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ECONOMIC GOVERNANCE BEYOND STATE AND MARKET: ISLAMIC CAPITAL MARKETS IN SOUTHEAST ASIA

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Abstract: Islamic finance has become an integral part of the financial systems of the Muslim-majority countries of Southeast Asia. At the same time, Southeast Asia has witnessed the emergence of new capital market governance practices and arrangements that are both multi-scalar and multi-sited. This article suggests that rather than only looking at the scale and rescaling of capital market governance in the region, more attention needs to be paid to the shifting balances between regulatory expertise, market practice and societal expectations. Indeed, for governance practices to be considered effective, they have to straddle at times competing demands of authority and legitimacy. This dynamic is nowhere as visible as in the case of Islamic finance, which explicitly involves Shariah experts, trained in Islamic law, in its governance structures. This article explores the novel forms of governance to which this new market has given rise. It argues that Islamic finance – rather than the product of privately held beliefs – has become increasingly bound up with the state apparatus. This facilitates the embedding of Islamic financial principles and ethical concerns throughout capital markets in the region. Yet, Islamic finance has also become increasingly submerged within national development and competitiveness agendas.

Key words: Economic governance; capital markets; Malaysia; Indonesia; Islamic finance

The fallout from the global financial crisis of 2007-9 has, once more, exposed the limitations of state-based financial governance in an age of substantive and complex international financial interconnectedness. In particular, that financial crisis has pointed to the difficulty of holding to account international financial market actors and to constrain effectively their speculative activities and the various types of regulatory arbitrage – across jurisdictions, across regulators and across products - in which they engage (Rethel 2014, 72-73). The crisis has led to numerous calls for rethinking finance and its regulation. One issue that has come up repeatedly in these debates is the question of how to ensure that financial practice adheres to ethical standards, if not indeed incorporates progressive ethical values. Reform proposals in this regard have ranged from introducing (voluntary) codes of conduct for financial market professionals to more radical suggestions such as refashioning finance from a profit maximising industry to a social banking model that puts human well-being and development at its centre. In the sense that these debates do not only seek to address and mitigate financial

excesses that were brought to light in the fallout from the crisis, but more generally question the moral fabric of finance, and of economic activity at large, there clearly is a progressive element to them. What is at stake here is the question of whether a principled approach to finance is possible as opposed to the logic of “no alternative” to the principles of the “free market.” Islamic finance can offer some insights in this regard, as it explicitly advocates a principled approach to finance to ensure compliance with the *Shariah*, also commonly known as Islamic law (Rethel 2017).

At the same time Islamic finance is no longer a niche phenomenon. Islamic finance is a rapidly growing segment of international financial markets. Recent growth rates of Islamic financial assets are estimated to be in the range of 15% to 20% annually; they have reached a share of roughly 1.4% of global financial markets. In Southeast Asia, Islamic finance has made even more significant inroads into domestic financial systems. In Malaysia, a country with a Muslim share of over 60% of the population and which has been at the forefront of developing both its domestic but also the international market for Islamic finance, Islamic finance has captured a share of over 20% of the banking system and more than half of the domestic corporate bond market. Moreover, Malaysia holds a share of more than half of the global *sukuk* market; *sukuk* are a financial instrument akin to bonds in conventional finance, but structured so that they comply with the *Shariah*. In Indonesia, a country in which around two thirds of the population do not yet have an account in the formal financial system according to the most recent World Bank Global Findex Database data and therefore are classified as “unbanked,” Islamic finance has nevertheless achieved a share of over 5% of the financial system.¹

Islamic finance is distinctive in that the design and marketing of financial products and services have to comply with the principles of the *Shariah*, the Islamic jurisprudential body of knowledge derived from the *Quran*. Stipulations include the prohibition of interest

(*riba*), gambling (*maisir*) and contractual ambiguity (*gharar*) (see Vogel and Hayes 1997; El-Gamal 2006). Compliance with these stipulations rules out speculative financial practices such as short selling or margin trading. In this sense and from a post-global financial crisis vantage point, Islamic finance clearly contains progressive elements. Questions of equity, mutuality and social justice are key concerns in Islamic economic thought. As a consequence, Islamic finance seeks to foster risk-sharing and to avoid financial instruments where one party benefits from the other's loss. Moreover, advocates of Islamic finance emphasise that the requirement of linking financial products to real assets gears Islamic finance towards supporting productive economic activity (Zeti 2012). Islamic finance thus is to be employed in the service of the real economy, not unlike how the role of finance was conceived in the Northeast Asian developmental state-type financial systems described by Johnson (1982) and others. On a global level, in almost all jurisdictions with the exception of Iran, Islamic finance co-exists with what practitioners call "conventional finance" – the mainstream financial system and its regulatory frameworks.

The unique character of Islamic finance poses several challenges when it comes to conceptualising Islamic financial governance practices. First, it unsettles attempts to draw clear lines between public and private and perhaps even civil forms of governance and associated knowledge practices. Drawing on the interpretation of religious texts, the *Shariah* clearly derives from outside the state and could thus be thought to constitute a "private," that is non-state, form of regulation.² Yet, in practice and as will be discussed in more detail below, in the two countries on which this article focuses, namely Indonesia and Malaysia, *Shariah* governance is deeply enmeshed with statist practices. Second, and related, Islamic finance challenges commonly held understandings as to the character of regulation. Typically, regulation is portrayed as public constraints imposed on the behaviour of market actors, with the additional caveat that much of international financial law is "soft," that is

non-binding and hence difficult to enforce. Yet, financial institutions seeking the designation of being “Islamic” voluntarily subject themselves to another layer of regulation and public scrutiny. This is not unlike the case of palm oil discussed by Nesadurai (2018) in this issue. Third and following from this, Islamic finance and its associated governance practices challenge dichotomous understandings of the “local” and the “regional/global.” As a universal religious code, the *Shariah* is clearly global in intention, aimed at safeguarding the welfare and prosperity of the *ummah*, the global Muslim community. It could thus be thought of as a clear example of “transnational” regulation superseding national boundaries. Yet, in practice, *Shariah* governance is bound up in idiosyncratic local practices and organisational structures, which impose significant limits on more recent efforts to harmonise *Shariah* governance across the region, if not globally. To summarise, looking at the multiple levels at which the *Shariah* governance of Islamic finance operates generates insights into the ongoing rebalancing of state-market-society relations and how they are governed in Southeast Asia more broadly.

