



**NATIONAL OPEN UNIVERSITY OF NIGERIA**

**SCHOOL OF ARTS AND SOCIAL SCIENCES**

**COURSE CODE: ISL 433**

**COURSE TITLE: THE CONCEPT AND PRACTICE OF ISLAMIC BANKING**



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**COURSE CODE/TITLE: ISL461 THE CONCEPT AND PRACTICE OF  
ISLAMIC BANKING**

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## **Introduction**

### **Welcome to ISL 461: THE CONCEPT AND PRACTICE OF ISLAMIC BANKING**

**ISL: 461:** The Concept and Practice of Islamic Banking is a two-credit and one-semester undergraduate course. It consists of four modules which are subdivided into 14 units. This course guide gives an overview of the course. It offers you with the necessary information on the organisation as well as requirements of the course.

### **Course Aims**

- a). to provide a background to the student on the concepts of structure of an economy
- b). to equip the students with an understanding of the overall profile of Islamic economy.
- c). to familiarize the students with the activities of different sectors and subsector of the Islamic economy
- d). to appraise some Muslim plans, policies and programmes as it affects the overall structure and different sectors.

### **Course Objectives**

To achieve the aims of this course, there are overall objectives which the course is out to achieve though, there are set out objectives for each unit. This is to assist the students in accomplishing the tasks entailed in this course. The objectives serves as study guides, such that student could know if he is able to grab the knowledge of each unit through the sets of objectives in each one. At the end of the course period students are expected to be able to:

- Explain the origin and history of Islamic banking
- Outline the aims, objectives and functions of Islamic banks
- Examine the basic concepts in Islamic banking
- Assess the contribution of the international community to the development of Islamic banking
- Discuss the operational techniques involved in Islamic banking

## Course Materials

Main materials required to go through this course are:

- a. course guide
- b. study units
- c. assignment file
- d. reference of textbooks listed under each unit
- e. presentation schedule

## Study Units

There are 14 units (grouped under four modules) in this course stated as follows:

### **ISL 461: THE CONCEPT AND PRACTICE OF ISLAMIC BANKING CONTENTS**

#### **Module 1 Overview of Islamic Banking System**

- Unit 1: Origin and Development of Islamic Banking System
- Unit 2: Objectives, Functions and Maintenance of Accounts in Islamic Banks
- Unit 3: International Islamic Financial Institutions

#### **Module 2 Foundation of Islamic Banking System**

- Unit 1: Financial Contracts in Islam
- Unit 2: The Concept of *Ribā* in Islam
- Unit 3: Illegalisation of *Ribā* in Islam
- Unit 4: The Question of *Gharar* and *Maysir*

#### **Module 3 Islamic Banking Instruments and Techniques**

- Unit 1: Instruments of Authentication in Islamic Finance
- Unit 2: Instruments of Service and Investment in Islamic Finance
- Unit 3: Islamic Financial Techniques I: *Mushārah* (Equity Participation) Contract

Unit 4: Islamic Financial Techniques II: The *Muḍārabah* (Trustee Project Financing)

#### **Module 4 Islamic Banking Products**

Unit 1: Islamic Financial Techniques III: *Ijārah* Contract

Unit 2: Islamic Financial Techniques IV: *Murābahah*, *Salam* and 'Istiṣnā'

Unit 3: Consumption Loan (*Qarḍ Ḥasan*)

#### **Textbooks and References**

Recommended books and eBooks for this course can be downloaded online as specified for References and further readings.

#### **Assignments**

An assignment file and marking scheme will be made available to you. This file presents you with details of the work you must submit to your tutor for marking. The marks you obtain from these assignments shall form part of your final mark for this course. Additional information on assignments will be found in the assignment file and later in this Course Guide in the section on assessment.

#### **Tutor-Mark Assignment (TMAs)**

You are required to submit a specified number of Tutor-Marked Assignments (TMAs). Every unit in this course has a tutor-marked assignment out of which you will be assessed on four of them and best three will be selected for you. The best three TMAs selected for you shall form 30 percent of your total marks. You are expected to send your completed assignment and TMAs to your Tutor on or before the deadline for submission. In case you are unable to complete your assignments on time, kindly contact your Tutor to discuss the likelihood of extension. Note that extension will not be granted after due date, unless under extraordinary situation.

#### **Final Examination and Grading**

You shall be examined on all areas of this course and your final examination for ISL 461 shall be 3 hours duration. It is necessary that you read through the units over and over again before the final examination. The final examination shall cover all the self assessment questions for practice and the tutor-marked assignments that you have come across earlier. Thus it is advisable you revise the whole course material after studying



from the first to the last units before you sit for the final examination. It is also advisable that you evaluate the tutor-marked assignments and your tutor's comments on them before you sit for the final examination.

