Sharia Compliance Task and Islamic Banking: Legal and Judicial Insights

Dr. Ghalib Mohammad Al-Bulooshi *

Abstract

Unlike conventional-financing, Islamic-financing, should adhere to values and principles of Islamic-Sharia. The Muslims and non-Muslims investors alike believe that the Islamic financial and banking operations are distinct and therefore remote from instability and immoral concerns attached to the conventional operations.

With the increase in number of Muslims and non-Muslims investors, Islamic finance and banking could have a significant role in the economic growth. However, its development is largely dependent on the recognition of its true potentials, which is reliant on the fact that it is Sharia-Compliant.

While, it is necessary to establish that the innovated instruments used in Islamic financial and banking operations are lawful an inconsistence with Sharia principles, the current modes of finance and banking are not free from doubt and in fact subject to Sharia non-compliance risk.

In this context, the paper addresses the diverse opinions of Sharia-Scholars in regard of Islamic financial operations to establish the undoubted need for the so-called Sharia-Compliance task. It notes that the current Islamic financial and banking practices are not free from serious legal and judicial challenges. Referring to case-rulings, it is strongly suggested that the mere approval of financial products or transactions by Individual Sharia-Scholars or Institutional Sharia-Boards is not enough to build the level of trust and confidence needed for the evolvement of Islamic finance as an alternative financial industry.

In order to enhance the task of Sharia-Compliance, the paper points to the newly emerged trend of having a so-called Higher or Central Sharia Authority. Nonetheless, it notes that the aim behind the existence of

* **Assistant Professor of Commercial Law, College of Law, University of Bahrain.**

such bodies in main could be to help in the harmonization of the Islamic financial and banking practices at the national level. To overcome the legal and judicial concerns related to the Sharia-Compliance task, the need is there for legislative and judicial changes, which should provide theses bodies with real powers to closely supervise the Sharia-Compliance task and assign special courts to oversee this difficult task more efficiently.

1. INTRODUCTION:

After the financial crisis of 2007-2008, Islamic finance and banking became more popular and attracted Muslims and non-Muslims investors alike. While, Muslims are faith-driven to choose Islamic-financing, non-Muslims perhaps started to see some merits in Islamic-financing that the conventional-financing obviously lacks.

On one hand, the increase of Muslim-population is notable all over the world. It is rising by 70% since 2015 and expected to reach 3 billion in 2060 representing a sizable 31% of the world's people.(1) Further, the demand for Islamic-financing among non-Muslim investors growing as well. In 2013, it was reported that non-Muslim investors owned over 60% of Islamic-Bonds (Sukuk).

On the other hand, the Islamic Development Bank reported in 2010 that, results of a survey focused on customers-attitude showed that 70% of Muslims (sample-based) do not see the difference between the profit rate and interest. Further, the same percent are not supporting Islamic-banking because they feel that they are not different from conventional-banking.(2)

Without denying the notable growth of Islamic finance and banking, this paper however argues that its full potential cannot be realized if

(1) Michael Lipka and Conrad Hackett, Why Muslims are the world's fastest-growing religious group. Factank-Pew Research Center, 6 April 2017. www.theedgemarkets.com/article/moody's-msia-accounts-over-60-global-sukuk-countrys-policy-supports-islamic-finance-growth

(2) Ahmad Faizal Abdul Aziz, "Sharia Governance: Challenges Ahead" (MPRA Paper No. 47772, International Centre for Education in Islamic Finance, Malaysia, May 2012), P: 2, http://mpra.ub.uni-muenchen.de/47772/1/MPRA paper 47772.pdf.

its operations remain similar to conventional ones. To enable the true and real development of Islamic finance and banking as an industry, the obstacles of legal and judicial nature concerning the Sharia-Compliance task should not go undermined.

Presenting a legal-text and judicial-ruling based study, the challenges surrounding the Sharia-Compliance task is addressed in three main parts. First, the distinctive nature of Islamic-finance is explained to establish that practices must adhere to a set of Sharia values and principles in order to be Sharia-Compliant. Then, Islamic financial contracts used in modern finance and banking is analysed and compared with conventional counterparts to underline the need for so-called Sharia-Compliance Task. Finally, reference is made to important cases, where discussed judgments highlight the legal and judicial challenges concerning this important task.

In conclusion, the paper argue for the need of legislative and judicial changes, which should provide the emerging Higher or Central Sharia Authorities at the national level with real powers to supervise the Sharia-Compliance task and assign special courts to oversee this difficult task more efficiently.

2. ISLAMIC VALUES AND PRINCIPLES OF FINANCE:

When the origin of Islamic financial intermediation is discussed, usually reference is made to practices of moneychangers and moneylenders in the cities of the Hijaz region (Makkah and Medina), who were catering for the needs of pilgrims. Nonetheless, the Islamic contracts of trade further evolved and were in extensive use in late 6th to early 11th century AD, which constitute the Islamic civilisation era.(3)

Despite the argument of some Sharia-Scholars, that an Islamic Institution cannot involve in financial mediation and should directly preform trade as buyer and seller,(4) Islamic financial mediation have

(3) Rodney Wilson. "Islamic Banking and Its Impact on the International Financial Scene," Journal of International Banking Law, no. 10 (1995): at 437.

(4) In fact, some late sharia-scholars as well Islamic-economists still hold this opinion. See for example, Tarek El-Diwany. "Is Islamic Banking Islamic?" Islamic Research Foundation International. June 2003. http://www.irfi.org/articles/articles_301_350/is_islamic_banking_islamic. =

become an undeniable reality. Today, majority of Sharia-Scholars allowed financial mediation arguing that its importance and benefits are not confined to Muslims.(5) Over the last 50 years or so, research in fact has indicated that Islamic financial and banking practices are more effective than conventional ones.(6)

While, conventional-banks mediation practices are interest-based where interest rates are charged and paid on both the side of assets and liabilities,(7) Islamic-Banks mediate between depositors and borrowers by using various interest-free instruments and must ensure that the money is invested only through Islamically accepted channels.(8)

Despite the fact that, Islamic-banking is widely practiced in the world, there is no single definition that could captures its true meaning and fully covers its scope. Nonetheless, Islamic-banking is commonly described as 'a form of modern banking based on Islamic legal concepts developed in the first centuries of Islam, using risk sharing as its main method, and excluding financing based on a fixed, predetermined return'.(9)

Since this definition, or any other for this matter, can hardly embrace the real nature and complete features of Islamic finance and banking, the main values and principles on which such practices are built must be addressed and discussed in the next section.

2.1 PROHIBITIONS IN ISLAMIC FINANCAIAL TRANSACTIONS:

It is important to underline that, Islamic financial and banking practices must adhere to a full set of consistent Islamic moral and ethical

= htm ; Taris Ahmad et al. Islamic Banking and Finance: What It Is and What It Could Be. 1st Ethical Charitable Trust, 2010.

(5) Noor Ahmed Memon, : Present and Future Challenges." Journal of Management and Social Sciences 3, no. 1 (2007): 01–10 P: 7. and M. Fahim Khan and Mario Porzio, Islamic Banking and Finance in the European Union: A Challenge (Edward Elgar Pub, 2010), P: 123.

(6) Munawar Iqbal et al. "Challenges Facing Islamic Banking," Islamic Research and Training Institute of Islamic Development Bank, Occasional Paper No 1, 1998. http://www.irtipms.org/PubText/80.pdf. P: 12–13.

