates that *Shari'ah* advisors must have a good knowledge in *Fiqh* particularly in *Fiqh Muamalah*. This is important because Islamic Finance and Capital Market products are based on the underlying contracts discussed by the scholars under the purview of *Fiqh Muamalah*. While the writer is of the view that the above requirements is very much important for the *Shari'ah* advisors, the possibility of including experts from other field related to the product of capital market is also important as their exposures will assist the *Shari'ah* advisors in making precise decision.

The important roles of *Shari'ah* advisor as outlined in the definition given are directing the related party on the intended product, reviewing the product and supervising the execution of the said product in order to ensure that it complies with all the requirements of *Shari'ah*.

The above AAOIFI definition also reiterated the status of the decision made by the *Shari'ah* advisors that they are binding in the specific areas of the supervision. This signifies the fact that others cannot challenge the *Shari'ah* decision issued by the *Shari'ah* board on a particular product.

Apart from the above definition there are many other definitions given by the scholars particularly on the *Shari'ah* supervisory, however, these definitions emphasise on the important role of the advisors as the person entrusted to ensure the compliance aspects of a particular product.³

In the context of Islamic Capital Market, it is important that the industry ensures competent people play the advisory role as capital market products are devised using different concept and to certain extent are more complicated compared to banking products. This entails the expert to understand not only the *Shari'ah* part of the product, it also requires the expert to comprehend the whole structure and ensures that the funds raised by the issuer are to be used in line with Islamic requirements. In order to understand the whole structure, the expert shall have adequate knowledge of the basics of capital market products including knowledge of its purpose and objectives.

Role of *Shari'ah* Advisors

Shari'ah advisors has a great role to play and their responsibilities is not only limited to the stakeholder but it is also a 'religious' duty to ensure that all the *Shari'ah* requirements is upheld. Therefore, in the development of Islamic

securities, the role of the *Shari'ah* advisor should be concurrent with that of the product itself in the sense that it should be formed from the moment the product is devised, and that it should provide continued supervision and permanent checking of contracts, transactions and procedures.

Shari'ah advisory roles in Islamic products are very different from conventional products. An entity issuing conventional products may have its legal advisor or business advisor; however, these advisors are different from Islamic securities *Shari'ah* advisors. It is because the management of the conventional entity is not bound to take any advice given by their legal and business advisor; whereas the entity that developed Islamic products are obligated to adhere with the decision made by their *Shari'ah* advisors when the product proposed or any operational issues defined contradicts with the *Shari'ah* principle.

The role of *Shari'ah* advisors in general is to ensure the products are developed according to *Shari'ah* requirements and specification from the beginning to the end. In addition it is also important to ensure that the funds raised in the issuance are utilised for the purpose which comply with *Shari'ah*. Specific role of the *Shari'ah* advisors in Islamic securities can be summarised as follows:

1. Ensuring the products are developed using the acceptable principles of *Shari'ah*⁴. Several contracts are allowed to be used in developing a particular structure. What is important in the development of a product is to ensure all aspects of the product comply with *Shari'ah* requirements and not just the main structure. As an example, a product that utilises the *ijarah* contract as its basis must comply with all conditions regarding *ijarah* contract such as the responsibility of the lessor to undertake major maintenance of the *ijarah* asset and others. In addition to the above, all the secondary contracts which is attached to the main contract such as

the collaterals, agency and other such contracts must also satisfy the *Shari'ah* requirements related to the particular contract.

2. Ensuring the underlying assets used in the issuance of the *sukuk* are in consistence with the requirements of *Shari'ah*. This usually involves assets that are partially considered as non-compliance such as a building which is partially used to operate non-compliance activities like conventional bank, gambling outlets etc.

3. The *Shari'ah* committee should ensure that securities being traded are asset backed, as this is an important distinguishing feature of Islamic instruments. As Islamic securities will normally be constructed on the back of an income yielding asset and the *Shari'ah* committee must make sure that the underlying income is legitimate, that the assets are acceptable under Islamic law and that the securities are properly designated with respect to the underlying finance being provided.

