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A CHRONOLOGICAL REVIEW OF THE DEVELOPMENT OF THE SHARIAH SUPERVISION SYSTEM IN ISLAM

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Abstract

The Shariah supervision system is a process to ensure Shariah compliance in business and economic activities. Nowadays, the Shariah supervision system is structured within the Shariah governance framework. Owing to its development directly from the Islamic financial system, it is somehow presented as if it is new, substantiated by a modern theoretical framework. Less attention has been paid to its background from an Islamic perspective, which, as seen in Islamic historical records, is well connected to many practices. This loophole has to some extent downplayed the significance of the contributions of Islam to this supervision system in the economy. This article offers a review of relevant literature to unearth evidence of the evolution of Shariah supervision from the time of the ancient Islamic world untill now. Using a qualitative research approach, data was collected from Islamic literature relating to the issue, and was analysed thematically. This study found that Shariah supervision is evidently crucial in Islam. It was widely practised by the Prophet Himself, and the superseding caliphs, as a tool to oversee the adherence of business practices in the market to Islamic law. It also evolved following the needs and context of society.

Keywords: Shariah supervision, Shariah governance, Islamic finance, hisbah.

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INTRODUCTION

Shariah supervision is the main ingredient of Shariah governance as one of the strategies for an Islamic bank to gain the confidence of its stakeholders, especially its customers. As mentioned by the Islamic Financial Services Board (IFSB), the Shariah governance system refers to the set of institutional and organisational arrangements through which Islamic financial institutions ensure effective independent oversight of Shariah compliance (IFSB, 2009). In terms of organizational structure, Shariah governance is an additional component of corporate governance represented by a Shariah committee whose members are experts in Islamic finance and Islamic financial law. The main role of this committee is to endorse the Islamicity of the bank's products and services offered to the market by examining whether or not they are Shariah-compliant. This function is not alien to Islam, being a concept traceable back to the time of the Prophethood.

In our modern time, the development of the Shariah governance codes to formulate the supervision process in their most recent form is new to the Islamic Financial Institutions. Islamic finance itself has been available for only around 50 years after the incorporation of Mit Ghamr Bank, Egypt, and the Tabung Haji, Malaysia, in 1963 (https://www.islamicfinance.com/2015/05/modern-journey-development/). At that particular time, Shariah supervision was not an issue at all. Arguably, the subject of Shariah governance as one of the main themes of the subject in Islamic finance has only experienced significant development since the formation of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI). Prior to that, Shariah governance was only reviewed under relevant corporate law without any special treatment, as long as it could serve the purpose of Shariah compliance. Since the rapid expansion of the Islamic financial market, especially after the 2007 global crisis, the subject has gained popularity owing to the pressing demand on specific corporate governance mechanisms to tackle the IFI's peculiarities.

The main objective of this article is to demonstrate how Shariah supervision has evolved over time since the first emergence of Islam. This is to offer evidence of its theoretical framework as well as the evolution of its implementation. It is imperative to mention here that when exploring the concept of Shariah supervision, it is important to realise that the concept is no stranger to Islamic literature, in which it can be traced back to the time of the Prophet-hood. However, it should be borne in mind that the forms of supervision were considerably different from, and diverse in comparison to, the modern system. As happens in all systems, it has evolved through time, places and circumstances. As long as it is compatible and comparable in terms of the principles and the idea, it is considered the same subject matter. As mentioned by path dependence advocates, the historic events in the past determine future paths (Gerd Schienstock, 2011).

In order to achieve this objective, this article is devided into five sections. The first and present section is the introduction. The second section will discuss how the Prophet PBUH carried out the supervision process during the time of the Prophet-hood. Then the third section will explore the expansion of the supervision system that was first taught by the Prophet PBUH, under the caliphate era. Following this, Section 4 will describe the development of Shariah governance after the emergence of the modern Islamic financial industry. Finally, Section 5 will conclude the discussion.

THE TIME OF THE PROPHETHOOD

In the Islamic tradition, the Quran and the Hadith are the main sources of the law. The Quran is the testament revealed by God to His prophet through Angel Gibrail, whereas the Hadith is any speeches and actions delivered by the Prophet PBUH. Broadly speaking, the Hadiths function as supporting evidence for the cases in the Quran. The Hadith contains, amongst others, commands to be followed by Muslims on multiple occasions. Other than that, Hadiths function as the determiner to the general remarks in the Quran. As an example of the functions of the Hadiths, we can look at some of the actions of the Prophet as the ruler of Medina. During His PBUH's lifetime, the Prophet applied Islam to all aspects of government and economics. In order to improve the economic activity of the citizens of Medina and the migrants who came from Mecca, the Prophet PBUH set up a new market and encouraged them to get involved. He said: By Him whose hand myself is, to take your rope and gather firewood on your back is better for you than that you come to a man to whom Allah has given some of His favour and ask him so he gives to you or refuses. (Narrated by Bukhari as reported by Abu Hurairah). He also said: Nobody has ever eaten a better meal for you than that which one has earned by working with one's hands. The Prophet Allah David used to eat from the earning of His manual labour. (Narrated by Bukhari as reported by Abu Hurairah).