The argument of this article unfolds in four steps.³ The next section situates Islamic finance vis-à-vis discussions of the emergence of more networked types of financial governance in Southeast Asia. In so doing, it will look at both the sites of Islamic financial governance, more specifically the role of state institutions, market practices and religious actors, and the scales of financial governance in the region. The section thereafter looks at the various models of *Shariah* governance of Islamic finance, specifically of capital markets, that operate in Malaysia and Indonesia. It traces how this type of financial governance has become institutionalised in these national contexts, as well as variations across the two countries and over time. The subsequent section focuses more squarely on how Islamic capital market governance practices are situated vis-à-vis the governance of other Islamic affairs and how they effectively constitute a rebalancing of relations between state, market

and religion, albeit in distinctive ways in the different national contexts. This is followed by a section that focuses more on the scales and rescaling of Islamic financial governance including an emerging regional dimension that manifests itself in particular through efforts to harmonise *Shariah* governance via more and less formal networks of *Shariah* scholars, and via the regional ambitions of market actors. The final section reviews the core arguments of this article and concludes.

ISLAMIC FINANCE: NEW MARKET, NOVEL FORMS OF GOVERNANCE

In the wake of the financial crisis of 1997-1998, financial governance in Southeast Asia has become increasingly networked. Various inter-governmental fora and dialogues as well as training schemes have been created in which financial policymakers interact regularly with each other and exchange knowledge. Considerable efforts have been undertaken to understand the drivers behind and effectiveness of this rescaling of financial market governance (see Nesadurai 2009; Rethel 2010; Hameiri and Jones 2015). However, in the design of binding regulations and their enforcement, authority remains firmly rooted within the nation-state and the financial bureaucracy comprised of central banks, monetary authorities, securities commissions and their like (Hamilton-Hart 2002). Nevertheless, whilst state actors remain the most important agents of financial governance, it would be wrong to study them in isolation, especially as they also draw their legitimacy and hence effectiveness from their relations with both market and societal actors.

At the same time, domestic financial systems in the region have undergone significant changes. Two key developments in this regard are: the progressively more important role of dis-intermediated capital market finance (see Rethel and Sinclair 2014); and, especially in the case of Muslim Southeast Asia, the growing importance of Islamic finance, more specifically of financial products and services structured so that they comply with the *Shariah* (Venardos

2006). These shifts have entailed important changes to both how regulatory expertise is constructed and perceived and how a much broader range of social actors is seen as an important force in markets, in particular the region's growing middle classes.

On the one hand, there have been deliberate efforts to bring market expertise and performance measures into the regulatory apparatus. For example, state investors, which are also referred to as government-linked investment companies, such as Temasek in Singapore and Khazanah in Malaysia have sought to incorporate market expertise and best practice in their operations and introduced market-oriented performance measures for senior staff (see Lai 2012; Fini and Rethel 2013). The same holds true for regulatory agencies and personnel, where greater market orientation has found its expression for instance in the adoption of similar performance metrics. On the other hand, regulators are undertaking significant outreach efforts to bring in societal actors and middle-class investors, for example through operating capital market schools such as the ones launched by the Indonesia Stock Exchange in 2012 and which literally include housewives (*ibu rumah tangga*) in their target audience (IDX 2015). What has perhaps received less attention is the extent to which these new investors bring their own values – and importantly in Muslim Southeast Asia this includes religious beliefs – to the market. Indeed, a growing body of literature seems to affirm the notion that once a certain income threshold has been reached, Muslim consumers are more likely to prefer financial products that comply with the *Shariah* (see Pepinsky 2013). This is part of a wider, rapidly growing Islamic economy which, including halal food and lifestyle products, has to be put at a size of around US\$4 trillion globally according to recent estimates (Thomson Reuters Zawya 2015).

The rescaling of economic governance in Southeast Asia therefore entails both ongoing negotiations between different sites of authority and expertise, be it state, market or even society at large, as well as a politics of scale that crosses from the individual and

privately held beliefs to the national, the regional and in some instances even the global levels and back. Moreover, this is not simply a story of authority moving uniformly in one direction, for example from society to state or from state to market, but it is a highly uneven and partial process in which various social interests compete at times fiercely to retain and shore up their control and influence and spend considerable resources on both promoting and subverting these trends. Neither is this merely a tale of functional specialisation in which an economic problem, such as the question of how to create resilient and efficient financial systems or perhaps even more idealistically how to incorporate progressive economic and social values in financial market activity, is addressed at the level where actors are most equipped to deal with this issue. And indeed in the case of financial markets, which affect both individual and national prosperity and well-being but are also intimately tied up with global circuits of capital, it is not clear what level should be accorded the most functional efficiency (see Hameiri and Wilson 2015; Breslin and Wilson 2015).

The case of Islamic finance is especially intriguing in this regard, as it ostensibly draws on values derived from outside the secular and very much Anglo-American dominated backdrop against which much of the financial innovation and (de-)regulation of recent decades has to be situated. Islamic finance in its current guise is a distinctively modern phenomenon. First experiments with infusing Islamic values with local financial practice took place in former British colonies at the middle of the last century. In 1963, the Muslim Pilgrims Savings Institution, later to evolve into the *Lembaga Tabung Haji* or Pilgrim's Fund Board, was created in Malaysia, making it perhaps the oldest Islamic financial institution that survived from this period. It was set up to aid Muslim Malays to save for the *haj* (pilgrimage) – one of the five pillars of Islam. The aftermath of the oil shocks of the 1970s, in combination with Islamic revival, saw the creation of the Islamic Development Bank in 1974, swiftly followed by the establishment of the first private Islamic banks in the Middle East from the

mid-1970s onwards. However, it was only from the late 1990s onwards that Islamic finance really gained traction in international financial markets, evidenced for example by the market entry of big conventional financial firms such as HSBC and Citibank (Warde 2010, 70-85).

The requirement that Islamic financial products and services comply with the principles of Islamic law has given rise to a somewhat unique governance challenge: how to ensure *Shariah* compliance in both form and substance? In its most basic form, this challenge is addressed by asking religious experts to confirm the *Shariah*-compliance of any given product that is to be labelled “Islamic.” However, from this basic precept, a more complex body of national and even transnational governance arrangements has emerged to both ensure *Shariah* compliance and foster the development of the Islamic finance sector more broadly. Whilst the emergence of novel forms of governance for a new market is in itself not surprising, what is striking is the strong resemblance that these developing governance structures for Islamic finance bear to the novel forms of governance discussed in this Special Issue and in the economic governance literature more broadly. In particular two issues stand out in this regard. These are: (i) the growing recognition that successful and not only multi-stakeholder governance arrangements deliberately bring together diversely situated actors, for example market players, state regulators, representatives from civil society organisations and so on, who command different types of expertise and derive their legitimacy from different sources; and (ii) the preponderance of non-binding rules, soft law and absence of clearly delineated enforcement mechanisms and the challenges associated with this. These two trends are also common to other cases, including Ba’s (2018) contribution on maritime safety regimes, Bünthe’s (2018) case study of mining governance and the palm oil case discussed by Nesadurai (2018).

