

## **CONTEMPORARY ISLAMIC FINANCING MODES BETWEEN CONTRACT TECHNICALITIES AND SHARĪ‘AH OBJECTIVES**

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### **ABSTRACT**

*Some contemporary Islamic banking and finance practices have raised legal controversies that arguably eliminate any substantial differences between them and their conventional counterparts. These practices seek their legitimacy from adherence to merely contractual requirements in terms of form and structure, far from considering and looking into the contractual substance and content. These controversial practices of Islamic banks are thought to pose a threat to this emerging industry, and they have somehow led to the distortion of the religion in the eyes of the discerning public and the non-Muslims. This paper examines, through a maqāṣidi approach, the most controversial financing modes adopted by different Islamic financial institutions, and discusses the various justifications provided to support their legitimacy. The paper also outlines the prospectus of what constitutes a genuine Sharī‘ah compatible product.*

### **1. INTRODUCTION**

Islamic banks and financial institutions have developed several financing instruments for the purpose of fulfilling the increasingly demanding market needs. Such sophisticated market needs were not perceived by the earlier generations of Muslim jurists and therefore, those jurists did not feel the need to further develop the already established financing instruments.

However, for developing and structuring the modern modes of finance, contemporary Islamic financial institutions have basically relied on the conventional financial institutions, which fall back on decades of experience in providing financial services. In other words, modern financing modes in the Islamic financial institutions were modelled after their conventional counterparts as

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Islamic financial institutions wanted to emulate, with some modifications, the conventional institutions in providing the best financial services.

In this respect, Sharīḥ, in principle, never objects to benefiting from others' experiences; rather, Islam is a religion that encourages and instructs its followers to exchange experiences with, and obtain knowledge from Muslims and non-Muslims alike. However, the problem arises when we know that interest or *ribā*, which is one of the gravest crimes a Muslim may ever commit, constitutes the core of almost every conventional financing instrument.

This is one important thing to bear in mind before embarking on our discussion in this paper. Another important thing is the well-known fact that any contract can be used to obtain good ends and bad ends. A contract thus is like a tool that one can use for different purposes, lawful or unlawful ones. A knife, for example, can be used in the kitchen and can be used to murder someone. A glass is another example as it can be used to drink water, or to drink wine with. Similarly, a contract like marriage contract can be resorted to by a couple not to realise its many original objectives but to only obtain the sexual pleasure for maybe one hour or two, then to immediately effect divorce. So used, it becomes a legal trick to avoid *zinā* (adultery). Thus, any contract, including a sale contract, can be used not to realise what it has been originally designed for, but to obtain some unlawful ends on grounds of its legitimate form and structure.

These two facts, namely the modern Islamic financing instruments being modelled after the conventional financing products though the later involves *ribā*, and the possible abuse of any contract, must not escape the attention of any researcher or scholar trying to examine and determine the legitimacy of the contemporary financing contracts as implemented in the Islamic financial institutions.

For the sake of brevity, our discussion in this paper will be limited to only examining the controversial financing instruments as practiced in some Islamic banks and financial institutions. As for financing instruments whose legitimacy is in principle free from doubt, they are excluded from this study, since there is no conflict between their technicalities and Sharīḥ objectives.

However, it is worth noting before we start our discussion that Islamic banks and financial institutions vary in terms of their adoption of the controversial financial instruments. This can be attributed to factors like: how committed and learned the Sharīḥ board members are; the policy of the institution and the extent of its adherence to Sharīḥ; the level of awareness of the public where the Islamic bank operates and their ability to evaluate Sharīḥ related matters.

## 2. SHARĪ'AH PRINCIPLES FOR DETERMINING THE VALIDITY AND PERMISSIBILITY OF CONTRACTS

The aim of the following discussion is to elucidate the juristic approaches towards determining whether a contract is valid and permissible from Shari'ah perspective.

### 2.1 Juristic Methodology in Validating Contracts

When jurists were in the process of deriving from Shari'ah texts the criterion that determines contracts validity, they could identify two categories of texts. The first category implies the need to adopt intention of contractors as one of the bases for validating their contracts, such as the well known *ḥadīth* “matters are determined by intention” (إنما الأعمال بالنيات)<sup>1</sup>. This *ḥadīth* implies that intention, i.e. the purpose or substance of the contract, is very basic to accept a contract and rule it as valid; therefore, contract's form or structure alone is not sufficient for ruling it as valid.

The second category of Shari'ah texts suggests the opposite; judging all things including contracts must be based on their form and structure alone, apart from contractors' intention and objectives.<sup>2</sup> Among these texts is the *ḥadīth* in which the prophet P.B.U.H. says: “I am a human, so I give judgments based on what I hear; however, if I happen to make a wrong judgment, my judgment then would not legalise the prohibited...”<sup>3</sup> Based on this text, judging things, including contracts, must be on the basis of apparent evidences. This suggests giving no attention or consideration to intentions and purposes.

Finding such apparently-conflicting evidences, jurists justifiably adopted two different approaches to validating contracts:

The first approach, which is adopted by the Hanafi and Shafi'i schools of fiqh (Islamic law), states that validity of contracts must be judged by means of their form and structure, giving no consideration to contractors' intentions and real purposes of a particular contract; even if the contract was accompanied by some clues that may suggest an evil intention of contractors. To this group of jurists, any contract whose structure and form comply with Shari'ah must be judged as valid, unless an unlawful objective is stated in the contract or declared by contractors.

<sup>1</sup> - This *ḥadīth* was narrated by Omar bin Al-khattab (ra). See *Sahih al-Bokhari*, 1/3, *ḥadīth* No (1); *Sahih Muslim*, 3/1515, *ḥadīth* No (1907).