In terms of the market supervision practices, the Prophet Muhammad PBUH nominated his companions as muhtasib (supervisor). In this case, Umar ibn al-Khattab was nominated muhtasib in Medina, as were Said ibn al-'As in Makkah and Uthman ibn al-'As in Ta'if. The Prophet even put a woman to the task by naming Samra' bint Nuhaik al-Asadiyyah as a muhtasib, and she was recorded as using a stick, patrolling and supervising the market. (Salahuddin Safadi, 2000). The Prophet Himself was a supervisor of the market. It was told by Abu Hurairah that the Messenger of Allah PBUH happened to pass by a heap of corn. He then thrust his hand in it and his fingers felt wetness. He said to the owner, 'What is this?' The owner replied, 'O Messenger of Allah! These have been drenched by rainfall'. He remarked, 'Why did you not place this [the drenched part of the heap] over the corn so that people might see it? He who deceives is not of us '(narrated by Muslim as reported from Abu Hurairah).

The conception of market supervision at this level was at an early stage. The focus of the Prophet PBUH was on the enactment of the concepts of al-amr bi al-ma'ruf wa al-nahy an al-munkar. It is worth noting here that this conception is the very foundation of Shariah supervision in its general sense. On top of that, as the best generation of Muslims, the Prophet and the companions are the best representations when it comes to practising Islam. It is owing to this that the above-mentioned provisions were referred to by the following generations of jurists when explaining the Islamic governance system, as in the works of al-Mawardi and al-Farra'. In this regard, both Al-Mawardi and al-Farra' authored two different books with an identical title, al-Ahkam al-Sultaniyyah (The Law of Islamic Governance), as a manual for the Abbasid caliphate (Muhammad Al-Mawardi, 2006).

THE TIME OF THE CALIPHS

The golden era of the Islamic empire lasted over a millennium and saw tremendous achievements in sciences, economics, politics, and the military, as well as the governance system for the succeeding generations. This is because Islam was at its high status and Muslims were free to practice their religion and comply with all the law revealed from heaven. It is thought that the concept of hisbah, as introduced during the time of the Prophet-hood, gained prominence over the centuries (Ahmad Faizol, 2011). The hisbah institution was one of the main organs of the caliphate governance structure, along with other institutions such as the judiciary, waqf, baitul mal, and the army under the name of diwan (Amalina Abdullah, 2010). For example, the wealth of the caliphate was managed under baitulmal, as the government treasury. The sources of the baitulmal come from zakah, sadakah, ghanimah, usyur, kharaj, jizyah and other relevant sources of tax. The baitulmal funds are distributed using the instruments derived from the provisions of the Quran and the Hadith and should be discharged by the government with accountability and transparency.

In the private sector, waqf could be considered the classic example of a former type of Islamic financial institution. Waqf is an endowment institution, which reached its golden peak during the era of the Islamic empire. Known as one of the key players that contributed to the development of Islamic civilisation, waqf provided critical support to the functioning of the Islamic cities, which were far larger than any town in the West, without direct involvement from the state or the government (Timur Kuran, 2005). Waqf also provided the drinking water system, paved streets, assistance to travellers, the financing of pilgrimages, and even the wedding dresses for brides (Timur Kuran, 2005). It served as a vehicle for financing Islam as a society, as mentioned by Marshall Hodgson (Marshal GS Hodgson, 1974).

The mechanism to govern these institutions was known as al-diwan, and the prominent organ pertaining to economic activities was diwan al-hisbah. Al-Mawardi and al-Farra' categorised the functions of diwan al-hisbah relating to business activities into three main areas. The first was monitoring the market price of goods (Muhammad Al-Mawardi, 2006). In some jurisdictions, based on the Shariah legal school of the local government, a muhtasib was authorised to take action under the law in certain circumstances related to the price, especially in the case of monopoly, price exploitation by hoarding, and over-pricing of goods classified as basic needs. Secondly, they were authorised to assert measurements and scales. The hisbah institution was responsible for the standardisation of business tools, including the use of standard currency in transactions (Amalina Abdullah, 2010). In this regard, a muhtasib held the power to nominate an eligible person to assist him. Thirdly, they supervised business activities. This function was carried out by confirming adherence to the business conduct of the Shariah precepts and preserving consumers' rights, such as in the case of disputes due to fraud and negligence (Muhammad Al-Mawardi, 2006).

