



DIFFERENTIAL APPROACHES TO ISLAMIC
BANKING: IDENTIFICATION OF ISSUES IN
PROSPECT FOR HARMONIZATION

BY

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the degree of Doctor of Philosophy in Law

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ABSTRACT

The research involves an analysis of the juristic differences between the scholars of Malaysia and Middle-East including Bahrain and Kuwait in the realm of Islamic banking. Disagreements exist in juristic views and rulings particularly between Malaysia and other governments. Debt financing is the central area where disagreements exist between the scholars of Malaysia and Middle-East. Broadly speaking, the Middle-Eastern scholars prohibit debt trading while the Malaysian scholars in official rulings permit it. The research will also look into the legal and regulatory aspects of the Islamic financial industry as the principles of the Islamic banks are alien to the existing legal structure applicable to the financial sector in general and to the banking sector in particular. The present research is an effort to look at the two divergent approaches from an Islamic jurisprudential perspective.

It was revealed that *uṣūl al-fiqh* has failed to stimulate *ijtihād*. *Ijtihād* is a central term with regard to law making in Islamic law. Nonetheless, *ijtihād* has been held responsible for making Islamic law un-systematic due to the lack of a standard application. A renowned modern jurist, Zakī Badāwī has emphasised on the use of *maqāṣid* oriented approach to *ijtihād* for the development of Islamic financial system. The same approach has been suggested by Hashim Kamali, whereby he proposed the extension of the theory of *maqāṣid* to *ijtihād*. The issue of disagreement is very significant and has a far reaching impact on the Islamic banking industry worldwide. It can be said that disagreement is unavoidable, but at the same time, there exist a reconciliatory mechanism in Islamic law to harmonize different interpretations from jurisprudential perspective which is the central theme of the present research. However, the issue of disagreement could be resolved from either juristic or administrative perspectives or both. Harmonization of the different views amongst the scholars from the different schools of thought is necessary to enhance the global development of Islamic banking and finance.

The study is mainly based on library research and is analytical, descriptive and comparative. The methodology that was used contains different mechanisms of *uṣūl al-fiqh* such as *ijtihād*, *istiḥsān* and its other supplementary proofs were applied to the existing juristic differences. The *maqāṣid* oriented approach to *ijtihād* can help to make the legal theory relevant to the needs of the Muslim world. It is recommended that any further move in this direction be made under the purview of *siyāsah sharīyyah*. *Maṣlahah* requires that juristic differences be harmonized for the sake of promotion and prosperity of the Islamic banking industry.

