

# **Universality of Islam and the Process of Localisation in Islamic Banking and Finance: Malaysia as a Case Study**

**By:**  
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## **Abstract**

*Islam is a world religion. History shows that it has been expanded from the place it originally emerged to almost all over the world. Today, Islam is the religion for about 25% of the total world population. It is proclaimed that Islam is a comprehensive religion that covers all aspects of human life, from the administration of a state to the management of one's personal life. There are also many evidences in Islam that indicate it respects cultures of different group of people. Therefore, the aim of this paper is to deliberate and examine how this world religion integrates itself with local cultures and what are the rules and guidelines to be applied when confronting conflicting issues between religion and culture. In order to examine this matter, banking and finance practices will be taken as case study. The practices of Muslims in Malaysia, the meeting point of different cultures, will also be a reference in this study.*

## **Introduction**

It has been more than twenty years since the first Islamic bank has been introduced in Malaysia. Throughout this period, it can be observed that a lot of development has taken place particularly, in introducing the Islamic banking instruments. It cannot be denied that Islamic banking and finance are the most exposed areas to changes. Clients' needs, complexity of projects and business competitions require innovative financing packages.

The purpose of this paper is to manifest how Islam, being a universal religion integrates itself with local cultures, particularly in the Islamic financial products. It is hoped that the paper will be able to provide some important basis that the Muslim scholars are relying upon in making their decisions in order to ensure that the Islamic financial products are Shariah compliance and at the same time are acceptable by the

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multi-cultural society and competitive with products offered by conventional banking system.

The deliberation will focus on some of the primary decisions made by Shariah Advisory Councils at different levels, i.e the Central Bank of Malaysia, Securities Commission and also at other banks such as Bank Islam Malaysia Berhad, Alliance Bank and others. Technical grounds that bear testimony within the *fiqh* and *uṣūl al-fiqh* framework put forward by committee members of those councils will also be examined.

This paper being in a nutshell highlights the nature of Islam as a universal religion, followed by a brief history about the development of Islamic banking and finance in Malaysia. Some important acts that are related with the issue of Shariah compliance will also be discussed. The paper will then focus on one of the characteristics of the Islamic law which is flexibility, a very much related subject to the topic under discussion. General knowledge about this issue will ease the process of understanding the main issue which is the process of localisation in Islamic banking and finance. This main issue is dealt by highlighting some important grounds that the Shariah Advisory Council (at national and banks level) are relying upon in making their decisions. Examples and evidences will be given in order to strengthen these arguments. This paper is ended with a conclusion.

### **Universality of Islam**

Islam is a religion for all people regardless of their races and backgrounds. The Prophet Muḥammad (peace be upon him) had been assigned to spread Islam to the whole universe. The Almighty Allah says in the Qur'an: "And We have sent you (O Muḥammad, peace be upon him) not but as a mercy for the *‘ālamīn* (mankind, jinn and all that exists)."<sup>2</sup> In another verse, Allah says: "Say (O Muḥammad, peace be upon him): O mankind! Verily, I am sent to you all as the Messenger of Allah – to Whom belongs

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<sup>2</sup> Al-Qur'an, 21:107.

the dominion of the heavens and the earth...”<sup>3</sup> Both verses indicate clearly that the Prophet (peace be upon him) was sent to the ‘*ālamīn* and therefore, reaffirmed that the religion of Islam is for all mankind.

It can be observed that there is no single rule and regulation in Islam based on races. Islam does not differentiate between people of different races. Everybody has been given equal opportunity to raise himself as the best servant of the Almighty Allah. Allah says: “Verily the most honoured of you in the sight of Allah is the most righteous of you.”<sup>4</sup> The most righteous person is the one who always observe the command of Allah the Almighty and shun away from whatever prohibited by Him. Those righteous people will be rewarded in the hereafter regardless of their races, economic and social backgrounds.

The Almighty has frequently utilised the word “*al-nās*” (mankind) in the Qur’an to address all people and asking them to surrender to Him alone. For example, Allah s.w.t. says: “O mankind! Be dutiful to your Lord, Who created you from a single person (Ādam), and from him (Ādam) He created his wife, and from them both He created many men and women...”<sup>5</sup>

Although Islam is a universal religion in nature, at the same time it recognises the different cultures of people. Allah the Almighty says in the Qur’an:

“O mankind! We created you from a single pair of a male and a female, and made you into nations and tribes, that you may know each other. Verily the most honoured of you in the sight of Allah is the most righteous of you.”<sup>6</sup>

The verse indicates that the wisdom of creating people of different cultures is to give opportunity for them to get to know each other. The understanding and tolerance will then lead to cooperation among them. At the level of implementation, Islam acknowledges the different cultures as one of the main sources of laws. The famous

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<sup>3</sup> Al-Qur’an, 7:158.

<sup>4</sup> Al-Qur’an, 49:13.

<sup>5</sup> Al-Qur’an, 4:1.

<sup>6</sup> Al-Qur’an, 49:13.

