

National Shariah Boards: Global Applications and the Case of Turkey

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The Shariah Boards Applications and The Case of Turkey

Islamic finance industry is growing very rapidly in Asia, as well as in Europe. Many countries would like to take advantage of it by changing their regulatory models. The current Islamic finance regulatory structures differ in various countries: Some jurisdictions are based on the sole authority of the government, while some of them are only based on the market, and some prefer a mixed system. In this study, we analyzed the most important Islamic finance markets and their Shariah governance systems. Ensuring Islamic financial operations fully in line with Shariah principles would first bring trust to the financial system and then augment the volume. Therefore, we compared diverse approaches and showed that establishing a national Shariah Advisory Board could accelerate the Islamic finance in Turkey.

Introduction

Islamic finance is continually developing in the world. Asian and many European countries are trying to build a legal structure for rational management of these developments in order to allow the public offering and the trading in secondary market of the relevant Islamic financial products, entirely in accordance with the Islamic law. Various initiatives are taken in order to take a share from this market in our country as well. At

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present, our share in the overall Islamic finance industry is extremely low, the required road maps have already been drawn, and first steps have been taken. Accordingly, the Undersecretariat of Treasury has issued the first sukuk in October 2012. The Capital Markets Board is taking necessary steps for establishment of an Islamic finance infrastructure parallel to the world, through its communiqués. This means to say that the governmental bodies and authorities are keeping their side of the bargain and as a result of these initiatives and efforts; Turkey will take a gradually increasing share from the global Islamic finance industry.

In an Islamic financial institution, Shariah Board is the organ that is in charge of ensuring that the products and services offered by that financial institution are fully compliant with provisions of the Islamic law. Thus, the Islamic law boards review the existing products, and examine the new products scheduled to be introduced to the market, and decide whether they are compliant with the ecclesiastical (religious) rules or not. Hence, these boards play a very important role in the development of new products. Therefore, they are also important for critical organizational units for meeting the expectations of their customers and for compliance with the industry's conditions by developing procedures in addition to development of new products. By definition, Islamic financial products must absolutely be in full compliance with the rules and regulations of Islamic law, and on the other hand, in tandem with the sophisticated structure and rapid evolution of finance. In this way, the Islamic finance will also be developed and thus, these boards should be capable of managing such evolutions and changes.

In the light of practices of many different countries, these boards have been organized in three types:

- (a)** First, each of the Islamic financial institutions operating in a country has its own and separate Shariah board, and it is in the discretion of these individual boards to decide whether financial transactions of these institutions are in accordance with the Islamic law or not. Furthermore, some of these institutions have in-house Shariah Assessment Departments established to support Shariah Board (Hasan, 2010).
- (b)** Another organization form of Shariah boards is the national Shariah boards in charge of centralized regulations of Islamic

finance practices on nationwide basis, and if and when needed, giving advice to Islamic financial institutions and other institutions on request.

- (c) Third one is the model, where both of the aforementioned boards exist, or to put it differently, the system is featured both by an official nationwide Shariah board, and by in-house advisory boards of each of Islamic financial institutions.

As it can be seen, framework of Islamic financial practices consists of various different systems. While some legal and regulatory arrangements required a wide participation of regulatory and supervisory authorities, some other statutory systems adopt a more liberal point of view and leave these boards and organization units to the discretion of Islamic financial institutions.

In Turkey, there is neither a nationwide advisory board, nor a Shariah board in each of the participation banks. Participation banks take fatwas from their advisors. Thus, the case of Turkey does not exactly fit to any of the three models referred to hereinabove. And this report is mostly focused on the national Shariah boards.

Functions of Official Advisory Boards, and Non-standardized Advisory Boards

In general, we can mention three functions of official Shariah boards:

- (1) Giving advice and consulting services to Islamic financial institutions;
- (2) Supervising the financial transactions of Islamic financial institutions;
- (3) Providing support to, and supervising, the new investments and new innovative financial products and services within the framework of Islamic law.

As understood, national Shariah boards are extremely important units for the sake of growth of Islamic finance. As a matter of fact, the decisions given by these boards have the power to reshape the future of Islamic finance.