ملخص البحث

يتناول البحث بتحليل الاختلافات الفقهية بين فقهاء ماليزيا وفقهاء دول الشرق الأوسط بما فيها بجرين وكويت في مجال البنوك الإسلامية. فعلى سبيل المثال التمويل بالاقتراض حيث يعتبر الموضوع المحوري الذي تدور حوله تلك الاختلافات الموجودة بين علماء ماليزيا وعلماء الشرق الأوسط، وبشكل عام فإن علماء الشرق الأوسط يحرمون التجارة بالدين بينما العلماء الماليزيين يسمحون بها في القرارات الرسمية. وسوف يلقي هذا البحث النظر على الأوجه المنظمة والقانونية لصناعة التمويل الإسلامي حيث أن مبادئ التمويل الإسلامي تعتبر مغايرة لما هو موجود في الصياغة القانونية المطبقة في قطاع التمويل بصورة خاصة والقطاع المصرفي بصورة عامة، ولقد ألقى هذا البحث النظر على طريقتين مختلفتين في منظور الفقه الإسلامي. فقد أظهر أن أصول الفقه أخفقت في تحفيز الاجتهاد الذي يعتبر شرط حيوي خاص بصناعة القانون في الشريعة الإسلامية. ومع ذلك فإن الاجتهاد يعتبر مسئول عن صناعة الشريعة الإسلامية والتي تعتبر غير منظمة لقلة التطبيق القياسي فيها. ولقد أكد القاضي الشهير زكي بدوي على استخدام المقاصد المهيأة للاقتراب من الاجتهاد من أجل تطوير النظام المالي الإسلامي. ولقد قام الدكتور هاشم كمالى باقتراح نفس الطريقة حيث اقترح بتوسيع نظرية المقاصد للاجتهد. وتعتبر قضية الاختلاف ذات مغزى هام ولديها تأثير، في المستقبل البعيد، على الصناعة المصرفية الإسلامية العالمية، ويمكن القول بأن الاختلاف محتوم لا مفر منه ولكن في نفس الوقت يوجد هناك آلية إصلاح فيتضمن البحث تحليل للاختلافات الشرعية بين علماء ماليزيا وعلماء الشرق الأوسط فيما الشريعة الإسلامية تهدف إلى التوفيق بين التفسيرات المختلفة من وجهة نظر فقهية والتي تعتبر موضوع هذا البحث المحوري. ومن ناحية أخرى فإن قضية الاختلاف من الممكن أن تُحل من منظور قضائي أو إداري أو كلاهما، ويعتبر توفيق وجهات النظر المختلفة بين العلماء من المذاهب المختلفة الاعتقاد ضروري لتعزيز تطوير المعاملات المصرفية والمالية الإسلامية العالمي. تستند الدراسة أساسًا على البحث المكتبي وتحليلاته، وكذلك؛ فإنها تعتمد المنهج الوصفي، والمقارن. وتحتوي

منهجية الدراسة المستخدمة على تقنيات مختلفة في أصول الفقه، مثل: الاجتهاد، والاستحسان، وكذلك البراهين الأخرى المكملة لهما، والتي قد طبقت على الاختلافات الفقهية الراهنة. وأما مدخل المقاصد الموجهه للاجتهاد؛ فإنه يُعزز من تقارب النظرية القانونية ذات الصلة بحاجات العالم الإسلامي. ولقد أوصت الدراسة بأن تكون أي حركة مستقبلية في هذا الاتجاه -إتجاه صناعة البنوك الإسلامية- لا بد لها أن تُصنع وفق السياسة الشرعية. وتتطلب المصلحة أن تكون الخلافات الفقهية متوائمة من أجل دعم صناعة البنوك الإسلامية.

APPROVAL PAGE

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DECLARATION

I hereby declare that this thesis is the results of my own investigation, except where otherwise stated. I also declare that this thesis has not been previously or concurrently submitted as a whole for any of my other degrees at IIUM or other institutions.

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Signature.....

Date.....

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To

MY PARENTS

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Praise be to Allah, the Cherisher and Sustainer of the worlds; Most Gracious, Most Merciful; Master of the Day of Judgment; worthy to be worshipped Alone, He Who taught (the use of) the pen, taught man that which he knew not.

Blessings and peace of Allah be upon His most righteous and guided servant, the mightiest and the last in the line of His Apostles and Messengers, whose name is Muhammad; May Allah be pleased with his pious companions, his pious converts, his progenies and all of those who follow him guided until the Day of Doom.