Islamic legal maxim of “*al-‘Ādah Muḥakkamah*” (custom is arbitrated) indicates the importance of culture in Islamic law.

### **The Development of Islamic Banking and Finance in Malaysia**

Islamic banking was officially introduced into the Malaysian banking system in 1983 with the implementation of the Islamic Banking Act (IBA) 1983 (Act 276). The IBA provides for the setting up and licensing of Islamic banks. Compared to only one bank<sup>7</sup> that has been licensed under IBA in 1983, currently there are another three banks<sup>8</sup> have been licensed under the said Act. The Central Bank of Malaysia is also offering the Islamic Banking License to a few foreign financial institutions.

In addition to a number of banks established under the IBA, other conventional banks and financial institutions are also allowed to offer Islamic banking products. All these institutions are governed by the Banking and Financial Institutions Act (BAFIA) 1989. Section 124 of BAFIA spells out clearly:

124. (1) except as provided in Section 33,<sup>9</sup> nothing in this Act or the Islamic Banking Act 1983 shall prohibit or restrict any licensed institutions from carrying on Islamic banking business or Islamic financial business, in addition to its existing licensed business, provided that the licensed institution shall consult the Bank before it carries on Islamic banking business or any Islamic financial business.

Based on the above provision, it can be observed that almost all conventional banks and financial institutions in Malaysia are offering Islamic products. All these products are offered through the so called “Islamic windows” or “Islamic counters” of the banks.

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<sup>7</sup> Bank Islam Malaysia Berhad, established on 1<sup>st</sup> July 1983.

<sup>8</sup> Namely, Bank Muamalat Malaysia Berhad, Commerce Tijari Bank Berhad and RHB Islamic Bank Berhad.

<sup>9</sup> Section 33 deals with restrictions on trading by licensed finance companies, licensed merchant banks, licensed discount houses and licensed money brokers.

It is very interesting to note that during the early stages of Islamic banking worldwide, the implementation of dual system banking was only found only in Malaysia. While the types of banking system implemented in other Islamic countries were as follows:<sup>10</sup>

- a) Only Islamic banking such as in Iran, Pakistan and Sudan.
- b) Only conventional banking. This system was implemented in most Islamic countries.
- c) Conventional plus where most banks were on conventional system. However, there were a few (non-main stream) Islamic banking practised in some countries such as in Saudi Arabia, Bahrain, Bangladesh, United Arab Emirates and others.

The tremendous growth of the Islamic banking industries in Malaysia in term of their total assets, financing and deposits can be observed from the table below:<sup>11</sup>

Year	Total Assets	Total Financing	Total Deposits
1983	RM 369,800,000	RM 249,800,000	RM 274,900,000
2003	RM 20,929,723,000	RM 9,764,505,000	RM 17,583,700,000

According to the Central Bank of Malaysia, the Islamic banking and finance sector continues to grow at the rate of 18% to 20% annually.

As far as the Shariah compliance is concerned, both the IBA and BAFIA require the banks and financial institutions to establish their Shariah Advisory Council. Section 3(5) of the IBA provides that the Central Bank shall not recommend the grant of a license, and the Minister shall not grant a license, unless he is satisfied:

- (b) that there is, in the articles of association of the bank concerned, provision for the establishment of a Shariah advisory body to advise the bank on the

<sup>10</sup> Nor Mohamed Yakcop, *Teori, Amalan dan Prospek Sistem Kewangan Islam di Malaysia* (Theory, Practice and Prospect of Islamic Financial System in Malaysia), 70.

<sup>11</sup> See the website of the Central Bank of Malaysia at: <http://www.bnm.gov.my>

operations of its banking business in order to ensure that they do not involve any element which is not approved by the Religion of Islam.

Under BAFIA, Section 124 reads as follows:

(3) Any licensed institution carrying on Islamic banking business or Islamic financial business, in addition to its existing licensed business may, from time to time seek the advice of the Shariah Advisory Council established under subsection (7), on the operations of its business in order to ensure that it does not involve any element which is not approved by the Religion of Islam.

In April 2004, the Central Bank of Malaysia issued a guideline requires all banks that are offering Islamic banking products to establish their own Shariah Committee. At least three members of the committee who are having shariah background should be appointed. A person is not allowed to be a member of Shariah Committee in more than one institution of the same industry. At the national level, the Central Bank of Malaysia had established a National Shariah Advisory Council. In general, members of this council are not allowed to be a member of any Shariah committees at the level of the banks. The main rationale behind this restriction is to open up the door for more players in the field. Hence, more ideas and discussions about shariah issues related to Islamic banking and finance can be developed.

