

## Guiding *Hajah* and *Darurah* Application in Islamic Finance

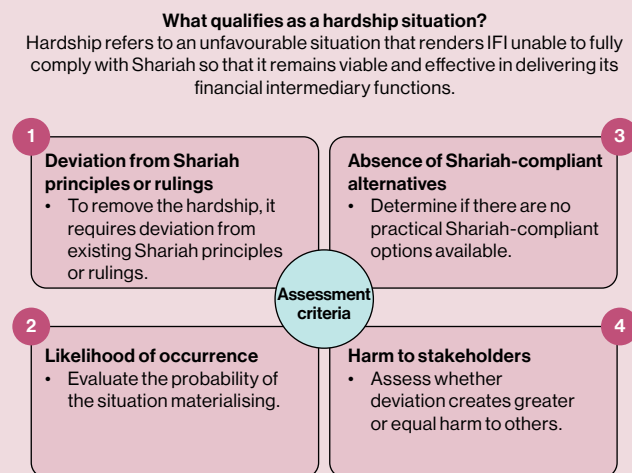
### Concept of *hajah* and *darurah*

Islamic finance is premised on the core obligation for its participants to fully comply with Shariah. This entails Islamic financial institutions (IFIs) entering into transactions or engaging in practices which are fully compliant with Shariah requirements. Nevertheless, in practice, there will be situations where achieving full Shariah compliance, has its challenges as our Islamic financial system operates within the broader domestic and international ecosystem that includes, conventional finance that practices elements which may be in conflict with Shariah requirements such as usury or excessive uncertainty.

As an example, to offer multi-currency products and services, an IFI in Malaysia needs to open nostro accounts with correspondent banks in other countries. However, it may not be possible to open Shariah compliant nostro accounts in places where Islamic finance is absent or limited. In this case, full compliance with Shariah will make it impossible for the IFI to offer such services. This, in turn, will affect their financial intermediation role, as they are unable to serve their customers and meet the needs of the economy. Thus, the concept of *hajah* and *darurah* provide guidance on circumstances where exceptions from Shariah rulings may apply, within defined parameters. In this regard, Shariah recognises that such difficulties and operational constraints may be present and provides a pragmatic way forward.<sup>1</sup>

*Hajah* refers to a situation where hardship arise due to unavoidable circumstances, which requires partial compliance or temporary relaxation of specific rulings (Diagram 1). This is intended to minimise harm (*mafsadah*) and maximise benefits (*maslahah*). For example, a takaful operator may transfer certain specialised risks to a reinsurance company where there is insufficient retakaful capacity to absorb the risks.

**Diagram 1: Assessment Criteria to Determine What Qualifies as a 'Hardship Situation'**



Source: Bank Negara Malaysia

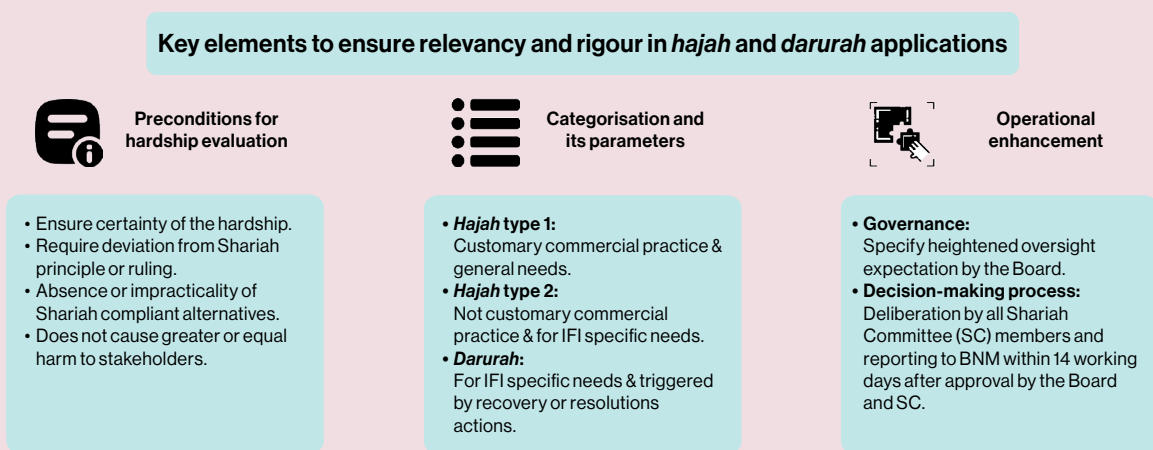
Meanwhile, *darurah* refers to extreme situations risking a financial institution's solvency or liquidity, which allows for tolerance of actions usually prohibited by Shariah. This is in view that Shariah recognises life and wealth preservation in specific circumstances over strict adherence to Shariah prohibitions. For example, an IFI may seek funding from conventional sources during a resolution process, when Shariah compliant funding is not available.

