

## SHARIAH SCHOLARS AND FATWA MAKING PROCESS IN ISLAMIC FINANCE

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### Abstract

*Islamic finance industry faces unprecedented new issues that need immediate attention by Shariah scholars. The issues require the Shariah scholars to exercise their own ijtiḥad whether it is a collective or an independent ijtiḥad especially in the innovations of Islamic finance. One of the main challenges in issuing a fatwa in the Islamic finance is the scholars have to innovate Shariah compliant products that are workable and meet the modern market needs. To address this issue, it requires the scholars to have mastery skills in both the turath (classical knowledge) and contemporary knowledge in Islamic finance. The study will evaluate the efforts of the scholars in the fatwa making process and examine the challenges faced over time.*

*Keywords: Shariah scholars, ijtiḥad, Islamic finance innovations*

### INTRODUCTION

Shariah scholars have played vital roles in the establishment of Islamic financial institutions since their inceptions in the 1970s. To date, the Islamic Financial Institutions (IFIs) worldwide grows on average of 15-20 percent per year. The total asset of the industry had reached approximately USD 2.1 trillion in 2014 (Kuwait Finance House, 2014). An Islamic banking industry by far is the largest sector of the Islamic Financial institutions and its market share has increased in more than half of the 31 tracked jurisdictions, and the number of countries where Islamic banking is systemically important (i.e. where it accounts for more than 15% of the total banking assets) increased to 11, with 84% of the global *sukuk* outstanding also concentrated in these markets (Islamic Financial Services Industry Stability Report, 2016).

Although the majority of the Muslim scholars do not involve directly in the industry, their *fatawa* especially related to the Islamic banking products were very important to the industry and public. However, the Islamic Financial institutions are still facing a shortage of scholars (Wallin, 2005). It is a general public perception that the conventional banks which operated based on the interest system is prohibited. The interest concept which is similar to *riba* is prohibited by

the virtue of Quranic verses 2:275,276, 30:39, 4:161 and 3:130. The Islamic resurgence in the Middle East and discovery of oil during the 1960s are believed as the key factors for the establishment of the Islamic banks. One of the earliest banks, Mit Ghamr was established in 1967 used a *mudarabah* concept. In addition, Vahid and Vawda (2008) argue that Islamic banking and finance have made phenomenal progress since the establishment of Dubai Islamic Bank in 1975.

The Islamic banks have adopted several *uqud musamma* in their business operations. For instance, a *mudaraba* or profit and loss sharing concept is regarded as a lawful alternative for Muslim customers as both the bank and customer work together as a partner. One party contributes a capital meanwhile the other party will use that capital to make a profit and involve in the business directly. The profit earned is then divided between the bank and the customer. This concept is acceptable by all Muslim jurists and hence it becomes the most popular products in the Islamic banks. This *mudaraba* concept has been used extensively for savings and investment products. Apart from approving the *mudaraba* for Islamic banking products, the Shariah scholars also approved the concept of *murabaha*. *Murabaha* is a concept where the customer will ask the bank to purchase a commodity and the bank will sell it back at a markup price. This concept is also known as *murabaha li amri li shira* which has been used as an underlying concept for financing products. Therefore, it is pertinent to analyse the role of Shariah scholars in the innovation of Islamic finance and to verify whether their role is sufficient to move the industry. Hence, this paper evaluates the role of the Shariah Scholars in the development of Islamic financial innovation. At the same time, the paper will answer the questions of what is their significant role in the innovation process and whether their contribution is sufficient to support and move the industry in the global market.

## ISLAMIC FINANCIAL INNOVATIONS

It is important for the Islamic financial institutions to be innovative to attain competitive advantage. New ideas and products can create commercial value (Salem, 2009). Although some say that the IFIs innovations are still low, some new products are proven to be successful in the market. As Salem (2009) argues that new IFIs products must be Shariah compliant, and must focus on quality and diversity. The needs for new products is the result of globalization, transparency and capital movement.

Dar (2003) elaborated that the innovation in business context involves a model and process innovation. Developing new instruments such as *sukuk*, new methods to achieve a target. Dar also defined an Islamic financial innovation as the process of utilising Islamic legal contracts in new ways to develop financial products. It must comply with the Shariah and has the ability to replicate the economic effects of the conventional financial products. This innovation is a process to bring new business and improve profitability.

