The Growth of Islamic Banking: A Singaporean Study on the Legal Conflicts of Embracing Shari'ah Law

Kylee R. Sargenti

Follow this and additional works at: http://digitalcommons.law.scu.edu/scujil

Recommended Citation
Available at: http://digitalcommons.law.scu.edu/scujil/vol8/iss2/3
The Growth of Islamic Banking: A Singaporean Study on the Legal Conflicts of Embracing Shari’ah Law

Kylee R. Sargenti*

I. Sahaid al-Harbi: A Hypothetical

Consider an international businessman, Sahaid al-Harbi, desiring to invest a portion of his wealth in a fast growing financial market. Domiciled in Saudi Arabia, al-Harbi is a devout Muslim who has amassed his fortune in the oil industry. Due to his religious affiliation, he seeks to place his money in a financial institution offering Islamic investments. Al-Harbi also desires to invest in a country with a stable government, and a regulatory system imposing a minimal impact and restraint on international investors. Considering these factors, al-Harbi places his money with a banker from the Singaporean branch of Citi’s Islamic Investment Bank.

* Kylee Sargenti is a graduate of Santa Clara University, School of Law. Originally from Morgan Hill, California, she holds bachelors degrees in Political Science and Psychology from University of California, Santa Barbara. Kylee wishes to extend her thanks to Professor Phillip Jimenez; her parents, Gary and Joanne Sargenti; and her rock, Kieran Boyle, for all of their assistance and support with this article.
After a year of conducting business with the bank, al-Harbi brings suit against Citi, citing negligent management of his account. The complaint contends that his contractual relationship with Citi is invalid, and requests that the matter be tried under Shari’ah (Islamic religious law) principles. Citi argues that Singapore’s Common Law system must be employed, because the transaction and investment occurred in Singapore. Al-Harbi counters that the transaction was made under Shari’ah law since the investment was intended to adhere to, and therefore be at the behest of, Islam. He further argues the law of his domicile, Saudi Arabia, requires the use of Shari’ah law, and thus the litigation must be determined and pursued in such a manner. The court is put in the predicament of determining whether the matter should be tried under the more conservative, Shari’ah law, or the westernized Singaporean law.

Singapore is a relatively young economically developed market and it is deemed to possess vast potential. The country’s attractive infrastructure and international regulations framework heighten its financial potential, and make it an important country to watch.

As the above hypothetical illustrates, such an attraction will likely bring about issues relating to, and exposing the incompatibilities between, foreign and domestic laws. The potential for conflict occurs all too often in former British colonies: that is the conflict between English law and Shari’ah law.¹ These “inevitable” and “endemic” conflicts are compounded by the possibility of clashes between statutory laws and legal precedents, as well as the aspect of private international law.²

In order to make such a determination of precedence and jurisdiction, the Singaporean government must decide the role Islam may and will play within its legal structure.

---

1. See Angelo M. Venardos, Islamic Banking and Finance in South-East Asia: Its Development and Future 150 (World Scientific Publ’g Co. 2005).
2. Id.
II. Introduction

The economic crisis currently plaguing major Western financial institutions, including the United States economy, has investors looking for safer, more stable investment options. Islamic banking is a conservative option catching the eye of many weary and anxious investors. As the Western world becomes more interested in Islamic banking, non-Muslim countries are grappling with the concept of formally incorporating such a financial system into their current economic and legal frameworks. Singapore is one country in which the economic structure may not be compatible or correlated to Shari’ah functionality.

At a time when the Middle East and Asia compete to attract wealthy international investors who made their money from high oil prices and booming economies, Singapore uses its strong infrastructure and flexible financial regulations to stand out. Some legal analysts, however, question how effectively a potential conflict between Singapore’s Common Law system and Shari’ah law will be managed. Regulations regarding investments are in place in Singapore to promote their facilitation. However, if a legal conflict should arise, under what set of laws shall the matter be reviewed? Should elements of Shari’ah law be adopted into the Singaporean legal system, or should a religious board be introduced to accommodate a matter that might arise? This comment seeks to address these questions.