The case of Islamic finance is somewhat distinctive in this regard as it explicitly seeks to incorporate the expert knowledge of religious scholars into its governance frameworks.

However, the way this is done differs significantly in the two countries whose experience is subject to scrutiny in this article. To analyse this emerging governance system, a wider range of actors and practices has to be considered than just those within the immediate purview of the state, and within it the financial bureaucracy. Indeed, it is in the analysis of how state institutions interact with other actors and their relevant expertise that important analytical insights can be gained.

In this regard, governance through *Shariah* boards has emerged as a key mechanism in the Islamic legitimization of Islamic financial products and services. Models of *Shariah* governance vary across countries as will be discussed in more detail in the next section. Typically, *Shariah* boards operate at the firm level, advising financial institutions on the *Shariah* compliance of the products they develop and market. Here, the *Shariah* board customarily derives its authority from the reputation of the scholars specialised in Islamic jurisprudence who compose it. Thus, for example, when a new firm enters the Islamic finance sector and tests the waters with a new instrument it can use the services of a *Shariah* advisory firm to get the product signed off. Typically, however, Islamic financial institutions have standing committees that meet on a regular basis. The number of scholars on these *Shariah* boards and their professional backgrounds can vary and may also depend on the interest of the institution in attracting customers from outside its home country.⁴ Whilst most accounts focus on different *Shariah* interpretations and the multiple schools of Islamic thought, it is important to note that there is also a comparative political economy dimension to how *Shariah* governance operates in practice and how *Shariah* boards are organised.

In a number of countries, including Malaysia and Indonesia as will be discussed in more detail below, there also exist *Shariah* boards or advisory councils at the national level, which hold the ultimate authority in ruling on what is compliant or non-compliant with the principles of the *Shariah*. This is meant to ensure consistency of *Shariah* interpretation and to

provide market participants with greater certainty (Lai 2015). In many countries, a major challenge is to find *Shariah* scholars who are not only proficient in Islamic jurisprudence but also have a good understanding of how financial markets work (Pollard and Samers 2007). In some cases this shortage is compounded by regulatory stipulations that mandate that *Shariah* scholars cannot sit on more than one board per industry (that is banking, capital markets, takaful insurance) to avoid conflicts of interests. These are national limits which do not prevent *Shariah* scholars to sit on further boards in other jurisdictions and consequently a potentially important dimension of the transnationalisation of *Shariah* governance.

The legal opinions issued with regard to the *Shariah* compliance or not of specific Islamic financial products and practices have the character of a *fatwa*. In Islamic law, *fatawa* (commonly also referred to as *fatwas*) are opinions issued in response to the question of whether a good or activity is *haram* (prohibited) or *halal* (permissible) (Devaraj 2005). Hence, *fatwas* are effectively scholarly opinions drawn from the individual scholar's knowledge of the *Shariah* and the subject matter. Binding on the issuer, *fatwas* are an inherently "private" form of governance, relying on the voluntary compliance of the person who sought the *fatwa* with the verdict of the *Shariah* expert. Once more, one might think, the way that *Shariah* compliance is ensured strongly resonates with key tenets in the economic governance literature, in particular discussions of "soft law," characterised by its non-binding, voluntary character (Abbott and Snidal 2000; Brummer 2011). Yet, in practice, in Southeast Asia, *fatwas* have become bound up with the state apparatus, be it either through the entanglement of *fatwa* making bodies and government agencies, the elevation of certain issues and corresponding *fatwas* to the level of national interest or the legalisation/codification of *fatwas* which includes their incorporation into a growing range of regulatory frameworks (Devaraj 2005). While this has been the case historically for example with regard to personal and family law pertaining to Muslim affairs, the growing importance

of Islamic finance extends this into commercial affairs. This is independent of the religious affiliation of the parties entering into an Islamic financial contract. Again, there remain significant differences in how this plays out in the two country cases, which will be discussed in more detail below.

In sum, not only is Islamic finance a relatively new phenomenon, but the way it is governed resonates strongly with the novel and emerging forms of transnational regulation and governance discussed in this special issue. On the one hand, this is manifest in the requirement of having the compliance or not with Islamic law of financial products and services confirmed, or perhaps rather certified, by *Shariah* experts. On the other hand, this is expressed in the ways that these confirmations actually operate, namely through *fatwa*. In so doing, the case of Islamic finance speaks clearly to both conceptual and empirical questions about the rescaling of economic governance in Southeast Asia and what this rescaling entails. The remainder of this article will look at the three dimensions of governance set out by Breslin and Nesadurai (2018) in the introduction of this Special Issue – structure, process and outcome – and how they operate with regards to the governance of Islamic finance, in particular of capital markets, in Southeast Asia. More specifically, it will look at how the *Shariah* governance of Islamic finance has become institutionalised as a form of public financial regulation in the two country contexts, the extent to and ways in which *Shariah* board rulings have become codified and translated into regulatory frameworks and more recent efforts to standardise and harmonise mechanisms of *Shariah* governance not just regionally but also globally.

MAKING THE PRIVATE PUBLIC: INSTITUTIONALISING *SHARIAH* GOVERNANCE

Islamic finance operates alongside the conventional financial system and is as such typically subject to the same laws and regulations, both domestically but also with regard to international standards such as capital adequacy rules. However, at the same time compliance with the principles of the *Shariah* has to be ensured. Effectively, this means that religious actors decide which products and services are permissible and which are not. Following Avant, Finnemore, and Sell's (2010, 2) definition of "governors," they "evaluate and/or adjudicate outcomes," in this case compliance or not with the principles of the *Shariah*, but do not necessarily embrace the more agenda-setting types of governance, on which typically the financial bureaucracy takes the lead (see Breslin and Nesadurai 2018). Both Malaysia and Indonesia stand out as they created national level *Shariah* boards in the mid- to late 1990s, relatively early in the development of modern Islamic finance in these two countries. Indeed, the success of Malaysia in developing its Islamic finance sector is often cited by countries that move from a decentralised model of firm-based *Shariah* governance to a model where *Shariah* governance is centralised at the national level. How has *Shariah* governance become institutionalised and embedded in these two financial systems and in what ways?⁵

The first Islamic bank in Malaysia was created in 1983 and was granted a ten-year monopoly. In 1993, the central bank, Bank Negara Malaysia (BNM), allowed other banks to open "Islamic windows" and in the early 2000s, these banks were required to convert their windows into subsidiaries. In terms of capital market development, the government took a guided approach and in 1994 BNM began to issue *Shariah*-compliant Government Investment Issues to enable Islamic financial institutions to manage their liquidity in a *Shariah*-compliant manner. The first corporate *sukuk* was issued by Shell Malaysia in 1990. Following sporadic *sukuk* issuance throughout the 1990s, the market took off in the early 2000s both domestically and globally.