### **Flexibility as One of the Characteristics of Islamic Law**

Before the process of localisation in Islamic banking and finance being further specifically discussed, it is better to understand the flexibility and applicability of Islamic laws in general. In this respect, al-Shāṭibī said in his famous book *al-Muwāfaqāt*:

“The events of daily life are of two kinds: the first are those which do not differ in time, place, and circumstances, such as eating, drinking, joy, sorrow, sleep, awakesness, love, hatred, resort to lawful pleasures and keeping away from painful and unlawful things. The second are the events which differ in time, place and circumstances such as the way of dress, residence, leniency and roughness, slowlines and haste in dealing with situations and such like.”<sup>12</sup>

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<sup>12</sup> al-Shāṭibī, *al-Muwāfaqāt*, 2/297.

Another well known Muslim scholar, Ibn al-Qayyim said:

“Legal rules are of two kinds: One is permanent under no change in time, place, or personal reasoning. This is like the definite obligations and prohibitions and the fixed punishments for certain crimes. The other kind is changeable rules according to different interests in different times and places. This is like the punishment of the offences which is known as *ta‘zīr*. This subject of changeable and unchangeable rules is a large one in which many fell into confusion.”<sup>13</sup>

Both statements above clearly summarised the flexibility of Islamic laws in term of its applicability. The first group of laws appears not flexible even though with the change of places and times. This is simply because, by its own nature, the laws can be applied at any place and time. In other words, it can be said that there should not be any difficulty on any individual or society in implementing this kind of laws. These matters are sometime beyond the comprehension of man, and are not subject to the development of society and are not affected by different habits and customs. In most cases, injunctions related to these matters are explained in details in the Qur’an, or given in such details in the traditions of the Prophet (peace be upon him).

Some examples that belong to this group of laws are as follows:

- a) Laws related to ethics such as trustworthy, honesty, etc. Some examples from Qur’anic verses are as follows:
  - “Verily! Allah commands that you should render back the trusts to those to whom they are due; and that when you judge between men, you judge with justice.”<sup>14</sup>
  - “... give full measure and full weight and wrong not men in their things...”<sup>15</sup>
- b) Laws of inheritance: Allah s.w.t. says: “Allah commands you as regards your children’s (inheritance): to the male, a portion equal to that of two females; if

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<sup>13</sup> Ibn al-Qayyim, *Ighāthah al-Lahfān*, 1/331.

<sup>14</sup> Al-Qur’an, 4:58.

<sup>15</sup> Al-Qur’an, 7:85.

- (there are) only daughters, two or more, their share is two-thirds of the inheritance; if only one, her share is half. For parents, a sixth share of inheritance to each if the deceased left children; if no children and the parents are the (only) heirs, the mother has a third; if the deceased left brothers or sisters, the mother has a sixth. (The distribution in all cases is) after the payment of legacies he may have bequeathed or debts...”<sup>16</sup>
- c) Some laws related to marriage: Allah s.w.t. says: “Forbidden to you (for marriage) are your mothers, your daughters, your sisters, your father’s sisters, your mother’s sisters, your brother’s daughters, your sister’s daughters, your foster mothers who gave you suck, your foster milk suckling sisters, your wives’ mothers, your step- daughters under your guardianship, born of your wives to whom you have gone in but there is no sin on you if you have not gone in them (to marry their daughters), the wives of your sons who (spring) from your own loins, and two sisters in wedlock at the same time, except for what has already passed, Allah is Oft-Forgiving, Most Merciful.”<sup>17</sup>
- d) Laws related to specific acts of worshipping (*‘ibādah khuṣūṣiyyah*) such as the obligation of fasting in the month of *Ramaḍān*, number of *raka‘āt* in obligatory prayers, number of circles in *tawāf* and *sa‘yi*, etc.

The other group of Islamic laws is related to matters that are subjected to changes due to time and space factors. In most cases, the laws come in general terms, with minimum details but possess wider applicability as such matters are ever developing and changing according to the development of human society.

One of the examples is the principle of consultation. Allah s.w.t. says in the Qur’an: “... and consult them in the affairs...”<sup>18</sup> In another verse, Allah s.w.t. says: “... and who conduct their affairs by mutual consultation.”<sup>19</sup> The two verses state clearly that any decision should be made through the process of consultation. However, ways and

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<sup>16</sup> Al-Qur’an, 4:11.

<sup>17</sup> Al-Quran, 4:23.

<sup>18</sup> Al-Qur’an, 3:159.

<sup>19</sup> Al-Qur’an, 42:38.



means of consultation have not been elaborated neither by the Almighty Allah, nor His Prophet (peace be upon him). This is to ensure a wider applicability of the system which can operate at all times and places, and at all levels of administration.

Apart from rules related to ethics,<sup>20</sup> it can be said that in general,<sup>21</sup> rules related to Islamic financial system belong to the second group of law which means that they are very dynamic in nature and subjected to changes due to time and space factors. Normally, for this category of laws, general guidelines are outlined by Shariah. These general terms and guidelines will be discussed further in the next chapter of this book.

It is significance to highlight here that the absence of detail rules will naturally invite different of views among Muslim scholars. It is intended to be this way so that those general terms can be analysed from different perspectives to suit different time and place. As long as everybody is aware about the ethics of differences of opinion, the dispute will not lead to disunity in the society. Furthermore, relevant authorities can play their role in selecting the most suitable view to be applied within their jurisdictions respectively. Once this is done and the view has become the law of the land, everybody must follow the law. The existence of this kind of laws also indicates that Islam respects men's state of mind and its contribution towards the development of human society.