<sup>2</sup> - For more details on this matter see *Contemporary Eina; is it a Sale or Usurious Transaction* by Abdulazeem Abozaid, p 47.

<sup>3</sup> - This *Hadith* was narrated by Umm Salama (ra). See *Sahih al-Bokhari*, 2/867, *ḥadīth* No (2326); *Sahih Muslim*, 3/1337, *ḥadīth* No (1713).

However, this group of jurists does not neglect or overlook the first category of *ḥadīth* as we will explain soon.

Unlike the first approach, the second approach gives weight and consideration to the contractors' intention or purpose of a specific contract. If the intention has not been made clear in the contract, it can be ascertained from any clues or surrounding circumstances that may harbour the contract initiation. If the clues suggest an evil or unlawful intention, the contract will then be deemed as null and void. Among the clues accepted in this regard is the customary unlawful objective of people from a specific type of contract. To them, this kind of customary objective is powerful enough to invalidate the contract regardless of the real intention of the contractors in a particular contract. This approach was adopted by Maliki and Hanbali schools of *fiqh*<sup>4</sup>

After demonstrating an exposition of the two juristic approaches in respect of validating contracts, it can be said that practicality and appropriateness tend to be in favour of the one that validates contracts on the basis of their form and structures alone, as it is obviously impractical, if not impossible, to ascertain the contractors' intentions in a particular contract. It is true that clues and customary practices may help assess the contractors' intention; however, there is still an avenue for making a wrong assessment of the contractors' intention. Hence, people's contracts may be invalidated due to a wrong assessment, which is an evil in itself.

## 2.2 *Al-Hukum Al-Diani and Al-Hukum Al-Qada'i*

In order to reconcile the conflicting texts pertaining to this issue, proponents of the approach that validates contracts on the basis of only their form and structure have distinguished between *Hukum Diani* and *Hukum Qada'i* in contracts. The former represents the validity of the act between God and Man, which is realised upon Man having a lawful intention. The later represents the validity of the act between Man and Man; in other words, it is concerned with the worldly affairs. This validity is realised upon having a sound and defect-free structure. They opined: let us judge people's conducts on the basis of their structure (*Hukum Qada'i*) and leave the issue of intentions and objectives (*Hukum Diani*) to the All-Knowing, Allah S.W.T. so as to avoid the evil of possibly making wrong judgments. However, this does not mean that the evil intention of contractors will go unpunished, simply because unlike man-made laws, Sharī'ah is a religion so that if one could escape a worldly punishment, and one did not repent or was not

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<sup>4</sup>- Ibn Abedeen. *Hashiyat (Rad al-Mukhtar ala al-Dur al-Mukhtar)* 5/48; Al-Dasuqi, *Hashiyah* 3/76; Qurafi, *Al-Furuq*, 3/268; Mohammad Ali, *Tahzeeb al-Furuq*, 3/275; Ibn Juzai. *Al-Qawanin Al-Fiqhiyyah*, p140; Al-Shafi'i, *Al-Um*, 4/114; Ibn al-Qaiyyem, *I'lam al-Muaqi'een*, 3/109-121; Al-Ghazali, *Al-Mustasfah*, 2/36.

forgiven, definitely one will not escape the punishment in the second life.<sup>5</sup> Therefore, a valid act from the perspective of *Hukum Qada'i* is in not necessarily valid from the perspective of a *Hukum Diani*.

To summarise, Hanafis and Shafi'is, just like the other schools of *fiqh* (Islamic Jurisprudence), believed that validity of all matters, be them devotions or transactions, must be originally determined by intention as the *ḥadīth* clearly suggested. However, they found it impractical to determine the validity of transactions by means of intention; in addition, they came across other texts that suggested that validating worldly actions must be determined by their form only. Therefore, they said: we limit the functionality of intention to the *hukum diani* and judge things on the basis of their structure and form.<sup>6</sup>

### 2.3 Judging a contract as valid does not necessitate its permissibility

The earlier discussion on determining contracts validity on the basis of their form and structure alone, or on the basis of also contractors' intentions and purposes does not in any case cover the issue of determining contracts permissibility. Rather, according to all schools of *fiqh*, the well established *ḥadīth* of role of Intention constitutes the basis for determining contracts permissibility. Should it have been identifiable and its assessment not possibly resulting in error, intention would have been relied on in determining contracts validity too, as it is the case with devotional acts for intention is essential for even the very existence of the devotional acts. For example, in fasting if a person refrains from eating and drinking from dawn until sunset without observing the intention of the legal fasting, he will not be performing the legal fasting.

Therefore, it is a flaw to take a valid contact as necessarily permissible, or to attribute such a stand to those jurists who validate contracts on the basis of their structure like Hanafis and Shafi'is. Rather, the basis of contract permissibility is always and unanimously its purpose and objective.

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<sup>5</sup>- Imam Shafi'i says: "We should judge things on the basis of their form, and Allah S.W.T. takes care of the unseen (purposes and intentions). One who judges peoples' conducts according to his own assessment of their intentions, he will have legalized for himself what Allah and Muhammad P.B.U.H. have prohibited, for it is only Allah S.W.T. who knows the peoples' real intentions (the unseen), and He will punish or reward them accordingly. Allah has commanded people to rely on form in judging each other's conducts. If there existed a person with authority to judge people's conducts on the basis of his own assessments of their intentions based on certain clues, then he would solely be the prophet P.B.U.H.". See Al-Shafi'i, *Al-Um*, 4/114.