4. Ensuring the decision of the *Shari'ah* advisor (committee) is understood by the issuer and implemented according to what has been decided. This is one of the challenging tasks as many of the issuer had conventional training and they are very familiar with the conventional issuance and not very much with *Shari'ah* requirements for the issuance. Therefore, it is important for the *Shari'ah* advisor to be satisfied with the understanding of the issuer so as for them to uphold and implement the decisions accordingly.

5. *Shari'ah* advisors must be competent enough to scrutinise the documents related to the issuance as there are many documents involved in the issuance. The negligence in scrutinising the documents might lead to non-compliance and to certain extent might have negative legal consequences on the issuance.

6. It is vital for the *Shari'ah* advisors to have full knowledge about the purpose of the issuance and how the proceeds are going to be used and ensure that the proceeds are used for the purpose which comply with *Shari'ah* requirements.

7. Apart from the technicalities, of the issuance, the writer is of the view that it is also important for the *Shari'ah* advisor to assess the economic implication of the issuance to the *ummah* as a whole. This area might need to be done with the expertise in the area. At present, many quarters are questioning about the corporate and social responsibilities of institutions undertaking economics activities. Therefore, it is vital to examine the impact of the issuance and advice the issuer from the *maqasidic* perspectives.⁵

The above brief account of the role of *Shari'ah* advisors demonstrate the importance of determination, competency, alertness and seriousness which is expected from a *Shari'ah* advisor. One important fact that need to be realised is that *Shari'ah* advisors are not rubber stamp that will endorse whatever that comes to them. However, the endorsement have to be done after a full investigation and satisfaction that the product is in line with *Shari'ah* requirements. On the other hand, the advisory process also requires the

credibility and honesty of the practitioners to disclose all the operational and technical part of the issuance so that the *Shari'ah* advisor will be able to make a correct and precise decision.

Different Approaches in *Shari'ah* Supervision

This discussion will focus on the different approaches used by the scholars globally in the interpretation of the *Shari'ah* issues in Islamic Capital Market. Generally, there are three different approaches of the scholars in making *Shari'ah* decisions. They are applicable to all rulings in Islamic Law including what is related to banking and capital markets. These approaches are as follows:

1. **Rigidity and inflexibility (*al-tadyik wa al-tashaddud*) in making *Shari'ah* decisions.** Islam is a *deen* that teaches its followers to be moderate in all their undertakings. It also emphasise on the importance of making decisions which will serve the need of the people and at the same time is practical to be implemented. The concept of "*al-yusr*" (choosing the simple and accurate decision) is also very much emphasised as the Prophet s.a.w. will always choose the easiest between two things as long as it is allowed in Islam and he s.a.w. will always emphasise his followers to facilitate the needs in life without going through difficulties provided that it is allowed in Islam.⁶ In addition, Islamic system was revealed to bring blessing in life and not rigidity. This is evidence in the following verse: "And We have sent you (O Muhammad SAW) not but as a mercy for the '*Alamîn* (mankind, jinns and all that exists)".⁷

The driven factors that might lead a person to be rigid are as follows:

- a. **Fanaticism towards a particular *mazhab*, views or scholars.** Fanaticism towards particular views shall not be the driving factor in making any Shariah decision. Be it in matters related to *ibadah* or *muamalah*. This is because every scholar will give their view based on

the circumstances in which they are in and the issues posed to them. The requirements as well as the circumstances might change according to the change of time. In this respect Imam Ahmad is reported to have said, "Whoever issue any fatwa shall not impose or force anyone to abide by their view"⁸

As for the views related to *muamalah*, Sheikh Yusuf al-Qardawi emphasised the following: "...some scholars when asked about a particular issue related to contemporary *muamalah* will always refer to a particular *mazhab* literature, if there are no similar instances in these literatures; they will disallow the referred *muamalah* issues on the ground that these issues does not exists in the classical literature; as though originally matter in *muamalah* is impermissible unless it is stipulated in the classical literatures".⁹

No doubt the classical scholars has done tremendous effort in developing different areas of Islamic *muamalah* and the contemporary scholars must refer to these works in order to further develop *Fiqh al-muamalah*. However, it is also important for the contemporary scholars to venture beyond the scope of the classical *ijtihad* in order to further develop and enhance the Islamic products particularly the Islamic Capital Market products.