(7) Munawar Iqbal. A Guide to Islamic Finance, Risk Books. 2007. P: 1.

(8) Rifaat Karim and Simon Archer, Islamic Finance: The Regulatory Challenge. John Wiley & Sons, 2007. P: 400.

(9) Van Schaik. "Islamic Banking," The Arab Bank Review 3, no. 1 (2001): P: 45–52.

standards, which include avoiding Riba, Gharar, and prohibited items or services. It is equally important to realize that avoiding those prohibitions is not an easy task. On one hand, their meaning, nature and scope is arguable. On the other hand, they are not free from legal and judicial challenges.

In term of Riba, it is necessary to understand that Sharia does not explicitly prohibits "Banking-Interest". It prohibits "Riba", which is an Arabic noun that means "to increase, to grow, to exceed". Some Sharia-Scholars share the opinion that 'Usury' is a more accurate translation than 'interest,[10] and in legal writings it is described as 'Unlawful Enrichment'. Nonetheless, Sharia explicitly states that Riba is not confined to a specific type of enrichment, but it can be evident wherever certain circumstances occur. Making reference to the Holly Scriptures (Qur'an and Sunnah), Sharia-Scholars notes that Riba is not less than seventy-three kind, which in main are classified as Riba-al-buyu or Riba-al-fadl (usury of trade) and Riba an-Nasiah or Riba-al-Diyun (usury debt).[11]

The view of "Banking-Interests" as prohibited Riba actually comes from the Islamic perspective that money does not hold a value of its own and is a mere means of exchange.[12] Therefore, simply returning more money against the sum that has been lent, actually means giving a time value to the lent money, and this is unacceptable in Sharia. However, the counter-argument is that the reality goes against this concept and practices prove that money today is considered a commodity in its own right.[13]

Despite such arguments, the majority of Sharia-Scholars share the opinion that "Banking-Interests" is equivalent to Riba. In fact, paying and charging of "Banking-Interests" is involve unjustness since it is

(10) Philip Moore, Islamic Finance: A Partnership for Growth, 1st edition. (Euromoney Publications, 1997).

(11) Mahmoud El-Gamal, A Basic Guide to Contemporary Islamic Banking and Finance (ISNA Islamic Banking & Finance Series, Rice University, 2000), P: 315.

(12) Shelagh Heffernan, Modern Banking in Theory and Practice, 1st edition. (John Wiley & Sons, 1996), P: 113–114.

(13) Zaman and Movassaghi, "Interest-Free Islamic Banking: Ideals and Reality," The International Journal of Finance 14, no. 4 (2002): at 2432.

guaranteed and free from the element of risk which justifies receiving "Profit" from the Sharia point of view.

Therefore, "Interest" is replaced by "Profit" in Islamic finance and banking practices. Instead of interest-based financing, Islamic-financing is based on "Profit and Loss Sharing" (PLS) structure,(14) in which the depositors take the position of shareholders and face an uncertain rate of return. Their profit or loss is reliant on the profits or losses the Islamic-Bank makes from the invested venture.(15) As provider of finance, Islamic-Banks becomes eligible for "Profit" when the investors project makes a gain since it bears the risk of losing money when this project was unsuccessful. In such a relationship, the Islamic-Banker actually takes the place of an investor rather than being a mere lender of money.(16)

Although, being "Interest-free" is a key feature of Islamic-financing, it does not constitute an accurate description for Islamic-Banking operations.(17) It is necessary to understand that Sharia not only allows but also encourages earning more money as long as these gains come from lawful transactions that fully conform to specific moral and ethical standards recognised by Sharia.

Therefore, it is of equal importance to address the other main prohibitions of Sharia. In this context, it is crucial to emphasize that these other prohibitions must not be undermined or considered less important than Riba in the sense that avoiding all of the prohibitions together is what makes the transaction Sharia-compliant. Hence, the occurrence on any single one of them is in fact sufficient to render the transition invalid or non-Islamic.

(14) Ausaf Ahmed. "The Evolution of the Concept and Practice of Islamic Banking-Part 1." Council for Islamic Banks and Financial Institutions, April 26, 2010. http://www.cibafi.org/newscenter/english/Details.aspx?Id=7968&Cat=12.

(15) Mohammed Akacem and Lynde Gilliam, "Principles of Islamic Banking: Debt versus Equity Financing," Middle East Policy 9, no. 1 (2002): P: 128–130.\\uc0\\u8220{}Principles of Islamic Banking: Debt versus Equity Financing,\\uc0\\u8221{} \\i Middle East Policy\\i0{} 9, no. 1 (2002

(16) Shahzad Qadri. "Islamic Finance: An Alternative," P: 9.

(17) Mohsin Khan and Abbas Mirakhor, Theoretical Studies in Islamic Banking And Finance (Islamic Pubns Intl, 2005).

In terms of the prohibitions other than Riba, the next major prohibition is Gharar, which means deception or misrepresentation and refers in legal terms to 'Unfair Business Conduct'. Although, the Holy text of Qur'an does not use this specific terminology "Gharar", Sharia-Scholars share the opinion that Gharar is equal to vanity, which is explicitly prohibited because it signifies ambiguity, uncertainty or lack of specificity in the terms of a financial contract.(18)

Like Riba, Gharar is not one kind. It can be classified to three main categories. Gharar al-yasir (trifling Gharar), Gharar al-mutawassit (average Gharar) and Gharar al-kathir (excessive Gharar). While, the first type may be accepted under some circumstances, the prohibition of the last one is undisputed in Sharia. Gharar al-mutawassit (average Gharar) falls between the two extremes and therefore judged differently under different circumstances.

Although Sharia-Scholars have listed a number of situations where Gharar is most likely to take place, and have formed useful guidelines to recognise prohibited Gharar, identifying it remains a difficult task. Despite this, Islamic-Banks must be careful and remote itself from financial transactions that may imply prohibited Gharar, which usually is hard to detect and in some cases easily confused with other meanings.

In addition to Riba and Gharar, prohibited items or services do not hold a value in the eyes of Sharia such as alcohol, pork, gambling, adult entertainment and tobacco. Therefore, they constitute invalid subject matters for Islamic financial and banking transactions.(19) Hence, Islamic-Banks must refrain from direct or indirect investment in these prohibitions. In addition, permissible transaction such as selling, buying and distributing become unlawful if attached to prohibited items or services. For instance, a glass company that produces bottles for alcohol or a cargo company that distributes pork must not be financed by Islamic-banks.

However, today markets are wide open to each other and multi-

(18) The Holy Qur'an (2:188, 4:161).

(19) Natalie Schoon. "Islamic Finance–An Overview," European Business Organization Law Review 9, no. 04 (2008): P: 629.

national investors undertake businesses together at national as well as international levels. Therefore, Sharia-Scholars decided that it is acceptable to deal with businesses where non-Islamic gains as a proportion of the total income of the business do not exceed 20%, and if the business are paying "conventional loan interests", the total of the amount paid as interest shall not exceed 25-45% of its assets.(20) Nonetheless, they have emphasized on criteria and specific conditions, which should be considered very carefully before involving in such investments, and suggested that "doubtful incomes" must not be used or invested be Islamic-Banks but rather should be given to charity.(21)

Applying this to Islamic-Banking means that, Sharia-compatible funds and their returns should not be mixed with non-Islamic ones, and Islamic-Banks must take all necessary precautions to ensure that this standard is maintained, especially when involved with non-Islamic markets or businesses.

