

LITERATURE REVIEW

## Sharī‘ah Resolution and Islamic Finance: A Review

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### Abstract.

**Purpose:** The purpose of this study is to look into the Sharī‘ah resolution framework in Islamic finance and see how it may be improved. This paper is based on a detailed examination of previous research into the need for a worldwide Sharī‘ah Resolution mechanism to be applied across all IFIs.

**Methodology:** A detailed analysis of past studies on the necessity of a Sharī‘ah Resolution framework to be implemented globally by all IFIs was used to develop the qualitative method.

**Findings:** Measuring the level of *fatwá* disclosure by specific Islamic banks through central banks Sharī‘ah judgements will add to the existing literature while also filling a gap.

**Significance:** This study is noteworthy because it lays the framework for future researchers on the topic. Using a central bank to assess the extent to which certain Islamic banks have disclosed *fatwá*.

**Limitations:** These articles’ implications may aid in the explanation of Sharī‘ah-related concerns in Islamic finance. Sharī‘ah resolution in Islamic finance will be a significant Sharī‘ah resource for new products supplied by Islamic financial institutions, as well as any existing goods given to new clients and industry practitioners.

**Implications:** The *fatwá* is the legal response to the present difficulties that have arisen in the community. *fatwá* are used to disseminate knowledge to Muslims in order to alleviate their difficulties and misconceptions. Any *fatwá*-related knowledge will have an impact on individuals, societies, and organizations. As a result, this paper examined the role of *fatwás* in sharing information and determining how far *fatwás* can educate society in resolving problems.

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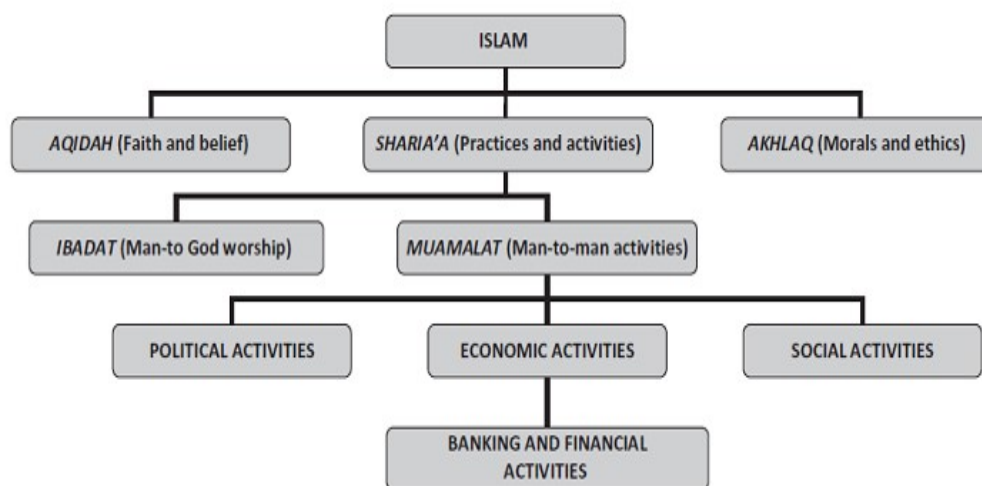
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## INTRODUCTION

In the Islamic scheme of things and the Sharī'ah framework, Islamic banking and financial dealings can be tracked back to Muamalat, Sharī'ah, Islam, and ultimately to Allah, who is the foundation of the Islamic system.



**FIGURE 1.** Sharī'ah: The framework of Islamic banking  
*Source: Kettell (2012)*

As a result, Sharī'ah offers the framework for a "set of rules and laws that govern the economic, social, political, and cultural aspects of Islamic culture", as well as assessing whether a transaction or business activity is acceptable or not.

Three main principles underpin the Sharī'ah system:

1. Individual interests are given less weight than group interests.
2. Relieving hardship takes precedence before promoting benefits.
3. A larger loss can not be approved in order to reduce a smaller loss, and a larger advantage takes precedence over a smaller advantage. However, a minor injury can be justified in order to avoid a larger one, and a smaller benefit can be ignored in favor of a larger one.

The *fatwá* is intended to clarify a legal decision (*ḥukm*) in light of an investigation, or it may be issued without an investigation to clarify a new circumstance and correct Muslim standards and practices. The *fatwá* necessitates the utmost sincerity since it clarifies the law of the Lord of the worlds, and the mufti rules in God's interest, following in the footsteps of the Prophet Muhammad (PBUH) by clarifying Sharī'ah judgements.