<sup>6</sup>- Al-Ghazali, *Al-Mustasfah*, 2/36; Ibn Abedeen, *Hashiyat (Rad al-Mukhtar ala al-Dur al-Mukhtar)* 5/48; Al-Dasuqi, *Hashiyah* 3/76; Qurafi, *Al-Furuq*, 3/268; Mohammad Ali, *Tahzeeb al-Furuq*, 3/275; Ibn Juzai. *Al-Qawanin Al-Fiqhiyyah*, p140; Al-Shafi'i, *Al-Um*, 4/114; Ibn al-Qaiyyem, *I'lam al-Muaqi'een*, 3/109-121.

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Al-Ghazali, another great Shafi'i scholar, also made it clear that ruling something as valid is a different issue altogether from ruling it as permissible. <sup>8</sup>

To summarize, to all jurist, contracts' permissibility is established on contractors' intention and objective; if it is to obtain an unlawful end, the contract is then *ḥarām*. If, on the other hand, the intention is to obtain a lawful end, the contract is then lawful.

### Examples:

Among the relevant applications of the distinction between a valid contract and a permissible contract is *bay' al-eina* (buy-back sale), which is a sale that may be resorted to for the purpose of circumventing the prohibition of *ribā* by selling a commodity on credit then instantly buying it back at a lesser price for cash. <sup>9</sup> This sale was naturally ruled as valid by Shafi'i, and also by Hanafis in certain cases. However, based on the former discussion, ruling this transaction of *bay' al-eina* as valid does not necessarily imply that it is permissible according to Shafi'i and Hanafis; rather, its permissibility is all based on the contractors' objective of this transaction; if it is to obtain cash with a hidden payment of interest by means of a sale contract, then it is *ḥarām* (prohibited). If, on the other hand, the objective is to genuinely acquire the commodity sold in both sale contracts so that the occurrence of the two consecutive sale contracts was not planned for from the beginning, then, it is lawful. In fact, this analysis is nothing but a practical implementation of the *ḥādīth* narrated by Omar bin al-Khattab "Matters are determined by intention".

Another application is a marriage contract; if the couple's intention is to have a permanent marriage relationship with all its implications, then this is a permissible marriage contract, while if their objective is merely to legalise having sex for sometime then to execute divorce afterwards, then it is an impermissible marriage

<sup>7</sup> - Al-Shafi'i, *Al-Um*, 4/114.

<sup>8</sup> - Al-Ghazali, *Al-Mustasfah*, 2/36.

<sup>9</sup> - See details of *bay' al-Eina* on page (13) of this paper.

contract, and it may be tantamount to *zinā* (adultery) though it may take a perfect structure and thus, be ruled as a valid contract due to observing all marriage contract requirements.<sup>10</sup>

#### 2.4 Good intention is not sufficient to legalise a contract

A financier via *eina* may not claim having a good intention to legalise his transaction, like intending helping those who need cash, not obtaining *ribā*. Similarly, a person selling grapes to a wine maker may not claim a neutral intention, i.e. normal trade, to legalise his transaction. According to jurists, if the contract results in evil, like committing *ribā*, then this contract is unlawful regardless of any intention that might be claimed to be observed therein.<sup>11</sup>

#### Result

The foregoing discussion has somehow indicated that in order for the financial products to be deemed Sharī'ah compliant, they must be both valid and permissible. In other words, their form and substance must comply with Sharī'ah. This result raises the question whether the current Islamic banking and finance products are indeed following the same principle.

Below some examples of various forms of controversial Islamic banking products are examined to illustrate the problem of failure in distinguishing between a valid contract and a permissible one, as well as the problem of the misapplication of *maqāṣid al-sharī'ah* (al-sharī'ah objectives) in legitimising contracts that substantially go against the very spirit and essence of *maqāṣid al-sharī'ah*.

### 3. EXAMINING SOME CONTEMPORARY MODES OF FINANCE IN ISLAMIC FINANCIAL INSTITUTIONS

Some Islamic financial institutions have practiced some financing modes that meet all contractual requirements but breach sharī'ah objectives. The following are the justifications provided in support of their adoption:

- Realisation of *maqāṣid al-sharī'ah*, which are basically structured on the basis of *maṣlaha* (public interest).

<sup>10</sup>- Al-Shafi'i, *Al-Um*, 3/78; Ibn Abedeen. *Hashiyat (Rad al-Mukhtar ala al-Dur al-Mukhtar)* 4/279; Al-Kasani, *Badai' Al-Sanai'* 5/198-199; Ibn Al-Humam, *Fatih Al-Qadeer* 6/71.

<sup>11</sup>- Al-Kasani, *Badai' Al-Sanai'* 5/198-199; Al-Shafi'i, *Al-Um*, 3/78; Ibn Abedeen. *Hashiyat (Rad al-Mukhtar ala al-Dur al-Mukhtar)* 4/279; Ibn Al-Humam, *Fatih Al-Qadeer* 6/71.

- Being in a state of *ḍarura* (necessity), and *ḍarura* may render prohibited things permissible.
- The flexible stand attributed to some schools of *fiqh* towards transactions such as *bay' al-eina* and *tawarruq*, which constitutes the basis of some contemporary modes of finance<sup>12</sup>

Before we subject these justifications to scrutiny, we examine some financing modes as adopted by different Islamic financial institutions. However, the last justification above has already been discussed, and we reached the conclusion that although some jurists validated *bay' al-eina* and its likes, this validity never entails the permissibility of these transactions.

### 3.1 *Eina*-based Financing (Back-to-Back Sale)

*Bay' al-eina* as indicated earlier connotes a sale contract whereby a person sells an article on credit and then instantly buys it back at a lesser price for cash. Example: "A" asks a loan of \$10 from B. B, instead of asking for interest on this loan applies a contrivance. He sells an article to "A" for \$12 on credit and then buys it back from him for \$10 cash. So, "A" departs having \$10 in hand but indebted to B for \$12.