Taking all of the aforementioned prohibitions and restrictions in mind, it is important to addresses next the main Islamic financial contracts employed in banking. Their similarity with conventional contracts is underlined and distinctive nature therefore argued in the sense that they should comply with the full set of Sharia values and principles just explained.

2.2 ISLAMIC FINANCIAL AND BANKING CONTRACTS:

In Islamic theory, contracts of exchange are permissible unless being clearly disallowed in Sharia sources. Since Islamic-Banking have to conform to the aforementioned set of Islamic values and principles, the structure of financial transactions and products offered by Islamic-Banks differ from conventional ones.(22)

(20) Atif Hanif, "Islamic Finance: An Overview," International Energy Law Review 1 (2008): at 10.

(21) Some Scholars argue that such disposal does not actually eliminate Riba or Gharar. See Jamal Abbas Zaidi, "Shari'a Harmonization, Regulation and Supervision". (AAOIFI & World Bank Conference on Islamic Banking and Finance, 2008), P: 2, http://www.iirating.com/Documents/PresentationSpeeches/speeches/sharia %20Harmonization%20Regulation%20and%20Supervision%20AAOIFI%20World%20Bank%2010-11%20November%20Manama%20Bahrain.pdf.

(22) Schoon, "Islamic Finance–An Overview," P: 631.

Today, Islamic-Banks use combination of revived instruments from the past and innovative ones. Innovative interpretations of Islamic financial principles and traditional Islamic commercial transactions have been used in the design and creation of new instruments for more complex financial transactions.(23) In general, Islamic-Banking operations relay on the following two structures:

• Equity-financing (Profit and Loss Sharing): the banker-customer relationship is based on partnership, where profit or loss resulting from the invested venture is shared according to a pre-agreed ratio. The only two contracts of financing used under this mechanism are Mudaraba (trust financing) and Musharaka (joint venture). (24)

• Debt-like financing: the bank charges the customers a cost plus a mark-up when selling back the asset bought on their behalf. A number of contracts falls under this category, mainly, Murabaha (cost-plus financing), Bai-bithaman-ajil or Bai-muajjal (deferred payment sale), Bai-al-salam (future delivery), Istisna (a forward sale), Bai-al-ina (sale and buy-back), Tawarruq (the reverse of Murabaha), and Bai-al-tawliya (sale to facilitate or serve others). (25)

The PLS principle is unanimously accepted in the Islamic legal and economic literature as the cornerstone of Islamic financial and banking operations. However, Islamic-Banks, started to heavily use the debt-like transactions after gaining several losses in the 1980s.(26) This latter model of financing enabled Islamic-Bank to compete with its

(23) Hassan and Lewis, Handbook of Islamic Banking, Edward Elgar Pub, 2007. Chapter 9, P: 138; Hjh Siti Faridah Abd Jabbar, "Sharia-Compliant Financial Instruments: Principles and Practice," Company Lawyer 30, no. 6 (2009): at 184–185.

(24) Rajesh Aggarwal and Takik Yousef, "Islamic banks and Investment Financing," Journal of Money, Credit, and Banking 32, no. 1 (2000): P: 96; Hussain Rammal, "Bending the Rules: Guaranteeing Profits in the Islamic Financial System," Ethics And Critical Thinking Journal 18, no. 1 (2004), P: 2.

(25) Nik Norzrul Thani et al. Law and Practice of Islamic Banking and Finance, 1st edition. (Sweet & Maxwell Asia, 2003), P: 56–57; Aggarwal and Yousef, "Islamic banks and Investment Financing," P: 96; Mahmoud El-Gamal, "Money Laundering and Terror Financing Issues in the Middle East." Statement for US Senate Committee on Banking, Housing and Urban Affairs' Hearing, July 13, 2005. http://banking.senate.gov/public/_files/gamal.pdf.

(26) Hassan and Lewis, Handbook of Islamic Banking, Chapter 9, P: 138.

conventional counterparts,[27] as it has proved to be less risky and renders almost fixed returns for depositors. Therefore, sale and lease based methods of finance that employ mark-up price structures started to become more popular than the PLS structure originally proposed.[28]

Today, Islamic-financing is not practiced in its purest form since financial mediation is exercised only in a modified Islamised manner.[29] Islamic financial contracts therefore are not used in their traditional sense;[30] their concept and structure are rather being employed to reproduce Islamic financial transactions, which are easily compared to conventional ones.

As such, the Islamic-Banking operations are not free from legal doubts and arguments. On one hand, some Sharia-Scholars see that contracts of exchange such as sale and lease, which originally were used for trade purposes, are not appropriate for today's banking purposes and in fact their purpose is destroyed when used in financial intermediation. On the other hand, other Sharia-Scholars argue that combining more than one contract in structuring a single financial transaction or product is likely to generate forbidden Riba or Gharar.[31] For instance, buying products on a deferred payment agreement is lawful, as is selling those products for immediate cash. However, if these two sales were undertaken by the same bank i.e. the buyer in the first contract is the seller in the second, it actually constitute borrowing cash for interest with the intention from the beginning to provide cash for the customer,[32] which is prohibited in Sharia.

Nonetheless, the majority of Sharia-Scholars hold the opinion that

(27) This was suggested by Dr Sami Humud. See Mahmoud El-Gamal, "Islamic Bank Corporate Governance and Regulation: A Call for Mutualization" (Rice University, September 2005), P: 311, http://www.ruf.rice.edu/~elgamal/files/IBCGR.pdf; Archer and Karim, Islamic Finance, Chapter 4, P: 44–45.

(28) Roy, "Islamic Banking." brahim Warde, "The Relevance of Contemporary Islamic Finance," Berkeley Journal of Middle Eastern & Islamic Law 2, no. 1 (2009): P: 166.

(29) Roy, "Islamic Banking."

(30) Hassan and Lewis, Handbook of Islamic Banking, Chapter 9, P: 138.

(31) Combining contracts generates forbidden interest. Tarek El-Diwany, "Holding Back the Tide," 2007. http://www.islamic-finance.com/item149_f.htm.

(32) El-Diwany, "Is Islamic Banking Islamic?"

mark-up agreements (i.e. debt-like financing) are permissible in Sharia.(33) Some have basically argued for their necessity, explaining that there is no other way but to accept and make use of them until a proper institutional set-up is built, at least to help promoting Islamic-Banking in its initial stage.(34) Others have simply assured the legality of such practices in Sharia. They argued that the sale and lease are tied to real commodities,(35) which sets apart Islamic-Banking from mere lending and borrowing for interest.(36) Further, they stress that the equivalence between debt-financing and mark-up financing is not because of prohibited interest.(37)

In this context, it is of importance to provide examples illustrating the main differences between Islamic-banking and conventional-banking operations. First, Islamic-partnerships differ from conventional-partnerships. Under an Islamic-partnership, the ratio of profit is negotiable and determined from the beginning while losses are only shared in accordance to the contribution in capital.(38) In a conventional-partnership however, parties freely negotiate the ratios of capital participation with profit and loss distributions. In fact, this is the main difference between a Musaraka-partnership and a conventional sleeping partnership or preferred-shareholder contract.(39) In addition, Mudaraba-contracts differ from conventional-loans because the cost of capital to a bank's customer takes the form of a pre-agreed ratio of profit rather than a fixed rate of interest.(40)

Second, Sharia permit the deferment of either payment or delivery of the sold item, which is fungible, but not both. While both Bai-al-salam

(33) Warde, "The Relevance of Contemporary Islamic Finance," P: 168–169; El-Gamal, Islamic Finance: Law, Economics, and Practice, Mahmoud El-Gamal, Islamic Finance: Law, Economics, and Practice, 1st edition. (Cambridge University Press, 2006), P: 21–25.