### Course Marking Scheme

The table below displays the broken down of how the course marked are allocated

<b>Assignment</b>	<b>Marks</b>
Assignments (Best three assignments out of four that is marked)	30%
Final Examination	70%
<b>Total</b>	<b>100%</b>

### Presentation Schedule

The date of submission of all assignments and date for completing the study units as well as the final examination dates shall be communicated to you online.

### Course Overview

The Table below describes the number of units contained in ISL 461, number of weeks to complete them and end of unit assignments.

<b>Units</b>	<b>Title of Work</b>	<b>Week's Activities</b>	<b>Assessment (end of unit)</b>
	Course Guide		
<b>Module 1 Overview of Islamic Banking System</b>			
1	Origin and Development of Islamic Banking System	Week 1	Assignment 1
2	Objectives, Functions and Maintenance of Accounts in Islamic Banks	Week 2	Assignment 2
3	International Islamic Financial Institutions	Week 3	Assignment 3
<b>Module 2 Foundation of Islamic Banking System</b>			
1	Financial Contracts in Islam	Week 4	Assignment 1

2	The Concept of <i>Ribā</i> in Islam	Week 5	Assignment 2
3	Illegalisation of <i>Ribā</i> in Islam	Week 6	Assignment 3
4	The Question of <i>Gharar</i> and <i>Maysir</i>	Week 7	Assignment 4
<b>Module 3 Islamic Banking Instruments and Techniques</b>			
1	Instruments of Authentication in Islamic Finance	Week 8	Assignment 1
2	Instruments of Service and Investment in Islamic Finance	Week 9	Assignment 2
3	Islamic Financial Techniques I: <i>Mushārah</i> (Equity Participation)	Week 10	Assignment 3
4	Islamic Financial Techniques II: The <i>Muḍārah</i> (Trustee Project Financing)	Week 11	Assignment 4
<b>Module 4 Islamic Banking Products</b>			
1	Islamic Financial Techniques III: <i>Ijārah</i> Contract	Week 12	Assignment 1
2	Islamic Financial Techniques IV: <i>Murābahah</i> , <i>Salam</i> and 'Istiṣnā' Contracts	Week 13	Assignment 2
3	Consumption Loan ( <i>Qarḍ Ḥasan</i> )	Week 14	Assignment 3
	Revision	Week 15	
	Examination	Week 16	
	<b>Total</b>	13 Weeks	

### How to Get the Most from this Course

The study units in distance learning are replacements of the university classroom lectures. A major advantage of distance learning is that you can read and work at the same time through specially designed study materials. It assists you to study at your own pace, your own time and places that go well with you. Consequently, you shall have to read the lectures instead of listening to a lecturer. Just like a lecturer might give you some readings to do, so also are the study units which provides you with readings on the units as well as exercises to do at the end of each units. It also consists of instructions on when you should read each unit in the course material and when you should do your assignments. The study units follows a common simple format where the first item is an

introduction to the subject matter of each unit followed by how a particular unit is integrated with the other units and the whole course.

In each unit, there are set of learning objectives intended to assist you to know what you should be able to do or what you should grab from the unit after completing it. These objectives should be your study guide such that at the end of completing each unit, you should reflect and check whether you have achieved the set objectives. Cultivating this habit will considerably increase your probability of passing the course. The main body of a unit guides you through the required reading from other sources. This will guide you through reading from other sources such as your text book or course guides. Realistic plans of working through the course are as follows: Phone or email your tutor if you have any trouble with any unit. Do not hesitate to call or email your tutor to provide assistance to you when you need one. In addition, follow the advices below carefully:

1. It is advisable you read the course guide with necessary care. See this as your first assignment.
2. Try to arrange a study plan by referring to the Course Overview in the Course Guide. The expected time to spend on each units and the assignment related to it should be well noted. Writing out your own dates for working on each unit according to your study plan is a good idea
3. Stick to your study plan after you have created one. Student usually failed because they are lagging behind in their course work. In case you have any complexity in your study plan, do not hesitate to inform your tutor before it is too late.
4. Turn to each unit and read carefully the introduction and the objectives for them.
5. Information about what you need for a unit is given in the “Overview” at the beginning of a unit.
6. The contents of a unit is presented in such a way that it provides you with a sequential order to follow, so work through the course units. As you work through each unit, use it to guide your readings. You may be required to read sections from one or more references other than the Course Material.
7. It is suitable if you can review the objectives for each unit for you to know if you have achieved them or not. In case you feel uncertain after reviewing the objectives, review the study material or consult your tutor.