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TABLE OF CONTENTS

Abstract	ii
Arabic Abstract	iii
Approval Page.....	v
Declaration	vii
Copyright Page.....	viii
Dedication	viii
Acknowledgements.....	ix
Table of Contents	x
List of Statutes	xii
List of Cases.....	xiv
Transliteration Table	xv
CHAPTER ONE: BACKGROUND OF THE STUDY	1
1.1 Introduction.....	1
1.2 Statement of Problem.....	6
1.3 Hypothesis.....	10
1.4 Objectives.....	10
1.5 Literature Review.....	11
1.6 Methodology	21
1.7 Scope and Limitations of the Study	21
CHAPTER TWO: ISLAMIC JURISPRUDENTIAL FRAMEWORK.....	22
2.1 Introduction	22
2.2 The Principles of Permissibility (<i>Ibāḥah</i>).....	25
2.3 <i>Maqāsid Al –Sharī‘ah</i> and its Relevancy to <i>Ijtihād</i>	29
2.3.1 <i>Maqāsid</i> Oriented Approach to <i>Ijtihād</i>	32
2.4 The Role of <i>Ijtihād</i> in Modern Financial Transactions.....	36
2.5 <i>Istiḥsān</i> (Juristic Preference).....	39
2.6 <i>Siyāsah Shar‘īyyah</i> (<i>Sharī‘ah –Oriented Policy</i>).....	42
2.7 <i>Maṣlahah Mursalah</i> (Consideration of Public Interest)	46
2.8 Custom (‘ <i>Urf</i>).....	50
2.9 <i>Takhayyur</i>	55
2.10 <i>Talfīq</i>	57
2.11 Conclusion	61
CHAPTER THREE: LEGAL AND REGULATORY FRAMEWORK OF ISLAMIC BANKING.....	65
3.1 Introduction.....	65
3.2 Licensing of Islamic Banking Business	67
3.3 Islamic Banking Business	73
3.4 Banking Operation of Islamic Banks	80
3.4.1 Current Account.....	81
3.4.2 Savings (<i>Wadī‘ah / Muḍārabah</i>) Account.....	83
3.4.3 Investment (<i>Muḍārabah</i>) Account	85

3.4.4 Hybrid Account.....	87
3.4.5 Essential Features of Islamic Deposit Accounts.....	89
3.5 <i>Shari'ah</i> Supervisory Board.....	91
3.6 Objectives of the Establishment of Prudential Information and Regulatory Framework for Islamic Banks	98
3.7 Resolution of Disputes for Islamic Financial Transactions	103
3.8 The Role of Islamic <i>Fiqh</i> Academy (IFA) in the Sphere of Islamic Finance	109
3.9 Conclusion	112

**CHAPTER FOUR APPLICATION OF JURISPRUDENTIAL FRAMEWORK
TO THE CONTRACT OF *BAY' AL-MURĀBAHAH*** 116

4.1 Introduction	116
4.1.1 Meaning of <i>Bay'al-Murābahah</i>	118
4.1.2 Legality of <i>Bay'al-Murābahah</i>	118
4.2 Classical <i>Murābahah</i>	120
4.2.1 General Requirements for Sale Contracts.....	120
4.2.2 The Classical <i>Murābahah</i> Contract	122
4.3 Contemporary <i>Murābahah</i>	128
4.3.1 The Contemporary <i>Murābahah</i> Contract	129
4.3.2 Overview of the Contemporary <i>Murābahah</i> Contract.....	140
4.4 Cases Involving the Contract of <i>Murābahah</i>	149
4.5 Conclusion	153

**CHAPTER FIVE: APPLICATION OF JURISPRUDENTIAL FRAMEWORK
TO THE CONTRACT OF *BAY'BI THAMAN ĀJIL*.....** 157

5.1 Introduction	157
5.1.1 Definition of <i>Ajal</i>	158
5.1.2 History of the Concept of Deferment	159
5.2 The Validity of Deferment	161
5.3 <i>AL Bay' Bithaman Ājil</i>	163
5.3.2 Arguments Against <i>Bay' Bithaman Ājil</i>	166
5.4 <i>Bay' Bithaman Ājil</i> : Sale or Loan Transaction	169
5.5 The Role of <i>'Iwāḍ</i> in Islamic Law of Contract	174
5.5.1 The Meaning of <i>'Iwāḍ</i>	175
5.6 The Concept of <i>Khiyār al-'Ayb</i>	177
5.7 Malaysian Court Judgments on <i>Bay' Bithaman Ājil</i>	180
5.7.1 Dato Haji Nik Mahmud bin Daud v. Bank Islam Malaysia Bhd (BIMB)	180
5.7.2 Bank Islam Malaysia Bhd v. Adnan b. Omar	182
5.7.3 Affin Bank Bhd v Zulkifli Bin Abdullah.....	186
5.8 Alternative Suggestions	192
5.8.1 Current Practice of <i>Mushārahah Mutanāqishah</i>	194
5.9 Conclusion	197