### **Globalisation and the process of Localisation in Islamic Banking and Finance**

One of the most exposed areas to socio-economical changes and developments is banking and finance. Clients' needs, complexity of projects and business competitions require innovative financing packages. It is widely accepted by all Muslim jurists that this area belongs to the second group of Islamic laws which are subjected to changes due to time and space factors.

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<sup>20</sup> Such as trustworthy in dealings, honesty, the obligation to pay debt, etc.

<sup>21</sup> In specific, there are certain rules that are unchangeable due to space and time factors such as the prohibition of *ribā*.

In this regards, it is very interesting to observe how Islam, a global religion integrates itself to local needs and environments. Malaysian experience in this area will be taken as a case study.

Upon close examination, it can be concluded that in order to assure its innovativeness and practical application of Islamic banking and financial system, some important grounds that the Shariah Advisory Council (at national and banks level) are relying upon in making their decisions are as follows:

### **1) Resorting to all sources of Islamic law.**

Beside the fundamental sources namely al-Qur'an and the traditions of the Prophet (peace be upon him), all available sources of Islamic law are also referred before arriving to a decision. The other sources are *ijmā'*, *qiyās*, *maṣāliḥ mursalah*, *istiḥsān*, *istiṣḥāb*, *sadd dharī'ah* and *'urf*. In addition, some other methods in the discipline of *Uṣūl al-Fiqh* such as *maqāsid shar'īyyah*, *siyāsah shar'īyyah* and *qawā'id fiqhiyyah* are also utilised. The existence of these rich sources of Islamic law gives rooms for practical applicability.

### **2) Decisions made are not bound to any specific school of thoughts**

Almost all Muslims in Malaysia are following the rules and regulations of Shāfi'ī *madhhab* in their specific *'ibādah* such as prayer and fasting. However, as far as finance and banking transactions are concerned, views of Muslim scholars in Malaysia are not bound to any particular *madhhab*. Views of scholars from all schools of thought are taken into consideration in making their decision. This is simply because Islamic transaction is in general, based on observing *al-'ilal* (reasons) and maintaining *al-maṣāliḥ* (benefit). In some cases, there are differences of views among Muslim scholars in finding those reasons and benefits. It cannot be denied that some of those views, regardless of schools of thought, are more suitable to be applied in local environment. Furthermore, those opinions are still considered Shariah compliance since they are normally based on acceptable sources of Islamic law.

One of the classic examples is the saying of the Prophet (peace be upon him): “Whoever reforms a barren land of no owner, he owns it.”<sup>22</sup> The jurists differ whether this saying is a general statement, so that who does such reformation owns the land without a special permission from authorities. Or this saying of the Prophet (peace be upon him) is a personal declaration from him as the head of the state, so that the reformer of land does need the permission of authorities. The majority of the Muslim scholars subscribe to the first idea, while Abū Ḥanīfah adheres to the other view.<sup>23</sup> Today, particularly in Malaysia, the view of Abū Ḥanīfah is more suitable to be implemented.

One of the current examples is in the case of *bayʿ al-dayn* (debt trading). The Shariah Advisory Council of Securities Commission agreed to accept the principle of *bayʿ al-dayn* as one of the concepts for developing Islamic capital market instruments. This was based on the view of some Muslim scholars, particularly Mālikī scholars, who allowed this concept subject to certain conditions.<sup>24</sup>

Another example is in the issue of warrants and futures contracts on crude palm oil. Traditionally, this kind of trading can be categorised under the principle of *bayʿ al-maʿdūm* (trading of non-existence object), which is in general, not allowed by the majority particularly Ḥanafī and Shāfiʿī scholars.<sup>25</sup>

On the other hand, Ḥanbalī scholars did not stipulate this condition. What is important is that a contract does not contain elements of *gharar*, which is forbidden by Shariah. Ibn Taymiyyah and Ibn al-Qayyim had analysed the question of *bayʿ al-maʿdūm* and concluded that a sale is forbidden not because of *maʿdūm* during the contract making, but rather because of the existence of *gharar*, which is a forbidden

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<sup>22</sup> Abu Dāwud, *Sunan Abī Dāwud*, 3/178.

<sup>23</sup> al-Zaylaʿī, *Tabyīn al-Ḥaqāʿiq*, 6/35, al-Qarāfī, *al-Furūq*, 6/35.

<sup>24</sup> See: Resolutions of the Securities Commission Shariah Advisory Council, 16-19.