However, it can be argued that, an innovation in the Islamic finance is not only to achieve worldly targets such as economic effects, profits and company reputation,

but most importantly the innovation in the Islamic finance must bring the industry closer to God. In other words, the innovation that can purify and remove the superficial and controversial elements in the industry. As a result, a better Shariah compliant products and processes can be innovated and offered to the customers. This will also bring more confident to the public proving that Islamic finance is not mere a duplication of a conventional system.

Two objectives of the Islamic products are to meet the need of society which is the Shariah compliance and not only copying the conventional products, or in other words, Islamising the conventional products. A research has been conducted to identify which Islamic products are successful. The products like *mudarabah*, *istisna* and *murabahah* were some successful examples (Saleem, 2009). Among others are the *Islamic* profit rate swap, *sukuk* as a development tool rather than a financial instrument. *Sukuk* can be an ideal solution in developing an integrated market of the financial instruments of various risk levels. HSBC in the United Kingdom has introduced an Islamic pension fund. Another example is the securitisation as an alternative for the loan making process. Various products of *sukuk* offered are not free from controversy. The Islamic scholars have to verify whether *sukuk* is a new version of 'islamicised' bond, or does *sukuk* really follow the Shariah principles.

It is also important for the Islamic scholars to understand the Islamic financial industry has to compete with its conventional counterparts. Therefore, the industry needs to be innovative and competitive to survive and offer better products to the customers. New contracts such as *ijarah thumma al bay* (hire and purchase), *musharakah mutanaqisah* (diminishing partnership) and *ijarah mausufah fi dhimmah* (forward leasing) were introduced. The Shariah scholars have contributed their efforts by finding the legal rules related to the matter. Various opinions and discussions among the scholars have contributed to the success of these products. For example, a series of discussion on the implementation of the new contracts for the innovative financial products have been conducted among the South East Asian Scholars through the series of *Muzakarah Cendekiawan Syariah Nusantara* (South East Asian Muslim Scholars Conference). The issues discussed were pension fund, imposition of various fee, tainted income and *ijarah mausufah bi al-dhimmah* (forward leasing).

Apart from the savings, investment and financing products as mentioned above, the Islamic institutions need to be innovative in offering *takaful* products. *Takaful* is a halal alternative for a conventional insurance used several models or Shariah compliant concepts such as *mudarabah*, *wakalah*, *waqf* and hybrid contracts. Islamic scholars have pointed out many basic and technical issues in the *takaful* industry. For example, the issues of *tabarru* fund (contingency fund) and the issue of surplus, whether the surplus belongs to the participant or whether the *takaful* operator has the right to claim the surplus. In Southeast Asian countries, the Muslim scholars have organized a series of seminar discussing a number of legal issues in the *takaful* industries. It is indeed a contribution to the *takaful* industry.

## SHARIAH SCHOLARS IN ISLAMIC FINANCIAL INNOVATIONS

A Muslim scholar or also known as *ulama* is defined as a person who possesses a deep knowledge and understanding in Shariah. There are two categories of Muslim scholars who contributed in the field of Islamic financial innovations. The first category is those who are independent and do not have any relation with any Islamic financial institutions and the second category are those who sit in the Shariah supervisory committee or board of the bank. Both independent and specialised Shariah scholars have to exercise their *ijtihad* in the process of analysing Islamic financial innovations. It has to be understood that the *ijtihad* process is a tedious work and the result of the *ijtihad* may be different from one scholar to another. This is due to the fact that one result of *ijtihad* cannot supersede other result of *ijtihad* (*al-ijtihad la yanqidu bi al ijtihad*).

In *fiqh* terminology, *ijtihad* is defined as an exhaustive effort made by a jurist in deducing new legal rulings by independent interpretation of the Islamic legal sources (Shaharuddin et al., 2012). It has been practiced since the period of the Prophet to solve problems faced by Muslims for which the rulings were not explicitly prescribed in either the Quran or Sunnah. The extensive practice of *ijtihad* from the second until the fourth century AH developed *fiqh* as a body of knowledge. Although the dominant view during the period of stagnation of Islamic civilisation was that the gates of *ijtihad* had closed, the contemporary jurists mostly agree that the gates of *ijtihad* still remain open and will continue to be exercised by the qualified *mujtahids*.