(34) Iqbal et al., "Challenges Facing Islamic Banking," P: 51–54.

(35) Iqbal et al., "Challenges Facing Islamic Banking," P: 49.

(36) Zaman and Movassaghi, "Interest-Free Islamic Banking: Ideals and Reality," at 2438.

(37) Aggarwal and Yousef, "Islamic banks and Investment Financing," P: 97.

(38) Muhammad Taqi Usmani, An Introduction to Islamic Finance (Quranic Studies Publisher, 2008), P: 2.

(39) Frank Vogel and Samuel Hayes, Islamic Law and Finance: Religion, Risk, and Return, Student. CQ Press, 1998. P: 3.

(40) Thani et al., Law and Practice of Islamic Banking and Finance, P: 49.

and conventional-futures are forward contracts, in the former only delivery is deferred, but under conventional-futures both payment and delivery are deferred. On the other hand, both Bai-al-salam and short-selling involve the sale of something which is not in the possession of the seller at the time of sale, although in short selling, unlike Bai-al-salam, this is non-fungible.(41)

Third, higher mark-up prices have been justified on the basis of high risks and legal liabilities. In fact, risks and liabilities under a Murabaha-contract are different from those under a conventional-loan contract. In a Murabaha contract, the bank bears both asset price-risks and credit-risks; the price-risk is evident in the disposal of the goods not received by the customer at the due date and the credit-risk is evident when the customer defaults on payment.(42)

On the other hand, whilst the financier under the Tawarruq-contract is exposed to risks related to commodities (such as delivery-risk and price-risk) and the credit-risk of the customer, the lender in a conventional lending transaction is only exposed to the credit-risk of the borrower.(43) Nonetheless, Tawarruq is still widely observed as the instrument to replace conventional-loans easily for general purposes.

Furthermore, Ijara-financing is not the same as conventional finance lease in that the rent must be agreed (fixed amounts or a benchmark rate) from the beginning,(44) and that the lessor actually holds the ownership of the leased asset during the leasing period. In addition, there is a difference between conventional hire-purchase and Ijara-muntahia-bittamleek (buy-back leasing); ownership at the end of lease period is transferred by way of Hibah (gift), i.e. the promise to give the leased asset as a gift for no consideration or payment of the remaining instalments, which would not be binding in a conventional

(41) Jabbar, "Sharia Compliant Financial Instruments: Principles and Practice," at 182.

(42) Thani et al., Law and Practice of Islamic Banking and Finance, P: 58; Archer and Karim, Islamic Finance, P: 32–33.

(43) Hanif, "Islamic Finance: An Overview," at 11–13;.Mahmoud El-Gamal, "Overview Of Islamic Finance" (Occasional Paper No 4, Department of the Treasury Office of International Affairs-US, 2006), http://ncusar.org/programs/09-02-17-materials/08042006_OccasionalPaper4.pdf. P: 5.

(44)There is an operating lease and a full-payout financial lease. Thani et al., Law and Practice of Islamic Banking and Finance, P: 46; El-Gamal, "Overview Of Islamic Finance."

hire-purchase contract.(45)

Providing justifications for some other types of mark-up agreements, it was argued by supporters that so-called back-to-back transactions used in a mark-up sale or lease contracts are permissible because Sharia does not require a minimum time interval to own the property before reselling or leasing it back. Thus, banks are allowed to own the property for only milliseconds before disposing of it. However, the counter-argument is also based on this very concept, as other Sharia-Scholars hold the view that if a typical interval is 'under a millisecond' then Murabaha-contracts in practice constitute a conventional-loan.(46) In fact, some Sharia-scholars have strongly suggested restricting the use of mark-up contracts fearing that they might form a back door to prohibited Riba and Gharar since they could easily imply a fixed return on investments for Islamic-Banks.(47) For instance, the Federal Sharia Court of Pakistan has declared the existing system of mark-up transactions to be "interest-based", and hence Islamically unlawful.(48)

Moreover, some prominent Islamic economists and scholars are afraid that depending on financial tools other than PLS actually endangers the authentic nature of Islamic finance and banking in the long term.(49) In particular, they have held banking transactions involving Tawarruq, Bai-al-dayn (debt financing) and Bai-al-ina contracts as Sharia non-Compliant, arguing that they imply hidden Riba or Gharar. In their opinion, these contracts adopt Sharia principles in form only but not in

(45) Jabbar, "Sharia Compliant Financial Instruments: Principles and Practice," at 182.

(46) Aaron Maclean, "Islamic Banking: Is It Really Kosher?" American Enterprise Institute. April 2007. http://www.american.com/archive/2007/march-april-magazine-contents/islamic-banking-is-it-really-kosher/.

(47) Muhammad Nejatullah Siddiqi, Issues in Islamic Banking: Selected Papers, vol. 4, Islamic Economic Series (Islamic Foundation, 1983); Mohammad Kabir Hassan and Mervyn Lewis, "Islamic Finance: A System at the Crossroads?," Thunderbird International Business Review 49, no. 2 (March 2007): P: 151–160.

(48) Muhammad Umer Chapra and Tariqullah Khan, "Regulation and Supervision of Islamic banks," Occasional Paper No 3, Islamic Research and Training Institute of Islamic Development Bank, 2000. http://www.scribd.com/doc/29418279/Regulation-supervision-of-islamic-banks.P: 31.

(49) Rammal, "Bending the Rules: Guaranteeing Profits in the Islamic Financial System," P: 36–42; Warde, "The Relevance of Contemporary Islamic Finance," P: 168–169.

substance, because of the way they are employed in banking.(50)

In Bai-al-ina, the customer would sell his asset to the bank for an immediate cash payment and then buy it back on an instalment basis at a higher price allowing the bank to make profit. Since the intention of parties from the start is to obtain instant cash, in the view of the Maliki and Hanbali Islamic-schools of thought this constitute the use of a legal artifice to achieve illegal ends, and the concluded contract is one of conventional-loan rather than an actual sale.(51) Shafi and a faction of the Hanafi prohibit Bai-al-ina if only if the second sale was explicitly stipulated in the first one. If not, they consider the two sales valid in separation from each other.(52)

On the other hand, Tawarruq is allowed only within the Hanafi and a faction of the Hanbali schools of thought,(53) and involves the sale of commodities to generate cash for the customer. Although, Murabaha-contracts is utilised to raise cash.as well, the Tawarruq structure do not require that customers to have physical possession of the commodities first and then find a buyer for them. In general, a Tawarruq transaction would involve the bank buying tradable-commodities from a broker and selling them to the customer at a mark-up price for deferred payment. The customer would then immediately sell the commodities to the same or a different broker for immediate cash. While, some Sharia-Scholars allow such transaction if the second sale was to a different broker, others view this structure as being nothing more than a disguised lending arrangement.(54)

Although, all Islamic schools of thought permit Hawalah (debt transfer) on the condition that it is paid in full and gives no benefit to the purchaser since deferred payment would involve the element of prohibited Riba in the form of Bai-al-kali,(55) Bai-al-dayn (the sale of

(50) Syed Imad-ud-Din Asad, "Issues in Islamic Banking," Dawn, September 2, 2009, http://www.dawn.com/news/342476/issues-in-islamic-banking.