Such mechanism suggests that the article itself is not meant for purchase; rather, it is used only as a tool to provide cash. To illustrate, it makes no difference to the one seeking finance to conclude the sale contract on a car, a house or anything else. Moreover, practically, such a transaction rarely involves actual possession of the item sold or official documentation of the contract.

#### Some examples of *eina* products

##### A. BBA Home Financing

BBA stands for *Bay' Bithaman Ājil*; an Arabic term which means "deferred payment sale". Technically, BBA refers to a sale contract practiced mainly in Malaysia whereby a person "A" who does not have enough cash to pay the full price of his house of choice will pay only around 10% of the full price. In return, "A" gets from the seller of the property a 'Beneficial Ownership', which is somehow a commitment on the part of the owner to conclude the sale upon payment of the balance (90%). After paying the 10% and obtaining the Beneficial Ownership, "A" sells the house as represented by the Beneficial Ownership to the Islamic bank for a cash price equivalent to the outstanding amount (90%) of the house price. So if the total price was RM (Malaysian Ringit) 100, 000, then the selling price between "A" and the Islamic bank would be RM 90,000. Afterwards,

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<sup>12</sup>-See these justifications in *Resolutions of the Securities Commission Syariah Advisory Council, Malaysia*, p. 21-22..

the Islamic bank immediately sells the house, which is represented by the Beneficial Ownership, back to "A" in instalments at a mark up, say for RM 130,000 over a period of 5 years.

The RM 90,000 paid by the Islamic bank as the purchase price will be extended to the property developer in conclusion of the sale contract. "A", however, remains indebted to the Islamic bank for the RM 130,000; the price in the last sale contract.

### **Resemblance of BBA home financing to Mortgage**

This mode of finance, apart from the technicalities followed therein, is hardly differentiated from the conventional mortgage used in home financing. The only difference an observer may find is the way cash is advanced from the bank to the client; in the conventional mortgage it is through conventional loan, while in BBA it is through *bay' al-eina*. Further examination of BBA contract particulars and terms of agreement will even enhance convergence of BBA with Mortgage.<sup>13</sup>

### **B. Islamic Overdraft Facility**

Another application of *bay' al-eina* is 'Islamic' Overdraft (OD) Facility<sup>14</sup>. It operates on the concept of *bay' al-eina* though it is marketed using different names – *al-nakad*, *al-tamwil*. The purpose of this overdraft facility is to enable customers to draw cash up to a certain limit over their accounts. Conventionally it functions on the concept of interest-bearing loans. Since charging interest on loans is prohibited in Islam, some Islamic banks have resorted to *bay' al-eina* as a presumably lawful alternative. To explain the mechanism, the Islamic bank would execute two simultaneous back-to-back sales with different prices; one on cash basis, the other on deferred payment terms. The objective of these two sale contracts is to create out of the difference between the two prices a debt liability on the part of the customer so as to deduct from which charges imposed upon utilizing the overdraft facility. Bank charges depend on the amount and frequency of draws.

So, the question that imposes itself after exposing these two application of *eina* is whether there exist a genuine difference between *eina*-based financing and conventional loans, that is capable of rendering the former a Shari'ah compliant basis for financing.

### **Shari'ah appraisal of *bay' al-eina***

As discussed earlier, while some schools of *fiqh* determine contracts validity on grounds of their form and structure, all schools of *fiqh* determine contracts

<sup>13</sup> - See for mortgage mechanism: Abozaid Abdulazeem. *Fiqh Al-Ribā*, p.576.

<sup>14</sup> - A product offered in some Islamic banks in Malaysia.

permissibility on grounds of their objectives and substance.<sup>15</sup> Examining *bay' al-eina* as implemented in some Islamic banks leads to the fact that its purpose is obviously to provide clients with cash yet in a securely profitable manner to the bank. Therefore, as far as the substance of *eina* is concerned, this transaction is nothing but a camouflaged interest-based loan.

Has *eina* been a real sale contract, it would not be free from risks that are normally associated with sale contracts; besides, it would then entail a real interest of the client in the commodity of sale. However, in *eina*, the underlying asset subject to the dual sale is inconsequential and typically not related to purpose of financing, and it may originate from the customer or the bank.

Moreover, the sequence of contracts in *eina* is not accidental; rather, it is something predetermined in order to reach the end set in advance, i.e. to legalize charging clients upon providing them with cash.

Logically, it makes no sense for the sharī'ah to prohibit *ribā* then to accept from its followers to circumvent such prohibition by some technique like *eina*. Definitely sharī'ah would then have contradicted itself and acted against its very principles and objectives, let alone against logic and sound reason. Thus, sharī'ah would fail then to convince its followers, before outsiders, of its rationality and validity which have always been some of its cornerstones in proving and defending its authenticity.

### 3.2 *Tawarruq*-based financing

The meaning of *tawarruq* is to purchase a commodity from one party on credit then sell it immediately to another for cash. Thus, *tawarruq* shares the same objective of *eina* as both are meant for extending cash money. However, *tawarruq* remains technically distinguished from *eina* as in the later the commodity is resold to its original seller, while in *tawarruq* it is sold to a third party.

#### **Tawarruq in Islamic banks**

The mechanism of *tawarruq* which is practiced in some Islamic financial institutions is a slightly modified version of the original form of the *tawarruq* described above.<sup>16</sup> In this institutional *tawarruq* the bank purchases some commodity from the market, like metal from London Metal Exchange (LME), and then sells it to the customer on *Murābaḥah* basis for deferred payment. Subsequently, the bank, as the customer's agent, sells the metal on LME for

<sup>15</sup> -Al-Shafī'i. *Al-Um*, 3/78; Ibn Abedeem. *Hashiyat (Rad al-Mukhtar ala al-Dur al-Mukhtar)* 4/279; Al-Kasani. *Badai' Al-Sanai'* 5/198-199; Ibn Al-Humam, *Fatih Al-Qadeer* 6/71; Al-Bahuti. *Kashaf Al-Qina'*, 3/186; Ibn Qudamah. *Al-Mughni*, 4/278-279.