The classical jurists have identified certain criteria for a scholar to be recognised as a *mujtahid*. A *mujtahid* is expected to be able to independently interpret the Qur'an and Sunnah, his mastery of both divine sources is necessary. This means that he knows, or can find, the Qur'anic verses and *hadith* relevant to the issue for which a ruling is being sought-after. In order to comprehend the Quran and Sunnah, a *mujtahid* must possess a good command of the Arabic language and its literature. In addition, a *mujtahid* must master the sciences of the Shariah such as the principles of jurisprudence (*usul fiqh*), Islamic legal history (*tarikh tashri*) and comparative *fiqh* (*fiqh al-muqaranah*). Shatibi added another criterion: a deep understanding of the *maqasid* objectives) of the Shariah (Shatibi, 1990). A *mujtahid* in the Islamic finance matters must have a strong understanding of the objectives of the Shariah regarding wealth and be thoroughly familiar with the contemporary practices.

It is realised, however, that the qualifications of a *mujtahid* put forward by the classical jurists are difficult for the contemporary scholars to achieve. Given the current education system, it is quite impossible to produce a graduate who is well versed in all required areas (Quran, Sunnah, Arabic language and Shariah). This is because the current education system is designed to produce specialists in each discipline of knowledge. For instance, a Shariah graduate might only specialise in *fiqh muamalat* (commercial transactions) but not in *munakahat* (marital

issues) and *jinayat* (criminal law). Therefore, the practise of a collective *ijtihad* (*ijtihad jamai*) has become a common practise nowadays.

The Shariah governance in Islamic finance is no exception in this respect. Most Shariah advisors are not qualified to be recognised as independent *mujtahids*. Based on their educational qualifications, they have not yet reached the level where they can undertake *ijtihad* on their own. However, the Shariah scholars can exercise a collective *ijtihad*. The establishment of Shariah advisory boards in the Islamic financial institutions is an example of a collective *ijtihad*. Each Shariah advisory board is comprised of a group of Shariah scholars specialised in *fiqh al-muamalat* who are responsible for making *ijtihad* in the new problems faced by the Islamic financial industry. Any matter related to a *Shariah* aspect of Islamic finance practices will be brought to them to seek a Shariah judgement. The Shariah board will deliberate on the issue and concluded upon reaching a resolution. The question arises as to whether the resolution should be considered a fatwa.

### INDEPENDENT SHARIAH SCHOLAR

The independent Shariah scholars or *ulama* are those who do not sit officially in the Islamic financial institutions. These *ulama* issue *fatawa* for any issue and problem faced by the Muslims. These scholars are either official *mufti* or Shariah scholars. They have a formal and informal training in Shariah and Islamic studies. Many of them have their own students. Some of the prominent scholars also compile their *fatawa* in business transactions such as Yusuf Qardawi, Wahbah al Zuhaili, Ibn Baz and Mutawalli Sharawi. Ibn Baz for example, together with other Saudi scholars such as Abd Al Rahman Al Saidi, Ibn Uthaimin and Ibn Fauzan has a compilation of their *fatawa* exclusive on the rulings of *buyu'* (business transaction). The compilation highlights the important current problems such as currency trading, trust sale, deposits, *ribawi* transactions, banks interests, investments, instalments and hybrid contracts. Wahbah Zuhaili (2003) in his treatise *Fiqh Al-Islami wa Adillatuh*, also dedicated a special chapter in the Islamic financial transaction. His work has a significant contribution to the classical work of *fiqh muamalat* and at the same time analysing the current problem in financial transaction from the perspective of Muslim jurists.

There has been a growing interest among Muslim scholars to revisit and analyse the traditional concept of business transactions. This is due to the fact that modern Islamic banking relies heavily on the Shariah contracts (*uqud musamma*) in their products such as *mudarabah*, *wakalah* and *wadiah*. For instance, an al Azhar scholar, Hawas (1987) revisited the work of al Mawardi on *mudarabah*. *Mudarabah* has been applied in the Middle East Islamic banks as this concept is known as a profit sharing and is regarded as the most idealistic concept for savings and investments products.