8. But when you feel convinced that you have achieved unit objectives, you can then move to the next unit. Progress unit by unit through the course and space your study plan such that you ensure you're on to-do list.
9. After submission of an assignment, do not wait for your marks before you proceed to the next unit so as to keep to your study plan. If you have any question, clarification or observation, contact your tutor as soon as possible.
10. On completion of the last unit, evaluate the course; check that you have achieved the objectives of each unit as listed in each unit and the overall Course objectives in the Course Guide. Then get prepared for the final examination.
11. The latest course information to keep you current about the course will be continuously available at your study center. So keep in touch.

### **Facilitators/Tutor and Tutorials**

There are six hours of tutorial for this course with allocated dates, time and location of tutorial which you will be notified of. You will also be notified of your tutor's name, phone number and email address as soon as you are allocated a tutorial group. Your completed and submitted assignment shall be marked by your tutor and you get your grade online. For this reason, you are to closely monitor your progress just as your tutor is doing. Tutor shall be ready to assist you as you move through the course when any difficulty is observed. Ensure you email your tutor-marked assignment to your tutor before the deadline. It would be marked by your tutor and your marks are email and text to you.

As mentioned earlier, feel free to contact your tutor by email, phone or through your discussion group whenever you need help. You may need to contact your tutor under certain circumstances, for instance:

- ✓ If you do not understand any part of the study units or the assigned readings
- ✓ If you have problem answering the self assessment questions;
- ✓ If you have question or clarification on your assignment, your tutor's comments on the assignment and TMAs or with your grading.

You shall be doing yourself good by attending tutorials because of the opportunity it provides for you to have face-to-face contact with your tutor and also to ask questions which are instantly answered. Any problem faced in your course of study could be raised, you as well as others could benefit from participating in active discussions and in asking questions you prepared before attending the tutorials.

### **Summary**

This Course guide provides you with an overview of what you should expect in the course of study. ISL 461: The Concept and Practise of Islamic Banking gets you acquainted with an overview of the origin, development and practice of Islamic banking in the world. Besides, the operational rules of Islamic banking are discussed. These include its supporting mechanisms and its financial techniques.



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## **ISL 461: THE CONCEPT AND PRACTICE OF ISLAMIC BANKING**

### **CONTENTS**

#### **Module 1 Overview of Islamic Banking System**

- Unit 1: Origin and Development of Islamic Banking System
- Unit 2: Objectives, Functions and Maintenance of Accounts in Islamic Banks
- Unit 3: International Islamic Financial Institutions

#### **Module 2 Foundation of Islamic Banking System**

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## **MODULE 1            Overview of Islamic Banking System**

The general aim of this module is to introduce you to the origin, development and important flash points in Islamic banking system. This would afford you the opportunity of acquainting yourself with the general knowledge of Islamic banking. These principles are essential for the understanding of the workings of an Islamic bank. Major components of this module include the origin of Islamic banking and its development over time. Its aims, objectives and goals are also well stated. In addition, you will be introduced to how Islamic modernist scholars reinterpreted the Islamic law of transactions in the light of western values and how the Muslims eventually succeeded in retracing their steps back to the right tract. This module, as well, dwelled into the establishment and functionality of some notable international Islamic organisations aimed at servicing Islamic banks in particular and the Islamic financial services industry in general.

This module which gives an overview of the Islamic banking system is made up of three units. In the first unit, you will have the privilege of knowing the source of Islamic banking and the role culture has played in it. The second unit explains the objectives and goals of Islamic banking. It also highlights the functions of Islamic banks in the least developed countries of the world. This is in addition to its ventilating on the accounting system in a normal Islamic bank. In the third unit, an insight into the profile of international Islamic financial services organisations is showcased.

Units in this module are in one way or the other linked together. By the end of this module, you would have been able to have a firm grip of not only the formative stages of Islamic banking but also the types of players in the Islamic financial services industry.

Unit 1:            Origin and Development of Islamic Banking System

Unit 2:            Objectives, Functions and Maintenance of Accounts in Islamic Banks

Unit 3:            International Islamic Financial Institutions



## **Unit 1: Origin and Development of Islamic Banking System**

### **CONTENT**

- 1.0 Introduction
- 2.0 Objectives
- 3.0 Main Content
  - 3.1 The Origin of Islamic Banking
  - 3.2 The Development of Islamic Banking in the Mediaeval Period
  - 3.3 The Development of Islamic Banking in the Modern Period
- 4.0 Conclusion
- 5.0 Summary
- 6.0 Tutor – Marked Assignment
- References / Further Reading

### **1.0 INTRODUCTION**

This unit introduces Islamic banking to you through explaining its origin and development. Islamic and conventional banking system transverse different paths towards the same goal since both deal with a common set of operating business realities with some fundamental differences. The basic or fundamental differences are treated in subsequent units. This unit traces the historical origin, growth, goals, objectives, functions and part of operational framework of Islamic banking.