- b. Depending on the literal meaning of the text (*al-Qur'an and Sunnah*) without referring to its objectives (*maqasid*).** It is important for a scholar to understand the objectives of *Shari'ah* in making any decision and not just rely on the literal meaning of the text. In this respect Ibn Qayyim emphasis that it is not allowed for a *mufti* to quote the Qur'an or Sunnah literally and said this is permissible and this is forbidden unless, he is aware that what he said is what is intended by the Lawgiver.¹⁰

c. Unnecessarily propagating the usage of *sadd al-dharai'i* (blocking the means to evil) in disputed issues. Some scholars will unnecessarily propagate the usage of *sadd al-dharai'i* concept in Islamic law which might lead to difficulties. This is evidence when some scholars held the view that it is forbidden to plant grape tree as the grape might possibly be used to make wine. Similarly, some would go to the extent of disallowing Islamic products to imitate the conventional products because it has no origin in Islamic *muamalah*. This approach is questionable as there is nothing which forbids such activities as the benefit (*maslahah*) of such action supersedes its harm (*mafsadah*). The means that is allowed should not be disallowed if the benefit of such action is greater than its harm. Imam Ibn Qayyim clarifies the prohibitions of ways and means when he says, “When Allah forbids a particular thing and there are means and ways to realize it, He will forbid these means and ways in order to reiterate the prohibition so as to ensure no one will take any step towards the prohibited actions, if Allah allows the ways and means which leads to the prohibited things, this will lead to the assumption that the prohibition is incomplete and it will encourage people to dwell into the prohibitions”.¹¹

2. Excessive flexibility (*al-tasahul*) in making *Shar'iah* decisions.

This approach is obvious among some of the scholars who will agree and allow most if not all what is brought to them. This approach is sometimes taken as a result of pressure from certain quarters for product approval or the negligence in the part of the scholars in their investigation on the given issues. The other factors that shall not be overruled is the tendency to

please others and lack of much needed knowledge in arriving at the best decision.

No doubt that Islam propagates tolerance and taking the easy and simple decision but this does not justify any decisions arrived at with negligence. In this respect, it is important for all scholars to understand the true meaning of *ijtihad*. *Ijtihad* as defined by Al-A'amidi is: "The total best effort in the search for an opinion as to any legal rule in such manner that the individual senses (within himself) an inability to expand further effort".¹² Therefore, *ijtihad* is the utilization of maximum effort by the *mujtahid* in arriving to a certain decision where he sees no possibility for him to further investigate the issue. If this is done by the scholars then they will be qualified to obtain the reward as mentioned by the Prophet s.a.w. in his *hadith* which means, "If a judge makes the right decision through *ijtihad*, he shall be doubly compensated. However, if he errs, he shall be compensated once". In conclusion it can be said that a scholar can be 'right' in his professional conduct as a scholar without necessarily being 'right' in his conclusions provided that he has exercised all the means in arriving at the right decision.

Among the reasons for excessive flexibility are:

- a. Excessive utilisation of the principle of *maslahah* and *darurah* which might lead to misusing these two principles. Among the examples of such usage in *muamalah* is the view which allows indulging in *riba* in order to generate economics activities. Practicing *riba* as it is obvious is against the Quranic injunction. It should be emphasised here that the utilisation of *maslahah* is disallowed in the situation where it is against the explicit text.¹³ Similarly the utilisation of *darurah* has its limitation as stipulated in the maxim which reads, "Necessity should be estimated according to its required amount (*al-daruratu tuqaddaru bi-qadriha*)".

- b. Choosing the facility (*tatabbu' al-rukhas*) and taking the easiest view of the *mazahib* (*al-talfiq bayn al-mazahib*). No doubt Islam allows its followers to utilise the facility given by Allah. However, there are limits to it as stipulated in the legal maxim, "Whatever is allowed because of an excuse would be cancelled when the excuse disappears (*ma jaza li-`udhr batala bi-zawalih*)". As for choosing the different views provided by the schools of Islamic thought, the method should be finding the strongest view and not the easiest as the strongest view is the best view to be followed.
- c. Finding legal devices (*al-tahayul al-fiqhiyyah*) in order to justify certain rulings. In arriving to a particular decision, a scholar shall examine the available text or exercise *ijtihad* according to the prescribed acceptable methodology. The usage of legal devices particularly to succumb to any prohibited matters is not allowed. Imam Ibn Qayyim has elaborated the approved legal devices and the disapproved ones when he said that it is not allowed for the scholars to engage the *haram* and *makruh* action as legal devices, however, if he has a good intention in engaging the allowable legal devices, than it is allowed as done by the Prophet s.a.w. when he instructed Bilal r.a. to exchange dates with dirham and buy with the dirham the intended dates so as to free himself from *ribawi* transaction.¹⁴