**CHAPTER SIX: APPLICATION OF JURISPRUDENTIAL FRAMEWORK TO
THE CONTRACT OF *BAY' AL- DAYN*** 201

6.1 Introduction	201
6.2 An Appraisal of the Qur'anic <i>Ayah al-Mudāyanah</i>	203

6.3	The Legal Ruling on <i>Bay' al-Dayn</i> (Sale of Debt)	206
6.4	Islamic Accepted Bill	215
6.6	The Sale of Receivable and the Practice of Discounting	218
6.9	Conclusion	226
CHAPTER SEVEN: APPLICATION OF JURISPRUDENTIAL FRAMEWORK TO THE CONTRACT OF <i>BAY' AL-ĪNAH</i>		229
7.1	Introduction	229
7.2	Definition of <i>Bay'al-Īnah</i>	230
7.3	Views of the 'Ulamā' on <i>Bay' al-Īnah</i>	232
7.4	The Effect of Intention on the Validity of Contracts	237
7.5	Need of the People and the Use of Legal Tricks (<i>Hiyāl</i>)	240
7.6	An Alternative Suggestion: <i>Tawarruq</i>	247
7.7	Current Practice of <i>Bay' al-Īnah</i> and <i>Tawarruq</i>	250
7.8	Conclusion	258
CHAPTER EIGHT CONCLUSION		261
BIBLIOGRAPHY		274

LIST OF STATUTES

Bank Negara Malaysia *Shari'ah* Governance Framework for Islamic Financial Institutions 2010
Banking and Financial Institutions Act, 1989 (ACT 372)
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447

TRANSLITERATION TABLE

Arabic Term	Transliteration	Arabic Term	Transliteration	Arabic term	Transliteration
ء	‘	ر	r	ف	f
ب	B	ز	z	ق	q
ت	T	س	s	ك	k
ث	Th	ص	ṣ	ل	l
ج	J	ض	ḍ	م	m
ح	ḥ	ط	ṭ	ن	n
خ	Kh	ظ	ẓ	ه	h
د	D	ع	‘	و	w
ذ	dh	غ	gh	ي	y
ا	a	ي	i	أ	u
آ	ā	إي	ī	أو	ū

CHAPTER ONE

BACKGROUND OF THE STUDY

1.1 INTRODUCTION

Islamic banking is an emerging and important area of the applied Islamic law and jurisprudence. Most of the provisions in the primary sources of Islamic law are in terms of general principles with regards to Islamic financial and commercial transactions such as the prohibition of “*ribā*” and the permission of “trade”. These general principles often need further interpretation through a dynamic form of legal reasoning known as “*ijtihād*”. Original interpretation and *ijtihād* is most essential today for the development of Islamic law generally, and of Islamic commercial law in particular. Despite the existing weaknesses concerning *ijtihād*¹, if there is a success story to be associated with the revival of Islamic jurisprudence in modern times, that story will certainly include Islamic finance. From little more than a concept during the first decade of its emergence, modern Islamic finance grew rapidly to take the form of Islamic banking and investment houses in 1980s and 1990s.²

Zakī Badāwī³ emphasized the importance of the use of *maqāṣid* oriented *ijtihād* for the development of Islamic financial system. He stated that little attention was paid by most of the *fuqahā* to the basic aims and purposes of the *Shari‘ah*, aims of which some of the companions of the Prophet (s.a.w) were well aware of. He

¹ This includes contemporary as well as classical *ijtihād*. Actually interpretation is essential in Islamic law as the law is not self-evident. In this context, a scholar exercises his full interpretative capabilities to produce a sound judgement. In this way, the exercise of *ijtihād* becomes an instrument of disagreement amongst the Muslim scholars. This is due to the lack of a standard application of *ijtihād* in the process of interpretation. The issue will be discussed in more detail in the following pages.