In Indonesia, Islamic finance was much slower to develop. The first Islamic bank, Bank Muamalat, was created in 1991 and the first Islamic window opened in 1999 (Lindsey 2012, 111). The first corporate *sukuk* was issued by PT Indosat in 2002. In 2008, the government issued its first sovereign *sukuk*. During the early history of Islamic finance in these two countries, *Shariah* governance took place at the firm- and product-level. Importantly, however, both countries began to institutionalise centralised modes of *Shariah* governance in the mid- to late 1990s. In so doing, *Shariah* governance came to be increasingly bound up with the public financial regulatory system.

In Malaysia, the *Shariah* governance of Islamic capital markets is to a considerable extent within the purview of the state. The regulatory body responsible for the regulation and supervision of capital markets in Malaysia is the Securities Commission (SC), a statutory body created in 1993 under the Securities Commission Act (No. 498) of 1993, reporting directly to the Minister of Finance. One of the core objectives of the SC is to develop domestic capital markets, including Islamic capital markets. In 1994, the Islamic Instrument Study Group was established under the auspices of the Securities Commission. Its membership comprised *Shariah* consultants and corporate figures. In May 1996, the Group was upgraded into the Shariah Advisory Council of the Securities Commission (SAC-SC) – actually preceding the better-known establishment of a similar body tasked with the *Shariah* governance of banks and located at the central bank in 1997. Endorsed by the Ministry of Finance, the mandate given to SAC-SC was “to ensure that the implementation of the Islamic capital market complied with *Shariah* principles” (SC 2006, 4). To this end, “[i]ts scope of jurisdiction [was] to advise the Commission on all matters related to the comprehensive development of the Islamic capital market and to function as a reference centre for all Islamic capital market issues.” Members of the SAC-SC are appointed by the king on advice from the

Minister of Finance after mandatory consultation with SC, but not with the Department of Islamic Development Malaysia, JAKIM.

In Indonesia, until recently, the agency tasked with the supervision and regulation of capital markets was Badan Pengawas Pasar Modal dan Lembaga Keuangan, the Capital Market and Financial Institutions Supervisory Agency or Bapepam-LK, established in 1976 by the Soeharto government. With regard to the development and institutionalisation of governance structures for the developing Islamic finance sector, or *Shariah* finance as Indonesians prefer to call it, however, an important role has to be accorded to the Majelis Ulama Indonesia or the Indonesian Council of Ulama (MUI). MUI was founded in 1975 and is one of the main *fatwa*-making organisations. It is partly funded by a grant from the Department of Religion. At the time of writing, it was also the sole domestic body allowed to do *halal* certification, another important source of its revenue (Lindsey 2012, 114).⁶ In 1999, in response to the growth of Islamic finance in Indonesia, MUI established its National Shariah Board or *Dewan Syariah Nasional – Majelis Ulama Indonesia* (DSN-MUI) (Atho 2013). DSN-MUI, with *Shariah* scholars drawn from both Muhammadiyah and Nahdlatul Ulama, the country's two biggest Islamic civil society organisations, has "responsibility for overseeing doctrinal compliance" of Islamic financial institutions (Lindsey 2012, 119). In 2003, Bapepam-LK and DSN-MUI sought to forge stronger links by signing a Memorandum of Understanding (Atho 2013, 12).

The move from a decentralised model of firm-based *Shariah* governance to a model where *Shariah* governance is centralised at the national level was an important step in the incorporation of *Shariah* governance as part of public financial regulation. In Malaysia, the developing organisation of *Shariah* governance closely matched the existing regulatory structure which since 1994 has been a two-peak system, with the SC in charge of capital market regulation and supervision and BNM in charge of the regulation and supervision of

banks and insurance companies. Until 2014, Indonesia had a similar two peak regulatory structure, with the central bank, Bank Indonesia in charge of bank regulation and supervision and Bapepam-LK in charge of capital markets. In 2011, Bapepam-LK and the regulatory division of Bank Indonesia were merged into Otoritas Jasa Keuangan or Financial Services Authority of Indonesia (OJK), a move that was politically not uncontroversial and resisted in particular by the banks, unhappy with OJK's fee regime. However, central authority when it comes to *Shariah* governance resides outside the state financial regulatory apparatus.

Nevertheless, this should not obscure the fact that the way the state is entangled in business and the economy at large takes different shapes not only across countries but also in different economic sectors. In the case of the *Shariah* governance of Islamic capital markets, we can identify two types of state-orchestration: regulative and constitutive functions.

Whereas in Malaysia, the developmental ambition of “creating a more organised and efficient Islamic capital market” (SC 2006, v) was a clear driver of the centralisation of *Shariah* governance, in Indonesia, considerations of doctrinal purity as endorsed and understood by DSN-MUI were the primary motive. Whilst in both countries the state, in particular the financial bureaucracy, was highly instrumental in giving these new forms of financial governance their shape and status as will be outlined further in the next section, in Malaysia the public regulation of the *Shariah* governance of Islamic finance is at one remove from the religious bureaucracy, whereas in Indonesia it is closely entangled with the latter.

Moreover, what we have seen in recent years is the emergence of a broader governance framework for Islamic finance in Malaysia, intimately linked to the country's developmental ambitions and international competitiveness agenda (see Rudnycky 2013; Lai 2015). This goes beyond product regulation or the narrow *Shariah* governance of Islamic capital markets and includes measures linked to the internationalisation of the sector such as the easing of market entry for foreign Islamic banks, more permissive labour regulation and

the lifting of foreign exchange restrictions. Similarly, fiscal incentives – from stamp duty waivers and tax deductibility of issuance costs in 2003 over the introduction of a “tax-neutral” framework in 2005 to the preferential treatment of certain *sukuk* structures in successive budgets – are used to foster the development of the sector. At the same time, efforts are underway to enhance the “*Shariah* quality” of Malaysian capital markets, in particular through introducing “*Shariah* parameters,” which effectively are reference documents that consider the practical implications of specific Islamic financial contracts. In Indonesia, on the other hand, Islamic capital markets have developed at a much slower pace. This can only to an extent be explained by the earlier stage of financial development occupied by the Indonesian economy. Until recently, Islamic capital market development just was not given the same significance as it was done by Malaysian authorities, which for more than a decade now have sought to establish Malaysia as regional and international centre for Islamic finance. For example, only in 2009 was a request made by Bank Indonesia to the taxation department to ensure *sukuk* were not double taxed (*Jakarta Globe* May 7, 2013). Deliberations in DSN-MUI were lengthy when it came to approving new types of contracts, and privileged questions of authenticity rather than market development more generally.