(51) El-Gamal, Islamic Finance: Law, Economics, and Practice, P: 21–25; Thani et al., Law and Practice of Islamic Banking and Finance, P: 68–69.

(52) Thani et al., Law and Practice of Islamic Banking and Finance, P: 68–69.

(53) Jabbar, "Sharia-Compliant Financial Instruments: Principles and Practice," at 183.

(54) Hanif, "Islamic Finance: An Overview," at 11–12.

(55) Ust Hj Zaharuddin Hj Abd Rahman, "Ruling on Debt Trading in Sharia ," NST Business

debt) is controversial. Bai-al-dayn is described as "a sale contract in which the creditor sells his payable right against the debtor either to the debtor himself or to a third party, and most Sharia-Scholars consider that its subject matter (debt) bears Riba-al-buyu which is also known as Riba-al-fadl (usury of trade).(56) Nonetheless, some forms of Bai-al-dayn is deemed permissible in the view of few Sharia-Scholars. They argue that the debt is created through a permissible contract of sale (particularly Murabaha) and the price in fact includes the profit on the transaction not prohibited Interest. Therefore, when the bank sells debt instrument at a discount, the buyer actually receives a share in the profit, not prohibited interest.

The influence of such divergence in opinions is evident in reality. It is noted that certain Islamic financial products while accepted and offered in some markets are rejected in others. For instance, most Middle-Eastern countries (GCC in particular) disallow Islamic financial and banking transactions that are based on contracts such as Bai-al-ina,(57) Tawaruq(58) Bai-al-dayn.(59) Nonetheless, such structures are widely unitised in Malaysia.(60)

Finally, it must be realised that that there is still room for Ijtihad in the fiqh-almuamalat as long as there is no Ijma (scholarly consensus) that forbids or condemns any particular practice or financial transaction. Today, the established practice is that Islamic financial Institutions, especially banks, seek the approval of their financial products or transactions either by individual Sharia-Scholars (issuing single fatwa) or by appointed Institutional Sharia-Boards. In fact, this is the currently the main method to ensure that their operations are Sharia-compliant

Times, June 21, 2006, http://zaharuddin.net/senarai-lengkap-artikel/38/58--ruling-on-debt-trading-in-sharia.html?tmpl=component&print=1&page=.

(56) Sano Koutoub Moustapha, The Sale of Debt as Implemented by the Islamic Financial Institutions in Malaysia, 1st edition (Kuala Lumpur, Malaysia: International Islamic University Malaysia, 2001).

(57) Jabbar, "Sharia-Compliant Financial Instruments: Principles and Practice," at 183.

(58) Warde, "The Relevance of Contemporary Islamic Finance," P: 164–165.

(59) Sudin Haron and Bala Shanmugam, Islamic Banking System: Concepts and Applications (Petaling Jaya, Selangor Darul Ehsan, Malaysia: Pelanduk Publications, 2001).

(60) Thani et al., Law and Practice of Islamic Banking and Finance.

i.e. in consistence with the full requirements of Sharia (addressed earlier), which enable potential investors (Muslim and non-Muslim) to have trust and faith in Islamic financial and banking Industry.

However, it is important to note that the consequence of diverse fiqhi-opinions, in itself, leads to doubtful practices and therefore negatively affects the image of Islamic finance and banking industry at national and international levels. Unfortunately, this is evident in judgments of courts in non-Muslim countries well Muslim countries, which is discussed in the coming section next to underline that mere approval of financial products or transactions by an Individual Sharia-Scholars or appointment Institutional Sharia-Boards is not enough for ensuring the task of Sharia-compliance.

3. JUDICIAL INSIGHTS ABOUT SHARIA-COMPLINACE:

In this section, important judgments are discussed, where the Sharia-compliance of some of the main Islamic-contracts used in finance and banking was questionable despite being Sharia-approved by individual Sharia-Scholars or Institutional Sharia-Boards. In consequence, this ad emphasise on the need to improve the current task of Sharia-compliance through legislative and judicial initiatives. In this context, the paper will address key rulings of English Courts, Malaysian Courts, and resent cases respectively.

3.1 RULINGS OF THE ENGLISH COURTS:

Although, the United Kingdom (UK) legal and judicial system do not recognize Sharia as a source of law, their courts where the first to settle disputes in regard of Islamic financial and bunking contracts. The significance of these cases relay on the fact that the conflicts rise between Islamic financial Institutions and Investors (non-Muslims and Muslims) who engaged in a contact that is supposed to be Sharia-Compliant and agreed to solve any disputes in this concern in accordance to English-law subject to its compliance with Sharia.

The English-courts faced such a situation for the first time in 2002, when Islamic Investment Company of the Gulf (Bahamas) Ltd filed a

case in the court gains Symphony Gems NV and Ors.[61] The plaintiff financed the defendant to buy precious stones and gems entering into a Murabaha-contract. The defendant questioned the contract being Sharia-compliant. The court experts, Dr Yahya Al-Samaan of the Saudi Law Firm of Salah Al-Hejailan and Dr Martin Lau of the School of Oriental and African Studies shared the opinion that the actual transaction was not a Murabaha-contract. Eventually, the court held that the contract was entirely valid from the English law point of view dismissing the argument of Sharia non-compliance.

About this ruling, it is important to note that the aim of court here was not to deny the application of Sharia-law and apply the English-law instead. In its reasoning, the court clarified that the reason behind doing so was the fact that there is no existence of so-called Sharia-law i.e. Sharia-principles are not found in a codified format to be easily referred to and applied by courts. Therefore, the validity of the contract as a legal matter was decided in reference to English-law because the parties' agreement was that disputes should be decided in accordance to both English-law and Sharia-law. Although, this judgment was in the favour of the plaintiff, the fact that the contract was not considered as a Murabaha contract should not go undermined.

After only two years, the English-courts faced a similar situation for the second time in the case of Shamil Bank of Bahrain v Beximco Pharmaceuticals Ltd & Ors,[62] where the disputed contract was again Murabaha. In 1995, the Bank agreed to provide the borrowers with a working capital facility utilising Islamic techniques to extract profit instead of Riba. When the borrowers defaulted, the Bank made an application to the court for summary judgment. In this case, the defendant pointed that the Sharia-jurists themselves are in dispute in regard to the content of Sharia itself. They argued that Murabaha-contracts were invalid and unenforceable since they were in truth disguised loans charging interest which is prohibited in Sharia.

(61) Investment Company of the Gulf (Bahamas) Ltd v Symphony Gems NV and Ors, [2002] All ER (D) 171, QB; Investment Company of the Gulf (Bahamas) Ltd v Symphony Gems NV & Ors, [2008] EWCA Civ 389, CA.

(62) Shamil Bank of Bahrain v Beximco Pharmaceuticals Ltd & Ors, [2004] 1 WLR 1784, CA.