<sup>25</sup> See: al-Kāsānī, *Badāʾiʿ al-Ṣanāʾiʿ*, 5/138, al-Zaylaʿī, *Tabyīn al-Ḥaqāʿiq*, 4/53, al-Nawawī, *al-Majmūʿ*, 9/257, al-Shayrāzī, *al-Muḥadhdhab*, 2/12.

element. The *gharar* in this context is the ability to deliver the sale subject (*al-mabīʿ*).<sup>26</sup>

Considering the above clarifications, the Shariah Advisory Council of Securities Commission abided to the opinion of Ḥanbalī scholars. This is because the study shows that the *ʿillah* (reason) for the prohibition of *bayʿ al-maʿdūm* is *gharar* due to the issue of deliverability of the sale subject, and not because of the non-existence of goods. In other words, *gharar* occurs when the seller is unable to deliver the objects for sale.<sup>27</sup> This can be avoided by having clear specifications of the goods and also stringent rules and regulation that govern such transaction related to crude palm oil. All these will also avoid any possible dispute among contracting parties.

### **3) Working as a team with experts in conventional banking and other related parties (laws, etc)**

It can be observed in Malaysia that Muslim jurists are working together with the experts from different related fields. This is to ensure that the issues are fully understood. Hence, suitable solutions can be recommended. In some cases, external experts are appointed as committee members of the Shariah Advisory Council. While in other cases, they are invited to attend the Shariah Advisory Council meeting to discuss and elaborate some related issues.

One example of this practice is the decision made by the Shariah Committee of Alliance Bank Malaysia in the issue of the usage of letter of *hibah* for a third party underlying asset.<sup>28</sup> This practice has not been allowed because it falls under *talāʿub* (manipulation) whereby the recipient must surrender the *hibah* received to the third party upon completion of the BBA transaction. This also contradicts the original concept of *hibah* whereby the third party surrenders the ownership and rights to the recipient without any consideration of counter-value. In addition, law experts are of

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<sup>26</sup> Ibn Qayyim, *Iʿlām al-Muwaqqiʿīn*, 2/8-10.

<sup>27</sup> See: Resolutions of the Securities Commission Shariah Advisory Council, 24-25.

<sup>28</sup> Please refer to Appendix 1 for the scenario of the transaction.

the opinion that the usage of letter of *hibah* is not an actual transfer of ownership. As such the recipient has no right to sell the asset to the Bank and therefore the usage of third party asset as an underlying asset for sale and purchase transaction is not allowed.

The bankers however, put an argument that the prohibition of the usage of letter of *hibah* had created difficulties to the Bank to promote Islamic Banking businesses. Most of the customers require working capital and they do not have any assets for BBA transaction. After a lengthy discussion involving experts of different fields, a new instrument which is *hiwālah* (transfer of debt)<sup>29</sup> has been suggested to overcome the problem.<sup>30</sup>

#### 4) Decisions made are subjected to revision

Another element that contributes towards the flexibility of Islamic transaction is the fact that all decisions made are subjected to revision due time and space factor. The famous Islamic legal maxim “*taghayyur al-ahkām bi taghayyur al-azmān*” (rules are subjected to changes with the changes of time) indicates clearly that this practice is compatible with the Islamic law.

This was also the practice of the Prophet (peace be upon him). ‘Āishah reported:

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<sup>29</sup> There are two types of *Hiwālah* :-

- a) *Hiwālah Al-Muqayyadah* ( Restricted/Bounded *Hiwālah* – to/by another same amount of loan with a third party)  
Under this concept, the Bank will buy an asset from the third party at the Bank Purchase Price and subsequently sell back the asset to the third party at the Bank's Selling Price. The third party owner will then grant as a loan the selling price amount to the Customer. Subsequently, the third party will transfer his liability to the customer who will be fully liable to pay back to the bank the selling price. The customer is therefore, released from any liability to pay back his loan to the third party.
- b) *Hiwālah al-Muṭlaqah* (Absolute *Hiwālah*)  
This concept is applicable for a joint application but payment is based on one person. For example, BBA facility under husband and wife but payment will be on husband. The buying and selling transactions with the Bank will be done by both parties (husband & wife). Subsequently the wife will transfer her liability to the husband who will be fully liable to the selling price.

<sup>30</sup> See: Minutes of the 2<sup>nd</sup> meeting of the Shariah Committee of Alliance Bank Malaysia held on 20<sup>th</sup> May 2005.

Some people come from the nomad tribes at the time of *Īd al-Adhā*, so the Prophet (peace be upon him), said regarding the sacrificed animal: “Store up from its meat up to three days and give some away in charity.” I said: “O Messenger of Allah! People were used to get benefit of the meat of their sacrificed animals they liked and store up their grease and make up containers for water out of their skin.” The Prophet said: “So what?” I said: “Now you have allowed such use for three days only.” He said: “I had forbidden it, i.e. the storing and distributing of meat after three days for the sake of the people who came from the nomad tribes. Now I say eat of the meat, give in charity and store up as you like.”<sup>31</sup>

It can be observed clearly in the above traditions that the Prophet (peace be upon him) had qualified his view considering the changes of circumstances.