The principles of Islamic law constitute the heart of Islamic financial practices. Accordingly, financial transactions in compliance with ecclesiastic rules give trust both to people and financial markets. This means that it is very important to conduct Islamic financial transactions within the framework of principles of the Islamic law. In general, though Shariah boards included in the organization of Islamic financial institutions that are tied with the Islamic law principles in the decision making process. Therefore, it is solely in their own initiative to elect one of the thought systems in connection therewith. On the other hand, for the sake of growth of Islamic finance, and for the sake of its global acceptance, standardization of regulations of both national Shariah boards and Shariah boards included in the organization of Islamic financial institutions bears great importance. In our country, the uniformity of decisions taken by the said boards could not yet be attained, which in turn establishes a ground for uncertainties in Islamic banking field.

Furthermore, there is neither a central religious authority generally accepted by all Muslim countries of the world, nor uniformity in religious principles adopted in different Islamic countries. This situation leads to different comments and interpretations on various different transactions, and as a result, causes some doubts as to accuracy of products and practices in Islamic banking and financial system. Different interpretation of Shariah provisions preclude an Islamic financial institution from copying the products from another financial institution, which naturally leads to growth of Islamic finance at a rate lower than its actual potential both in domestic and international scale. Failure in standardization further causes a low trading volume in sukuk markets.

Cases of Different Countries¹

A. Case of Malaysia:

System applied in Malaysia is the mixed system containing both a central Shariah board and an individual in-house Shariah board in each

1 Zulkifli Hasan "Regulatory Framework of Shari'ah Governance System in Malaysia", Kyoto Bulletin of Islamic Area Studies, 82-115, 2010.

of Islamic financial institutions. Official Shariah Board is organized under the roof of the Malaysian Central Bank (Bank Negara). Shariah Board makes final comments and gives advices regarding Islamic Banking and insurance fields, but is not entitled to give a final comment or say in court lawsuits. In other words, final judgment is taken by the relevant court.

In addition, persons sitting in the Central Shariah Board are not permitted to work in or for any Islamic financial institution. On the other hand, persons sitting in Shariah boards founded by Islamic financial institutions can work only in one field. (In Malaysia, insurance and banking sectors are described as different fields.)

B. Case of Pakistan:

Pakistan has also adopted a structure similar to Malaysian practices. Central Shariah Board is established as a part of Pakistan Central Bank. Central Shariah Board is the sole judge in Islamic finance area, while each Islamic financial institution is under obligation to establish a Shariah advisory board under its own roof.

In contrast to the Malaysian system, persons taking part in the Central Shariah Board of Pakistan may also be assigned to advisory boards of any Islamic financial institution.

C. Case of Kuwait:

In opposition to Malaysia and Pakistan, Kuwait has not organized any central Shariah Board. Hence, in Kuwait, each Islamic financial institution has its own in-house advisory board. However, in the case of a conflict or dispute among members of an advisory board, the case may be escalated to Fatwa Board within the Islamic Affairs Ministry. If a case is escalated to the Fatwa Board, the Board is responsible of making the final decision in the issue. Accordingly, the Fatwa Board functions just like a type of Central Shariah Board. Persons sitting in the Fatwa Board may, similarly to Pakistan system, take offices in Islamic financial institutions.

D. Case of Bahrain:

Just like the case of Kuwait, there is no nationwide Shariah board in Bahrain either. On the other hand, a National Shariah Board is established at the helm of Bahrain Central Bank, and the mentioned board gives fatwa regarding only its own products. As a matter of fact, there is no national fatwa mechanism exists in Bahrain. Other Islamic financial institutions are responsible of establishing their own Shariah advisory boards.

E. Case of United Arab Emirates:

A central Shariah Board named Higher Shariah Authority has been established also in United Arab Emirates. On the other hand, the Board does not give nationwide fatwas. Islamic financial institutions establish their own advisory boards.

F. Case of Qatar:

Qatar Model is also similar to Kuwait Model, where no central Shariah board is established. However, Supreme Shariah Council established as a part of the Ministry of Awqaf which functions as a Shariah board, and members of this council are appointed by the Central Bank.

G. Case of Egypt:

By a law enacted in May 2013, a Shariah Board will be established in Egypt. In Egypt, the Islamic financial institutions have their own advisory boards. According to the new law, these boards are permitted to take their actions and transactions only with a prior approval of the official Shariah Board.