### **2.0 OBJECTIVES**

At the end of this unit, you should be able to:

- (i) Explain the origin of Islamic banking, and
- (ii) Examine the development of Islamic banking.

### **3.0 MAIN CONTENT**

#### **3.1 The Origin Islamic Banking**

The Islamic law of financial transactions is domiciled in the aspect of *fiqh* (Islamic jurisprudence) called *fiqh al-mu'āmalāt* (Islamic law of transactions) which embodies the code of conduct of Muslims in their daily lives. A renowned scholar, *al-shātibī* defines *fiqh al-mu'āmalāt* as whatever engenders benefit to people. This includes sale, lending, hiring, mortgaging and other commercial activities. In essence, *fiqh al-mu'āmalāt* consists of the rules of Islam which aim at bringing about benefit to man in his dealings with others.

*Fiqh al-Mu'āmalāt* is divided into two parts: moral and material. While the spiritual aspect concentrates on behaviour with regards to religious obligations, the material aspect features, among others, the modus operandi of contracts and obligations and the exchange of properties and usufructs. This course is devoted to the material aspect of *fiqh al-mu'āmalāt*.

Material transactions are hinged on properties that are jealously guarded by man. Owing to that, dealings regarding material transactions have to be handled with all the care that they deserve. Because man is a social being and not an island, Allah has structured the system of man's dealings with properties in a just and equitable manner. As such, any act of injustice and exploitation is not tolerated in Islam.

The Islamic law of *mu'āmalāt* is unique and dynamic in that it gives great regard to custom (*'urf*) and practices (*'ādah*) of the people. The custom and practices of people are dictated by the situations and circumstances they find themselves. As much as a considerable number of these customs and practices are sound and tenable some of them could be absurd. The customs and practices which are in line with the teachings and spirit of Islam are retained while those that are in contrast to it are abolished. Consequently, cultures and practices that were prevalent among the Arabs at the time of Prophet and were not abolished by Islam are recognised by it. After the death of the Prophet, new cultures and practices were subjected to validity tests based on those already accepted in his life time.

Arising as a result of the above, the body of Islamic law adopts all the customs and practices of the Arabs before the mission of the Prophet (*Jāhiliyyah*). These Arab customs and practices have influenced the Islamic law in both its formative and developmental stages. Thus, Islam is not aimed at abolishing any customs or practices it encounters. Rather, it stands for the re-engineering of culture and practices along the right tract. Islam's standard for accepting or rejecting any custom or practice is simple subjecting it to validity test by measuring its usefulness or otherwise for humanity and its consistency with the divine laws. Therefore, Islam perfectly fits into any constructive cultures and practices.

Transaction is viewed by Islam as a necessity in any society. For the implementation of this necessity, Islam has stipulated certain injunctions guiding the regulations of man's transactions. It has also granted man the right to possess property and benefit from other property rights. Although Islam vests the right of real ownership of property in Allah, man enjoys the benefits of the property as though he/she owns it. This enjoyment is not without the condition of applying the principle of social solidarity, which abhors exploitation and injustices to others. As such, *fiqh al-mu'āmalāt* is dynamic in its application irrespective of its place or time.

### **SELF ASSESSMENT EXERCISE 3.1**

Examine the Origin of Islamic banking.

### **3.2 The Development of Islamic Banking in the Mediaeval Period**

Islamic banking otherwise known as non-interest or profit sharing banking system is not an innovation but a divinely ordained injunction that stems from the *Qur'an* and *Sunnah* (traditions of the Prophet) which together form the *Sharī'ah*. The *Sharī'ah* derives a web of interrelated injunction prohibiting interest and usury on one hand and speculations on the other hand. Consequently, all financial transactions had to be based on profit-sharing principle. Prior to the mission of the Prophet in the Arabian Peninsula,

the currencies in circulation among the Arabs were either struck by the Byzantine regimes. Also, two major techniques were applied and adopted in the financing of economic activities. These techniques are: profit sharing arrangements (*muḍārabah*) and partnership financing arrangements (*mushārah*).