Their *fatawa* are typically quite general in every case without elaborating in depth on the technical issues. This is due to the fact that these independent scholars did not receive a formal training in the banking and finance industry.

Their expertise is in deducing the rule, tracing its legality from the various textual evidences and implementation in the classical era. Their *fatawa* can be regarded as an eye opener to the other Muslim scholars in the field. When the Islamic finance and banking industry started to flourish during the 1990s, the numbers of Muslim scholars who are trained in both Islamic knowledge and finance increased. Furthermore, the fatwa of these independent scholars are not bound by any Islamic financial institutions.

### **SPECIALISED SHARIAH SCHOLARS**

As compared to the independent Shariah scholars, the specialised Shariah scholars involve in the Shariah advisory or supervisory boards in the Islamic financial institutions whether in the Muslim or non-Muslim majority countries. Some studies had been done to define the Shariah supervisory from *fiqhi* perspective (Salaheen and Dhalaeen, 2013). Shariah supervisory or *riqabah Shariah* originated from the Arabic word *raqaba*. It is defined as waiting, keeping and guarding. Salaheen and Dhalaeen (2013) argue that Shariah banking supervisory is a mixed of various type of control that combines the administrative, accounting, banking and financial facets of control or supervisory. The core task of Shariah supervisory is to ensure the activities of the bank is in accordance to the Shariah. The Muslim scholars who sit in the Shariah Supervisory Board of Islamic financial institutions have more responsibilities as compared to those who are not. The Shariah board as an independent body that specialised in *fiqh muamalat* who directs the activities of the institutions, controls and supervise the activities of the banks to ensure its compliance to the provisions of the Shariah besides its decisions are obligatory to the institutions. (Salaheen and Dhalaeen, 2013). These Shariah boards are regarded as the regulators of Islamic finance, with the responsibility rating the banks and then ensuring a religious compatibility of the financial instruments they issue and trade. Initially there were only two Shariah boards in Cairo and Islamabad but the boards have proliferated as the industry have evolved (The Middle East, 2005).

Different countries have different regulations pertaining to the appointment of a Shariah board in the Islamic financial institutions. In Malaysia for example, it is obligatory under the Islamic Financial Services Act 2013, that all Islamic banks to have a Shariah Supervisory Board or Shariah Committee (Islamic Financial Services Act, 2013). The appointment of the committee must obtain a prior approval from the Central Bank. The committee must be competent, fit and have proper qualifications to become a Shariah committee. Surianom and Muhammad (2013) argue that the availability of this clause under IFSA is vital to ensure the products and services introduced by the Islamic financial institution complied with the Shariah principles via the supervision of the competent members. Miskam and Nasrul (2013) further argue that the Section 32 of IFSA 2013 contributes to the significance of Shariah Committees in every institution through the introduction of the Shariah governance which not only set out the

duties of the Shariah committees in the institution, but rather blend into the structure of the company itself. The number of committee members appointed however, differ between the Malaysian financial institutions. For example, the CIMB Islamic Bank Berhad appointed 9 scholars in their Shariah supervisory board, meanwhile the KAF Investment Bank Berhad only appointed 3 scholars for their committee (Bank Negara Malaysia, 2015).

Similarly, the United Arab Emirates also requires the establishment of a Shariah Supervisory Board for the Islamic financial institutions Salaheen and Dhalaeen (2013). The appointment of the Shariah supervisor varies depending on the banks. For example, Jordan Islamic Bank appointed one advisor meanwhile Dar al Mal al Islami appointed five advisors of qualified and professional scholars. The issues and challenges of appointing the Shariah committee will not be elaborated in lengthy since this paper does not focus on the appointment of Shariah advisor.

Polland and Samers (2013) made a comparative study on the role of Shariah advisers between the United Kingdom and United States. They found that the development of the Shariah supervisory in the United Kingdom is at an advanced state. The United Kingdom, as the home for nearly half of the fifty Islamic financial institutions in a non-Muslim majority country has no fixed rules in terms of the size of Shariah Supervisory Boards. Similarly in the United States. It can be said that all Shariah scholars in the Islamic financial institutions in Malaysia, United Kingdom and United States perform their duties by attending regular meetings, email correspondences, telephone conversations or face-to-face conversations.