Unlike other countries, members of the Shariah Board are appointed by the Prime Minister from the candidates nominated by the Ministry of Finance, and in order to be eligible for election as a member to the Shariah Board, one must hold at least a doctorate degree in the relevant fields, and must have at least three years of experience in Sukuk-related fields.

H. Case of Saudi Arabia:

Saudi Arabia has a system differs from all other countries. Saudi Arabia does not have a written constitutional law, since the Holy Qur'an and Sunna have been accepted as the constitution. Accordingly, there is no nationwide Shariah board in Saudi Arabia. On the other hand, each financial institution has its own advisory board, but no fatwa mechanism exists for the newly launched products. Individual in-house boards follow the Shariah standards of the Islamic Fiqh (Jurisprudence) Academy.

The cases described hereinabove are summarized in the following table:

Table 1: Cases of Shariah Boards in Different Countries

Country	Shariah Board	Relevant Regulatory Authority	Islamic Financial Institution Advisory Board
Malaysia	Shariah Advisory Council	Bank Negara Malaysia (Malaysian Central Bank)	Available
Pakistan	Shariah Board	State Bank of Pakistan (Pakistan Central Bank)	Available
Kuwait	Not available	N/A	Available
Bahrain	Not available*	N/A	Available
United Arab Emirates	Higher Shariah Authority	1) Dubai Financial Services Authority (UAE CMB) 2) Central Bank of UAE	Available
Qatar	Not available**	Awqaf Ministry	Available
Egypt	Shariah Board	Prime Ministry	Available
Saudi Arabia	Not available	N/A	Available

* *There exists a National Shariah Board in the organization of Bahrain Central Bank, but it can review only legitimacy of its own financial products.*

** *There exists a Supreme Shariah Council under the name of Awqaf Ministry, which gives comments and fatwa on some certain issues.*

As it can be seen in the Summary Table, all countries reviewed hereinabove do not have a nationwide Shariah board, the gap arising from non-existence of such a board is filled in by another fatwa mechanism fulfilling the functions of this board.

Case of Turkey

Almost all of the Islamic banking institutions of the world have Shariah advisory boards. In such Islamic financial institutions, the members of Shariah Board are introduced in their websites; thereby the composition of the board becomes known by the public. On the other hand, no information is available in the websites of four participation banks operating in our country. Nor is it publicized in their websites from whom they take fatwa.

Furthermore, there is not any nationwide Shariah board in our country either. As known, one of the most rapidly growing fields of the global finance industry is Islamic finance. At present, Islamic finance grows by 15 to 20% per annum, and this growth trend is expected to be continued. Islamic finance industry was projected to reach a volume of \$1.3 trillion as of the end of 2012, and a volume of \$4 trillion as of the end of 2020. Due to its existing volume and growth trend, Islamic finance whets the appetite of many countries that aim to take a larger share from the growing market. To this end, countries are taking steps in order to issue various different legal regulations to integrate Islamic finance into their financial systems. Furthermore, Islamic financial products are being used to a gradually increasing extent. This two-digit growth trend in Islamic finance around the globe is observed in our country as well. Our country is taking the necessary steps in order to become an important center of Islamic finance, and our financial institutions are preparing their expansion plans in order to meet this demand.

Considering the possible causes of the absence of not having a nationwide Shariah Board in Turkey, the first reason is that, up until now the Islamic Banking sector has been seen as a complimentary banking system to traditional banking. Therefore, the regulation steps taken were behind the actual situation.

Second, Islamic banking uptrend could not be evaluated correctly. Now, mega project financing demands of Turkey definitely need a nationwide regulation about Shariah Boards in Islamic banking sector.

Third, Turkey was not politically ready to discuss Islamic finance in depth. Having said that, and truly understood the importance of Islamic finance in how it can contribute to the economic growth of the country, now the actual steps can be taken.

Furthermore, it is necessary to mention the position of Turkey within the Islamic finance sector all around the world. As Turkey's economic power increases, Turkey's Islamic finance sector will attract much more financing opportunities to its economy. As the economic situation was different than before, there were other economic problems to focus on. In this regard, Turkey could not give necessary importance to the Islamic finance issues.