² Nathif J. Adam and Abdul Kadir Thomas, *Islamic Bonds, Your Guide to Issuing, Structuring and Investment in Sukūk*, UK, Euro Money Books, 2004, at 1.

³ Zakī Badāwī, Views and Analysis of Islamic Banking, Finance and Insurance, *Islamic Bankers*, Mushtaq Parker Associates, London, 1996.

pointed out that Al Shaṭībī as well as Al Ghazālī, Ibn Taymiyyah, and Ibn Qayyim called upon the *fuqahā* to take heed of the purposes of the *Sharīʿah* and meet the needs of the new societies in changing circumstances. The task of identifying and assessing the real needs of the communities, together with their relevance to the purpose of the *Sharīʿah* is not easy. It places the scholar in between two contending claims: that of the text (or a derivative of the text such as *qīyas*), on one hand and the purposes of the *Sharīʿah* on the other. He concludes that new *ijtihād* must begin by adopting the post Al-Shaṭībī approach to *uṣūl al-fiqh*.⁴

Kamali argued that *uṣūl al-fiqh* has become a theoretical discipline studied as a part of the legal heritage rather than a tool to regulate and encourage *ijtihād*. The *uṣūl al-fiqh* is not without weaknesses and some of the weaknesses are not new, but existed for almost as long as the *uṣūl al-fiqh* itself. A legitimate use of human intellect and discretion or *ijtihād* in coping with the emerging circumstances is guided only by general principles of *Sharīʿah* based on justice and benevolence (*Al ʿadl wa ihsān*).⁵

Al Shaṭībī⁶ has also emphasized the importance of *maqāṣid* for *ijtihād*. He advocated a sound knowledge of the goals and the objectives of the *Sharīʿah* as a pre-requisite to reach to the rank of a *mujtahid*. Sano Koutub argued that the protection and preservation of wealth is one of the essential elements of *maqāṣid al-Sharīʿah*. Therefore, the continuity and growth of wealth in the society should be ensured at all costs. The continuous distribution of wealth in the society should also be enhanced to

⁴ Zakī Badāwī, Views and Analysis of Islamic Banking, Finance and Insurance, *Islamic Bankers*, Mushtaq Parker Associates, London, 1996.

⁵ See Muhammad Hashim Kamali, Issues in the Legal Theory of *Uṣūl* and Prospects for Reforms, *Islamic Studies* 41(2002), at 1-200.

⁶ Al-Shaṭībī, *al-Muwāfaqāt*, vol.VI, 179 in Kamali, *Principles of Islamic Jurisprudence*, UK, Islamic Text Society of Cambridge, 1991 at 405.

bring happiness and financial stability in the society⁷. To achieve these objectives, a supportive Islamic jurisprudential framework is required based on the concept of *maṣlahah* and the broader objectives of the *Shari'ah*.

Islamic Banking has ascended to greater prominence in recent decades as one of the most important trends in the global financial system and has fast extended beyond the traditional predominantly Muslim economies to major industrial economies.⁸ This growing significance is a manifestation of the viability of Islamic banking as a financial intermediation channel that supports economic growth and development of nations. While it was initially developed to fulfil the needs of the Muslims, Islamic banking and finance has gained universal acceptance. The appreciation of its promising potential has prompted interest amongst conventional financial institutions to venture into this fast expanding market. Islamic banking and finance can expect to evolve into an increasingly important component of the global financial system.⁹

There has always been a demand amongst Muslims for financial products and services that conform to the *Shari'ah*. With the development of viable Islamic alternatives to conventional finance, Muslims are beginning to find *Shari'ah* compliant solutions for their financial needs. Amidst an increasingly challenging and competitive financial environment, the evolution of a comprehensive Islamic financial system seeks to meet the range of requirements of a rapidly changing economic environment. The soundness and stability of the system can be secured through the robustness of its regulatory framework supported by the strength of its financial

⁷ Sano Koutub Moustapha, *The Sale of Debt as Implemented by the Islamic Financial Institutions in Malaysia*, Kuala Lumpur, IIUM Press Research Centre, 2001, at 60-61.