<sup>1</sup> As stated in the Quran, '*Allah intends ease for you, not hardship*'. (Surah Al-Baqarah, 2:185).

### Application of *hajah* and *darurah* in Islamic finance

As part of BNM’s efforts to promote a sound and progressive Islamic finance sector through the prudent application of exemptions to Shariah rulings, BNM issued the *Hajah* and *Darurah* Policy Document (HD PD). The HD PD aims to provide clearer guidance on applying *hajah* and *darurah*, in line with the fundamental Shariah principles. It also intends to streamline industry practices to effectively mitigate Shariah non-compliance risks. Furthermore, the HD PD facilitates regulatory oversight through standardised *hajah* and *darurah* parameters (Diagram 2) which enable consistent interpretation and informed decision-making by Shariah Committee (SC) of IFIs.

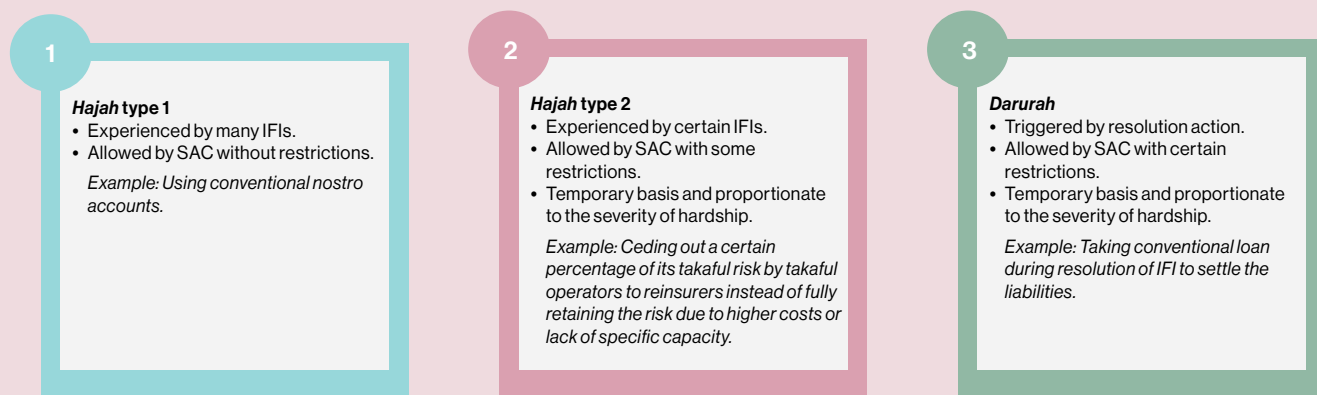
Diagram 2: Key Elements in *Hajah* and *Darurah* Applications



Source: Bank Negara Malaysia

In applying *hajah* and *darurah*, IFIs must carefully evaluate multiple factors in respect of its categorisation (Diagram 3). This is to ensure that any exception to Shariah compliance is recognised by the IFIs’ SC and the Shariah Advisory Council (SAC) thereby preserving the integrity and credibility of the Islamic finance sector.

Diagram 3: The Three Categories of *Hajah* and *Darurah*



Source: Bank Negara Malaysia

A key aspect of this evaluation is understanding the extent and impact of the hardship involved, including whether the hardship affects a wide segment of the community or specific to certain IFIs. Proportionality ensures the exception matches the severity of the hardship, preventing unnecessary departures from Shariah principles. It is also crucial to assess whether the hardship needs any remedial actions, thereby requiring specific temporary exceptions to Shariah compliance. The application of SAC rulings concerning *hajah* and *darurah* is inherently temporary to the specific hardship at hand. This underscores the commitment to return to full Shariah compliance once the hardship is alleviated. This careful balance considers the need for flexibility weighed against the overarching objectives of Shariah to ensure that the responses are appropriately scaled to the severity and scope of the hardship.

## Conclusion

In the pursuit of growth and sustainable innovation, the HD PD is integral to ensure IFIs continue to operate within Shariah-compliant boundaries while navigating hardships guided by a robust governance framework. IFIs' adherence to these boundaries will result in more consistent and rigorous applications of *hajah* and *darurah* and further foster trust and credibility in the practices of IFIs. As a pioneering initiative, the HD PD could serve as reference for the global Islamic finance community, promoting best practices and enhancing resilience of the broader ecosystem.