It can be characterized as an Islamic ruling on a matter of Islamic law issued by a recognized authority based on strong evidence, or it can be defined as enlightening others about Sharī'ah principles without imposing any obligations (Hasaballah, 1971).

This report investigates the spread of *fatwás* through Islamic banking websites in Malaysia. The organization of Islamic Financial Institutions Accounting and Auditing Standards (AAOIFI) and *fatwá* disclosures and Sharī'ah resolution were proposed by the "Islamic

Financial Services Board (IFSB)", the world's highest-ranking governing organization for the Islamic financial industry. Because many modern topics are complex, gaining a full grasp of them and appreciating their decisions necessitates the *fatwá*. On a fundamental level, a *fatwá* does not impose legal restrictions, but it does impose religious restrictions. When there is clear confirmation of a *fatwá's* correctness, a Muslim cannot disregard it. Islamic financial organizations must adhere to the *fatwás* of Sharī'ah bodies within the framework of the Fiqh Academy decision-making mechanism. Financial *fatwás* are critical to the advancement of Islamic products, as they cannot be properly sold without an unambiguous endorsement from a Sharī'ah perspective.

In the context of Islamic banking and finance, a "*fatwá* is a spiritual belief expressed by a qualified Sharī'ah scholar regarding the structure of an Islamic financial product, such as a mortgage, the conduct of management, such as a fund manager, and the operations of an Islamic financial institution, such as an Islamic bank." In order to determine their compliance or noncompliance with Islamic law (Malaysia's Central Bank). If a *fatwá* is given by a single scholar or jurist, it is non-binding, and so its utility" is restricted in this regard. A *fatwá* issued by a group of scholars under an enforcement system, such as the government or another similar institution, could be rendered binding on market participants.

In the absence of "Islamic law in most countries (particularly those with a majority Muslim population), it is critical that the goods, procedures, and operations of Islamic financial institutions and other entities providing Islamic financial services" be independently Sharī'ah verified. This verification should, ideally, come from a government agency such as the central bank or another financial regulator. Because it has enforcement power, the best option remains the government authority. Other groups will be ineffectual unless governments embrace their "Sharī'ah Standards" and make them enforceable on Sharī'ah compliant firms.

Throughout the year, an Islamic financial institution should disseminate *fatwá* rulings and directives provided by its SSB. Online interfaces have been increasingly popular in the financial industry for a variety of reasons, the most important of which is the competitive advantage that they provides by providing a single point of entry to a multitude of financial goods and services. To ensure that all market participants, such as Islamic banks and *takāful* companies, follow the *fatwás* and Sharī'ah rulings issued by the Sharī'ah Advisory Council of Bank Negara, Malaysia's central bank, Malaysian law makes it mandatory for judges hearing cases involving "Islamic banks and finance in Malaysian courts to follow the *fatwás* and Sharī'ah rulings publicly issued by the Sharī'ah Advisory Council".

## LITERATURE REVIEW

The emergence of Islamic banking is frequently linked to the revival of Islam and Muslims' desire to construct their own system, such as an Islamic economic system, free of capitalism and communism's ideologies and life's complexities.

This section of the paper will also clarify the elements that should be included in the proposed framework of *fatwá* in Islamic finance in order to ensure that Islamic banks' Sharī'ah procedures and behavior comply with Islamic ethical norms.

A Sharī'ah Supervisory Council is essential for Islamic banking. 1994 (Abdala). However,

under an Islamic system, dealing with future market instruments is deemed an unearned profit and is prohibited by *gharar* (excessive/needless risk) (Wilson *et al.*, 1997). As a result, Haniffa and Hudaib (2007) claim that any connection with illegal activities, and if so, why, the proportion of this activity contributes to profit, and how these activities have been handled, such as revenues going to charity, should be declared to Islamic financial system users. As a result, the necessity to propose a *fatwá* framework will benefit the global industry.

According to some theories, such as the agency theory, "there is a conflict of interest between shareholders (principals) and managers (agents)" that can influence corporate investment decisions and lead to investments in projects with negative net present value, significantly affecting firm performance (Jensen & Meckling, 1976). To reduce agency difficulties, managers should provide considerable information to shareholders in order to protect their interests (Healy & Palepu, 2001). The Islamic agency theory teaches spouses to treat one another with respect, thanks, patience, and tolerance, as well as to believe in spiritual rewards as well as economic rewards, as in conventional agency theory (blessings from Allah). Khalid and Sarea (2021), have contributed to Islamic agency theory by investigating the relationship between internal Sharī'ah audit efficacy and independence (reporting level, direct contact, no conflict of interest, unrestricted access, appointments and removal, and organizational hierarchy status). The authorities must establish a clear framework for internal Sharī'ah audit to address the essential needs for efficient Sharī'ah governance, according to the study's practical implications.