As early Muslims grew and became a political and economical power, the need for a better economic organisation arose. The various wars fought against the relatively rich tribes and nations brought a relative large inflow of wealth, especially in the form of currency. This unfamiliar situation necessitated the establishment of new economic institutions. The first financial institution to be established by the Muslim community (*Ummah*) came on stream ten years after the death of Prophet Muhammad (SAW). This coincided with the reign of the second rightly guided caliph of Islam 'Umar bn Khaṭṭāb. The institution has its root in *dīwān* (account books of the treasury), which was inspired by the Persian bureaucracy. Behind the establishment of *dīwān* is aid to be the arrival of Abu Hurayrah with large sums of money from a city called Bahrain. They tried to count the money and establish how it should be paid out as allowances and claims. It was on that occasion that *khālīd bn Walīd* advised the use of *dīwān* after which Caliph 'Umar accepted the idea. It has also been said that the person who advised 'Umar to introduce *dīwān* was *al-Hurmuzah*. This was because he noticed that the military missions were dispatched without a master roll (*dīwān*) after which 'Umar heeded his advice.

The common funds acquired from the conquered territories ('*Atā*) were kept in the *Bayt al-Māl* (treasury) which was managed by the caliph. Generally, the whole wealth was distributed immediately they were brought. The distribution of '*Atā* was done for both for ideological and military reasons. Accordingly, the '*Atā* was regarded as a gift from Allah to the members of the Muslim community and distributed to individuals in the community with the aim of affording everyone a fair share of the wealth irrespective of tribal affiliation. It was equally distributed to the soldiers in order to stimulate their zeal to fulfil their task. A point to note is that the *Bayt al-Māl*, which was managed by remunerated officials, functioned only as an institution for the distribution of available funds as they came, a situation that made it a temporary institution.

In the first century of Islam, the Muslim rulers had adopted the administrative and the legal institutions of the conquered territories including Byzantine. This situation exposed the Muslims to the adoption and inheritance of the local financial practices of the conquered territories which was characterised by a relatively high degree of development. The Muslims initially maintained the existing financial institutions in Persia and Iraq without changing their functions wherein their functionaries belonged to the local communities in addition to most of them being non-Muslims. The local languages were used in the area of administration with the organisation and practices remaining the same.

Consequently, the inherited economic institutions went through Islamic reforms in the areas of administration and monetary policies. In the area of administration, the language was changed from the local one to Arabic and the non-Muslim functionaries were replaced by Muslims. Further, the existing tax system was given a religious colouring through the levy of different taxes on different people based on their religious affiliation. In addition to the existing taxes, two others were introduced. They are the *Zakāh* (poor due) for Muslims and *Jizyah* (head tax) for the 'Ahl al-

*dhimmah* (non-Muslims in a Muslim territory). The fiscal policies were also determined by the notion of legitimate expenses. The budget of public officers and authorities were determined by the funds available in the *Bayt al-Mal*. There was also the forbiddance of interest in all its forms, leading to the development of financial transactions based on only two modes of profit sharing finance that had existed before the Prophet's mission: *mushārah* and *muḍārah*. The *Bayt al-Mal* was centralised at Baghdad, the empire's capital with smaller branches in the provinces and villages.

The *Bayt al-Māl* reached its peak between the period of 333-892 CE /218-279 AH. 19. However, this period represents the senile period of the empire which eventually ended with the destruction of Baghdad in 1258CE/656AH. Eventually, the eighth century of Islam witnessed the forceful transfer of power and authority from the Arab dynasties to foreign tribes and clans. The budget of the empire then recorded chronic deficits owing to the increase in military expedition, numerous rebellions, growth of bureaucracy and low cash inflow from conquered territories. In order to finance the growing expenses, the financial system that was hitherto developed along Islamic lines was derailed as the government started obtaining loans against interest by issuing paper money (*sakk*) to represent government bills and letter of a credit (*suftajah*). There was also the sale of right to collect taxes from certain territories to private bankers and functionaries based on an annual pre-determined and fixed rate of return (interest).

Furthermore, the central *Bayt al-Māl* sold letters of credit to the bankers of the court, at lower prices than their face values. The state also took loans from the private bankers and merchants. These loans were based on interests that were usually as high as eighty percent (8%). The empire also invited money changers, landlords and merchants to offer funds on competitive terms. Further, the ruler who lacked political and religious legitimacy and popularity contributed to the development of private financial institutions by using the confiscation of private wealth and property as a political tool. Those who revolted against the central power were punished through confiscation of their properties. Others in a bid to safeguard the unlawful confiscation of their wealth invested in jewellery and hid their gold, silver, money and coins under the ground, in wells, barns and the like of them. Owners of real estate, turned their lands into pious property, *waqf* since this could not be confiscated by law.