The introduction of national *Shariah* boards in Indonesia and Malaysia represents a rescaling of both religious and economic governance onto a centralised body. However, the location of this centralised body within, or perhaps in relation to, the state governance apparatus differs. In Malaysia it is situated within the financial regulatory bureaucracy. In Indonesia, it is a separate body with close affinity to both the country’s biggest Islamic civil society organisations and the religious bureaucracy. Thus, despite similar efforts at institutionalising a more centralised mode of *Shariah* governance in both country cases, the ways in which this has occurred reflects specific settlements between the state, market and religious actors. Faith and the compliance of everyday economic activity with Islamic

stipulations are no longer the private matter of religiously conscious financial consumers, as the governance of Islamic finance has become increasingly centralised and incorporated in the governance framework of the state apparatus. Nevertheless, variations exist across the two country cases. Whereas in Malaysia, the public regulation of *Shariah* governance is part of the financial bureaucracy, in Indonesia, it is more intimately tied up with the religious bureaucracy as well as Islamic civil society organisations. Yet, how does the *Shariah* governance of Islamic capital markets operate in practice in these two country contexts? The next section will look in more details at the work done by SAC-SC and DSN-MUI and how the status of the rulings of these *Shariah* boards has changed over time.

MAKING SOFT RULES BINDING: CODIFYING *SHARIAH* GOVERNANCE

The *fatwas* of the national-level *Shariah* councils play an instrumental role in the governance of Islamic capital markets in both countries. *Fatwas* are the products of reasoning by experts in Islamic law; they provide an informed legal opinion about specific issues. Traditionally issued by individual muftis, collective *fatwas* have become more common and are the norm in Islamic finance. Scholars issuing *fatwas* need to be knowledgeable of the Quran and Hadith, but also aware of the views of classical and modern experts in Islamic law as well as Islamic legal theory and previous *fatwas*. Indeed, *fatwas* typically set out in much detail the reasoning that led to a specific conclusion. At the same time, knowledge of the subject matter is also crucial. Issuing a *fatwa* on Islamic finance thus requires a process of double translation: translating a financial market practice into language that can be understood by *Shariah* experts (who are not necessarily financial market experts) and translating *Shariah* principles back into market practices. It presents a significant challenge for the composition of *Shariah* boards in terms of cultures of expertise that seek to meld market practice with religious knowledge and vice versa.

The role of *fatwas* has evolved from the non-binding legal opinions which they are in traditional Islamic law to instruments of financial regulation. Similar to the challenges of soft law in global financial governance, codification by state actors has played an important part in turning *fatwas* into binding rules. In so doing, state actors in both countries do not only influence who the addressees of these *fatwa* are, for example the general public, Islamic financial institutions or even the judiciary, but also the status that is accorded to these *fatwas*. However, the role of state actors goes further as they define who can issue capital market *fatwas* that are being made binding. In other words, for Islamic capital markets, the state effectively determines whose interpretations of Islamic rules count and to what extent. Along these lines, the institutionalisation of the *Shariah* governance of Islamic capital markets via national level councils has been accompanied by a growing body of regulations and stipulations specifically targeted at the Islamic finance sector and Islamic capital markets.

In 2002, Malaysia's SAC-SC began to publish the *Resolutions of the Securities Commission Shariah Advisory Council*, with a second edition in 2006 and a third in 2014. Based on these resolutions, a separate regulatory framework for the issuance of Islamic securities emerged. Until 2004, *sukuk* fell within the remit of the *Guidelines on Private Debt Securities*, first issued in 1988, covering the issuance of corporate bonds and developed for the conventional financial sector (Ibrahim and Wong 2006, 115). In 2004, *Guidelines on the Offering of Islamic Securities* were introduced. According to the new guidelines, Islamic securities were deemed to be those “issued pursuant to any *Syariah* principles and concepts approved by the *Syariah* Advisory Council (SAC) of the SC” (§1.05a). In Indonesia, since 2001 DSN-MUI has been instrumental in issuing a number of *fatwas* to steer the development of the Islamic capital market. These include several *fatwas* on permissible *sukuk* structures (for example No. 32 and No. 33, both issued in 2002) and *Fatwa* No. 80 on equity trading mechanisms issued in 2011 (see also Rethel and Abdalloh 2015). In terms of formal financial

regulatory authority, Islamic capital markets were governed by Bapepam-LK Rules No IX.A.13 and A.14. The former defines as Islamic securities those that fall within the remit of the 1995 Capital Market Law, and where both contract and method of issuance meet with the principles of the *Shariah* based on the *fatwas* of DSN-MUI (§1.a.2); the latter sets out a number of permissible contracts, in accordance with DSN-MUI *fatwas*. In 2015, OJK issued a further set of regulations, governing *inter alia* the application of *Shariah* rules (POJK Nomor 15/POJK.04/2015), *Shariah* experts (POJK Nomor 16/POJK.04/2015) and permissible contracts (POJK Nomor 53/POJK.04/2015). Thus, in both countries, public financial regulation bestows the national level *Shariah* councils with the ultimate *deutungshoheit* (interpretive authority) when it comes to the question of what capital market products and activities are deemed to be “Islamic.”⁷

The importance of the SAC-SC in the governance of Islamic capital markets in Malaysia was further reinforced with the 2010 amendment of the 2007 Capital Markets and Services Act. Whilst the original version did not refer to the SAC-SC at all, the 2010 amendment codified the existence of the SAC-SC.⁸ Moreover, according to the amendment, in case of different interpretations, SAC-SC rulings “prevail” over the rulings of firm-level registered *Shariah* advisors (316H§1), further entrenching the authority of SAC-SC in the *Shariah* governance of Islamic capital markets in Malaysia. However, most importantly, the amendment stipulates that SAC-SC rulings are “binding,” not only on financial firms that have referred to it for a ruling, but that indeed civil courts and arbitrators are also bound by its rulings (316G). Moreover, courts and arbitrators must take into account existing SAC-SC rulings and refer *Shariah* matters to the SAC-SC for a ruling (316F). In so doing, the amendment clearly sets out the relationship between SAC-SC governance of Islamic capital markets and the secular judiciary. Jurisdiction on *Shariah* matters is effectively granted to the SAC-SC, a development which Maznah and Saravanamuttu (2015, 205), referring to similar

manoeuvres with regard to the BNM Shariah Advisory Council, see as “empowering” the financial regulator and “displacing” the judiciary.