4. See id.
III. Background

A. Singapore

Increasingly known as the “Switzerland of Asia,” Singapore is making an effort to leverage its existing infrastructure to promote Islamic asset management and private banking within its borders.\(^8\) Switzerland’s position as an offshore financial center will progressively weaken as a result of the government’s recent decision requiring Swiss account holders to pay taxes on their investment income to their respective governments.\(^9\) As a result of this revision in the law, these wealthy investors with accounts in Switzerland will likely decide to place their fortune in other wealth management centers, namely Singapore.\(^10\)

Singapore has strong fundamentals that closely resemble those of Switzerland.\(^11\) As one of the world’s largest foreign exchange centers, Singapore boasts a significant amount of public equity, private equity, fixed income managers, and hedge fund managers.\(^12\) Singapore has an attractive regulatory environment for the investment of offshore funds; for example, its tax system allows offshore funds to compound tax free, with no taxes on interest and capital gains imposed on non-residents.\(^13\) In addition, the government maintains an active role in promoting transparency and reducing bureaucratic red tape.\(^14\) Singapore, like Switzerland, also maintains strict client confidentiality laws.\(^15\)

---

9. See VENARDOS, supra note 1, at 204-05.
10. See id. at 205.
11. See id.
12. See id.
13. See id.
14. See id. at 206.
15. See VENARDOS, supra note 1, at 206. The analogy to Switzerland regarding client confidentiality laws should, for purposes of this article, be held by the reader as a reference to Swiss laws as they existed before 2009 when UBS was coerced by the United States to surrender information on many bank customers accused of tax evasion in the United States. See, e.g., Press Release, The United States Department of Justice, UBS Enters into Deferred Prosecution Agreement (Feb. 18, 2009), http://www.justice.gov/opa/pr/2009/February/09-tax-136.html (“As part of the deferred prosecution agreement . . . UBS, based on an order by the Swiss Financial Markets Supervisory Authority (FINMA), has agreed to immediately provide the United States government with the identities of, and account information for, certain United States customers of UBS’s cross-border business.”). How this development will further affect Swiss client confidentiality laws is beyond the scope of this work.
Finally, Singapore is politically stable, with a history of maintaining sound economic policies in a financial industry regulated to the highest international standards. The country’s political system closely mirrors that of a Western-style democracy, with a unicameral parliament, and an independent judiciary.

Once under British rule, the colonial regime enforced a structure of government designed to implement an administration closely modeling its own. This British influence was intended to be sustainable even after the colonial rule.

The current legal framework in Singapore is very similar to the English Common Law system. In essence, English Common Law governs matters that have not been legislated upon by the Singapore Parliament. Thus, as the English Common Law courts make a decision on a case today, it would be declared law in Singapore as it always has been based on the principle that “the Common Law was traditionally conceived of as having existed from time immemorial and was merely declared by the judges from time to time.”

B. Islamic Banking

Shari’ah is Islam’s legal system, derived from both the Quran as the word of God, and the rulings of Islamic scholars (called fatwa) devised to provide guidance to Muslims. Shari’ah informs and governs every aspect of a Muslim’s life. In practice, many Muslims turn to Shari’ah to assist them in making decisions about direction in their day-to-day lives.

An industry expected to grow to upwards of $4 trillion by 2010, Islamic banking emerged in the 1940s. It was born out of resentment against the imposition of Western-style, capitalist banking. The application of Western

16. See VENARDOS, supra note 1, at 206.
17. See id. at 138.
18. See id.
19. See id.
20. See id. at 210.
21. Id. at 210-11.
22. See Casciani, supra note 5.
23. See id.
24. See id.
27. See id.
banking was forced upon much of the Islamic world during the period of European colonial domination.\textsuperscript{28}

The theological foundation of Islamic banking is located in scripture, which declares that a collection of interest is a form of usury, and is thus prohibited by Islam.\textsuperscript{29} For example, the Quran states, "Whatever you give as riba [interest] so that it might bring increase through the wealth of other people will bring you no increase with Allah."\textsuperscript{30} In the world's modern economic environment, this principle translates into an attitude toward money in that it may not remain idle and generate more money.\textsuperscript{31} Rather, to grow it must be invested into productive enterprises as interpreted by Shari'ah.\textsuperscript{32} As a result, interest-based banking and investments in industries related to alcohol, tobacco, weapons, pork, gambling, and pornography are prohibited.\textsuperscript{33} In the Western world bankers design investment instruments to satisfy government regulators, whereas in the Islamic banking world, the Shari'ah board must also be satisfied.\textsuperscript{34} Finance lawyers, therefore, work alongside Islamic finance scholars, who study and review a product before issuing a fatwa, or ruling, on its compliance with Shari'ah law.\textsuperscript{35}