Moreover, people deposited their wealth with difference merchants and lenders who were mainly viziers, high ranking officials, provincial prefects and land owners. The funds acquired from confiscation were either used in the payment of previous debts or deposited as funds belonging to the officials who had ordered the confiscation. These private bankers were usually the clerks of the *Bayt al-Māl* who were easily identified by the government and who have their offices searched in case confiscation. This development prompted people to always look for anonymous individuals who were usual merchants for the safekeeping of their money and valuables.

By the early ninth century, merchants had already established themselves as a new category of banks, while making use of their stores as financial institutions. They offered the exchange of different currencies, transfer of money, acceptance of deposits and advancing of loans. They also developed advanced financial techniques based on limited period and interest. These financial

techniques are depository account, (*wadī'ah*) letters of credit, letters of exchange and bills of order or cheques. There was however, a consensus between the bankers and the government on the cutting down excessively high rate of interest. Thus, the patronage of the private bankers by the government and the confiscation of private property developed the financial system based on interest.

### **SELF ASSESSMENT EXERCISE 3.2**

Discuss the early development of Islamic banking system

#### **3.2.2 The Development of Islamic Banking in the Modern Period**

The military expedition carried out by Napoleon in 1798 is considered to mark the beginning of the modernisation period in the Middle East. This modernisation does not exempt the financial institutions. The existing legal system was reformed by the Muslim modernist scholars, who included western-influenced legal codes in virtually all the Muslim countries. Thus, there was the establishment of many central national and private Banks, with the introduction of new financial methods and operations based on interest. The practice of advancing and accepting loans against interest then became wide spread among the government officials, artisans, traders and the general populace. Consequently, the institution of interest became a natural feature in official records. The institution of interest on financial transactions received a religious legitimacy when some high ranking Islamic jurists and theologians formulated legal precedents (*fatāwā*) permitting the transaction in interest. The modernist jurists and theologians who accepted the advance of loans against interest belonged to a movement initiated at the end of 19<sup>th</sup> century which aimed at bringing Islamic renaissance (*nahḍ*) by re-interpreting Islamic jurisprudence. This movement was seriously resisted by many orthodox Muslim jurists and theologians.

The consensus for the closure of the gate of independent reasoning, (*ijtihād*) was reached by Muslim jurists and theologians owing to the invasion of Baghdad by the Mongols in 1253 CE/ 656 AH. The closure of the gate of *ijtihād* was necessary due to the fear entertained by Islamic scholars that non-Islamic customs and norms could be integrated into Islamic system. This decision, though meant for good reasons, had negative effect on the development of Islamic banking through *ijtihād*. Related to this is the reign by politically and religiously illegitimate rulers which adversely affected the development of Islamic banking. It has been noted that after the Second World War and in the modern times, many Muslims have advocated the reopening of the gate of independent reasoning to save Muslims from stagnation. In the financial sector, Muslim jurists, theologians and economists, have reached a consensus that financial theories, must be developed in order to effectively manage contemporary economic requirements which should function as alternatives to the western financial institutions.

Consequently, Islamic scholars such as Mirza Basheer-ud-Din Mahmood Ahmad, Naeem Siddiqi, Maulana Maududi, Muhammad Hamidullah and Muhammad Baqir al-Sadr were early writers on Islamic economic system. These writers have at different times advocated the need for commercial banks to base their operations on project trustee

financing (*Muḍārabah*) which shares profits and losses with clients rather than dealing in interest. These were closely followed by the contribution by some other scholars like Muhammad Uzair, Abdullah al-Araby, Nejatullah Siddiqi, al-Najjar, and Baqir al-Sadr.

The early 1970s witnessed a number of institutional involvements in Islamic economics. These were manifested through the floating of conferences. These conferences included: the Conference of the Finance Ministers of the Islamic Countries held in Karachi in 1970, the Egyptian study in 1972, the First International Conference on Islamic Economics in Mecca in 1976, and the International Economic Conference in London in 1977. These institutional interventions were responsible for putting impetus into the involvement of institutions and governments in Islamic banking through the establishment of the first interest-free banks. The Islamic Development Bank, was also a product of this institutional involvement.