Whereas in Malaysia Islamic finance disputes are decided by civil courts and arbitrators, albeit subject to the rulings of the SAC, in Indonesia Islamic finance cases are dealt with by the Religious Courts and the National Syariah Arbitration Body - BASYARNAS (Lindsey 2012, 109). And it is here that we can see another major difference between the two countries. Whilst BASYARNAS itself was set up by MUI, it makes its own claims to interpretive authority. According to one report (*Hukum Online* August 15, 2010), religious judges and arbitrators focus on the character of *fatwas* as non-binding and thus could potentially challenge the primacy of DSN-MUI as granted through state regulation. However, to some extent this is offset by the fact that regulations previously issued by Bapepam-LK and now OJK on permissible contracts are much more detailed, and in clear correspondence with DSN-MUI *fatwas*, whereas in Malaysia regulatory emphasis is put on clarifying and entrenching the role and authority of the SAC-SC. Taken together, the two cases point to variegated *fatwa* politics characterised by different degrees of embeddedness in the financial regulatory apparatus.

National Islamic finance *fatwas* and the financial regulatory apparatus thus co-exist in a relationship of mutual dependence. Whilst *fatwas* to varying degrees serve as the bases for regulatory guidelines and laws, *fatwa* making bodies rely to a significant degree on the state for their status. However, there are also differences in how the state controls and regulates who can make these *fatwas*: in Indonesia, it is the organisationally independent MUI via its National Shariah Board, whereas in Malaysia it is the SAC-SC which is under the purview of the Ministry of Finance and SC. Similar differences exist where it comes to appointments of *Shariah* experts on firm-level *Shariah* boards. In Malaysia, the 2004 Guidelines set out basic requirements for *Shariah* advisers which were further specified in the 2009 *Registration of*

Shariah Advisers Guidelines issued by the SC. According to the Guidelines, *Shariah* advisers have to be experts in Islamic law as well as command several years working experience in Islamic finance. Membership of the SAC-SC as set out in the 2010 Amendment does not stipulate market experience. In Indonesia, authority to determine the number and composition of firm level *Shariah* boards (*dewan pengawas Syariah* or DPS) also rests with the financial regulator, namely Bank Indonesia (and now OJK) (Bank Indonesia Regulation No.10/32/PBI/2008). However, effectively DSN-MUI controls this process as DPS members have to be DSN-MUI approved and DSN-MUI makes recommendations about appointments (Hikmahanto, Yeni, and Yetty 2008; see also POJK Nomor 16/POJK.04/2015).

Not only does the emergence of this new form of governance challenge secular understandings of financial regulation, but the ways in which it is implemented in both countries makes it difficult to locate this new form of regulatory authority as squarely being either state or market. Financial market knowledge, more specifically of financial market practice and the structuring of financial products, is undoubtedly a necessary requirement for *Shariah* boards to work effectively and to be able to reason about and make judgments on the financial products and activities they assess. At the same time, as the *Shariah* governance of Islamic capital markets has become increasingly part and parcel of the public regulatory system for finance, a disclosure-based system in which Islamic investors actively engage with the *Shariah*-quality of any given product and the reputation of the scholars on the approving *Shariah* boards, has been superseded by a regime of certification. In this, the state continues to play an important role both as legislator and in controlling who can act as a *Shariah* adviser, either directly as in the case of the SC in Malaysia, or through delegation as in the case of MUI in Indonesia. Thus, rather than leaving the implementation and enforcement of *Shariah* compliance to market actors – financial institutions choosing *Shariah* scholars to sign off their products and financial consumers accepting or rejecting the word of these

scholars - in both countries the state sets the framework within which the *Shariah* governance of Islamic capital markets operates and within which *Shariah* principles are defined. By making *Shariah* resolutions binding and in determining whose *fatwas* ultimately count and in what ways, states effectively delineate the agency of both everyday financial consumers and *Shariah* experts.

Thus, studying the development of Islamic capital markets reveals multiple sites of governance and authority, which do not always co-exist in an easy relationship. Whilst the creation of national level *Shariah* boards embeds a clear hierarchy into pronouncements of *Shariah* compliance, these bodies must rely on further endorsement by state actors and codification in state regulations for their pronouncements to become binding. Despite the existence of competing *fatwa* making bodies, be it the National Fatwa Council in Malaysia, or the *fatwa* committees of the big Islamic organisations Nahdlatul Ulama and Muhammadiyah in Indonesia, in both cases states have granted ultimate authority to one single body – SAC-SC and DSN-MUI respectively. It is fair to say that the creation of national *Shariah* boards is an attempt to “depoliticise” the *Shariah* governance of Islamic capital markets in delineating the space for deliberation and dissent, which in itself is an indicator of their contested politics. This is compounded by their bureaucratic nature and the politicised nature of appointments to national *Shariah* boards in both countries.

Yet again, the ways in which *Shariah* governance is entangled with the state apparatus differs in these two countries. Thus, whilst Lindsey (2012), in an eponymous article, sees Islamic finance in Indonesia as a matter of “state *syariah*,” the comparison to the Malaysian case demonstrates the relatively greater independence of DSN-MUI, both with regard to where it is located vis-à-vis the state apparatus, especially the financial bureaucracy, and with regard to how it governs as well as its role in the governance of Islamic capital markets. The authority that states grant to national level *Shariah* councils with all their idiosyncrasies and

their *fatwas* makes it difficult to see how these governance arrangements can be projected onto the regional, if not even global levels. Nevertheless, in recent years there have been renewed efforts to harmonise *Shariah* governance as will be discussed in the next section.

MAKING THE LOCAL TRANSNATIONAL: HARMONISING OF *SHARIAH* GOVERNANCE

So where does this leave us in terms of progressive regional, if not global governance? One of the major developments in the aftermath of the Asian economic crisis was the emergence of increasingly networked models of financial governance in the East and Southeast Asian region. This mode of governance was geared towards the further development of Asian financial systems, whose vulnerabilities had been exposed in the crisis, and strengthening regional safety nets. Whilst a lot of academic attention has been focused on initiatives in the wider East and Southeast Asian region (Nesadurai 2009; Rethel 2010), important developments have also taken place on the ASEAN regional scale. The emergence of increasingly regional approaches to Islamic finance is an especially understudied phenomenon in this regard.

As the preceding discussion has shown, governance arrangements for Islamic capital markets remain tightly bound up with domestic political economy structures. At the same time, however, Islamic finance is a rapidly expanding international market. Even within the region we see a growing number of cross-border finance arrangements as well as Malaysian Islamic banks venturing into new regional markets, partly driven by decreasing profit margins at home. Moreover, Malaysia has both the ambition and the capacity to act as regional if not global financial hub and has promoted several initiatives in this regard. In 2001, SC launched its *Capital Market Masterplan*, including the aim to establish Malaysia as an international Islamic capital market centre. This focus on the international dimension of

Islamic capital market development is further developed in the current *Capital Market Masterplan 2* (2011-2020). Thus, high-level efforts have been put not only into creating the foundations for a thriving domestic *sukuk* market but also into achieving increased international salience. Pivotal to these are Malaysia's ambitions to establish itself as a regional if not international financial centre for Islamic finance and its efforts to shape the processes of knowledge production that underpin the further development of Islamic finance.

