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## Endnotes

- <sup>1</sup> See Accounting and Auditing Organization for Islamic Financial Institution (AAOIFI) (2000), *Ma'ayir al-Muhasabah wa'l-Muraja'ah wa'l-Dawabit li'l-Mu'assasat al-Maliyah al-Islamiyah*. Manama, Bahrain: AAOIFI; Accounting and Auditing Organization for Islamic Financial Institution (AAOIFI) (1997), *Statement of Financial Accounting No. 1 / Objectives of Financial Accounting for Islamic Banks and Financial Institutions*. Manama, Bahrain: AAOIFI; Accounting and Auditing Organization for Islamic Financial Institution (AAOIFI) (2004), *Accounting, Auditing and Governance Standards for Islamic Financial Institutions 2003-4*. Manama, Bahrain: AAOIFI; Accounting and Auditing Organization for Islamic Financial Institution (AAOIFI) (2004), *Shari'a Standards*. Manama, Bahrain: AAOIFI.
- <sup>2</sup> See Malik Muhammad Mahmud Al-Awan (2006), "Show me the Way", *Islamic Banking and Finance*, Issue no.10, Summer 2006/1427; See also Mahmoud A. El-Gamal (2001), "An Economic Explication of the Prohibition of Gharar in Classical Islamic Jurisprudence", *Islamic Economic Studies*, 8: 2; and W. Hegazy (2005), "Fatwas and the Fate of Islamic Finance: A Critique of the Practice of Fatawa in Contemporary Islamic Financial Markets", in S. Ali (ed.), *Islamic Finance: Current Legal and Regulatory Issues*. Cambridge, MA: Islamic Finance Project, Harvard Law School.
- <sup>3</sup> See Ibn Rushd (1997), *Bidayat al-Mujtahid wa-Nihayat al-Muqtasid*. Beirut: Dar al-Ma'rifah; Rashid Rida (1986), *Al-Riba wa'l-Mu'amalat fi al-Islam*. Beirut: Dar Ibn Zaydun; and Nabil Saleh (1986), *Unlawful Gain and Legitimate Profit in Islamic Law, Riba, Gharar, and Islamic Banking*. New York: Cambridge University Press.
- <sup>4</sup> See Malik Muhammad Mahmud Al-Awan (2006), "Show me the Way", *Islamic Banking and Finance*, Issue no.10, Summer 2006/1427; Mabid 'Ali Al-Jarhi (1981), *Towards an Islamic Monetary and Financial System: Structure and Implementation*. Jeddah, Saudi Arabia: International Center for Research in Islamic Economics, King Abdulaziz University; Al-Jaziri (1986), *Al-Fiqh 'ala al-Madhahib al-Arba'ah*. Qahirah: Dar Ihya' al-Turath al-'Arabi; Al-Shafi'i (1939), *Al-Risalah*. Beirut: Al-Maktabah Al-'Ilmiyyah; Mustafa al-Zarqa (1998), *Al-Madkhal al-Fiqhi al-'Am*. Dimashq: Dar Al-Qalam; Wahbah al-Zuhayli (2003), *Financial Transaction in Islamic Jurisprudence*. Trans. M. El-Gamal. 2 vols. Damascus: Dar al-Fikr.
- <sup>5</sup> See Malik Muhammad Mahmud Al-Awan (2006), "Show me the Way", *Islamic Banking and Finance*, Issue no.10, Summer 2006/1427; H. Dar and J. Preseley (2000), "Lack of Profit and Loss Sharing in Islamic Banking: Management and Control Imbalances", *International*

## HOST / PARENT COUNTRY DIVIDE

Prevalence of separate juristic regimes in various countries poses challenging problems for multinational banks operating in various jurisdictions. In a prohibition driven operating framework, most banks offer product lines approved by their own Shariah boards or Shariah advisory councils. They are not bound by the decisions of another board or another Shariah council. They can face two different sets of Shariah opinions when they are operating across international borders. The operation of Kuwait Finance House in Malaysia is a good case study in this regard. The bank had to decide upon which Shariah opinion to abide by in Malaysia when there was a clear difference between the position of Bank Negara Malaysia Shariah opinion and the opinion of its own Shariah board. It decided to abide by the opinion of its own Shariah board because from the corporate governance standpoint, it is ultimately accountable to its own Board even though it has to comply with the regulatory regime established by Bank Negara Malaysia. Host countries such as Malaysia have to reconcile these differences of Shariah opinions if they want to attract additional investment from other jurisdictions. Common law variations among various countries pose legal issues for enforcement of contracts among the contesting parties. Courts have traditionally set aside the Shariah basis of the parties' original agreements and assumed jurisdiction based on Common Law precedents. For example, in the cases of Islamic Investment Company of the Gulf versus Symphony Gems NV (2002), and Beximco Pharmaceuticals versus Shamil Bank of Bahrain (2004), Shariah issues were declared nugatory, and English contract law was applied to decide the cases.

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*murabahah, muqassah, salam, istisna', ijarah, 'urbun, hawalah, kafalah, wakalah, wadi'ah, ujr, rahn, bay' al-mu'ajjal, etc.* However, these have not deviated from conventional benchmarks of modern regulated banking practices. Currently, religious advisers from the various banks have been tasked by banks to research the vast fields of Islamic jurisprudence and come up with precedents and analogies that help with the engineering of new products that meet market needs as facilitated by the regulatory environment of each country. Fortunately for them, each major school offers enough exceptions and loopholes that legal stratagems can be exploited to design new products complying with both Basel and Shariah.