⁸ Zeti Akhtar Aziz, *Islamic Banking and Finance, Progress and Prospects, Collected Speeches*, Bank Negara Malaysia, 2000-2005.

⁹ Ibid.

infrastructure and the sophistication of its products and services. Indeed, the strength of the respective components of the system and the interconnections of its market will open new frontiers in Islamic banking and finance and will maximize the potential and opportunities that it accords.¹

Although, Islamic banking has made significant achievements in a short period of time, disagreements still exist in juristic views and rulings particularly between Malaysian scholars and the scholars of other countries. Debt financing is one of the core areas of concern here, where disagreements exist over products such as *bay' al-murābaḥah*, *bay' bithaman ājil*, *bay' al-dayn* and *bay' al-īnah*.¹ The perceptions of Muslim scholars tend to differ in the two regions. Generally speaking, the Middle Eastern scholars prohibit debt trading while the Malaysian scholars in official rulings permit it. The present research will examine the reasons behind this difference in rulings, and would attempt to come up with a more workable solution to harmonize the two divergent views from a jurisprudential perspective.

Zakī Badāwī argued that the contradicting views are due to the difference in business environments. The Middle East is an exporter of capital with comparatively moderate scope for investment. The one commodity, namely oil dominates its economic life and a few people hold most of the accumulated capital. By contrast, Malaysia is a vibrant booming market on a major privatization program. It needs vast investment to acquire a significant share of it. The Malaysians, therefore, have to find sources of capital to ensure a future for their community in the business sector. Unlike the situation in the Middle East, funds are not concentrated in a few hands. The objective of the Malaysian Islamic bankers was to find ways to bring the small

¹ Ibid.

¹ The disagreement exists in all of the above mentioned financial contracts. *Murābaḥah* and *bay' bithaman ājil* in general and *bay' al-dayn* and *bay' al-īnah* in particular remained the subject of disagreement.

investors into this growing activity and to secure a valuable source of capital. It was natural for them to attempt to find Islamic alternatives to the conventional business practices, and design products to meet their objectives. ¹ 2

Apart from this, there are many issues that have to be addressed by Islamic banks both in terms of documentations and transactions. The general legal framework in many countries will need to be modified to promote Islamic banking. Zeti argued the need for the development of the regulatory dimension to explicitly address the unique features of Islamic banking and finance. She further stated that at present, Islamic banking and financial institutions have, to a large extent, been governed by the conventional regulatory framework, reinforced by the *Sharī'ah* framework and Islamic accounting standards. However, Islamic banking is distinct from conventional financial activities in terms of its philosophy of prohibiting interest, which in turn shapes the nature of its financial transactions, and its risk attributes. Therefore, she suggested the development of a separate regulatory framework in view of the unique risks in Islamic financial transactions to provide for their effective assessment and management. ¹ 3

In addition, Sudin Haroon stated in his book that there is no uniformity of laws and procedures in the practice of Islamic banks around the world. Islamic banks have to conform basically to two types of laws, i.e. the *Sharī'ah* and positive laws. While *Sharī'ah* law is based on religious foundations, positive laws are promulgated by the sovereign bodies to safeguard public interest. The positive laws, in most cases are under the supervision of the Central Banks. In Malaysia, for example, the establishment of an Islamic bank is governed by the Companies Act 1965, and its

¹ Zakī Badāwī, Views and Analysis of Islamic Banking, Finance and Insurance, *Islamic Bankers*, Mushtaq Parker Associates, London, 1996.