In August 2006, the Malaysia International Islamic Financial Centre initiative was launched. Its overarching goal is "to create a vibrant, innovative and competitive international Islamic financial services industry in Malaysia ... and to strengthen Malaysia's position as an Islamic finance hub" (BNM 2007, inside cover). Moreover, Malaysian financial policy-makers have played key roles not only in developing the domestic financial architecture but also in shaping the emerging global governance framework for Islamic finance. This includes hosting the Islamic Financial Services Board, created in 2002 to develop global capital requirement standards for Islamic financial institutions (Rethel 2011). More recently, in 2011 the International Islamic Liquidity Management Corporation was created to facilitate the cross-border management of liquidity for Islamic financial institutions. Based in Kuala Lumpur, its founding shareholders are the central banks of Indonesia, Kuwait, Luxembourg, Malaysia, Mauritius, Nigeria, Qatar, Turkey and the United Arab Emirates and the Islamic Development Bank.⁹ Malaysia has been keenly involved in developing the transnational regulatory architecture for Islamic finance.

Another important initiative was the launch of the International Centre for Education in Islamic Finance (INCEIF) in 2006 to "fulfil the human capital needs of a rapidly expanding industry" (BNM 2007, 28). INCEIF offers postgraduate degrees in Islamic finance as well as courses for professionals such as the Chartered Islamic Finance Professional Programme. Some Indonesian Islamic finance professionals have undertaken courses at

INCEIF. It also organises seminars that are attended by practitioners and financial regulators from both Muslim-majority and non-Muslim countries. There are clear indicators that Malaysia wants to shape the Islamic finance knowledge base by taking a lead in facilitating the production of those hybrid combinations of market and religious knowledge that underpin Islamic finance not just locally but globally. Along these lines, in 2008 the International Shari'ah Research Academy for Islamic Finance (ISRA) was created to promote applied research on Islamic finance matters and in particular to facilitate collaboration of industry and academia. ISRA is at the forefront of organising international Islamic finance knowledge exchange. In 2006, Malaysia initiated the Regional Shariah Scholar Dialogue (*Muzakarah Cendekiawan Syariah Nusantara*), an annual conference that brings together *Shariah* scholars from the Southeast Asia region under the sponsorship of the Malaysian and Indonesian central banks and facilitated by ISRA. It is a deliberative forum to “achieve greater appreciation and understanding ... of the *Shariah* practices that are peculiar to the respective jurisdictions” (Zeti 2009).

In addition to this initiative focused on *Shariah* scholars, there exists a whole plethora of regulatory and industry conferences in which *Shariah* scholars from the region regularly interact with regulatory officials and market practitioners. These include the bi-annual Global Islamic Finance Forum organised by the Malaysian central bank as well as several conferences organised by private providers such as the Redmoney Group or Middle East Global Advisors, often supported through state sponsorship. These conferences are targeted at issuers and investors and Islamic finance practitioners more generally. Knowledge exchange is further promoted via regulatory dialogues and courtesy visits, often held in conjunction with these events.

Despite attempts to increase knowledge exchange among *Shariah* scholars, the composition of the national *Shariah* boards is surprisingly homogeneous. Thus, at the time of

writing the 11 members of SAC-SC were all Malaysian nationals, whereas the 36 members of the DSN-MUI Executive Board were all Indonesians. Having said that, previous iterations of the SAC-SC included *Shariah* scholars from Indonesia and the Middle East. Firm-level *Shariah* boards in Malaysia are more diverse, including scholars from other Southeast Asian countries and the Middle East, whereas in Indonesia DPS positions are occupied by Indonesians. However, the educational background of these scholars indicates much greater internationalisation, with university degrees taken at highly esteemed Muslim institutions such as Al-Azhar University in Cairo or Islamic University of Al-Madinah in Saudi Arabia, but also North American and European institutions. Furthermore, many of these scholars are internationally networked and serve on *Shariah* boards in other countries ranging from Morocco to Sudan. Whilst regulatory stipulations about single board memberships mean that interlocking *Shariah* boards are less of a problem than they are in the Middle East, one Malaysian *Shariah* scholar in particular, Dr Mohd Daud Bakar serves/served on more than a score of firm-level *Shariah* boards and has his own *Shariah* advisory firm Amanie Advisers (Bassens, Derudder, and Witlox 2011; Funds@Work 2009). Thus, again, we see attempts at harmonisation with national characteristics or “convergence within national diversity”, a phrase used by Lütz (2004) in an eponymous article to highlight persistent heterogeneity in financial markets.

A key group of actors spreading Islamic financial practices across the region are financial firms such as the Malaysian CIMB or Maybank, which see their Islamic financial expertise as a competitive advantage and are keen on tapping and developing the regional Islamic finance market. Nonetheless, market access is dependent on approval by financial regulators and state control remains tight. Even though in particular Malaysia has eased entry requirements for foreign Islamic banks as well as migration rules for Islamic market professionals, which also extend to the registration of foreign *Shariah* advisors, state control

is still pervasive. In Indonesia, market access is relatively more tightly controlled and Indonesian regulators favour market entry through acquisition of existing Indonesian banks, also as part of an attempt to further consolidate the Indonesian banking sector. Indeed, the only foreign full Islamic bank in Indonesia at the time of writing is PT Maybank Syariah Indonesia, established via the acquisition of BII by the Malaysian Maybank. A number of Malaysian banks also have established Islamic windows in Indonesia, including CIMB which acquired Bank Niaga in 2008. Thus, to some extent Islamic finance has been at the vanguard of greater integration of Southeast Asian financial markets, but this is a slow and uneven process.

In sum, whilst there has been not much institution building when it comes to *Shariah* governance frameworks on the regional level, there has nevertheless been momentum for fostering greater interdependence, if not integration. This has originated mainly from two levels: harmonisation of *Shariah* expertise and market integration. On harmonisation, whereas convergence to a single, universalised model of *Shariah* governance is unlikely given the heterogeneity of governance practices, there have been nevertheless considerable efforts undertaken at regional harmonisation, the development of global standards and knowledge exchange among *Shariah* scholars. As the integration of Islamic finance with global financial markets proceeds, pressure for harmonisation will increase further.