The committee roles are pertinent to the industry, to advice, to ensure all businesses, affairs and activities comply with the Shariah principles. The banks are also required to provide accurate, complete and not misleading documents and information to the committee. This is important to ensure the committee gained enough information and enabling them to carry their duties especially in issuing new rulings or *fatawa*.

In addition, Salaheen and Dhalaeen (2013) also argue that the Shariah scholars in the financial institutions act as *mufti* and *muhtasib* at the same time. The role as a *mufti* is by giving Shariah consultations and deducting Shariah rules related to the products and activities in the banks. They have to verify whether the products offered, business and process involved complied with the Shariah rules. Meanwhile, the role as a *muhtasib* (controller) is by practicing its control over the banking activities as well as auditing the activities. However, it should be noted that, the *fatwa* of Shariah committee or any Islamic financial institutions is bound by the banks. This is different with the general *fatwa* issued by any *mufti* or Shariah scholars which does not have the legal binding effect. Therefore, Salaheen and Dhalaeen (2013) are correct in their argument stating that the Shariah supervisory board acts like a judge or *qadi* not only as a *mufti*. Poland and Samers (2013) also argue that the Islamic banking and finance governance relies overwhelmingly on

the embodied religious authority and practices of Shariah scholars who engage in the *ijtihad* to interpret Quran and adjudicate whether a particular financial contracts are Islamic or vice versa.

The prominent specialised Shariah scholars such as Sheikh Nizam Yaqubi, Mohammed Ali Elgari, Muhammad Imran Asraf Usmani, Sheikh Abdul Ghuddah and Mohd Daud Bakar are those whose opinion are seek by the Islamic Financial Institutions. Apart from these specialised Shariah scholars, many other scholars also issue their opinion regarding the Islamic Financial innovations through a formal body or council.

There are a number of Fatwa Bodies in the Muslim countries, whether the council issues all types of *fatwa* or only concentrates on the *fatwa* related to the Islamic financial issues. For example, in Malaysia, the Islamic capital market is governed by the Securities Commission. The Shariah Advisory Council was set up in 1996 to provide guidance and advice to the Securities Commission on matters pertaining to the Islamic capital market in order to ensure its consistency with the Shariah principles. They are regarded as the highest authority for issuing fatwas for investors, government and the industry at large. There is also a Shariah Advisory Council for Bank Negara Malaysia that governs the Islamic financial institutions in Malaysia. New products, fees imposed, Shariah non-compliant audit finding or appointment of institutions' advisers must be reported or obtained approval from the Bank Negara.

Kuwait Finance House (KFH) was established in 1977. Today, it is recognised as one of the market leaders in the Islamic financial industry. A Shariah supervisory board was set up by the bank to ensure all financial products and services are Shariah compliant. The members of the Shariah Supervisory Board actively responded to the daily Shariah problems faced by the bank's management. In order to disseminate the knowledge to the public, KFH has taken the initiative to compile all related fatwas. From 1985 to 2012, KFH has published four volumes of the fatwas issued by its Shariah Supervisory Board.

The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) is an independent international organization based in Bahrain that prepares accounting, auditing, governance, ethics and—most importantly—Shariah standards for Islamic financial institutions. More than 70 standards have been issued since its establishment in 1990. Not limited to the Gulf countries, the standards have also been adopted in Malaysia, Singapore and South Africa. It can be argued that AAOIFI is one of the most influential standard setters for Islamic financial institutions in the world today.

Dallah al-Baraka (DAB) is a Riyadh-based international conglomerate established in 1969. The company is involved in many different businesses such as trades, real estates, transportations and financial services. To ensure its operations are carried out according to the Islamic laws, the Dallah al-Baraka Group set up its own Shariah committee, led by a prominent scholar, Dr. Abdul Sattar Abu



Ghuddah. Their activities include issuing fatwas and conducting researches related to the Islamic financial transactions and contracts.

Since its inception in 1975, Dubai Islamic Bank (DIB) has established itself as one of the leaders in the Islamic banking industry. As a commercial bank, Dubai Islamic Bank's main activities are retail and business banking. In addition, the Bank has an investment division which provides advisory services to the corporations, financial institutions, governments and institutional investors of the Gulf countries regarding investment in *sukuk* and shares.