Though the industry has met the same challenges as Western institutions during the current economic crisis, advocates of Islamic banking say the system has "built-in protection" from the kind of uncontrolled collapse affecting capital markets around the world.\textsuperscript{36} For instance, excessive risk taking as well as the use of financial instruments such as derivatives (blamed for the downfall of the banking, insurance, and investment leaders) is prohibited.\textsuperscript{37} In recognition of this ban, it has been attributed that, "The beauty of Islamic banking and the reason it can be used as a replacement for the current market is that you only promise what

\begin{itemize}
\item \textsuperscript{28} See \textit{id}.
\item \textsuperscript{29} See Ambah, \textit{supra} note 3.
\item \textsuperscript{31} See Ambah, \textit{supra} note 3.
\item \textsuperscript{32} \textit{Id}.
\item \textsuperscript{33} See Kolesnikov-Jessop, \textit{supra} note 6.
\item \textsuperscript{34} See Ambah, \textit{supra} note 3.
\item \textsuperscript{35} \textit{Id}.
\item \textsuperscript{36} \textit{Id}.
\item \textsuperscript{37} \textit{Id}.
\end{itemize}

436
you own. Islamic banks are not protected if the economy goes down—they suffer—but you don’t lose your shirt.\textsuperscript{38}

To put this in perspective, the following is an example of an Islamic banking transaction as realized through a property transaction. Instead of lending money to a homebuyer and collecting interest on it, an Islamic bank will buy the property and then lease it to the buyer for the duration of the loan.\textsuperscript{39} The client will then pay the bank a fixed amount each month, obtaining full ownership when the entire amount, including the cost of the house plus a predetermined profit margin for the bank, is paid in return.\textsuperscript{40}

Islamic finance is growing at a rate of about fifteen percent each year, and now accounts for approximately one percent of the global market.\textsuperscript{41} That growth, in and of itself, will engender the attention of institutions and nations eager to augment their present organic growth investment vehicles. Previously projected to occupy twelve percent of the market by 2025, Islamic investments are now expected to reach that point much sooner as a result of the current worldwide financial crisis.\textsuperscript{42} Though an increase in Islamic business provides investors with an opportunity to rebuild their confidence amidst this crisis, the aspects of its incorporation in a non-Muslim society presents a legal point of contention.

\section*{IV. Conflict of Laws: Shari’ah and Common Law}

Whether due to the stigma of terrorism or the imposition of severe religious guidelines, many countries in the Western world and Southeast Asia have experienced a hesitance regarding the incorporation of Islamic law. But in order to provide more financial options in these difficult economic times, openness to services such as Islamic banking has grown around the world.\textsuperscript{43}

\begin{thebibliography}{9}

\bibitem{38} \textit{Id.}
\bibitem{39} Ambah, \textit{supra} note 3.
\bibitem{40} \textit{See id.}
\bibitem{41} \textit{See id.}
\bibitem{42} \textit{See id.}
\bibitem{43} \textit{See Ambah, \textit{supra} note 3.}
\end{thebibliography}

437
No Western nation has allowed Shari’ah law to be used in full, although Canada has come close.44 The United Kingdom has incorporated Shari’ah into two particular areas of British law: food regulations (e.g. allowing meat to be slaughtered according to Islamic practices) and financially, where the Treasury has integrated Shari’ah-compliant financial products such as mortgages and investments.45 In Southeast Asia, the relationship between Shari’ah law and secular state legal systems has been a matter of individual state legal policy.46 Although it is up to each state to determine Islam’s influence on their legal system, that trend appears to be influenced by the current, and projected, size of the state’s Muslim population.47

Through the Administration of Muslim Law Act, a statutory board, known as the Islamic Religious Council of Singapore was created to advise the President on matters relating to the Muslim religion.48 Along with this Council, a Shari’ah Court was created through the 1957 Muslim Ordinance, which rules over divorce and inheritance cases. There is not, however, a clear and singular board that manages disputes relating to Islamic financial conflicts.