In the 1920s Muslim businessmen began to realise that the conventional financial intermediation was of limited value in modern economics. This is because they often experienced difficulties in obtaining credit from the conventional Banks. This factor and some others led to a pioneering effort at Islamic banking in Egypt by Ahmad Elnaggar. Although this attempt was done in secrecy for fear of the institution being wrongly labelled an Islamic fundamentalist act which was inimical to the political situation of the country at that time. This legendary attempt in the town of Mit Ghamr in 1963 was in the form of savings bank based on profit-sharing. This experiment which started in 1963 ended in 1967. However, in 1972, this Mit Ghamr Savings project was incorporated into Nasr Social Bank which exists till now. Furthermore, in 1975 Dubai Islamic Bank was established. Incidentally, this attempt marked the first modern Islamic commercial bank.

This first modern attempt was followed by some other attempts which included: Kuwait Finance House in 1977, the Faisal Islamic Bank of Egypt in 1977, and the Bahrain Islamic Bank in 1979. In Malaysia, the first Islamic Institution was the Muslim Pilgrims Savings Corporation established in 1963. It was aimed at helping people save for Hajj (Pilgrimage). This corporation developed into the Pilgrim's Management Board. The success recorded by this board later served as impetus for the establishment of Bank Islam Malaysia Berhad (BIMB) in 1972. Moreover, Malaysia now operates a dual Banking system and the Bank Negara Malaysia now (the central bank) has its own *Sharī'ah* advisory board which set the rules for the entire Islamic Banking sector ensuring uniformity of products and services. Islamic Banks have developed in many Muslim countries. In addition, a Jordanian, Sami Hassan Homoud, who was the first to obtain his Ph D in Islamic banking with emphasis on *Muḍārabah* mode of financing, was instrumental to the establishment of the Jordanian Islamic Bank in 1978.

In the area of the growth of Islamic Banking, the unprecedented and dramatic increase in oil prices in 1970s brought a drastic degree of affluence and increased savings to the

inhabitants of a number of oil rich Middle Eastern countries as substantial number of their ruling families and merchants had investable funds which were put in Islamic banks which is growing at a rate of 10-15% per annum. With over 300 Islamic banks in over 51 countries, the industry has the potential of growing consistently. Countries currently practising Islamic banking either in full and as windows include the United States of America, the United Kingdom, France, Saudi Arabia, Bahrain, Malaysia, United Arab Emirates, Egypt, Sudan and Nigeria among others. In the United States alone, there are well over 250 mutual funds operating in line with the teachings of Islam. There are also business ventures, such as the University Bank in Michigan, that practises *Sharī'ah*-compliant financial services. Islamic finance is the fastest-growing segment of the global financial system. The assets of Islamic banks which was, in 2010, estimated to be \$826 billion was forecasted to reach \$1.1 trillion in 2012.

The Islamic Banks have continued to be sophisticated and innovative. This is due to the different types of financial institution operating in the market. The entry of institutional investors, increasing number of instruments and products and the way regulatory bodies are dealing with the market are also contributory factors to its sophistication and innovativeness in the industry. The growth drivers of this industry are committed long term retail investors, gradual shift to Islamic banking in Muslim societies and increasing relevance of Islamic Banking in Muslim countries, closer cooperation between conventional and Islamic banks and the emergence of new players in the Islamic banking industry. It also has as at is drivers greater interaction between *Sharī'ah* boards and the management of Islamic Institutions, increasing availability of reliable, accurate and timely data.

### **SELF ASSESSMENT EXERCISE 3.3**

Assess the modern developments in Islamic banking.

#### **4.0 CONCLUSION**

Islamic banking has its origin in the *Sharī'ah*. This banking system which has a humble beginning became widespread and organised when Islam got exposed to foreign cultures and institutions. Though these cultures influenced the Islamic banking situation, it initially did not affect its values. However, a negative turning point featured in the 1798 when modernity was introduced to the Muslim territories, making Islamic banks to deal in interest. This started changing when Muslim merchants established Bank Misr in 1920. Islamic banks now abound around the globe.

#### **5.0 SUMMARY**

- Islamic banking originated from the teaching of the Qur'ān and the *Sunnah*.
- Islamic banking is within the Islamic concept of *fiqh al-Mu'āmalāt*
- In actualising the Islamic financial system, culture and practices of the people that are in consonance with the wisdom of Islam is considered.
- Islamic banking started from *dīwān* and *bayt al-Māl*.

- The extension of Islamic territories gave organisation to Islamic banking.
- Modernity negatively affected Islamic banking.
- Islamic banking is a fast growing industry
- Islamic banking is operated in over 51 countries of the world

## 6.0 TUTORIAL ASSIGNMENT

- Explain the origin of Islamic banking.
- Critically examine the influence of foreign cultures on the development of Islamic banking.