¹ Zeti Akhtar Aziz, *Islamic Banking and Finance, Progress and Prospects, Collected Speeches*, Bank Negara Malaysia, 2000-2005.

operations are subjected to the Islamic Banking Act 1983 and to some extent also to the Banking and Financial Institutions Act 1989. Islamic banks must conform to all requirements as stipulated in all the above stated Acts. Similarly, other governments have passed special laws that govern the operations of Islamic banks in their countries. Islamic banks in Malaysia are subject to the Malaysian's Companies Act 1965, while the Islamic banks of Bahrain are subject to the Bahrain Commercial Companies Law 1975 and the Kuwait Finance House (KFH) is subject to the Kuwait Commercial Companies Laws 1960.¹ Whilst Malaysia and Kuwait have recently legislated on Islamic Banks, Bahrain has no special laws on the subject.

Keeping in view the differential juristic views of the two regions studied in this thesis, the present research will look into the concepts and practices as well as the position of the *madhāhib* from the Islamic jurisprudential perspective and then point to the ways as to how one can develop the idea of harmonization between the two divergent positions of Malaysia and the Middle East.

1.2 STATEMENT OF PROBLEM

The social changes in the modern times have introduced complexities in the application of Islamic law. The prevailing diversity in the contemporary application of Islamic law as a response to social change on one hand is perhaps a welcome development but on the other hand, it creates new challenges too. Islamic banking industry is the most prominent example, where the emerging challenges are significant and required to be addressed urgently.

¹ Sudin Haroon, *Islamic Banking, Rules and Regulations*, Kuala Lumpur, Pelanduk Publications Malaysia, 1997, at 167-170.

While the diversity in *fiqh* opinion is presently contributing to the global growth, it may soon become a constraining factor in the global growth of the industry if the challenges arising out of it are not properly addressed. Diversity in *fiqh* opinion started with the start of the interpretative judgments (*ijtihad*). In fact scholars date it back to the days of the Prophet (s.a.w.). During the Prophet's life time there was no controversy over *Shari'ah* precepts because he provided the necessary guidance. After the death of the Prophet (s.a.w.), the Islamic state expanded and the Prophet's companions migrated to different regions and countries, whose customs and traditions they had to understand. This compelled subsequent generations of jurists to come up with solutions regarding new issues. If they failed to find a solution from the Qur'an and Sunnah they would resort to *ijtihad*. They agreed on certain issues and differed on others¹. *Ijtihad* thus became a vehicle also of diversity and juristic disagreements (*Ikhtilaf*).

The two distinct mechanisms that operate side by side to carry out business according to the divine revelation are equity financing and debt financing. Equity financing is effected through "*Uqūd al-Ishtirāk*" (profit sharing contracts), while debt financing is affected through deferred contracts of exchange. The Qur'an further elaborates debt financing where the contracts of deferred exchange are allowed and interest based lending is forbidden¹. The main disagreement which prevails between the two regions under review is over debt based financial products such as *bay' al-murābahah*, *bay' bithaman ājil*, *bay' al-dayn* and *bay' al-īnah*.

Murābahah in *fiqh* literature is considered as a variety of sale. The only feature in *murābahah* distinguishing it from other kinds of sale is that the seller expressly

¹ Tariq Hasan, Legal Process for Establishing Rules for *Murābahah* Contracts, *Journal of Islamic Banking and Finance*, Vol. IV, at 17-74.