English Common Law, upon which Singapore’s legal system is founded, does not consider the religious customs and laws identified in the Quran.49 Because of this lack of continuity, Muslims cannot look toward the state’s legal system for guidance in their religious livelihood.50 The structural separation of the courts of these two entities provides ample room for inconsistency.51 As a consequence, the query of which court’s decision shall supersede the other will certainly arise.52 The main point of contention that emerges when Shari’ah law is involved is the validity given to this law as practiced in English courts.53 In order to resolve this issue, the following question is presented, “How does one ascertain the proper law to decide

---

44. See Casciani, supra note 5.
45. See id.
46. See VENARDOS, supra note 1, at 139.
47. See id. at 139-40.
49. See VENARDOS, supra note 1, at 147.
50. See id.
51. See id.
52. See id.
53. See id. at 148.
a conflict of principle between the tenets of Islam and the laws of the State?\textsuperscript{54} Neither Islam nor secular legal systems provide a solution to this predicament; rather the answer to the question is complex and left to policy.\textsuperscript{55}

\section*{A. Maria Hertogh}

The complexity and inconsistencies rising to the predicament between Shari'ah law and secular Common Law came to a head in Singapore in the 1950s during the highly publicized case of Maria Hertogh.

Maria was born in 1937 to Dutch Eurasian parents in Java, then part of the Dutch East Indies.\textsuperscript{56} When Maria's father was taken prisoner in World War II, during the Japanese occupation of Java, her mother gave her to one of their servants, Aminah.\textsuperscript{57} Following the separation, Aminah moved to Trengganu, Malaysia,\textsuperscript{58} where she cared for and raised Maria (whose name had been changed to Nadra) as a Muslim.\textsuperscript{59} After the war, Maria's parents were reunited and lodged a request with Dutch officials in Singapore to locate Maria.\textsuperscript{60} In 1949, Maria was found and a custody battle ensued in Singaporean courts.\textsuperscript{61}

The father succeeded in regaining custody of Maria before the Singapore High Court.\textsuperscript{62} However, a subsequent complication occurred in that Maria (age fifteen at the time) was already married to a Muslim man.\textsuperscript{63} The Court was asked to decide upon the validity of the marriage, and found Maria to be Muslim.\textsuperscript{64} The finding was later invalidated based upon the Court’s decision, both at first instance and on appeal, that the marriage was invalid.\textsuperscript{65}

\begin{thebibliography}{65}
\bibitem{54} Id.
\bibitem{55} See VENARDOS, supra note 1, at 148.
\bibitem{56} See Bonny Tan, Maria Hertogh (Nadra), NAT'L LIBR. BOARD SING., Mar. 13, 2000, \textit{available at} http://infopedia.nl.sg/articles/SIP_508_2004-12-23.html.
\bibitem{57} See id.
\bibitem{58} See id.
\bibitem{59} See VENARDOS, supra note 1, at 149.
\bibitem{60} See Tan, supra note 56.
\bibitem{61} See id.
\bibitem{62} See VENARDOS, supra note 1, at 149.
\bibitem{63} See id.
\bibitem{64} See id.
\bibitem{65} See id.
\end{thebibliography}
All jurisdictions first look to the fundamental private international law (conflicts of law) principle that the capacity to marry is determined by the law of the domicile at the time of the marriage.\(^{66}\) In the case of a minor, the domicile is that of the father.\(^{67}\) Relative to this instance, Netherlands law applied, which ordered that a girl had no capacity to marry at the age of fifteen unless certain permissions had been obtained.\(^{68}\) Because permission had not been obtained, the marriage was deemed invalid.\(^{69}\) As a result of the Court's decision, violent rioting ensued for three days throughout Singapore's Muslim communities.\(^{70}\)

The use of this strict interpretation of the law (in a situation where there was a significant conflict of legal principles) was criticized as "being mechanical and unsuitable to the needs of a multi-ethnic society, such as Singapore, in which a variety of religious and racial groups live side by side."\(^{71}\) The rioting stemming from this type of condemnation left eighteen dead and 173 injured, illustrating to Singapore and the rest of the world how inconsistencies between religious and state law can result in violent political confrontations.\(^{72}\)

Within the United States, each state retains their own decision-making autonomy when a conflict of laws arises. Similarly, countries must make the decision of how to resolve potential conflicts with Shari'ah law. Such resolutions might include the incorporation of Shari’ah into the state’s secular legal system, a Shari’ah board to rule on religious-related matters, or no recognition of Shari’ah in the state’s legal framework.