3. The moderate approach in arriving at *Shari'ah* decisions

Islam is a system that emphasise on the importance of moderation (*al-wasatiyyah*) in everything. Therefore, it is vital for the *Shari'ah* advisors to follow this method in resolving and arriving at a vice *Shari'ah* decisions including in tackling issues related to Islamic capital market. This means, the scholars shall investigate the issues and arrive at a decision without

compromising the fundamentals of *Shari'ah*. As for the interpretations, it might vary from one situation to another depending on the circumstances, practices as well as the need of society and the industry as a whole. Imam al-Shatibi emphasised the importance of moderation when he says, "A vice mufti is the one who provides moderate and practical solutions for the public and will not burden them with unnecessary burdens (*al-shiddah*) and will not also be incline towards excessive flexibility (up to the point of compromising *Shari'ah* principles)¹⁵."

In the context of the development of Islamic capital market, it is important for the *Shari'ah* scholars to follow this method and the important factor is to study the suitable *Shari'ah* principles to be applied in any product and to understand the need of market. *Shari'ah* scholars must also assist those in the industry to come up with competitive product which is marketable locally and at global level. All this has to be done without jeopardizing the fundamentals of *Shari'ah*.

Challenges in *Shari'ah* Supervision of Islamic Securities

Shari'ah supervision of Islamic securities is not an easy job. It requires complete competency, alertness and seriousness. There are several challenges that need to be addressed in the supervision of Islamic securities. Among these challenges are:

1. Knowledge and the know-how of Islamic securities. It is important for the *Shari'ah* advisor to understand in full the different aspects of Islamic securities including the structure, documentation, the regulators requirements and other aspects related to Islamic securities. At present not many scholars are fully well versed on the above aspects and the scholars must take up the challenge in order to equip themselves with the necessary

knowledge and skills. Unfortunately, not many are serious enough and willing to take up the challenge and this is evident when the participation of scholars in workshops and training organized by the Securities Commission and other bodies are very limited.

2. Synergizing between the *Shari'ah* requirements with the legal and taxation framework. In the advisory task of Islamic securities, the *Shari'ah* advisors shall try to come up with the product which satisfies the *Shari'ah* as well as the legal and taxation framework. This will sometimes delay some of the process particularly in finding the alternatives in order to ensure the product satisfies all the above requirements. It is a challenging task which requires the *Shari'ah* experts together with the legal and taxation experts to sit together and find a viable solution to this issue. In order to ensure the above requirements are met, it is important to engage all the experts from the very beginning of the development of product so as to ensure all parties are aware of the anticipated consequences of the product. Some market practitioners will only get the *Shari'ah* advisors involved after the product has been developed. The writer believes this is not the best practice as it will sometimes put the *Shari'ah* advisors in a difficult situation in order to accommodate the requirements of the product. Therefore, it is important that all the aspects are taken care simultaneously as the products are being developed.
3. *Shari'ah* compliance and viable products. Any products that are developed must have economical value. The task of the *Shari'ah* advisors shall not only focus on the *Shari'ah* aspects but also includes business aspect, market scenario and operations. Sometime it is easy to discover a product that is purely *Shari'ah* compliant but is hardly marketable or its structure turns out to be very complex to understand and promote. On the other hand, certain products may be very marketable but it does not meet the *Shari'ah* standards and requirements. Therefore, it is a challenge for *Shari'ah*

advisors to work together with the market experts to come up with a *Shari'ah* compliance product and is competitive at the same time.