In spite of the developments briefly summarized above, as mentioned before, there is no nationwide Shariah Board in our country yet.

Suggestions for Turkey

As part of the operational system of Islamic financial institutions shortly summarized in the preceding paragraphs, we believe that it will be rational for Islamic financial institutions to have a Shariah advisory board under their very roofs. Structure of foreign Islamic financial institutions may be taken as an example in the establishment process of such boards in our country. Again departing from the foreign examples, members of these boards should be introduced in websites of the relevant institutions, and information should be disclosed about organization of the board. In addition, reports of activities of these boards must also be available for public on yearly basis. Members of such boards may be procured from home countries of the participation banks operating in our country.

In parallel, it has been decided to establish such a board mentioned above in the Participation Banking workshop organized by BRSA (Banking Regulatory and Supervisory Authority) in Ankara between 21st and 23rd of December 2013.²

As a matter of fact, we believe that establishment of a nationwide advisory board in order to fill in this gap will make great contribution to the Islamic finance practices in our country. As mentioned earlier, Islamic finance is growing very rapidly both on the world and in our country, and sustainability of this growth is first of all dependent upon establishment of trust in this system. As known, the basic factor underlying the growth of banking/financial industry is trust of public to such institutions. The

2 BRSA, Association of Participation Banks of Turkey, "Participation Banking and Non-interest Finance Workshop Report", Kızılcahamam, 21 – 23 December 2013

element of trust is far more evident and obvious for Islamic financial institutions. Islamic financial institutions are obliged to continually test the compliance with Islamic rules of both their deposits, and the investments made by using such deposits. Within this framework, the decisions taken by Islamic financial institutions must undergo a review and audit of not only their own internal mechanisms, but also a nationwide advisory board, thereby strengthening the base of such decisions, and it is unequivocal that such strengthening will pave the way for more positive results in economic terms.

On the other hand, establishment of a nationwide Shariah advisory board will further increase the current market share, which is at such a low level as 4%, of participation banks operating in our country. If an institution operates on nationwide basis and authorized by the government takes its place in the system. It will not only augment the volume of Islamic financial practices, but also increase the trust of persons wishing to make investments in this field. As a natural result of it, a larger volume of practices will be created in this field as well.

Another benefit of establishment of a nationwide advisory board relates to the regulations and communiqués issued by our public regulatory authorities with a view to enhancing the global integration of the Turkish Islamic finance, which has been accelerated in recent years. Mentioned authorities have taken important decisions especially in sukuk field. However, it is unequivocal that in the course of harmonizing the developing Islamic financial products and practices with our national legislation, such regulatory authorities and board will be in need of an advisory Shariah board that is experienced in Islamic finance and capable of giving advices regarding Islamic financial products and practices on national basis.

Finally, our country can become one of the important centers of Islamic finance with support of well-trained, educated and experienced labor force. A nationwide advisory Shariah board may further fill in a great gap therein.

Though composition and functions of a national advisory Shariah board are required to be dealt with in a separate article, its members must include persons well-trained in such disciplines as conventional finance, law,

fiqh, sunna, banking and accounting, and said persons must meet a certain past experience condition in their own fields. Although it can be formed of a several board members within the Central Bank of Turkey or BRSA; however, it can be a public institution with a private budget such as CMB of Turkey. The operations of a nationwide Shariah Board will be definitely autonomous.

Conclusion

Accordingly, parallel to the global trends, it is required to establish a national Shariah advisory board in our country. Through such a board, decisions taken in complicated fields of Islamic finance will become more and more efficient in our country.

Again departing from the foreign examples, members of fatwa board of participation banks operating in our country should be introduced in the websites of the relevant institutions, and information should be disclosed about organization of these boards. In addition, reports of activities of said boards must also be available for public on yearly basis.

Establishment of a nationwide board will form a basis for establishment of a healthier infrastructure for decisions in Islamic finance field, which will in turn increase trust in Islamic finance. A natural result of this increase of trust will be the increase of market shares of participation banks from its current rate of 4% to the higher levels in our national banking system. Growth of Islamic financial institutions will also allow the entry of more funds from abroad to our country, and Istanbul's financial center vision will be further strengthened.

Establishment and organizational structure of a nationwide board and its place in hierarchical order of government in our country may be the subject matter of another study.

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