One of the examples in the context of Islamic banking system in Malaysia is the acceptance of Green Accepted Bill. In 1992, the Shariah Advisory Council of the Central Bank has considered the bill, which is based on conventional banking system, as an Islamic financial instrument. This is because, at that point of time, the existence of Islamic instrument to cater for the short period investment is very limited.

Later, an Islamic instrument that replaced the Green Accepted Bill has been developed and subsequently introduced. The instrument which is called Accepted Bill-i (AB-i) is a combination of *murābahah* (cost plus financing) and *bayʿ al-dayn* (debt trading).<sup>32</sup> With the introduction of this new instrument, the Shariah Advisory Council of the Central Bank has revised their earlier decision. In its meeting held on December 23, 2003, the Council has decided to remove the Green Accepted Bill from the list of instruments that are Shariah compliance. This is due to the existence of

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<sup>31</sup> See: al-Haythamī, *Majmaʿ al-Zawāʿid*, 4/27, al-Tarmidhī, *Sunan al-Tarmidhī*, 4/94.

<sup>32</sup> Accepted Bill-i normally involves the following arrangements:

- a) Banks appoints the customer as its agent to purchase the required goods on its behalf and customer then purchases the required goods from the supplier on behalf of the bank.
- b) Bank pays the supplier the purchase price.
- c) Bank resells the asset(s) to the customer at an agreed selling price comprising the purchase price and profit margin. The profit margin is computed base on the profit rate comprising the AB-i rate for the relevant financing period tenor or such other applicable rates plus drawing commission. The sale of the goods by the bank to the customer on deferred term constitutes the creation of debt. The debt is securitised in the form of a bills of exchange drawn by the bank and accepted by the customer for the full amount of the bank’s selling price payable on the maturity of the AB-i. Customer pays the selling price on maturity.

some elements of *ribā* in the process of issuing the Green Accepted Bill by conventional banks.<sup>33</sup>

##### 5) Islamic banking and financial system is based on general principles.

There are rooms for flexibility at the level of implementation as long as those general principles are maintained. Among others, some examples of the general principles are as follows:

- Allah the Almighty says in the Qur'an: "O you who believe! Eat not up your property among yourselves unjustly except it be a trade amongst you, by mutual consent."<sup>34</sup> This is the general guideline that all kinds of immoral transactions such as cheating, coercion (*ghaṣb*), bribery and others are prohibited in Islam.

Based on this principle, the Shariah Advisory Council of the Central Bank concluded<sup>35</sup> that the practice of giving *hibah* (gift)<sup>36</sup> in inter-banks loans<sup>37</sup> should be avoided. This is to avoid the element of coercion on the creditor.

The verse also emphasises on the consent of related parties in transactions. In this regards, there is flexibility about the ways and means on how the consent is obtained. It can be in the form of written agreement, telephone conversation, etc.

- In another verse, Allah s.w.t. says: "Allah has permitted trading and forbidden *ribā* (usury)."<sup>38</sup> This verse in general, grants permission to all kind of trades and prohibits all kind of *ribā*. In general, *ribā* is divided into two categories:<sup>39</sup>

- a. *Ribā qurūd* is *ribā* that occurs through debt/loan. This kind of *ribā* is similar to activities practiced by commercial banks because loans are given out and interests are obtained from it.

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<sup>33</sup> See: Minutes of the 40<sup>th</sup> Meeting of Shariah Advisory Council of the Central Bank held on December 23, 2003.

<sup>34</sup> Al-Qur'an, 4:29.

<sup>35</sup> In its meeting no. 36, held on 26<sup>th</sup> June 2003.

<sup>36</sup> This practice has been widely implemented in conventional banking system to the extent that it has been understood as a must to give *hibah* to the creditor.

<sup>37</sup> Normally between banks in helping one another in their daily activities.

<sup>38</sup> Al-Qur'an, 2:275.

<sup>39</sup> See: Resolutions of the Securities Commission Shariah Advisory Council, 75-76.

- b. *Ribā buyū* occurs in the trading of *ribawī* products as stated by the Prophet (peace be upon him):

“Exchange gold for gold, silver for silver, grain for grain, barley for barley, dates for dates, salt for salt in the same amount and of the same type and must be handed over in an *‘aqd* (contract) ceremony. If what you have exchanged differs in type, you can trade according to your wishes but it must be done on the spot.”<sup>40</sup>

The flexibility in implementing this general guideline can be observed when Muslim scholars determined the *‘illah* of the items mentioned in the tradition. The items represent two categories of product, namely, medium of exchange (represented by gold and silver) and non-perishable staple food (represented by other items). Any product possessing similar features can be classified accordingly. Therefore, currency is classified as a *ribawī* product because it acts as a measure of value. In Malaysia, rice would be included as a *ribawī* product since it shares the same feature as non-perishable staple food.