In line with court ruling, the High Court and Court of Appeal granted summary judgment to the Bank on its claims, concluding that the principles of Sharia did not apply to the Murabaha-contracts because that had not been the parties' intention. In addition, the court justified that mentioning Sharia-law in the governing law clause was not meant to replace the English-law as governing-law, and only reflects the nature of business the parties intended to conduct.

Although, the defendants were not successful in their argument, it is crucial to underline that the court concentration was again the validity of the agreement from a mere English legal point of view and in relation to the intention of the parties. However, it disregarded the fact that Sharia validation constitute the real reason for Investors (Muslims and non-Muslims) to enter into such contracts. Therefore, a counter-argument in this regard could be that the court miss-applied the legal principle it used to reason its ruling, which is the intention of contracting parties. In Islamic commercial contracts, the parties do not seek mere financial gain, but to conduct transactions that are accepted in Islamic religion and believed to fulfil a socio-economic role.

In the case of Investment Dar Co KSSC (TID) v Blom Developments Bank Sal (BDB),(63) which took place in 2009, the defendant appealed against the summary judgment in favor of the plaintiff, which granted the latter some US$10.7 Million. Interestingly, TID argued that the Wakala-agreement is Sharia non-compliant and therefore contradict TID's constitutional documents since it consider itself an Islamic-institution. The court observed that the Sharia-board of TID itself has approved the transaction, and therefore held that the Wakala-agreement was valid and enforceable.

This judgment is important and interesting form two prospects. First, the outcome of this ruling suggest that the court had to look into the Wakala-agreement in order to reach its decision that it is Sharia-compliant, unlike the judgment in the previous cases. Second, the case pointed out another crucial issue, which is the role of the Institutional Sharia-Boards in the Sharia-compliant task. Obviously, the court in

(63) Investment Dar Co KSSC v Blom Developments Bank Sal, [2009] EWHC 3545 (ch).

this particular ruling denied TID the opportunity to challenge its own Sharia-board decisions. Nonetheless, this opens doors to question the true role of such boards and in consequence the very task of Sharia-compliance, which in fact is reliant on such bodies' pronouncements.

3.2 RULINGS OF THE MALAYSIAN COURTS:

Today, most Islamic-states obtain westernized legal systems and adopt financial system where Islamic financial institutes operate alongside conventional ones. Therefore, the challenge of Sharia-compliance is evident in Muslim-countries despite the fact that they recognize Sharia as a source of law.

In this context, the study refers to key judgments of Malaysian-courts. The significance of these cases relay on the fact that the conflicts rise between parties who are Muslims and concluded transactions using Islamic financial contracts. In addition, the disputes were decided by courts where Sharia-law is not alien to the legal and judicial system of the country.

The intention of Malaysian-courts to examine critically the Islamic financial transactions offered by the Islamic-Bank was not noticed before the Affin Bank Berhad v Zulkifli Abdullah case, which was decided in 2006.(64) The defendant bought a house under Bai-bithaman-ajil from the bank, repaying its financing by monthly instalments for the duration of 18 years. He defaulted on payments after few instalments and the bank took legal action. The court granted the order for the sale of the property and held that the remaining balance had to be repaid by the defendant.

The importance of this judgment underlies in restricting the bank from recovering the full amount of profit. Since the transaction was terminated earlier, the total amount of profit should not be claimed by the bank. Although, this gives the impression that the court held the opinion that contract was Sharia-Compliance and therefore denied the Islamic-Bank from receiving prohibited interest, this is not entirely true. When we carefully read the reasoning provided for this judgment, it becomes

(64) Affin Bank Berhad v Zulkifli Abdullah, [2006] 3 MLJ 67.

clear that the court actually held that the Bai-bithaman-ajil contract was similar to a conventional-loan contract and simply denied the bank the unearned profits in equality to conventional-loan contract. (65)

This conclusion is further supported when look into similar cases that followed. In Malayan Banking Berhad v Marilyn Ho Siok Lin.(66) again the bank concerned was entitled to the sale price but not the unearned profit. The court held that it would be inequitable for any financial institution, Islamic or otherwise, to claim for the complete agreed profit when the customer in fact never had the benefit of the full tenure. A similar reasoning was given in Malayan Banking Berhad v Ya'kup bin Oje & Anor.(67)

It is crucial to note that the so-called "Sharia Advisory Council" (SAC) was founded in Malaysia back in 1997. Nonetheless, its opinion was not regarded by the judicial system until the pass of the new Central Bank of Malaysia Act 2009,(68) which required in section (56) that all proceedings relating to Islamic financial business should take into consideration the published rulings of the SAC. However, this did not change arguing and questioning the validity of Islamic financial contracts in court cases afterwards.

In the Affin Bank Berhad v Zulkifli Abdullah case, the court reference was that, the feedback of the SAC should be of great assistance. Nonetheless, the beginning of the pro-active attitude of the Malaysian-courts in examining the validity of Islamic-Banking practices was with the judgement of the High Court in the case of Arab-Malaysian Finance Bhd v Taman Ihsan Jaya Sdn Bhd & Ors,(69) which took place in 2008. In this case, the disputed contract was again Bai-bithaman-ajil. In fact, it encompassed twelve separate civil suits involving issues pertaining to the Bai-bithaman-ajil facility, where all of the defendants were asked to

(65) This ruling has been cited in subsequent cases including, Arab-Malaysian Merchant Bank Bhd v Silver Concept Sdn Bhd (2008), Tan Sri Abdul Khalid bin Ibrahim v Bank Islam Malaysia Bhd (2009), and Bank Islam Malaysia Bhd v Lim Kok Hoe & Anor (2009).

(66) Malayan Banking Berhad v Marilyn Ho Siok Lin, [2006] 7 MLJ 249.

(67) Malayan Banking Berhad v Ya'kup bin Oje & Anor, [2007] 6 MLJ 398.

(68) The Central Bank of Malaysia Act No (701) of 2009.

(69) Arab Malaysian Finance Bhd v Taman Ihsan Jaya Sdn Bhd & Ors, [2008] 5 MLJ 631.

pay the whole amount of the selling price after defaulting in payments.

Interestingly, the High Court judgment in this case was that the application of Bai-bithaman-ajil was contrary to the Islamic Banking Act 1983,(70) and the Banking and Financial Institutions Act 1989.(71) However, this judgement was overturned by the Court of Appeal, which held that the contract was valid. Again, the same decision was followed the next year in the case of Light Style Sdn Bhd v KFH Ijarah House (Malaysia) Sdn Bhd.(72)

It is important to note that in ruling of the Arab-Malaysian Finance Bhd v Taman Ihsan Jaya Sdn Bhd & Ors case, the court opinion was that a principle needs to be "accepted by all four Islamic-schools of thought" in order to be considered as Sharia-compliant. However, this was overruled by the Court of Appeal in the case of Bank Islam Malaysia Bhd v Lim Kok Hoe & Anor and Other Appeals.(73) In consequence, the task of Sharia-Compliance in regard of Islamic financial and banking practices remains subject to controversy resulting from diverse fiqhi opinions of not only the four main Islamic-school of thought but as well other Sharia-Scholars, which in fact enlarge the scope of Sharia non-compliancy risk.

Finally, it should be noted that the new Islamic Financial Services Act of 2013(74) came to emphasises that Islamic financial Institutions shall comply with any written circulars, guidelines or notices issued in accordance with the advice or ruling of the SAC and within such time as may be set out in them.(75) However, this study was unable to find suitable cases to discuss and compare their rulings with the ones already addressed above.