The establishment of a Religious Supervisory Council by an Islamic bank is required to ensure that its activities are compliant with Sharī'ah principles, including *fatwá* rules. Bucheery and Hood (1997) claimed that the Sharī'ah auditors' role is to certify those Islamic financial institutions' financial transactions are conducted in accordance with Sharī'ah principles before delivering reports to stakeholders. The Sharī'ah supervisory council is responsible for conducting an ex-ante and ex-post audit to demonstrate how closely Islamic banks' operations adhere to Sharī'ah rules AOIFIF (2002). The Islamic bank's accounting policy is likewise overseen by the Sharī'ah Supervisory Board. Karim (1995) and Abdala (1994) proposed that the Sharī'ah supervisory board should be made up of Muslims who are experts in three fields: Islamic jurisprudence, law, and economics (accounting).

To carry out their duties, the Sharī'ah Supervisory Board members adhered to Islamic faith and beliefs as stipulated in the Qur'ān, Sunnah, and *ijmā'*. It adds more value to the world than professional conventions of ethics or legal guidelines. Given the aforementioned debate among Islamic scholars, it is evident that the Sharī'ah Supervisory Board has a crucial role to play in ensuring that Islamic banks follow Sharī'ah rules.

In the Islamic system, the Sharī'ah "Supervisory Board (SSB)" is required to put the Sharī'ah screening procedure into practice. The prohibited sector or firm must be screened if it engages in haram activities such as selling whiskey, pork, or haram meat, or if it engages in gambling, tobacco, managing night clubs, or anything which is deemed to be damaging to society (Beekun & Badawi, 2005). Harahap (2003) had two noteworthy findings. For starters, previous investigations have focused on Sharī'ah noncompliance income (SNCI) declarations, which are of lesser importance because it is problematic to comprehend the general practices

of the Sharī'ah system when it comes to SNCI statements. This is especially important in the Sharī'ah system to publish their SNCI as part of their disclosure obligations. Islam directs all aspects of human life in this world and the afterlife, including social, financial, and economic activity. Islam is concerned with more than simply religion; it is also concerned with the way of life (Alam *et al.*, 2012). This means that Islam is a guide in all aspects of life, not just in prayer. The Qur'ān describes every aspect of human existence, including the distinction between haram and halal actions. Islam explicitly directs even trading transactions, such as what to trade, how to trade, and how to engage with others. Financial institutions based on Sharī'ah principles provide an opportunity for Muslims to invest their money or make investments in the financial system. Religion, according to Alam *et al.* (2012), is one of the most universal and significant social institutions that can impact people's views, values, and behaviors at both individual and societal levels.

It is backed up by Conroy and Emerson (2004), who defined religion as a principle that shapes people's ethical ideas and can reflect human conduct and obligations. All communities have earned trust in products established on the basis of Sharī'ah principles, and banking is not just focused on Muslim consumers, but is also able to attract non-Muslim clients due to the system's benefits. backed up by (Kishada & Wahab, 2013).

"Wan Abdullah *et al.* (2013) and Abu Kasim (2012)" emphasize on the value of Sharī'ah governance (SSB), Sharī'ah compliance, and voluntary disclosure, with Sharī'ah noncompliance income (SNCI) as one of the disclosure elements. Wan Abdullah *et al.* (2013) highlights the degree of disclosure on the SSB as well as the content of the board report. To analyze the level of disclosure on SSB and *zakāh*, they used both disclosure indexes and content analysis. The relationship between SSB features and *zakāh* disclosures is highlighted in this article. The findings show that SSB and *zakāh* disclosures are still missing; additionally, the bank reports a "low level of disclosure on important issues". Abu Kasim (2012) focuses on the SSB's publishing of a Sharī'ah compliance report.

Oz *et al.* (2016), in accordance with earlier arguments, emphasize the importance of effective Sharī'ah governance and disclosure, and suggests that SNCI reporting, and disclosure should be improved. Furthermore, the relevant report cited by Oz *et al.* (2016) either does not provide material information to users or information remains unreported due to a lack of a consistent and highly structured regulatory framework on SNCI disclosure requirements for assessing Sharī'ah non-compliance risk.