Regarding market integration, over the last ten or so years, Southeast Asian financial firms have begun to increasingly reach beyond their home markets. This includes the ambitious expansion of Malaysian Islamic banks into Indonesia and to a somewhat lesser extent also into Singapore. However, it also extends to the introduction of cross-border *sukuk* issuance, involving firms from Malaysia, Singapore and Indonesia as arrangers and legal advisors, but also as borrowers and investors as well as participation in broader regional frameworks such as the ASEAN Collective Investment Scheme framework launched in 2014 and whose

member jurisdictions at the time of writing are Malaysia, Singapore and Thailand. With the official launch of the ASEAN Economic Community in late 2015, these types of initiatives are gaining traction with regional politicians and financial policymakers, although it is important to note that the AEC framework specifically refers to “freer” movements of capital, but not the “free” movement (ASEAN 2008; see also ADB and ASEAN 2013).

CONCLUSION

Recent years have seen the rapid growth of Islamic finance in several Southeast Asian countries. At the same time, the emergence of new capital market governance practices and institutions in Southeast Asia have been both multi-scalar and multi-sited, although this does not mean that different scales and sites wield the same powers. The development of governance mechanisms for Islamic capital markets is an intriguing case in point. Thus, rather than only looking at the scale and rescaling of capital market governance in the region, more attention needs to be paid to the shifting balances between regulatory expertise, market practice and societal expectations and values. Indeed, for governance practices to be considered effective, they have to straddle at times competing demands of authority and legitimacy. This trend is nowhere as visible as in the case of Islamic finance as it explicitly involves *Shariah* experts, trained in Islamic law, in its governance structures.

In Indonesia and Malaysia, efforts were undertaken to establish a centralised model of *Shariah* governance of capital markets at the national level, DSN-MUI and SAC-SC. These bodies are intimately bound up with the financial regulatory apparatus. Nevertheless, differences persist. In Malaysia, the supreme authority on the *Shariah* governance of Islamic capital markets is organisationally located at the Securities Commission, whereas in Indonesia it resides outside the formal state apparatus, but is implicitly dependent on state support. In both cases, an at times uneasy balance has been achieved between religious

establishment and state power. Moreover, not only has the *Shariah* governance of capital markets become increasingly institutionalised, but there have been concomitant changes in the status of the rulings issued by these governing bodies. Their *fatwas* are no longer “merely” part of a social/moral code aimed at providing guidance to pious Muslims on how to conduct their everyday economic affairs, but they have been turned into legally binding instruments, either by state fiat as in the case of Malaysia or by codification in financial regulations as in the case of Indonesia.

Along these lines, we also see tentative steps towards greater harmonisation of *Shariah* governance, both in terms of market activities and permissible structures, but also with regard to underlying knowledge practices. Greater effort is put into building consensus in support of the expanding industry, where traditionally diversity of Islamic thought was at least to some extent celebrated, and perhaps one of the great strengths of Islamic finance in terms of its progressiveness. What does this mean with regard to developing a more principled, if not progressive approach to financial governance? On the one hand, the fact that Islamic financial governance is increasingly bound up with the state apparatus facilitates the embedding of Islamic financial principles throughout capital markets in the region. This means that Islamic principles and ethical concerns have become a mainstay of the everyday life of financial markets in the region. On the other hand, it is precisely this nexus that allows wider Islamic financial principles of equity, mutuality and social justice to be subordinated to national development and competitiveness agendas. The deliberative work of *Shariah* boards has been curtailed, to some extent by the sheer amount of material they must digest, but also because market practitioners and regulatory authorities are keen to bring new structures to the market in support of the expanding Islamic finance sector. Form seems to have taken precedence over substance. Taken together, the governance of Islamic finance in Southeast Asia is another instance of what Hameiri and Wilson (2015, 2) call the “emergence of

variegated forms of regional governance that do not take a formal multilateral form but, nonetheless, involve the rescaling of economic governance [at and] beyond the national level.”

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NOTES

¹ Even in Singapore, a country in which Muslims only constitute around 15% of the population, Islamic finance is beginning to leave its mark. Indeed this is closely related to the country's regional and international financial centre ambitions, the growth markets of Malaysia and especially Indonesia, but also Singapore's strategic geographical location between the Middle and the Far East. Islamic finance also exists in Brunei, Thailand and the Philippines and there are regulatory considerations to introduce Islamic finance in Cambodia and Vietnam. However, in this article I focus on the two Southeast Asian countries in which Islamic finance has arguably made the most progress, both in terms of its share of the financial system and in terms of the range of financial products and services on offer.

² *Sharia* can be divided into *ibadat* (largely personal) and *muamalat* (community interactions), with financial transactions more closely linked to the latter which means they are reliant on some form of community authority. Thus, "private" does not translate into "individual" in this instance. I thank Afif Pasuni for making me clarify this point.

³ This article draws on semi-structured and unstructured interviews with policy makers, market practitioners and *Sharia* scholars and participant observation at Islamic finance training seminars and industry conferences.

⁴ For example, whilst the *Sharia* Supervisory Committee of Standard Chartered Saadiq, its Islamic arm, is composed of three Middle Eastern Scholars, the Sharia Advisory Board of Standard Chartered Saadiq Berhad, the Malaysian subsidiary, is composed of four Malaysians and one Singaporean (Standard Chartered 2015a and b). Some Southeast Asian

Islamic financial institutions seek to have a scholar from the Middle East on their *Sharia* board to attract investors from the region.

⁵ For more detailed overviews of the development of Islamic finance in Malaysia, see Rudnyckyj (2013), Lai (2015) and Maznah and Saravanamuttu (2015). For Indonesia, see Lindsey (2012); Atho (2013) and Rethel and Abdalloh (2015). The history of Islamic finance in these two countries is rich and bound up with domestic politics and international ambitions. In this article, the focus is on governance structures for Islamic capital markets. Other important aspects of Islamic finance are not discussed in this article, including insurance (*takaful*) and alms tax (*zakat*).

⁶ In October 2017, this function was assumed by the newly established Halal Products Certification Agency.

⁷ A similar process was seen in Indonesia's Islamic banking. Atho (2013, 17) discusses how Bartolini traces successive Indonesian Islamic finance legislation and how the definition has moved from banks that use the principle of "profit-sharing" (1992 Law No. 7) to "banking based on the principles of the Sharia" (1998 Law No. 10) to "banks [operating] ... on Sharia principles ... the principles of Islamic law on banking activities based on fatwas issued by institutions with authority of issuing fatwas on Sharia" with the same law later on identifying MUI as the institution with the authority to issue *fatwas* (2008 Law No. 21).

⁸ The original Act only makes reference to "*Sharia*" twice (both in section 316), granting the Ministry of Finance the authority to "make such modifications in the prescription on the usage of expressions in the securities laws as may be necessary to give full effect to the

principles of Shariah in respect of such Islamic securities” (§2) and authorising the SC to issue specifying guidelines (§3).

⁹ The list of founding shareholders and further information about IILM is available at:
www.iilm.com.