<sup>16</sup> -This transaction is mostly practiced in some Islamic banks of Arab Gulf countries.

immediate cash. In result, the bank gains *Murābahah* profit and agency fees, the customer obtains immediate cash and remains committed to repay the outstanding debt that he has incurred when acquiring the commodity from the bank on *Murābahah* basis.<sup>17</sup>

### Shari'ah appraisal of *Tawarruq*

A very limited number of early jurists ruled that *tawarruq* was allowed; however, the *tawarruq* that was practiced and received somehow some jurists' acceptance is different from the modern contrived *tawarruq* from different aspects.<sup>18</sup>

First, the former *tawarruq* was in most cases free from deliberate contrivance and complicity. Its modus operandi was as follows: 'A' individual purchases a commodity from B on credit. After purchasing and taking possession of the commodity from B, A sells it in the market to a third party without B's assistance or mediation. Although the purchase of the commodity was for the mere objective of selling it in the market at lower price, this transaction had received some jurists' acceptance (Hanbalis)<sup>19</sup> due to the absence of contrivance and complicity between contractors. However, even if there was an element of contrivance between parties, then the transaction would be deemed **valid** by Hanafis and Shafi'i' with all differences, of course, between valid and permissible as explained earlier.<sup>20</sup>

Second, the views in *fiqh* literature on *tawarruq*, even if contrived, are all related to individual practices and cases, and they were deemed irregular and dissenting from the mainstream juristic view on *tawarruq*.

Third, similar practices to *tawarruq* were sometimes criminalized in the Islamic state, and were subject to constant interference and patrol by shari'ah authorities,

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<sup>17</sup> - See for example mechanism of *Tawarruq* in Abu Dhabi Islamic Bank.

<sup>18</sup> - To all jurists, purchase of a commodity then selling it without an intention of sale at the time of purchase is not a form of *Tawarruq*. The mechanism is as follows: An individual owns a particular commodity which he has bought for its own sake against spot, deferred payment or other means. After sometime he wants to have cash so he sells it in the market for immediate cash. If he has acquired it on credit, he remains committed to repay the outstanding debt that has been incurred during acquiring the commodity. This kind of transaction raises no Shari'ah objection.

<sup>19</sup> - Al-Bahuti. *Kashaf Al-Qina'*, 3/186; Ibn Qudamah. *Al-Mughni*, 4/278-279; Ibn al-Qaiyyem. *Tahzeeb Al-Sunan*, p. 9/253-254.

<sup>20</sup> - Ibn Abedeem. *Hashiyat* 4/279; Al-Dasuqi, *Hashiyah* 3/78; Qurafi, *Al-Furuq*, 3/275; Mohammad Ali, *Tahzeeb al-Furuq*, 3/275; Al-Shafi'i, *Al-Um*, 3/78; Al-Kasani. *Badai' Al-Sanai'* 5/198-199; Ibn Al-Humam, *Fatih Al-Qadeer* 6/71.

while *tawarruq* is introduced nowadays as a well-established Islamic banking product and as an integral part of the Islamic financial system.<sup>21</sup>

In conclusion, including the *tawarruq* practiced nowadays by some Islamic financial institution under the *tawarruq* approved by some early jurists is incorrect especially that it involves known intensions and complicity.

As a matter of fact, in both *eina* and *tawarruq* the bank acts as a financier who makes a secured profit from the clients he finances, and not as a real trader who takes market risks, though taking market risk is, as commonly known, the line between sale and *ribā*, profit and interest. Moreover, in both transactions, *eina* and *tawarruq*, bank knows that the client has no interest in the commodity but to resell it immediately; either to the bank as in *eina*, or to third party but through Bank's mediation as in *tawarruq*. These facts about *eina* and *tawarruq* eliminate real differences between the two; and more generally, they eliminate differences between both of them on one side and an interest-bearing loan on the other, reducing differences to only technicalities followed in the execution of the two. Had *eina* or *tawarruq* not been *ḥarām*, it would then be easily and comfortably resorted to by people to circumvent the prohibition of *ribā*; anyone wishing to legitimately provide interest-loaded loans would simply effect *eina* or *tawarruq* with people seeking finance, so *ribā* would be 'lawfully' practiced. Therefore, claiming the permissibility of such transactions contradicts the *sharī'ah* objective meant from the prohibition of *ribā*.

Furthermore, the absence of substantial differences between *eina/tawarruq* based financing in Islamic banks on one hand, and conventional loans on the other, annuls the justification for burdening clients seeking finance from Islamic banks with extra costs due to extra procedures. For clients of some Islamic banks accept willingly bearing extra cost for cash financing in return for obtaining *sharī'ah* compliant products, but ultimately they end up paying the cost of the technicalities followed by some Islamic banks to claim legitimacy of their products.

### 3.3 *Al-Rahn* Islamic Pawn Broking<sup>22</sup>

*Al-Rahn* (collateral) contract in the *sharī'ah* is meant to be used as a debt security. However, in some Islamic banks it is used to generate profit thereof in a transaction called Islamic Pawn Broking. In this transaction, the Islamic bank provides its customer with so called benevolent loan on condition that the later provides *rahn*; e.g. a valuable jewel to be kept by the bank under its custody as collateral; however, the problem arises when the Islamic bank charges this customer for the so called safe-keeping of this jewel. Ironically, the fee charged

<sup>21</sup>- See for some examples Ibn Abedeem. *Hashiyat* 4/175

<sup>22</sup>-Currently being offered by a number of Islamic financial institutions in Malaysia.

varies with the amount of the loan, and it is sometimes equivalent to the market interest rate.