3.3 RECENT CASES IN COURTS:

In light of the aforementioned ruling of Investment Dar Co KSSC (TID)

(70) The Malaysian Islamic Banking Act No (276) of 1983.
(71) The Malaysian Banking and Financial Institutions Act No (372) of 1989.
(72) Light Style Sdn Bhd v KFH Ijarah House (Malaysia) Sdn Bhd, [2009] CLJ 370.
(73) Bank Islam Malaysia Bhd v Lim Kok Hoe & Anor and other appeals, [2009] 6 MLJ 839.
(74) The Malaysian Islamic Financial Services Act No (759) of 2013.
(75) The Central Bank of Malaysia Act No (701) of 2009.

v Blom Developments Bank Sal (BDB),(76) the recent case of National Sukuk Company v. Al-Madina Finance and Investment Company was decided by courts of Kuwait in 2013.(77)

The two companies singed a Wakala-contract, whereby National Sukuk Company provided facility amount of AED 120 Million to Al-Madina Finance and Investment Company and agreed that the latter (as Investment Agent) would repay the original amount plus a prescribed profit amount. However, the defendant failed to repay the amounts on maturity date and on settlement agreed to pay a lesser amount on a later date. Up on failing to pay for the second time, the plaintiff filed a civil claim against the defendant in courts of Kuwait.

The Kuwait-court judgment was in favour of the plaintiff ordering the defendant to pay the settlement amount basing its decision on an expert report. Nonetheless, the defendant appealed this judgment arguing that the contract violated law since it is Sharia non-complaint with i.e. not based on Islamic Wakala-principles as the expert's report concluded. The report said that the parties intended for the facility amount to be repaid with a fixed profit, while in a Sharia-compliant Wakala the two parties actually share the risk of loss and hence the profit is expected and probable but not fixed. Furthermore, the agent in Wakala-contract is in fact a trustee and not guarantor and therefore liable to repay the amount only in the case of negligence and misconduct, which was not proven.

The appellate court held the opinion that if the plaintiff did not provide an acceptable counterargument, the lower court's ruling could be overruled. Therefore, it remanded the case to a panel of three experts from the Kuwait Department of Experts at the Ministry of Justice to

(76) Investment Dar Co KSSC v Blom Developments Bank Sal, [2009] EWHC 3545 (ch).

(77) Paul Saba and Fatema Fathnezhad, "Implication of the Kuwait TID v. Blom Judgment on Wakalah Contract", Al-Tamimi & Co., www.tamimi.com, 2013, (last entered 16-03-2018) .http://www.tamimi.com/law-update-articles/implications-of-the-kuwait-tid-v-blom-judgment-on-wakala-contracts/; Erdem Oz, Mohammad Mahbubi Ali, Zahid ur Rehman Khokher, Romzie Rosman. "SHARIAH NON-COMPLIANCE RISK IN THE BANKING SECTOR: IMPACT ON CAPITAL ADEQUACY FRAMEWORK OF ISLAMIC BANKS". IFSB WORKING PAPER SERIES no. WP-05/03/2016, March 2016. P: 43-44. https://www.ifsb.org/docs/2016-03-30%20SNCR%20Paper%20(WP-05)%20(Final).pdf

determine the issues concerning law, especially if the contract in question was Sharia-compliant. Finally, the appellate court slightly reduced the award to the plaintiff.

From a legal and judicial point of view, the outcome of this ruling may provide an affirmative defence for Islamic financial and banking institutions because the Wakala agreement was eventually viewed as Sharia non-compliant despite the fact that the parties willingly and knowingly entered this so-called Wakala-contract.

Finally, the newest case of Dana Gas (UAE) v. Bondholders should not go unnoted. Although, the case is in process, it is of importance to refer to this case because it proves that the debate and questionability attached to Islamic financial contracts or transactions is actually an ongoing matter. In June 2017, Dana Gas announced that it would not redeem its outstanding Sukuk (bonds based on Mudarabah-contract) because they were no longer Sharia-compliant and therefore unlawful.

The proceedings of the case are taking place in the United Kingdom (UK) and United Arab Emaciates (UAE) courts because part of the bond contract (purchase undertaking) is regulated by English law and agreement underlying the Sukuk structure was approved by a UAE-firm following the UA- law. The initial ruling of the UK court was in favor of the Bondholders saying that Dana's interpretation of the terms surrounding its Islamic bond is "unfounded", and is still pending before the UAE courts to determine the validity and enforceability of the Mudarabah-agreement under UAE-law.(78)

Financial experts thinks that it is a Liquidity issue rather than Sharia-compliancy issue. It seems that Dana had hoped to restructure the debt worth $700 million as its repayment deadline loomed, after claiming that the bonds are no longer Sharia-Compliant.

However, the case still is seen by both countries courts, and its ruling, whatever it may be, without doubt will affect the Islamic financial and banking Industry at large. The case has attracted global attention

(78) Jane Croft, Dana Gas accused of trying to avoid Sukuk payment , Financial Times, September 26, 2017, https://www.ft.com/content/9832412a-a207-11e7-b797-b61809486fe2

because it could set a legal precedent for Sukuk issuers to refuse to redeem their paper based on changes in the religious permissibility of the debt instrument, which bears huge influence and significance on Islamic financial markets. Also, of significance and interest in this case is the fact that, Dana Gas is disapproving the compliancy of the Mudarabah-agreement that itself approved previously, which seems to be for business purposes rather than true religious reasons or believes.

To conclude, these recent two cases and all aforementioned ones negatively affect the trust and confidence of investors (Muslims and non-Muslims) in the task of Sharia-Compliance, which in turn negatively affects the credibility of Islamic financial institutions. In consequence, this endangers the growth and development of Islamic financial and banking as an industry, and decrease if not eliminate, its hoped and in fact needed socio-economic impact. Eventually, if challenges to the so-called Sharia-Compliance, could lead to losing faith in Islamic finance and banking practices as true alternatives to conventional ones.

4. CONCLUSION:

Presenting legal and judicial insights, this study addressed first the distinctive nature of Islamic-financing pointing that they must adhere to a full set of Sharia values and principles to be considered as Sharia-Compliant. Then, the main Islamic financial contracts employed in banking were analysed and compared with conventional ones to underline the legal challenges concerning such practices, which emphasis the need for so-called Sharia-compliance task. Finally, reference was made to important case judgments to highlight the main judiciary issues in respect of compliancy of Islamic financial contracts with Sharia arguing the necessity to improve the Sharia-compliance task at the national level.

It is important to admit that it is indeed a step forward that Muslims today in both the East and the West are able to use banking facilities that conform to the Sharia teaching they are obliged to respect and follow. As case-law establishes, western and eastern courts remain sceptical about the Islamic financial and banking industry because

the Islamic financial products do not look different from conventional products.

There is no doubt that the design and use of innovative contracts or transactions in Islamic finance and banking requires more complex legal tasks and increases the requirement for Sharia approval by Islamic institutions. Usage of modified and innovative versions of the traditional Islamic financial instruments requires special attention and in-depth interpretation of Sharia as well as financial knowledge.

As underlined in this paper, the reality of the inconsistency in the Sharia pronouncements and fatawa results in greater diversity in modern Islamic financial practices. Also, the fact that there remains a degree of controversy in terms of the exact meanings of the agreed Islamic prohibitions, conveys clearly the difficulty regarding the essential task of Sharia-Compliance.