The scope of diwan al-hisbah did not stop at the level of business and market matters. The head of diwan al-hisbah was a member of the shura, the highest council of the government at the central level. Diwan al-hisbah was an independent body, and its accountability was beyond the caliph himself. It is argued that the expressed hisbah jurisdiction was, at least as stated in the provision, to remove a caliph if he was seen as no longer fit for the post. By any means, diwan al-hisbah was a vital governance organ within the Islamic empire that served as a supervisory and auditing institution. To some extent, this central power represents a model of a supervisory mechanism that is answerable to a higher authority, which is God. In this sense, 'answerable to God' should not be regarded to mean answerable to an unclear authority, but rather interpreted as answerable to the highest law of the state, which is the Shariah law.

THE TIME OF MODERN ISLAMIC FINANCE

There is rather a big gap between the ancient Shariah supervision model and the modern one as implemented in the Islamic financial insitutions. This is due to the fact that the scope of Shariah supervision of the old day was wider in scope and jurisdiction, whereas the modern application is more specific which is to oversee Shariah compliance in Islamic financial products and services. Its emergence also isolated to the Islamic financial industry where it is modernized based on the needs of the industry. Therefore, to comprehend this is to take a deep insight of its development in the market.

DEVELOPMENT OF ISLAMIC FINANCIAL INSTITUTIONS

Historically, the development of IFIs has taken place under a conventional setup. However, with the rapid growth of the Islamic financial industry, each jurisdiction has adopted a separate regulatory structure based on its institutional setup and market practices (Asad Khan, Sarfaraz Tanveer, Abdul Qadir Shah, & Raja Ahmed Jamil, 2015). To understand these circumstances, scholars in this area of research have divided the modern era of IFIs into phases. Prominently, Khurshid Ahmad mentioned that the development of the Islamic financial system has gone through three significant phases (Muhammad Umer Chapra, 1985).

First Phase: The Theoretical Concepto Interest-Free Banking

After the collapse of the Ottoman caliphate, the final empire of Islam, no known formal institution offered business transactions with Shariah compliance. The Ottoman Empire had broken into several countries, each forming individual governments, either by claiming their independence or by being colonised by the Western civilisations. Not one of these countries was proclaimed as an Islamic country or to have implemented the same notions as the former empire, neither politically nor economically.

By this time, the financial system introduced by the Western colonisers dominated the market and spread widely over all the regions previously known for their Islamicity. In fact, the Westernisation process had already taken place decades before that, as is traceable by the formation of many banks in several localities throughout the Ottoman Empire. Since the 19th century, some Islamic regions have started opening branches of foreign banks. For instance, in Egypt, the first conventional bank opened its doors in 1856 under the name Bank of Egypt, which was actually a branch of an English bank (Ahmad Alharbi, 2015). In 1898, the National Bank of Egypt was established and is still in operation today (Ahmad Alharbi, 2015). These developments were followed by many other financial institutions, which finally created the need for the Muslim community to create a similar banking system but under Shariah prescriptions.

As mentioned by Siddiqi, the earliest writing on the subject of Islamic banking and finance dates back to the 1940s (Muhammad Nijatullah Siddiqi, 1983). At this stage, scholars were looking for an alternative system to overcome the domination of interest-based finance, which eventually triggered the possibility for modern IFIs to emerge a few decades after that. There is no trace of any specific discussion on the subject relating to the Shariah governance system.

Second Phase: The Emergence of The Islamic Banks

Almost two decades since the first idea for an alternative financial model appeared, the first group of IFIs emerged in 1963 in Malaysia with the formation of Tabung Haji, and in Egypt with Mit Ghamr Bank, as well as the interest-free-based bank of Karachi. Of these three IFIs, the Tabung Haji is the only one that has survived throughout the decades. In truth, there was no specific body responsible for advising, supervising or monitoring these IFIs on Shariah matters. The establishment of the first modern Islamic bank, Mit Ghamr in 1963, was made without setting up any Shariah body as part of its internal corporate governance structure (Grassa Rihab, 2013). The need for a robust Shariah governance system was not an issue, and moreover, the collapse of the other two IFIs was due to external factors, and political factors in particular.

Early in the 1970s came the Dubai Islamic Bank, which took deposits in current as well as investment accounts and engaged in profit-making activities directly as well as through working partners. Consecutively, the Islamic Development Bank, which started its operations in 1975, was designed to serve Muslim countries and communities by arranging finance for trade and development on a non-interest basis. By the late 1970s there were half a dozen more banks in the private sector in Egypt, Jordan, Kuwait, and the Gulf states. The following decade saw rapid expansion, bringing the number of banks into the dozens by the end of the decade. More importantly, when the Dubai Islamic Bank and the Islamic Development Bank opened in 1975, neither had a designated Shariah department within their governance structure. In order to resolve Shariah matters they established relationships with several scholars for consultation on their activities, transactions, products and services, as well as asking for fatwas for specific questions and transactions (Munzir Kahf, 2004).