Another related example to this is the trade of commemorative coins which are normally sold at the higher than their actual price. This practice has not been allowed by the Shariah Advisory Council of Bank Islam Malaysia Berhad because it involves *ribā buyū*.<sup>41</sup>

- It was reported that the Prophet (peace be upon him) forbids *gharar* trading.<sup>42</sup> *Gharar* refers to elements of uncertainty that can expose someone to danger. In the context of buying and selling, if it is said that a contract has the element of *gharar*, it means that there is an element of uncertainty in it. As an example, a sale and purchase contract which does not state its price is said to possess an

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<sup>40</sup> Muslim, *Ṣaḥīḥ Muslim*, 3/1211.

<sup>41</sup> In its 59<sup>th</sup> meeting held on May 29, 1998. However, since it was a request by the Central Bank for all banks to sell the Commonwealth Commemorative Coins with the fixed price of \$80.00, the Council advice the bank to clearly state in the contract that the actual price of the coin is \$50.00 and the balance of \$30.00 is considered buyers' contribution. The profit from this activity is not considered an income to the bank. It is place in a special fund called *Tabung Ihsan*.

<sup>42</sup> Muslim, *Ṣaḥīḥ Muslim*, 3/1153.



element of *gharar* as uncertainty in price can occur.<sup>43</sup> This is again a general guideline. *Gharar* may occur in the contract, the subject matter, the parties involved, etc. The flexibility in implementing this principle can be observed when it is connected with the custom of the society. In its 35<sup>th</sup> meeting held on May 22, 2003, the Shariah Advisory Council of the Central Bank decided that bidding by percentage<sup>44</sup> in *sukuk* (Islamic bond) transaction is allowed. The issue of *gharar* (uncertainty) in the price of the *sukuk* does not rise here because it is known to those involved in the field by their customary practice. In other words, the price of *sukuk* is known by the contracting parties and there is no element of *gharar* (uncertainty) involved even though it is cited in the form of percentage.

**6) Islamic transaction is based on observing *al-‘ilal* (reasons) and maintaining *al-maṣāliḥ* (benefit)**

Unlike in *‘ibādah* where in most cases, no explicit reasons can be given (such as the number of *raka‘āt* in prayers), transactions are based on reasons. Al-Shāṭibī said: “The original rule in *‘ibādah* is *al-ta‘abbud* (purely worshipping) without having to know the reason and the original rule in *al-‘ādāt* (customs, including transactions) is to identify the reasons.”<sup>45</sup>

While for the meaning of *al-maṣāliḥ*, Al-Ghazālī explained: “The interest in this meaning is to observe the aim of the Islamic law. This aim is to preserve for every person his religion, soul, reason, progeny and property. Any thing that keeps and guards these five things is beneficial and anything goes to the contrary is harmful.”<sup>46</sup> The benefits are subdivided into three categories; the benefits pertaining to necessary things, those related to the needs of the daily life and those which are connected with morality and good manners.

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<sup>43</sup> See: Resolutions of the Securities Commission Shariah Advisory Council, 78.

<sup>44</sup> For example, the par price for the bond is \$100.00. The investor will bid for the bond by percentage (for instance, 5% below the par price) instead of stating the price (\$95.00).

<sup>45</sup> al-Shāṭibī, *al-Muwāfaqāt*, 2/300.

<sup>46</sup> al-Ghazālī, *al-Mustaṣfā*, 1/140.

One of the examples related to *al-maṣāliḥ* is the case of *al-tas'ir* (determining the price of goods by the authority). The Prophet (peace be upon him) used to prohibit this practice during his time.<sup>47</sup> However, later, due to the changes of circumstances, some Muslim scholars allow this practice to maintain the general interest of the society.<sup>48</sup>

Another example is the contract of *Bay' Bi thaman Ājil* (BBA – sale with deferred payment). Normally, the selling price in BBA for properties is fixed with a long payment period and the installments are equally distributed throughout the period. In a competitive banking sector, if the loan rate of the conventional banks is raised, the Islamic banking will remain with the fixed rate. In this case, the return to the share holders will not be as competitive as conventional banks. In order to ensure the competitiveness of the Islamic banking sector, the floating rate of payment (according to the actual market) has been allowed. This practice is allowed because the *'illah* in this transaction is well understood. It is allowed as long as the selling price (but not the monthly installment which is floating in nature) is fixed to avoid uncertainty (*gharar*). The floating rate of payment here is supported by the instrument known as *ibrā'*.<sup>49</sup> At the end, the total amount of payment should not exceed the selling price which is fixed and agreed upon by both the buyer and the seller. This differs with the conventional banking system whereby the payment is based on the BLR and the actual selling price is uncertain.<sup>50</sup>

## 7) The original rule (*al-ḥukm al-aṣl*) in transactions is *al-ibāḥah* (permissible)

Unlike in specific *'ibādah* such as prayers and fasting,<sup>51</sup> the original rule in transactions is permissible. Allah s.w.t. says in the Qur'an: "Say O Muḥammad (to

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<sup>47</sup> According to al-Tarmidhī, the status of this tradition is *ḥasan ṣaḥīḥ*. See al-Tarmidhī, *Sunan al-Tarmidhī*, 3/605.