Dusuki and Abdullah (2007) identified a number of important reasons why Malaysians favor Islamic banks and measured the fundamentals such as status, service delivery, product price, and Islamic bank social responsibility. The study focuses on the corporate customer's acceptance of the Islamic system due to the arrangement of Sharī'ah principles, as well as quality service and goodwill, as the primary supporting aspects.

Ahmad and Harun (2002) focused their research on customers' perceptions of the Islamic system in Malaysia based on banking facilities, respondents' understanding of Islamic banking concepts and practices, and personal opinions, and concluded that the price of products and services, as well as Sharī'ah disclosure, are the most important factors for corporate customers when choosing their banks.

### Sharī'ah Resolution: Malaysia Experiences

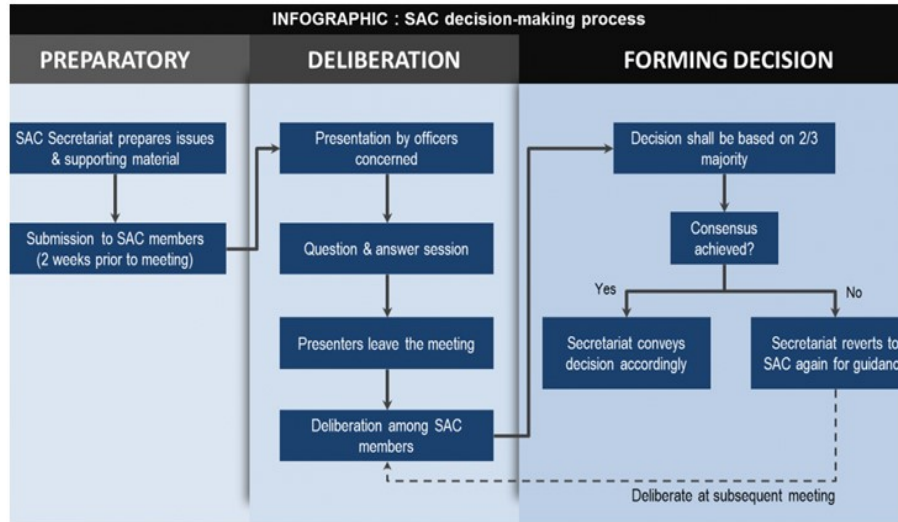
Sharī'ah standards must be followed in order to certify the acceptability of Islamic financial products and services. Financial transactions entered into between an Islamic financial institution and a customer will become void if the basic conditions of a Sharī'ah contract are not certified. This could have a negative influence on the safety and soundness of the institution.

The Sharī'ah advisory board's principal responsibility is to give *fatwá* on issues concerning an Islamic financial institution's ongoing operations. The boards, on the other hand, are prohibited from utilizing *fatwás* given by other Islamic financial institutions advisory committees. According to SAC 2019, this aims to prohibit the practice of *talfiq* in the Islamic finance business. The Bank Negara Malaysia BNM (Central Bank of Malaysia) issued a framework known as the Sharī'ah Governance Framework 2020 to strengthen the role of the Sharī'ah advisory committee in Malaysia. This framework gives the Sharī'ah advisory boards a lot of control over the Islamic banks in the country. The BNM required all Islamic banks in Malaysia to not only follow the *fatwá* given by their boards, but also to seek their advice on any matter. Similarly, in order to improve the functions of the Sharī'ah advisory council (SAC) and ensure effective Sharī'ah compliance in the Islamic financial sector, the BNM revised the Central Bank of Malaysia Act 1958. The amendment has granted the SAC sole authority over all matters relating to Islamic finance, including the resolution of Sharī'ah-related disputes inside Islamic financial organizations. In addition, various laws in Malaysia have been altered in order to ensure the success of Sharī'ah governance in Islamic financial organizations. The revisions to the Banking and Financial Institutions Act (BAFIA) of 1984 and the Securities Commission Act of 1993, for example, have been noted. The National Sharī'ah Advisory Council (SAC) is the sole competent body in Islamic finance, according to the Central Bank of Malaysia Act 2009. The Bank has also issued BNM/GPS1 as a guideline for the effective governance of the Sharī'ah committee in Islamic financial institutions. In addition, the Securities Commission of Malaysia established the Sharī'ah Advisers Registration Guidelines 2009, which establishes the registration criteria for Sharī'ah advisers in the capital market sector.