On the other hand, there are Muslim fatwa councils that also issue resolutions or *fatawa* in business transactions. This council issues various type of *fatawa* ranging from the worship, marital affairs, criminal and business transactions. The International Islamic Fiqh Academy was established in 1981 to serve as a platform for the Muslim scholars to discuss the contemporary issues faced by the Muslim Ummah. Under the auspices of the Organization of the Islamic Conference (OIC)'s 57 members, the organization has 43 scholars who are appointed as members of the Fiqh Academy Council. They specialized in various Islamic branches of knowledge such as jurisprudence, theology, Qur'an and hadith. Since its inception, the international Fiqh Academy has organised 19 roundtable discussions and 15 conferences to discuss different issues including economics, health, medicine, issues of belief and law and the body does not concentrate on the business related issues only. The scholars of the International Islamic Fiqh Academy issue resolutions at the end of each conference articulating their views, which can serve as guidelines for the Muslims.

Apart from issuing a fatwa in the Shariah supervisory boards and scholars' conference, the specialised Muslim scholars also produce books, articles, journals or concept papers in Islamic financial innovations. Monzer Qazf for example in his book, *Asasiyat al-Tamwil al-Islami*, evaluates new innovative financial products. The most challenging part in the invention of Islamic financial instruments, is most of the products applied hybrid contracts or use more than one simple contract. For instance, the product of *musharakah mutanaqisah*, contracts such as *bay*, *ijarah*, *wakalah* and *musharakah* are all used together in the product. The same goes with the issuance of *sukuk*. Although he is an economist rather than a Sharia scholar, he did make a contribution in assessing the development of Islamic financial products.

## DISPUTES IN ISLAMIC FINANCIAL INNOVATIONS

Upon examining the Shariah scholars' *fatawa*, it can be said that they are different in the resolution of the Islamic financial innovations. The problem of divergent in the Shariah resolutions could hinder the industry's development. Conflicting *fatawa* between the Shariah advisers of Islamic financial institutions occur when a contract is recognised in one region but rejected in another. For example, the acceptance of the contract of *bay inah* by the latter has become the main subject of disagreement (Shaharuddin, 2012). In Malaysia, *bay inah* is applied to create

various Islamic financing products such as the home and personal financing and credit cards. Furthermore, the controversy of this contract has led to the generalisation that Malaysian Shariah scholars adopt lenient and flexible approaches in deducing rulings for the Islamic finance practices (Shaharuddin, 2012). Another clear example of the difference is the issue of the leakage of Islamic funds into the non-Islamic investments. In Malaysia, the Islamic funds are not allowed to be leak out to the conventional *riba* based financial market, as stated in the resolution of the Shariah Advisory Council of Bank Negara Malaysia.

As the Shariah-compliance issue is crucial to the majority of Islamic banking customers, the existence of globally accepted Shariah standards is vital for maintaining public confidence and acceptance. Although a juristic disagreement is acceptable from the *fiqh* perspective, the practitioners consider its practice in Islamic finance to bring more disadvantages than benefits. The divergence of fatwas has led to confusion among the public about the legality of certain financial products, and this affects their acceptance. It is argued that homogeneity in the Shariah rulings will further accelerate the growth of the industry as it is easier to promote Islamic financial products worldwide if there are no disputes about their legality. Hence, the harmonisation of the Shariah rulings in the Islamic finance is seen as an urgent need (Shaharuddin, 2012).

Differences in juristic opinions is not a new phenomenon. It is a normal phenomenon since the first generation of Muslims. A case in point is the issue of *iddah* (waiting period for widow or divorced women). The differences is due on differing interpretations of the term *quru'* in the verse 2:228, the Companions issued different fatwas. Abdullah bin Masud was of the opinion that the *iddah* for a divorced wife ends with a purification from the third menstrual cycle. However, according to Zayd ibn Thabit, her *iddah* ends when the third menstrual cycle begins. This example clearly substantiates the existence of different opinions among the Companions. Islam recognises such disagreement, as Shariah scholars differ in their understanding of the sacred textual evidences i.e. the Quran and hadith of the Prophet.