The influx of international investments, particularly from the Middle East, into Singapore introduces the potential for international and religious legal conflicts. To examine potential resolutions to these conflicts, the previous hypothetical situation can be applied to the different legal options that countries such as Singapore might consider.

\(^{66}\) See Venardos, supra note 1, at 149.
\(^{67}\) See id.
\(^{68}\) See id.
\(^{69}\) See id.
\(^{70}\) See id.
\(^{71}\) Id.
\(^{72}\) See Venardos, supra note 1, at 149.
B. Shari’ah integration in the secular legal system

Legal obstacles inevitably arise when it comes to the accommodation of Shari’ah law with a country’s secular legal system, which is often based upon European Common Law. To avoid potential conflicts between the laws, while maintaining the appeal of increased Muslim business in its market, Singapore might consider the incorporation of Shari’ah principles into its legal framework. Though such an action would reduce the amount of legal conflicts, it is a significant undertaking for Singapore to enact.

With Buddhism as the predominant religion in Singapore, only 14.9 percent of the population is Muslim. Though this is a sizable population, it is likely not enough to immediately convince the rest of the non-Muslim population that Shari’ah should be incorporated into the country’s laws.

This topic has recently become a significant point of contention in the United Kingdom. Some argue that adopting parts of Islamic Shari’ah law would help maintain a sense of social cohesion by allowing Muslims to decide whether to adjudicate marital disputes and financial matters in Shari’ah or English court. Arguing that there is a common misunderstanding regarding Shari’ah, the Archbishop of Canterbury, Dr. Rowan Williams, believes that Muslims should not have to choose between “the stark alternatives of cultural loyalty or state loyalty.” Claiming that the incorporation of Shari’ah into civil matters is not a “parallel legal system[,]” Inayat Bunglawala of the Muslim Council of Britain, argues that Shari’ah would not have the power to override the English Common Law system. Rather it would still be at the mercy of the secular legal system.

Lord Phillips, the most senior judge in England and Wales, similarly opines that there is no reason Shari’ah principles could not be used in mediation, though still

73. See id. at 93.
76. Id.
subject to the jurisdiction of the English and Welsh courts. Furthering the jurisdictional superiority and priority of U.K. courts, Lord Phillips added, "Severe physical punishments such as flogging, stoning and the cutting off of hands would not be acceptable." Rather, he states that those who understand this proposition also understand that it is not a very radical move to advocate Shari’ah law as it is already possible in the United Kingdom to enter into a contractual agreement governed by a law other than English law. Radical or not, many British citizens are outraged at the notion of integrating Islamic law into the historic English Common Law system.

Lord Carey, the former Archbishop of Canterbury, countered the current Archbishop’s comments stating that there can be “no exceptions to the laws of our land which have been so painfully honed by the struggle for democracy and human rights...[the integration] would be disastrous for the nation.” Other officials go on to defend the use of religious courts to arbitrate marital issues, but acknowledge those courts could never challenge civil law.

Without the full and complete integration of Shari’ah law in to the Common Law framework, a strong argument exists for the allocation of jurisdictional powers to religious courts. This practice thrives simply because religious courts are already in daily use in the United Kingdom. Jewish courts have been successfully used in Britain for centuries, hearing only cases concerning civil matters either between private citizens or privately owned companies, where both parties are Jewish. Therefore, the proposition of incorporating Shari’ah courts in the existing legal framework does not appear to be farfetched. If it is conceivable in a country based upon English Common Law, it is conceivable that Singapore would follow the lead of the United Kingdom with regard to Shari’ah courts.