The judgments on different cases outlined above is proof of this. In most of the cases, the defendants who defaulted on payment, despite the fact that they entered the contracts knowing or acknowledging that it was an Islamic one, used the defence of Sharia non-compliance. More interesting was that in some cases, the defendants argued for the Sharia non-compliancy of the contract, which was approved by their own institutional Sharia-boards. Therefore, the approval of financial products or transactions either by individual Sharia-Scholars or by Institutional Sharia-Boards appointed by the Islamic financial institutions is not enough.

To avoid disputes in courts or easily settle it when the dispute reaches the court, the agreeing parties may consider to insert protective provisions (as waivers) in their Islamic-contracts to any defence toward the transaction being Sharia non-compliant, despite being approved by appointed Sharia-Scholars or Institutional Sharia-Board. However, this obviously, may open doors for other legal and judicial complications instead of resolving the current one.

In order to mitigate the contradiction of Islamic financial practices resulting from diverse opinions of Sharia-Scholars and appointed

Institutional Sharia-Boards, the emerging trend in most Muslim-countries is to establish a Higher or Central Sharia Authority.

In this capacity, Malaysia established the so-called Sharia Advisory Council (SAC) in 1997, which was empowered to have a legal authority in regard of Islamic financial and banking disputes only in 2013.(79) Other countries that are active in term of Islamic finance and banking i.e. the Gulf Corporation Countries (GCC) announced the appointment of similar bodies only few years back.

In the State of Kuwait, disputes in regard of Islamic banking matters maybe transferred by the Board of Directors of the Islamic Banking Institutions to the Fatwa Board in the Ministry of Awqaf and Islamic Affairs.(80) It is important to note that this is specific to the situation where there is difference of opinions between the members of the Sharia Supervisory Board of the Islamic Banks i.e. this procedure could be followed to solve only the disagreements among the Sharia-Scholars serving in the Sharia Supervisory Board of the Islamic Banks. In other words, this is not applicable to disputes related to Islamic financial matters other than those of Banking and in fact cannot be taken by financial institutions other than banking Institutions.

Also, the UAE federal law allows for the establishment of a Higher Sharia Authority by a cabinet decision which is attached to the Ministry of Justice and Islamic Affairs. It should undertake higher supervision over Islamic banks, financial institutions and investment companies to ensure legitimacy of their transactions according to the provisions of Sharia-law, and its opinions shall be binding.(81) On 17 March 2015, at a meeting of the Board of Directors of the UAE Central Bank, some of the recommendations that will help expedite the process to set up such an authority were approved.(82) However, this body is not found

(79) The Malaysian Islamic Financial Services Act No (759) of 2013.

(80) Article (93) of the Law No (32) of 1968 Concerning Currency, the Central Bank of Kuwait and the Organisation of Banking Business.

(81) Article (5) of the U.A.E Federal Law No. (6) of 1985 Regarding Islamic Banks, Financial Institutions and Investment Companies.

(82) Haseeb Haider. "Shariah Authority on Cards." Alkhaleej Times. March 22, 2015. http://www.khaleejtimes.com/biz/inside.asp?xfile=/data/uaebusiness/2015/March/uaebusiness_March255.xml&section=uaebusiness.

until today.

On the other hand, in October 2014, the Central Bank of Oman (CBO) decided to select five members to represent the apex bank at the Authority and approve nomination of a secretary. As a National Sharia Supervisory Board, it will advise the CBO on issues concerning Sharia-compliant of products have direct oversight of Islamic banking institutions constituting a reference point for the industry in Oman.(83) The President of the CBO (Mr Hamood Sangour Al-Zadjali) declared that it would be made up of Sharia scholars, some of them Omani with possibly one or two experts from outside Oman.(84) Also, in December 2014, the governor of the Central Bank of Bahrain (CBB) declared the intention of setting up a Central Sharia Board to help oversee Islamic finance products in the country and to introduce new rules to strengthen governance in the financial sector.(85) In fact, the CBB have established the so-called Central Sharia Supervisory Board by the issuance of resolution no. (3/2016) that formed this body. However, it do not state its purpose, scope of work, or authorities.(86)

It need to be said that, regardless of their form and allocated role, the existence of such bodies is actually a step forward toward the enhancement of the Sharia-compliance task at the national level. Since the announcements of establishing such bodies was only in recent years, the scope of their work and authorities remain unknown.

Nonetheless, it needs to be noted that, the scope of their work could actually be limited to the harmonisation of the Islamic financial and banking practices at the national level. In addition of minimizing other

(83) Bernardo Vizcaino, "Oman Sets up Central Sharia Board in Move to Boost Islamic Finance," Reuters, October 8, 2014, http://www.reuters.com/article/2014/10/08/oman-islam-financing-idUSL6N0S305J20141008.

(84) "Oman: Central Bank Appoints Sharia Board," Issue 979, Gulf State News, October 16, 2014, http://archive.crossborderinformation.com/Article/Oman+Central+bank+appoints+sharia+board.aspx?date=20141016#.

(85) Bernardo Vizcaino, "Bahrain to Develop Central Sharia Board for Islamic Banks," Reuters, December 3, 2014, http://www.reuters.com/article/2014/12/03/bahrain-islam-regulations-idUSL3N0TN1A020141203.

(86) The CBB Resolution no. (3/2016) concerning the formation of the Sharia Supervisory Board.

practical and legal issues,[87] which are not the focus of this study.

This assumption is supported when taking in consideration the very recent standard issued by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI). In summer of last year 2017, the AAOIFI issued Governance Standard No. (8) about Central Sharia Board,[88] which in its rationale states that the "aim of this standard is to establish an advanced degree of harmonization and convergence in the work of Sharia Supervisory Boards of Islamic financial institutions" and avoid "inconsistencies and differences between the Fatwas, rulings, decisions and applications by such entity-level boards".

If the financial regulators in the mentioned counties decided to follows this standard, the capacity of the announced Higher or Central Sharia Authorities may actually be limited. Although, this may increase to some extent the credibility of the Islamic financial and banking practices at the national level, it cannot in fact eliminate or stop the legal and judicial challenges concerning the Sharia-Compliance task as discussed in this paper. In fact, the true influence and role of so-called Higher or Central Sharia Authorities in supervising the task of Sharia-Compliance cannot be realized before seeing court disputes that place their work in test or challenge.

With this note, the paper wish to conclude with the suggestion that efforts of Islamic financial and banking regulators in Muslim and non-Muslim countries should be focused more now on legislative and judicial changes, which should not ignore the difficulties surrounding the Sharia-compliance task as underlined in the aforementioned case-rulings. It is of importance to provide the Higher or Central Sharia Authorities with real powers and pro-active role to supervise the Sharia-Compliance task. Moreover, to have an effective supervision over the Sharia-Compliance task, specialised courts should be assigned to decide the disputes concerning this difficult and unique task.

(87) such as shortage of Sharia-Scholars, conflict of interest attached to appointed Sharia-Scholars, the scope of Sharia-Bards supervision, the legal status of their pronouncements, and the accountability of their members.

(88) The AAOIFI Governance Standard No. (8) concerning Central Sharia Board, issued in 2017 (accessed in 18-3-2017). P: 5 See http://aaoifi.com/books/gsifi-8-central-shariah-board/?lang=en

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