¹ BIMB, *Islamic Banking Practice from Practitioner's Perspective*, Kuala Lumpur: BIMB, 1994, 16.

informs the purchaser of his cost and the profit he intends to make.¹ The main objections to *murābahah* are that it partakes into *bay' al-ʿinah* as practised by some Islamic financial institutions and that it combines two sales in one. There are also differences of views amongst the scholars regarding the binding nature of a promise to purchase.¹ As far as *al bay' bithaman ājil* is concerned, there are controversies amongst the Muslim scholars whether the price charged by the seller under *al bay' bithaman ājil* can be higher than the spot price. Even the scholars, who are of the view that charging a higher price than the spot price is permissible under *Shari'ah* do not recommend a heavy reliance on it.¹

9

As far as *bay' al-dayn* is concerned, it has always been an issue amongst the past and present Muslim jurists. The jurists who do not allow *bay' al-dayn* have premised their objections on *ribā*, risk to the buyer and absence of *qabaḍ*.² The majority of the *fiqh* schools have declared *bay' al-dayn* as a prohibited contract because of the apprehension of its indulgence in *ribā* (interest) and *gharar* (uncertainty) transactions. However, this objection has not influenced many of the contemporary scholars. The two important types of the sale of debts are *bay' al-dayn naqd* and *bay' al-dayn nasī'ah* which is also known as *bay' al-kalī bi al-kalī*. Majority of the past Muslim jurists are unanimous on the prohibition of *bay' al-kalī bi al-kalī*.

¹ Muḥammad Taqī ʿUsmānī, *An Introduction to Islamic Finance*, The Hague, Kluwer Law International, 2002, at 37.

¹ A promise to purchase a commodity in the future is an example of contemporary *ijtihād*. Therefore, the treatment of 'promise to purchase' as binding attracted criticism. The issue will be discussed in detail in the following pages.

¹ Please see Sheikh Maḥmūd Aḥmad, "*Towards Interest-Free Banking*", Institute of Islamic culture, Lahore, 1989, at 46; also Siddiqui, Muhammad Najatullah, "*Issues in Islamic Banking*", Leicester, The Islamic Foundation, 1983, at 139.

² Please see Mohammad Hasfīm Kamali, paper presented at the Colloquium on Islamic Private Debt Securities, jointly organized by the International Islamic University Malaysia and the Securities Commission, Kuala Lumpur, 24 June, 2004; also Muḥammad Taqī Usmānī, *An Introduction to Islamic Finance*, The Hague, Kluwer Law International, 2002, at 99.

Nonetheless, there were differences amongst the classical Muslim jurists regarding the sale of debt from the creditor to the debtor and the sale of debt from the creditor to the third party. This issue will be discussed in more detail in the following pages.

And as far as *bay' al-ṭinah* is concerned, the majority of the past Muslim jurists were of the opinion that it was not permissible because it was a legal excuse (*ḥīlah*) to legitimize *ribā*. This opinion is being followed by the jurists of Islamic finance of the Middle East.² *Bay' al-ṭinah* is being¹ practiced by Islamic financial institutions in Malaysia. The issue which concerns us is how Islamic law would view such a contract: Should the sale be allowed *prima facie* or disallowed as the motive behind the sale is to legalize that which is illegal.

In addition, the general legal framework in many countries will need to be modified to promote Islamic finance. At present, Islamic banking and financial institutions are governed by the conventional regulatory framework, reinforced by the *Sharī'ah* framework. However, as earlier stated, Islamic finance is distinct from conventional financial activities in terms of its underlying philosophy on the prohibition of interest, therefore, a separate legal and regulatory framework needs to be developed in view of the unique risks in Islamic financial transactions.

The Muslim scholars and the Islamic Banking Act² of Malaysia have explained that the term 'Islamic banking' means the conduct of banking operations in consonance with Islamic teachings. The Islamic financial system cannot be introduced merely by eliminating *ribā*, but by adopting the Islamic principles of social justice and by introducing laws, practices, procedures and instruments which help in the maintenance and dispensation of justice.

² See Mohammad Hashim Kamali, paper presented at the Colloquium on Islamic Private Debt Securities, jointly organized by the International Islamic University Malaysia and the Securities Commission, Kuala Lumpur, 24 June, 2004.

² Islamic Banking Act 1983, Section 2.