<sup>48</sup> al-Zuḥailī, *al-Fiqh al-Islāmī wa Adillatuh*,

<sup>49</sup> Technically, *ibrā'* means "an act of absolving or dropping one's financial rights (to collect payment) from a person who has the obligation to repay the amount borrowed from him". See: al-Nasafī, *Ṭalabāt al-Talabāt fī Iṣṭilāḥat al-Fiqhiyyah*, 34, Ibn Ābidīn, *Ḥāshiah Radd al-Mukhtār*, 4/276, Ibn Rushd, *Bidāyah al-Mujtahid*, 2/153.

<sup>50</sup> See: Minutes of the 32<sup>th</sup> Meeting of the Shariah Advisory Council of the Central Bank held on February 27, 2003.

<sup>51</sup> The original rule in inventing something new in *'ibādah* is prohibition.

these polytheists): Tell me, what provision Allah has sent down to you! And you have made it lawful and unlawful. Say O Muḥammad: Has Allah permitted you (to do so), or do you invent a lie against Allah?”<sup>52</sup> This verse condemns polytheists who had prohibited lawful foods and transactions merely based on their ancestors’ customs.

In another verse, Allah s.w.t. says:

“Allah, it is He Who has subjected to you the sea, that ships may sail through it by His Command, and that you may seek of His Bounty, and that you may be thankful. And has subjected to you all that is in the heavens and all that is in the earth; it is all as a favour and kindness from Him. Verily, in it are signs for people who think deeply.”<sup>53</sup>

In his comments to the above verse, Ibn Kathīr said that Allah s.w.t. has provided to human beings all those things for their earnings.<sup>54</sup> Consequently, it indicates that all matters related to it (earning) such as transactions are allowed and permitted.

The Prophet (peace be upon him) said: “Muslims are bound to their conditions.”<sup>55</sup> In another tradition he said: “Muslims are bound by what they stipulate of conditions except a condition that may forbid a lawful thing or allow forbidden thing.”<sup>56</sup>

The above verses and the traditions of the Prophet (peace be upon him) indicate clearly that the original rule in transaction is permissibility. This gives a wide room of applicability, particularly in establishing conditions, rules and regulations that are compatible with local environment. All these conditions are permissible as long as they do not contravene any of the Islamic principles.

In Malaysia, for example, there are many conditions, rules and regulations that have been established to facilitate innovative agreements under Islamic banking system. It can be observed that those rules, with some adjustments made, are in general in line with conventional banking system. Some examples of these conditions

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<sup>52</sup> Al-Qur’an, 10:59.

<sup>53</sup> Al-Qur’an, 45:12/13.

<sup>54</sup> Ibn Kathīr, *al-Tafsīr al-‘Azīm*, 4/148.

<sup>55</sup> al-Bukhārī, *Ṣaḥīḥ al-Bukhārī*, 3/52.

<sup>56</sup> al-Tarmidhī, *Sunan al-Tarmidhī*, 3/635.

are the application of cross default clause<sup>57</sup> in the letter of offer, letter of undertaking, material adverse effect, negative pledge,<sup>58</sup> etc. Based on the principle of *al-ibāḥah al-aṣliyyah*, all these conditions are allowed by Islamic law to be applied in the contract.

## Conclusion

It can be observed from the above discussion that Islam, despite its universal characteristic, respects local environments. The global characteristic of Islam in the field of transaction is maintained by some fixed rules that come in the form of general principles. Some examples of those principles are the principle of *al-ʿadālah* (justice), *al-tarāqī* (mutual agreement/consent of all parties involved in the contract) and the prohibition of *ribā* (usury), *gharar* (uncertainty/element of cheating), etc. All these general principles are applicable globally.

At the same time, in order to maintain the relevancy of Islamic law under all circumstances (due to time and space factor), ways and means in applying all those principles have not been elaborated. This is to give room for flexibility.

In addition, the existence of rich sources of Islamic law also gives rooms for flexibility. Rules for new matters which are not directly mentioned in the Qur'an or the traditions of the Prophet (peace be upon him) can be obtained by resorting to these other sources. Furthermore, the principle of *al-ibāḥah al-aṣliyyah* (the original rule of permissibility) in transaction plays a very important role in maintaining the flexibility of Islamic law to with local environment.

In Malaysia, the practice of working as a consultative team (Muslim scholars with experts in different areas, particularly in banking and finance) gives more understanding on the subject matters. Hence, practical and suitable instruments with local environment which are Shariah compliance can be developed together. The flexibility of Islamic banking system in Malaysia is further enhanced with the openness of Muslim scholars in

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<sup>57</sup> A provision in a financing agreement that puts the debtor in default if he defaults on another obligation.

<sup>58</sup> Negative pledge is a provision in a contract which prohibits a party to the contract from creating any security interests over certain property specified in the provision.

Malaysia in accepting views of all school of thoughts (even though the principle *madhhab* in Malaysia is Shāfi‘ī).

Finally, based on the evidences above, it can be said that Islam is a universal religion that respects local environment, not only in theory but also in practice.

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