If Singapore were to follow the current Archbishop of Canterbury’s suggestion, a revisitation of the hypothetical situation in Section I, supra, regarding Sahaid al-

---

78. See id.
79. See id.
80. Id.
84. See id.
The Growth of Islamic Banking

Harbi, might be resolved with a minimal amount of conjecture concerning a conflict of laws. Al-Harbi would argue for the exclusive oversight of a Shari'ah court on the matter. Consequently, Citi would likely petition for the application of Singaporean law, as it is more forgiving than Islamic law toward defendants. The application of Islamic law introduces two potential conflicts. First, following the U.K.’s religious court requirement, there would be a dispute as to the test that both parties must be Islamic. Citi would likely identify this requirement and contend that they are not an Islamic company, rather a corporation that, in addition to many other non-Islamic services, provides a variety of Islamic-approved products. Thus the court must make a decision regarding the religious classification of the corporation. Based on the fact that Singapore and the Islamic banking industry are both trying to attract Muslim and non-Muslim investors, it is in Singapore’s best interest to enact policies, either through specific guidelines or Common Law precedent, with respect to the type of party allowed in a Shari’ah court. The second potential issue: must a Singaporean Common Law court first approve of a case transferring to a Shari’ah court? The United Kingdom’s example does not provide much background as to how the legal system deals with this dilemma. This complication implies that the Common Law court would retain the ultimate decision as to whether the case is tried in the Common Law or Shari’ah court. Such a decision to allow Common Law to take precedence might bring about more social approval of the integration of Shari’ah courts within the domain, therefore enforcing the notion that ultimately the Common Law courts have the final say.

Singapore must attack the issue of which rights are allotted to Muslims and which are allotted to non-Muslims. An argument might be raised that only matters where both parties are Muslim may present their case in Shari’ah court. This references the United Kingdom’s requirement that both parties must be Jewish in order to bring a case to Jewish court. Facialy, the argument seems plausible. Thus, if it is Singapore’s intention to attract both Muslim and non-Muslim investors to its Islamic banking market, the prospect of judgments based (or not based) upon Shari’ah principles might influence an investor’s decision to conduct business within the state. Referencing back to the case of Maria Hertogh discussed in section IV.A, supra, Muslims felt that the Court’s actions posed an unwarranted
interference in what was a perfectly valid arrangement under Muslim law. This sentiment left many believing that the situation could have been avoided by considering the social implications of a decision before the technical constraints of laws, which are not designed to manage the implications of internal conflicts involving personal laws. However, this solution might be interpreted as being too radical, because it tends to disregard the notion that a domicile determines the right to decide the application of a personal law: a major principle of Common Law.

Though the present issue is one regarding potential financial disputes, not custody battles, the knowledge and sensitivity of a society’s religious barometer is necessary when making any decisions about the recognition of that society’s religious beliefs. This will, for instance, become of critical importance when a Muslim investing in an Islamic fund in Singapore wishes to know if there will be a conflict relating to his investment and its relationship to his religious beliefs. Furthermore, a non-Muslim attracted by the conservative nature of Islamic banking might also want his investment relationship to be subject to Shari’ah law. After all, the distinct religious influence on Shari’ah products is often the rationale for their investment.

A contractual clause outlining an agreed upon forum in which legal proceedings will take place is ideal for a situation where a conflict between Common Law and Shari’ah law might arise. In that event, Singapore must be prepared for possible jurisdictional issues such as these to occur concurrent with the growth of Islamic finance in its country. At present, this remains a heated issue in the United Kingdom; it is also an issue that Singapore must contemplate and solve for its healthy future.

V. Conclusion

The current status of economies around the world provides more than enough proof that there is enthusiasm toward advancement of safe investment options. As one of the markets striving to flourish through these difficult financial times,

85. See Venardos, supra note 1, at 151.
86. See id.
87. See id.
Singapore is attracting new international investors into its capital markets through the prospect of Islamic banking. Given this economic expansion, Singapore is increasing its exposure to legal disputes involving the conflict between Shari’ah and Singaporean law. Such conflicts are often manageable through forum selection clauses in a contract, as well as deciding to utilize religious courts in foreign nations. However, these preconceived decisions often give rise to many conflicts.

This analysis provides for the logical conclusion that Singapore should follow the lead of the United Kingdom and incorporate religious courts, subject to Common Law jurisdiction, to govern disputes under Shari’ah law. Singapore then would be able to continue to accomplish its goal of attracting Muslim investors without the detrimental effect of complex and exclusive laws.

The rising potential for legal disputes has brought about a discussion that is necessary not only for Islamic banking to successfully grow in Singapore, but also for the proper integration of Muslim investors onto the world stage. The issues discussed in this analysis are not uncommon to many Western nations, and are important for each country to consider if those nations intend to capture any part of the Muslim financial market and the benefits they inure.