The Sharī'ah Resolution and Compilation of Sharī'ah Resolution were issued by Bank Negara Malaysia as a reference to understand the Sharī'ah interpretations made by the Sharī'ah Advisory Council (SAC) on any particular matter, ensuring that Islamic industry investors and stakeholders have a complete understanding of the principles made by SAC.

The Sharī'ah Advisory Council of Bank Negara Malaysia (SAC) was established in 1997 as the leading authority in Malaysia for determining Sharī'ah issues related to Islamic finance. The SAC is in charge of authenticating all Islamic banking and *takāful* products, as well as establishing Islamic law for the purposes of Islamic financial business or any other Sharī'ah-based enterprises that are regulated by the Malaysian Central Bank. In Malaysia, where the Sharī'ah Advisory Council of Bank Negara Malaysia's resolutions are enforceable on all Islamic financial institutions, *takāful* corporations, courts, and arbitrators, the compilation of *fatwás* or resolutions is becoming increasingly essential. When the goals are explored

within the framework of Islamic juristic contentions and Islamic style of thinking of *ijtihad*, in particular the collective *ijtihad*, the value of this arrangement can be recognized.



**FIGURE 2.** SAC decision making process

Source: The Shari’ah Advisory Council of Bank Negara Malaysia (SAC)

**Sharī’ah Governance**

Governance is a critical component in ensuring the Islamic system’s stability. To promote open trust in the corporate aims, the board, and the commercial activities of the Islamic industry, a well-functioning Sharī’ah administration system is essential. In 2020, the Sharī’ah Governance Framework for the Islamic Industry was released. The system plays a critical role in facilitating the structured growth of the Islamic financial industry. It corresponds to regulatory goals of ensuring continuous and thorough Sharī’ah compliance. In Malaysia, there are two tiers to ensure Sharī’ah compliance and defend the public interest. The institutional level and the regulatory level.

The Islamic Financial Services Act and Sharī’ah governance comprise the SAC at the institutional and regulatory levels, respectively, to ensure that all business activities and operations of Islamic financial institutions are compliant with Sharī’ah principles.

To achieve Sharī’ah compliance, the Islamic Financial Services Act 2013 (IFSA) contains rules on Sharī’ah Governance. An institution’s goals and economic activities should always be guided by Sharī’ah principles. Any decision made by the Sharī’ah Advisory Council regarding corporate operations would be declared Sharī’ah compliant. If an institution becomes aware of any conduct that violates the Sharī’ah governance council, the institution must immediately notify the bank and its Sharī’ah committee. Stop doing so right now and submit a plan to the bank to modify the disobedience within thirty days. The bank may provide a further term to confirm whether the disobedience was repaired or not by the organization, after which the bank may evaluate the situation. Anybody who violates the law commits an offense and is liable under the act.

### Power of Bank to Specify Standards for Sharī'ah Matters

The bank may designate Sharī'ah criteria that require the ascertainment of Islamic law regarding economic activity and its effect in accordance with the Sharī'ah advisory council's counsel or judgment. The Bank may also establish guidelines for cases that do not require Islamic law to be determined. Sharī'ah governance, includes the governance and Sharī'ah committee's functions and responsibilities. A governance member of an institution's Sharī'ah committee must act in accordance with the bank internal policies and regulations.

## RESEARCH METHODOLOGY

In comparison to earlier studies, the research was improved by a thorough analysis of previous studies on the necessity for a Sharī'ah Resolution framework to be implemented globally across all IFIs. Data collection method: The qualitative data was obtained through a secondary method. 1. Checked different products, services, and modes of finance provided by IFIs, such as "*muḍārabah* (profit sharing), *wadī'ah* (safekeeping), *mushārah* (joint venture), *murābahah* (cost plus finance), *ijārah* (leasing), *hawālah* (an international fund transfer system), *takāful* (Islamic insurance), and *ṣukūk* (Islamic bonds)".

2. Checked the "Sharī'ah contracts etc... for different products, services and modes of finance".

Several research papers have examined the topic of *fatwá* and Sharī'ah governance in various nations, including (Beekun & Badawi, 2005; Sarea *et al.*, 2018). These researches looked into a variety of Sharī'ah and *fatwá*-related topics. This is the first study to provide a Sharī'ah-based framework for Islamic finance.