Third Phase: Islamic Financial Expansion

Scholars have stated that during this period of time the IFIs spread all around the world, and many IFIs that were established in the early 1970s and 1980s are still in operation (Adnan Abdeen & Dale Shook, 1984). The need for a robust alternative financial system, exacerbated by repeated financial crises, has encouraged the IFIs to grow. Along with this progress, the importance of a prudent and sound governance system to tackle the expansion of the institutions has intensified. This has resulted in the emergence of the Shariah governance codes and standards issued by several standard-setters at national or international level, such as the AAOIFI, IFSB and Bank Negara Malaysia (BNM).

EMERGENCE OF SHARIAH GOVERNANCE CODES

In the last millennium, coinciding with the expansion of the Islamic financial industry, we witnessed exponential growth in concern about Shariah governance both theoretically and practically. The proliferation of IFIs in the past decades has started to create multiple issues for policymakers and regulators (Asad Khan, Sarfaraz Tanveer, Abdul Qadir Shah, & Raja Ahmed Jamil, 2015). Notably, for Shariah governance, various codes have been issued by numerous standard-setters, nationally and internationally, to address the specific needs of IFIs for a robust governance system. The objective is to sustain the credibility of the Shariah compliance mechanism, which is crucial, and plays a pivotal role as the primary objective of the IFIs (Ahmed, 2011). However, this development is still in its early stages as compared to their counterparts, and they have experienced several improvements since their first appearances during the 1980s (Tricker Bob, 2009). Over the years, Shariah governance has been discussed in the context of how to assign the Shariah committee duties that are capable of achieving the IFIs' economic and religious objectives (Malek Marwan Yusoef Injas, Mohamad Sabri Haron, Rashela Ramli & Raghad Azzam Injas, 2016). The latest developments in the industry show that Shariah governance has gained more attention and more efforts have been made to observe the complete Shariah compliance chain, given that non-compliant features could injure IFIs and have an adverse effect on the industry (Akram Laldin, 2011). In the same vein, it is believed that the lack of a standard framework is also one of the factors that exacerbates risk exposure for the IFIs (Smolo Edib, & Mirakhor Abbas,, 2010).

It is argued that the most significant and well referred standards and codes were those issued by the AAOIFI, the IFSB and the BNM. The AAOIFI and the IFSB are carrying out an effort internationally. Both have published several standards and codes as guidelines and references for national controlling bodies to adopt within their jurisdictions, regardless of their models. These codes have their own specialties, designed to cater for the needs of IFIs on multiple occasions. All jurisdictions are at liberty to find the best way to adapt the guidelines in conjunction with their own characteristics, legally or economically (Mahmood Ahmed & Maksuda Khatun, 2013). In this regard, Malaysia is considered one of the most advanced markets that has implemented almost all, if not all, of the guidelines. It is also worth mentioning that these guidelines and codes share the same notions as other corporate governance codes, especially those published by the The Organization for Economic Co-operation and Development (OECD) and the Basel Committee on Banking Supervision (BCBS). Concerning this, Archer and others state that the roles of AAOIFI, the IFSB and the BNM in the development of Shariah standards, the frameworks or the guidelines for the Islamic finance industry, differ in some ways: AAOIFI is concerned with the substance of Shariah rulings at an international level; the IFSB is concerned with systems and procedures for compliance, but not the substance, also at an international level; and the BNM and the Malaysian Shariah Advisoty Council (SAC) are concerned with both substance and systems and procedures, but on a national or jurisdictional level (Simon Archer & et.al., 2016).

CONCLUSION

To conclude, we can see that Shariah supervision is a new and expanding Shariah compliance mechanism embedded within IFIs' corporate governance. It is a system formulated from the Islamic teachings based on its very foundation regardless of its diverse implementations throughout the history. It was evidently widely practised by the Prophet Himself, and the superseding caliphs, as a tool to oversee the adherence of business practices in the market to Islamic law. As for the Islamic financial industry, despite the fact that the early IFIs did not utilise the concept in its full capacity, Shariah supervision is not strange to Islam as the basis for building the IFIs Shariah compliance mechanisms. Coinciding with the expansion of the market, Shariah supervision has evolved to attend to the characteristics of the IFIs. It also evolved following the needs and context of the society. To achieve that in the IFIs, Shariah supervision looks after the area that is not addressed by conventional financial institutions which is to ensure the Islamicity of the IFIs.

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