Should the storage cost be reflective of actual storage costs incurred by the bank, it would be then determined by size, weight or some other physical dimension, instead of the amount of the loan. This is besides the many sharī'ah provisions that invalidate this transaction, such as the prohibition to combine between a loan contract and any commutative contract (contract that involve exchange of two counter values) in order to block the means to charging interest indirectly through the later, in addition to the sharī'ah provision that expenses of the keeping the collateral must be borne by the *muratahin* (mortgagee).

### 3.4 The Misguided Justifications

The proponents of the current controversial practices of Islamic banks and financial institutions argue that Islamic banks need to be treated with leniency especially at their infancy stage. This is needed in order to facilitate their growth and development, and to ensure their sustainability and viability amid the hegemony and prevalence of the conventional banks and the interest-based economic systems. Otherwise, Islamic banks would be doomed to fail, and their failure is a failure of the whole Islamic economic system, which would in turn affect the very project of establishing the modern Islamic state. This, to the proponents of such views, necessitates a more flexible and liberal approach when structuring Islamic banking products in order to meet the sharī'ah objectives.

Obviously, from this justification it can be implied that they have based their arguments on various sharī'ah concepts, the most important of which are sharī'ah objectives (*maqāṣid al-sharī'ah*), *maṣlaḥah* and *ḍarura*.

To further address this issue we need to examine these concepts in detail in order to have a better understanding on how the justifications of the contemporary controversial financial transactions can be refuted.

## 4. REALISATION OF MAQĀṢID AL-SHARĪ'AH & MAṢLAḤAH

*Maqāṣid* (the plural of *maqṣad*: objective) al-sharī'ah are the objectives, spirit and the rationale of the Sharī'ah. A comprehensive and careful examination of the Sharī'ah rulings entails an understanding that sharī'ah aims at protecting and preserving public interests (*maṣlaḥah*) in all aspects and segments of life.<sup>23</sup>

So, sharī'ah laws in general are designed to protect these benefits, and to facilitate improvement and perfection of human lives' conditions on earth. This

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<sup>23</sup> - Ibn al-Subki, *Al-Ibhaj*, 3/52; Al-Shatibi, *Al-Muwafaqat*, 2/2.

fact suggests that we are required to maintain *maqāṣid* al-sharīʿah when implementing sharīʿah rulings, and to observe these *maqāṣid* when deducing rulings for the new arising matters.

Therefore, in the context of Islamic banking, if observing *maqāṣid* al-sharīʿah naturally entails observing the rationale and the spirit of the texts, then to observe only the form and the structure requirements of a transaction while structuring a financial banking product functions against the very concept of *maqāṣid* al-sharīʿah. Hence, for a proper realization of *maqāṣid* al-sharīʿah, Islamic banking and finance must ensure that all transactions comply with sharīʿah; not only in terms of legal technicalities and forms but more importantly in terms of the economic substance of these transactions which is premised on the objectives outline by sharīʿah.

Surprisingly enough, *maqāṣid* al-sharīʿah have been used as a justification for adoption of some *ribā* -disguised banking products though observing *maqāṣid* al-sharīʿah must be the first factor to determine their prohibition.

#### 4.1 Macro *Maqāṣid* versus Micro *Maqāṣid*

One may think that by legalizing some controversial transactions such as *bayʿ al-eina* the macro *maqāṣid* are observed. What we mean by macro *maqāṣid* here is the interests or benefits related to the overall well-being and welfare of the economic system, which have always been the objectives of Islamic economics; whereas micro *maqāṣid* only relates to certain micro issues pertaining to certain individual financial transactions. Obviously macro *maqāṣid* are more important to observe than any micro *maqāṣid*. These macro *maqāṣid* manifest themselves in structuring an Islamic economy and pushing it forward to compete with and supersede the conventional banks at least in the Muslim countries. On the other hand, maintaining the prohibition of certain transactions helps in observing the particular *maqāṣid* of certain detailed rulings but possibly at the expense of the macro *maqāṣid* of sharīʿah in a particular age, or more specifically, the *maqāṣid* of the Islamic law of transactions, since the later aims at building a strong and just economic system.

To address this misconception, we need to highlight a very important issue which is the conflict between a perceived *maṣlaḥah* and sharīʿah texts. In brief, if there appears to be a conflict between a perceived *maṣlaḥah* and a sharīʿah text, then sharīʿah texts must always prevail over the perceived *maṣlaḥah*. This is particularly true for three reasons: Firstly, the very presumption of the occurrence of a conflict between a definitive sharīʿah text and a real *maṣlaḥah* is false, simply because all Sharīʿah texts aim at realisation of *maṣlaḥah* as admitted by proponents of *maṣlaḥah* prevalence. Secondly, even if such a conflict hypothetically exists, then it is the sharīʿah texts that must be given priority over the perceived *maṣlaḥah*.

This is because *maṣlaḥah* itself derives its authority from the sharī'ah texts and not vice versa. Moreover, jurists who stated *maṣlaḥah* as one of the authoritative sources of sharī'ah had qualified this *maṣlaḥah* by being *mursala* (silent on); i.e. there is no textual authority on its validity or otherwise. Therefore, *maṣlaḥah* does not operate if found to be in conflict with definite sharī'ah texts. Thirdly, human perception of *maṣlaḥah* is not necessarily true; human intellect is doomed to err and change its perceptions.