## DISCUSSIONS: THE PROPOSED FRAMEWORK

The Islamic Banking Act (IBA) makes it a necessity for securing a permit, by any financial institution that is willing to function based on an Islamic model, to make provision for Sharī'ah compliance. Board in its article of association due to the significance of the Sharī'ah committees in the Islamic system. In general, Islamic banks operate under different school of thought in different countries and this may lead to different understandings of *fatwá* which is against the concept of *ijmā'* consensus between scholars. However, previous studies in the area of Islamic banking and finance, such as Sarea *et al.* (2018) confirm the need of full Web-based Financial Reporting Disclosure as part of the principle of Islamic law and Sharī'ah objectives. Thus, proposing a framework of *fatwá* guidelines will lead to a common practice worldwide.

In this section, we present and debate the proposed Sharī'ah Resolution framework in detail, illustrating the framework in practice with the case study Sharī'ah Resolution published by the Central Bank of Malaysia in two editions in 2010. Figure 3 depicts our suggested framework, which is comprised of four steps. The proposed model's design is based on a literature review. Overall, the conceptual framework proposed in this study adds value to the existing framework.



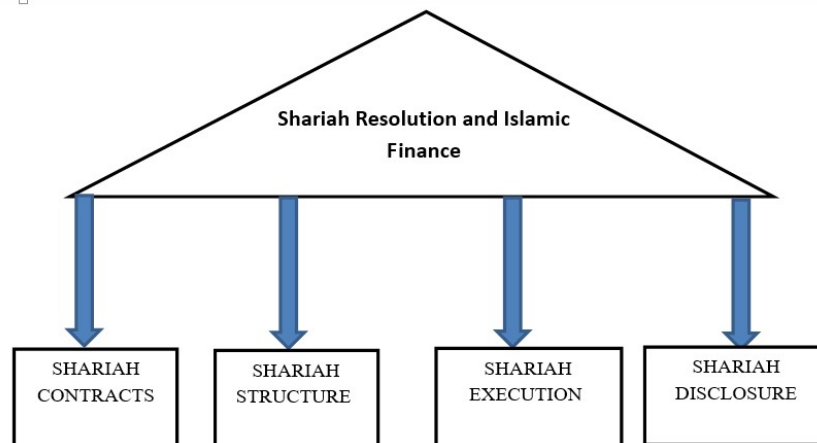


FIGURE 3. Research conceptual framework

### Proposed Sharī‘ah Resolution Framework Rating through Four Stages

#### **Phase 1: Sharī‘ah Contract**

Because a single forbidden clause could render the entire contract null and void, this phase covers the essence of the deal. Ambiguity (*gharar*) should be avoided to the greatest extent possible. Also, counterparties to the contract must be scrutinized because when evaluating an Islamic bank’s Islamic contract with a conventional bank, greater caution should be given than when evaluating an Islamic bank’s Islamic contract with a fellow Islamic bank (Sani & Abubakar, 2021).

#### **Phase 2: Sharī‘ah Structure**

Because Islamic finance transactions frequently undertakings comprise a combination of contracts or agreements, such as agency or purchase undertakings, the form of the transaction is also critical. In order to ensure Sharī‘ah-compliant transactions, the contract structure’s sequence is crucial (Sani & Abubakar, 2021).

#### **Phase 3: Sharī‘ah Execution**

The IFI must guarantee that what the Sharī‘ah board recommended was followed to the letter, with no erroneous interpretations or deliberate deviations by the business units (Sani & Abubakar, 2021).

#### **Phase 4: Sharī‘ah Disclosure**

This step covers the level of disclosure of *fatwá*.

## CONCLUSION

The establishment of legal interactions in the Islamic finance business is trust and honesty, which can be realized by publicly disclosing realities in a way that removes all ambiguity, conforms with reality, and harmonizes with the Sharī‘ah perspective. Previous studies in Islamic banking and finance have dealt with different concerns about *fatwá* disclosure in different nations. Therefore this work fills a theoretical gap in the literature. However, a few studies in different nations have looked into *fatwá* concerns. This article outlines the four processes of Sharī‘ah resolution in Islamic finance: Sharī‘ah contract, Sharī‘ah structure,

Sharī'ah execution, Sharī'ah disclosure, and overall approval. Different levels of permitted disclosure may result from cross-jurisdictional variances and different schools of thought in terms of minor readings of varying texts in the Islamic law and regulatory context. The focus of this subject is on a better understanding of *fatwá* in Islamic business research, which will lead to improved societal welfare throughout Muslim countries, including the worldwide Islamic banking industry. In principle, this study suggests that Islamic banks adopt a *fatwá*-based architecture. Future research should include using social media to disseminate more *fatwá* disclosure information in the Islamic finance industry.

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