The Scholars have identified six main factors that lead to differences in juristic opinions: 1) distinctive interpretations of the meaning and intent of some words and verses of the Quran; 2) distinctive interpretations of the meanings of *hadith*, differences in the number of *hadith* memorized by different jurists, and differing criteria for accepting *hadith*; 3) disagreements on the legal weight of the fatawa of the Companions, whether or not they are a binding reference; 4) disparities in understanding the wisdom (*hikmah*) behind laws, their *ilal* (effective causes) and the *maqasid* (purposes) of the Shariah; 5) differences of environment and customs; 6) differences in the way to harmonize apparently contradictory to the Shariah texts or give a preference (*tarjih*) to one text over another. In addition, there are differing views regarding the validity of certain categories of evidence such as *qiyas*, *istihsan*, *istislah*, *istishab* and regarding certain legal maxims used to

conclude rulings. These differences have led to the establishment of various schools of Islamic law (*madhhabs*).

It should be noted that a juristic disagreement is allowed in Islam as long as it occurs within the standard norm of ethics and proper behavior. Also, the disagreement must be motivated by the pursuit of knowledge and truth. If the disagreement is motivated by an egotistical desire or a personal gain, it is then prohibited. There are many examples from the early generation of jurists which demonstrated that they differed in the juristic rulings for the objective reasons not because of any personal motives. For instance, the difference of opinion over the necessity of reciting *bismillah* in prayer did not prevent them from performing prayer behind one another. Similarly, the ethics of disagreement should be followed by the contemporary Shariah scholars and practitioners in the Islamic finance when dealing with the differing fatwas issued by various Shariah advisory boards. Perhaps they should be reminded that the Shariah advisors deserve two rewards if their opinions are right and one reward if their opinions are wrong, provided they do not contravene any definitive evidence (*dalil qat'i*) such as the prohibition of *riba*.

Shaharuddin (2012) argued if the divergence of fatwas centred on a few *fiqh* issues only (i.e., *bay inah*), the standardisation will not be as complicated as one might think. Once the Shariah scholars reach a consensus on the issues, the Islamic financial industry will have a standardised Shariah practise. On the other hand, if the divergence involves many different *fiqh* issues, a standardised framework for issuing fatwas is required to assist the Shariah advisors.

Although the issue of fatwa divergence is frequently raised by the critics of Islamic finance, their criticisms are rarely supported by a rigorous quantitative study. The differences in fatwas are usually addressed in the discussion of the legality of financial products offered by the Islamic financial institutions. With the exception of a study conducted by Grais and Pellegrini (2006), no other researchers have embarked on identifying the contradictory fatwas in Islamic finance. In the course of studying the corporate governance framework of Islamic financial institutions, Shaharudin et al (2012) surveyed 6000 *fatawa* in six fatwa issuing bodies that are related to the business transactions. They found that only 10 percent of them are contradictory.

## THE MUSLIM SCHOLARS' METHOD IN ISLAMIC FINANCIAL INNOVATIONS

The application of Islamic classical contracts in the Islamic capital market has triggered a number of Shariah issues. The crux of the issues lies in the *ijtihād* made by the Shariah scholars' attempt to modify the classical contracts in adapting them to the modern finance practices. Such modification is understandable since the Islamic financial institutions operate in a completely different environment compared to what was elaborated by the classical jurists. It is generally acknowledged that not all of the classical *fiqh* rulings related to financial

transactions are applicable in the modern era. Hence, a new *ijtihād* is needed to end the classical *fiqh* doctrines so that they become relevant in meeting the sophisticated financial needs of the contemporary Muslims.

The Shariah scholars have adopted two general approaches in this respect. The first is to innovate new Islamic financial products based on the adaptation of various Islamic classical contracts. Advocates of this approach are normally the Shariah scholars who work closely with the Islamic financial institutions i.e. those who sit in the Shariah advisory boards or Shariah consultants for the bank. They try to understand the problems faced by the practitioners and then suggest possible solutions according to the principles of the Shariah. Hence, their work focuses mainly on how to apply the *fiqh* doctrines in creating financial instruments that are compatible with the conventional products in all aspects. These scholars are responsible for the Shariah compliance of the existing Islamic financial products and represent the Sharia governing bodies in most Islamic banks. However, due to the duplication of the orientation they have adopted, the current products are perceived by critics as not being significantly different from their conventional counterparts.