In other words, the determination of *maṣlaḥah* in terms of what is beneficial and what is harmful cannot be left to human reasoning alone. Instead, as Muslims we should put high recognition to what has been prescribed by the Lawgiver in sharī'ah text. This is because the inherent limitations of human beings posit a strong reason which requires divine guidance especially to ascertain what is right and what is wrong. In this regard, *Ibn Taymiyah* says: "What constitutes a *maṣlaḥah* or a *mafsada* (the opposite of *maṣlaḥah*) is subject to the sharī'ah standards".<sup>24</sup> *Al-Dahlawi* also says: "Our lawgiver is more trustworthy than our reasons".<sup>25</sup>

If there was any kind of *maṣlaḥah* in *ribā* or its sale-based tricks, then the Lawgiver would not have considered *ribā* as the worst of evil and one of the gravest sins that invoke curse and declaration of war by the Almighty. The Qur'an says: "But God has permitted the sale and forbidden the *ribā*" (2:275) and, "God destroys/eliminates the *ribā*;" (2:276) and, "O ye who believe, fear God and quit what remains of the *ribā* if ye are indeed believers; but if ye do it not, take notice of war from God and His Messenger" (2:278-279). As a matter of fact, no other sin is prohibited in the Qur'an with a notice of war from God and His Messenger. Obviously, *maqāṣid* al-sharī'ah have been abused to justify certain financial contracts which in fact contradict the sharī'ah texts and principles.

#### 4.2 Overruling the Prohibited Practices on the Grounds of *Ḍarura*

There is a tendency in some Islamic banks today to justify implementing *aina* and its likes, as well as some other controversial practices, on grounds of *Ḍarura*. So, what is *Ḍarura* and is it a valid justification?

*Ḍarura* means necessity. Unanimously *Ḍarura* renders the prohibited things permissible as this constitutes a well-established *fiqh* maxim in sharī'ah "Necessities permits the forbidden" (*Al-Ḍarurat Tubih Al-Mahzurat*). However, when jurists discussed and explained the applications of this *fiqh* maxim, they mentioned what is known in Arabic as *ḍawābit*, which means conditions and guidelines, for the functionality of this maxim. These guidelines (*ḍawābit*) are of course stated in or derived from the sharī'ah texts. The first guideline (*ḍabit*) is:

<sup>24</sup>- Ibn Taymiyah, *Al-Fatawah*, 8/129.

<sup>25</sup>-Al-Dahlawi, *Hujattullah al-Balighah*, 1/13.

what constitutes a *ḍarura*. The juristic concept of *ḍarura* can be summarised by saying that *ḍarura* is something which is indispensable for the preservation and protection of the five essential values: faith, life, intellect, posterity and wealth.<sup>26</sup> This means that the concept of *ḍarura* would give the Muslim a legal excuse to commit the forbidden; if indispensable for his survival, spiritually and physically.<sup>27</sup>

Applying the principle of *ḍarura* to the case in question would not in any way imply rendering the unanimously forbidden transactions to be permissible so as to apply them in Islamic banks. If it is presumed that such products are indispensable for the Islamic bank's survival and long-term sustainability due to certain considerations, then the argument is that the very concept of the bank itself is not indispensable for the Muslim's survival from the Sharī'ah perspective. If such *ḍarura* hypothetically exists, then it would rather legitimise dealing with conventional banks directly.

Obviously, when sharī'ah prohibits something it provides alternatives; when it prohibits *zinā* it permits marriage, when it prohibits wine and pork for consumption it permits all other sorts of food and drinks. Likewise, when sharī'ah prohibits certain contracts such as contracts based on *ribā*, it alternatively permits many other contracts like sale, lease, *salām*, *istiṣnā'*, *muḍārabah* and *mushārahah*. To economists, such contracts are the better alternatives to *ribā*, and ultimately can yield a prosperous and a healthy economy.<sup>28</sup> Conversely, an economy based on *ribā* leads to disparity and inequality of wealth distribution between rich and poor. If this is the case, then where is the *ḍarura* that may allow Muslim to abandon these beneficial contracts in favour of harmful and destructive ones? In fact, legalising a forbidden thing on the grounds of *ḍarura* is supposed to solve a problem not to create a bigger one. Surprisingly, Islamic banks have been in the business for more than three decades, and they still offer the same excuses of *ḍarura* and the impracticality or impossibility of adopting genuinely lawful business contracts, due to the existence of certain obstacles and deterrents. Do these obstacles and hindrances still exist after more than three decades of Islamic banking development? Are there any indications to suggest a possible change?

Moreover, it is a well-established ruling that when a person is given the excuse to commit the forbidden on the grounds of *ḍarura*, he can never deny the original ruling of its prohibition; i.e., he cannot claim the original permissibility of his commission of the forbidden. For example, if a person is excused to seek a *ribā*-

<sup>26</sup> - Al-Shatibi, *Al-Muwafaqat*, 2/10.

<sup>27</sup> - Majallat Al-Ahkam Al-'adliyyah, section 22; Ibn Nujaim, Zainulddin, *Al-Ashbah Wal Naza'ir*, 1/105-107; Al-Seyoti, Jalaulddin, (911 H). *Al-Ashbah Wal Naza'ir*, p.84-92; Al-Kurdi, Ahmad. *Al-Madkhal Al-Fiqhi*, p.48.

<sup>28</sup> - Abozaid Abdulazeem, *Al-Murabaha and its Modern Applications in the Islamic Banks*, p.71.

based loan due to the occurrence of an extreme urgency and the absence of any possible alternative source of finance, then under no circumstances can he deny the prohibition of *ribā* or regard it as permissible. Otherwise, such an act is tantamount to betrayal of God's ruling and *kufur* since *ribā* impermissibility is definitive. Therefore, even if the justification of *ḍarura* to implement a contract like *bay' al-eina* is valid, Islamic banks must then acknowledge the original ruling of the contract and not simply alter it then attribute it to sharī'ah.