4. Balancing between the monetary gains and fulfilling the *Shari'ah* objectives. This challenge is commonly referred to as fulfilling the corporate and social responsibilities (CSR). Many quarters are questioning how far the current Islamic securities products are fulfilling the CSR. Some claims that, at present, the Islamic securities market are focused solely at raising fund in funding mega infrastructures or projects which only benefit certain segment of the society. It is argued that such move does not satisfy the *maqasidic* approach of ensuring that wealth are benefited by the society at large and do not confined to certain quarters of the society. Therefore, it is a challenging task for the *Shari'ah* advisors to educate and raise this concern so as, to strike the balance between "making money" and serving the corporate and social responsibilities. One point that needs to be realised is, it is impossible for the *Shari'ah* advisors to push this noble agenda without a firm support from the investors as well as the market practitioners.

5. Clear and transparent procedures in decision-making. One of the challenges in *Shari'ah* advisory is to ensure the procedures for decision-making by *Shari'ah* committees should be clear and transparent.¹⁶ This is important in order to preserve the integrity of the committee and the decisions made. Investigations of issues referred shall generally involve the study of *Fiqh* and the examination of *fatwa* by other *Shari'ah* committees and *Fiqh* councils, many of which have been classified and published as compendiums by many quarters. In addition, the experience of some *Shari'ah* committee members who served on several financial service providers may be of great value.

Conclusion

Islamic securities are no doubt an important instrument that serves the Islamic financial services industry as a whole. The *Shari'ah* advisors are the backbone of the industry without which the integrity of the whole industry will be at stake. It is important to note that advisory services are an *amanah* (responsibility) and must be discharged with utmost professionalism and integrity. It is hoped that more interactions can be generated between the *Shari'ah* advisors and the market players so that the supervisory role will be enhanced. The *Shari'ah* scholars must ensure that all the decisions made are realistic and serve the interest of the *ummah*.

Finally, it has to be noted that the rapid progress of Islamic securities would not have been possible without the pioneering efforts of the regulators, Islamic financial institutions and all those who have put tremendous effort in building up a successful and vibrant industry. Despite that, the opportunity and prospect for a greater future success lies in the hand of all. Allah says in the Qur'an: "...Verily! Allah will not change the good condition of a people as long as they do not change their state of goodness themselves..." (Al-Ra'd: 11) and in another verse Allah says: "And say (O Muhammad) Do deeds! Allah will see your deeds, and so will His Messenger and the believers. And you will be brought back to the All-Knower of the unseen and the seen. Then He will inform you of what you used to do". (Al-Taubah: 107)

-
- 1 Source obtained from the presentation in Kuala Lumpur Islamic Finance Forum 2005, Kuala Lumpur, December 2005.
 - 2 See AAOIFI Accounting, Auditing and Governance Standards for Islamic Financial Institutions Governance Standard p. 5, 1425-6H/2004-5
 - 3 See Shahatah, Husin. Al-Tanzim al-Idari, Majallah al-Iqtisad al-Islami, issue no 116, pg. 42
 - 4 The complete Approved *Shari'ah* Concepts and Principles for the Purpose of Structuring, Documenting and Trading of Islamic Securities can be obtained from the Securities Commission web page.
 - 5 See, Siddiqi ,Mohammad Nejatullah. Shariah, Economics and the Progress of Islamic Finance: The Role of Shariah Experts, Concept paper presented at the Pre-Forum Workshop on Select Ethical and Methodological Issues in Shari`a -Compliant Finance SEVENTH HARVARD FORUM ON ISLAMIC FINANCE, Cambridge, Massachusetts, USA, Friday 21 April 2006
 - 6 See Kitab al-Jihad in Bukhari and Muslim
 - 7 Al-Anbiya': 107
 - 8 Ibn Mufleh, Al-Adab al-Shar'iyyah, vol.2, pg.45
 - 9 Al-Qaradawi, Al-Ijtihad fi al-Islam, p. 175
 - 10 Ibn Qayyim, l'lam al-Muwaqqi'in, vol. 4, p. 134
 - 11 Ibid, vol.3, p. 109
 - 12 Al-A'amidi. Al-Ahkam fi Usul al-Ahkam, vol. 4, p. 169
 - 13 Al-Ghazali, Al-Mustasfa, vol. 2, p. 293
 - 14 Op. cit, vol. 4, p. 170-171
 - 15 Al-Shatibi, Al-Muwafaqat fi Usul al-*Shari'ah*, vol. 5, pp. 276
 - 16 Wilson, Rodney, Regulatory Challenges Posed By Islamic Capital Market Products and Services