The duplication orientation has led to criticism by another group of Shariah scholars. This group questions the conformity of the current Islamic capital market products to the principles and ethical framework of Islamic commercial law propounded by the classical jurists. They perceive many of the *fatawa* and resolutions passed by the Shariah advisers of the Islamic financial institutions as contradicting the rulings found in the classical *fiqh*. The Shariah advisers are accused of being too lenient in satisfying the demands of Islamic capital market practitioners. This group also criticises the legal methodology adopted by the Shariah advisers. They argue that in assessing the Shariah compliance of the new financial products, the Shariah committee can be very rigid, concentrating solely on the legal technicalities while being excessively flexible in applying the doctrine of *maslahah* in an unregulated manner (Shaharuddin, 2012).

#### NON-BINDING FATWA AND LEGALLY BINDING SCHOLARS' OPINION

It should be understood that the opinion of the specialised Sharia scholars sit in the financial institution is legally binding as compared to the general *fatwa* issued by a *mufti*. The history of fatwa in Islam began during the Prophet's lifetime. The Prophet Muhammad was the first mufti, and all his fatwas are considered binding laws as well as a major legal source in Islam. A fatwa is derived from an Arabic word (فتى-يفتى-فتوا), which means an answer to a question or request. In technical *fiqh* terminology, a fatwa is a formal legal opinion issued by a recognized religious legal authority in response to a question related to Islamic rulings. In order to be a mufti, one must fulfil the previously mentioned criteria to be a *mujtahid*. The Shariah boards of Islamic financial institutions clearly fulfil the criteria as the institutional muftis. Each Shariah board practises a collective *ijtihād* to provide

solutions to the industry. However, the scope of their fatwas is limited to the *muamalat* (business and financial) matters. A review of a classical literature reveals that the majority of the jurists were of the opinion that a fatwa is a non-binding legal opinion. This means the *mustafti* (who asks for a Shariah ruling) is not obligated to act upon the issued fatwa and, hence, a person who does not act upon it should not be punished. The view of the classical jurists was that a fatwa only becomes binding and enforceable when it is issued by a *qadi* to settle a dispute brought before a court.

However, the current practise of the Islamic finance appears to contradict the classical understanding of fatwas. AAOIFI has clearly ruled that Islamic financial institutions must adhere to the fatwa issued by their respective Shariah boards. The institution is obliged to follow the fatwa once it is issued regardless of whether it meets the satisfaction of the management or not. This obligation holds true when the fatwa entails enforcement or prohibition of a certain act. When the fatwa entails permissibility of the act in question, the institution has the right to refrain from following it, if it believes that for practical needs it has to do so. In this case, however, rejection of the board fatwa should be reported to the General Assembly of the institution. (AAIOFI, 2010).

Similarly, the Islamic Financial Institution Act 2013 also requires the Malaysian Islamic financial institutions to adhere to the opinion of their respective Sharia boards. This rule aims to prevent the practise of *talfiq* (picking, choosing opinions and patching them together) to pursue Shariah exemptions without observing their relevant controls or their contexts and circumstances, an act which leads to adoption of irrelevant *fatawa*. Malaysia gives a greater authority and responsibility to the Shariah committees in the management of the Islamic banks. The Islamic banks not only have to abide the fatwas issued by the Shariah committees but must also seek their opinion on the strategic business management matters to avoid any Sharia issues.

## CONCLUSION

It can be concluded from the discussions above, the Sharia scholars have played vital roles in the Islamic financial innovation. The independent Sharia scholars and specialized Sharia scholars both had contributed to the success of the Islamic financial innovation. At the same time, they educate the public at large in understanding the Islamic financial system. Their *fatwa* is pertinent to move the industry to be at par with the conventional counterparts. However, their role is not without challenges. They need to be vigilant, knowledgeable and responsive to meet the need and demand of the market. The shortage of Shariah experts, the lack of training for the scholars, and contradicting *fatwas* are among the hurdles in innovating the Islamic financial systems and products. However, the differences in opinions and methods employed by the Shariah scholars in Islamic financial innovation should be seen as a wisdom or right to express one's own view. This

can be seen as an opportunity to grow the Islamic financial industry in a more dynamic sphere.

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