Very clearly, the proponents of *bay' al-eina* and its likes, in their endeavour to justify them, have fallen in contradiction when they claimed their original permissibility as discussed before, and at the same time used the principle of *ḍarura* to justify them, though using *ḍarura* conceptually entails their original prohibition.

##### **5. IMPLICATIONS OF IMPLEMENTING *RIBĀ*-DISGUISED SALES ON ISLAMIC BANKING INDUSTRY AND SHARĪ'AH**

In order for Islamic banking industry to survive and maintain its popularity, urgent and diligent efforts must be made towards restructuring many of its products. It is quite noticeable to observers that as time goes on Islamic banking is slowly making more concessions at the expense of sharī'ah principles, thus bringing this industry closer to its conventional counterpart. It is feared that such concessions may eventually lead to people losing confidence in Islamic banking, though this confidence is its greatest asset giving it a competitive advantage against conventional banks. Once this confidence is lost, it is very hard to be restored. Islamic bankers as well as sharī'ah boards should be far-sighted enough not to allow controversial practices to bring about the demise of this industry. If the current practices continue as such, sooner or later Muslim public will start losing confidence in the Islamic banks and their sharī'ah boards. They will start to question the legitimacy of every single product Islamic banks are offering despite any endorsement by sharī'ah boards that these products may have received.

Therefore, Islamic banking needs to differ significantly from conventional banking, not only in the ways of doing business, but above all in the values which guide Islamic banking operation and outlook. More importantly, implementing controversial transactions has defamed sharī'ah by transforming some of its rulings into a meaningless set of rules that is incapable of convincing Muslims and non-Muslims of its rationality and wisdom. Rather, it leaves the public baffled; being unable to comprehend why *ribā* or interest is prohibited regardless of how small the interest is, while a financing based on *bay' al-eina/tawarruq* which share the same economic and social implications is permissible. Why is it forbidden for the Muslims to seek a personal financing on basis of interest-bearing loan from a conventional bank while it is permissible for him to seek a personal financing from

an Islamic bank though in the later case, he might end up repaying even more than what he repays to the conventional bank.

There are many state-owned conventional banks that offer businessmen, farmers and manufacturers cash at very low interest rate to support development of economy. Does it make any sense to claim that such finance is *ḥarām* while resorting to a product like *eina* or *tawarruq* as offered by some Islamic banks is *ḥalāl* though their clients may end up paying double or triple what they pay to governmental banks.

Furthermore, non-Muslims who have no knowledge of shari‘ah might be mistakenly thinking that some controversial Islamic banking products described in this paper represent the true face of the shari‘ah. Moreover, they would believe that it is sufficient in Islam to change the name of the forbidden contracts and tailor their mechanism to make it permissible. Surely, such practices, if continued, may indirectly distort the teachings of Islam.

## 6. CONCLUSION

After deliberation on the foregoing arguments, we may conclude the following:

- So far, most of efforts to Islamise the banking and financing products have been focusing on their forms and technicalities, while the shari‘ah objectives of these transactions are to great extent neglected. This is because the economic substance of many products of Islamic banks is hardly differentiated from that of conventional banks and financial institutions.
- Both form as well as the substance of contracts are important and so must be in compliance with shari‘ah. However, substance rather than form is what should be more importantly looked into when structuring a financial product. Thus, the restricted view of understanding shari‘ah compliance by merely focusing on the legality of contractual forms and technicalities needs to be changed. Otherwise, Islamic banks will just appear as an exercise of semantics; their functions and operations will become no different from conventional banks, except in their use of euphemisms to disguise interest and circumvent the many shari‘ah prohibitions.
- Islamic banks and financial institutions are facing some ideological and conceptual challenges. These challenges emerge from the improper understanding of *maqāṣid* al- shari‘ah and the *maṣlahah* and *ḍarura* concepts. Failure to understand these concepts and their application to modern transactions has led to their abuse, such as using *maqāṣid* to justify certain contracts which are in fact contradictory to the shari‘ah texts and principles.

- Circumventing the prohibition of *ribā* by means of *bay' al-eina* or *tawarruq* and their likes is against the very *sharī'ah* objectives of *ribā* prohibition. Therefore, those who claim the permissibility of such transactions under the pretext of realising *maqāṣid* al-*sharī'ah* are effectively acting against the true spirit of *maqāṣid* al-*sharī'ah* .
- Attributing the permissibility of *bay' al-eina* and its likes to the early great jurists like Shafi'i is wrong as these jurists ruled the validity and not the permissibility of these transactions, for a valid contract is not necessarily permissible.
- As a criterion for distinguishing between a lawful transaction and an unlawful one is to examine the economic substance of a given transaction; if found to be identical to that of the prohibited transaction, such as a sales contract in which the bank or the financier acts as a creditor not as a real trader of real property, then this must render the transaction impermissible regardless of any legal form it may take, or any name it may be given.
- Use of dubious financial products may have fatal implications on the Islamic banking industry as a whole, since such practices may eventually lead to convergence between Islamic banking and conventional banking; confining differences only to semantics and technicalities.
- Claiming *sharī'ah* permissibility of the *ribā*-disguised products leads to the distortion of the *sharī'ah* and harms the image of Islam.
- In the final analysis, Islamic banks should forgo all the *ribā*-disguised products and all controversial contracts that may impede the growth and progress of Islamic banking and finance industry. Indeed Islamic banking system has the potential to become one of the promising sectors to realize the noble objectives of *sharī'ah*; however, this requires the internalisation of *sharī'ah* principles on Islamic financial transactions, in its form, spirit and substance. By so doing, it epitomizes the objectives of *sharī'ah* in promoting economic and social justice.

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