Since the original goal of Shariah was never the compliance of Basel or any other mainstream regulatory regime of this world, the real purpose or objective of Shariah has rarely been met. Adherence to "*Maqasid al-Shariah*" (as formulated by al-Ghazali and al-Shatibi) remains a distant dream for the Islamic financial industry. Two products in this regard stand out which serve to illustrate the differences in Shariah interpretations. One is *bay' al-'inah* (same-item sale-repurchase) from Malaysia which derives support from the Shafi'i school and the other is *tawarruq* (three-party variation on *bay' al-'inah*) practiced in GCC countries based on support from the combination or hybrid version of Maliki / Hanbali schools. Criticism of both products from Islamic *Fiqh* Academy and rejection by AAOIFI boards has not dampened the use of these products in the respective markets. Opponents of both product lines find them reprehensible as legal stratagems to circumvent the prohibition of *riba*. But most banks continue to promote them while equating financing charges to market interest rates on loans to similar borrowers, regardless of the actual underlying commodities being used. The two product lines are a source of friction among the competing regions and can have a negative impact on the growth of Islamic financial industry on a global basis.

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حديعمل في الارض خير لاهل الارض من ان يمطروا الربيعين صباحا \* الحديث

political changes that have ensued have altered the landscape of Shariah implementation.<sup>4</sup> It will be instructive to simulate the decision making of the eight main schools of Islamic jurisprudence in the light of present day realities. Beyond the Hanafi, Maliki, Shafi'i, Hanbali, Zahiri, Ja'fari, Zaydi, and 'Ibadi schools, there remain many other approaches that need to be evaluated to deal with the complexities of today's market dynamics. The industry has been overly focused on substituting interest with artificial constructs of traditional Islamic contracts that have only resulted in higher transaction costs and have not improved the allocative efficiency or optimality of the product offering.<sup>5</sup> The resulting Islamicity of these products also remains questionable.<sup>6</sup>

### THE HANBALI / SHAFI'I SPLIT IN PRODUCT FOCUS

Product development in Islamic banking has moved on different lines in GCC and Far Eastern countries such as Malaysia reflecting the broad reliance on Hanbali and Shafi'i schools respectively. This is different from the Hanafi school led developments in Pakistan and neighbouring countries where the Ottoman "*Majalla*" (based on Ibn 'Abidin's *Hashiyah Radd al-Mukhtar*) still holds sway. Early product development can be traced to efforts to replace the prohibited interest based offerings with Islamic contractual structures based on trading or sales contracts. The binding constraint has always been to stay within the confines of a heavily regulated conventional banking system. This has limited the flexibility of Islamic bankers and they have been forced to design banking products that have borrowed from classical Arabic structured contracts without compromising the basic character of a conventional banking system that meets the approval of all the regulators.

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has also been made possible by the regulatory pressure to stay within the confines of an international monetary system which promotes compliance with Basel I and Basel II Guidelines. Thus, the twin objectives of Shariah compliance and adherence to Basel Guidelines have moved together to keep Islamic finance as part of the conventional mainstream. While there have been historical differences of opinion among Islamic jurists over the centuries and the entire field of "muamalat" remains fragmented, the recent progress towards convergence is remarkable for its wide acceptance.<sup>2</sup> A robust banking and insurance industry enabled by sufficient liquidity has made it possible to achieve harmonization of practices among the various parts of the world. But, there is an element of specialization and relative concentration in various regions that requires careful analysis. We begin by surveying these regional specializations.

## ENFORCEMENT OF SHARIAH

There exists a general agreement on the essentials of Islamic law as provided by the *Qur'an* and the *Sunnah* across the globe. Differences occur when the law is applied to various situations that arise in economic and financial dealings. Compliance with Shariah, its adoption, implementation, and enforcement leads to various choices for individuals, organizations, and nations. Most entities are not ready for full Shariah implementation in letter and spirit and they have looked for compromises. This is generally true of all walks of life and economic and financial matters are no exception. Islamic jurisprudence is full of examples where opinions and practices differ regarding the enforcement of canonical texts of Shariah. How a particular jurist approached the implementation of Shariah in a particular situation became the precedent for the later jurists even when the later situations were dramatically different from the original example.<sup>3</sup> Technological advances of the last fifty years combined with the socio-economic and

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# DIFFERENCES IN SHARIAH INTERPRETATIONS: THE IMPACT ON ISLAMIC FINANCIAL INDUSTRY

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## ABSTRACT

Significant progress has been made in recent years in standardizing interpretations of Islamic finance law with the work of Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), Islamic Financial Services Board (IFSB), and other international organizations including rating agencies and competitive indices. However, the industry remains regionalized because of perceived and actual differences in Shariah interpretations. This paper reviews the essential nature of these differences and examines the impact they have on the efficiency and growth of the industry.

## INTRODUCTION

Islamic financial industry has gone through a major transformation over the last quarter century with the adoption of various Shariah standards by AAOIFI, IFSB, and multiple *fiqh* academies operating under the auspices of the Organization of Islamic Conference (OIC), Islamic Development Bank (IDB), and other institutions. Most of this progress has been due to industry demand and reflects a growing consensus among market participants.<sup>1</sup> This consensus