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## **Unit 2: Objectives, Functions and Maintenance of Accounts in Islamic Banks**

### **CONTENT**

- 1.0 Introduction
- 2.0 Objectives
- 3.0 Main Content
  - 3.1 Objectives and Goals of Islamic Banking
  - 3.2 Functions of Islamic Banks
  - 3.3 Maintenance of Accounts in Islamic Banking
- 4.0 Conclusion
- 5.0 Summary
- 6.0 Tutor – Marked Assignment
- References / Further Reading

### **1.0 INTRODUCTION**

This unit introduces you to Islamic banking. An average Islamic bank also performs the routine duties of a conventional bank with some differences in their objectives, goals and operational styles. This unit examines the objectives, goals, functions and part of the operational framework of Islamic banking, especially in the area of account keeping. Here, a nexus is reached between socio-economic development and carefully observing the teachings of Islam. An Islamic bank is not just out to make money but to also contribute positively to the lives of individuals in the community.

### **2.0 OBJECTIVES**

At the end of this unit, the student should be able to:

- (i) Explain the origin of Islamic banking,
- (ii) Examine the development of Islamic banking,
- (iii) Describe the objectives and goals of Islamic banking, and
- (iv) Give an overview of the accounts maintained in Islamic banks.

### **3.0 MAIN CONTENT**

#### **3.1 Objectives and Goals of Islamic Banking**

The objectives of Islamic banking are: first, to provide financial facilities as provided for by the conventional banking system but in accordance with the dictates of the *Shari'ah*. Secondly, it is to assist in realising the Islamic concept of socio-economic development. This Islamic concept of socio-economic development is divided into two types. The first one is the increment of economic welfare of the Muslims while the second one is the achievement of a balanced economic development through social justice and equitable distribution of wealth.

The Islamic bank is to assist in achieving Islamic concept of socio-economic development by increasing the economic welfare of Muslims since all sources of wealth have been created for the benefit

of man. In view of this, Muslims are enjoined to strive for the improvement of their lives and the material standards. Welfare does not only comprise the quantitative improvement of the physical well being but qualitative development of the individual. The Islamic bank is also to achieve a balanced economic development through social justice and equitable distribution of income and wealth as all resources are considered as gifts from Allah. In that light, Islam guarantees every member of the society a fair share in these resources. The Islamic state or community is to ensure the minimum standard of the basic necessities of life for everyone while considering the fact that people cannot be rewarded equally since human ability and activities are not equal. The monetary and fiscal policy of Islam is to aim at the redistribution of wealth through the institution of *zakāh*. This is to be carried out by the Islamic bank as it is expected to create an account for *Zakāh* fund. Lastly, Islamic bank is to participate actively in the programme of socio-economic development of its country.

The goals of Islamic banking are as follows:

- i. The bringing about of a broad-based economic well-being with full employment,
- ii. The creation of socio-economic justice and equitable distribution of income and wealth,
- iii. The bringing about of stability in the value of money,
- iv. The mobilisation of savings and investment for economic development in an equitable manner, and
- v. Effective rendering of all services normally expected from banking services.

### **SELF ASSESSMENT EXERCISE 3.1**

Explain the objectives and goals of an Islamic bank.

### **3.2 Functions of Islamic Bank**

The functions of Islamic banks are not uniform across countries due to differences in their socio-economic conditions. As such, the role of Islamic banks in high and middle income economies differ from its role in low income economies of which Nigeria belongs. This sub-unit discusses the functions of Islamic banks in the low income countries. These functions are:

- i. Creating a web of branches in areas with minimum number of conventional banks,
- ii. Innovation of new financial tools desirable for petty depositors and educate them on the benefits accruable from the financial assets,
- iii. Engage in other financial activities as provided for by the conventional banks but in accordance with Islamic rules and norms of the *Shari'ah*.
- iv. Concentrate more on affordable poverty eradication projects with a wide outreach.
- v. Favouring of small scale ventures through providing financial assistance, technical advice and promoting private initiative.
- vi. Creating a *Zakāh* fund which would be collected and distributed by it especially in as benevolent loans in a bid to contributing to social justice and equitable distribution of wealth.

- vii. Advancing funds to industries prioritised in the national development plan and participating in government developmental projects when and where required.
- viii. Revisiting saving and deposit accounts in the areas of mobilisation.
- ix. Selling its equity shares in competed projects so as to promote additional investments.
- x. Eradicating of regional imbalances through embarking on projects or high socio-economic benefits.

### **SELF ASSESSMENT EXERCISE 3.2**

Highlight the functions of an Islamic bank.

### **3.3 Maintenance of Accounts in Islamic banking**

The main duty of conventional and Islamic banks is to collect savings for productive uses. These are four basic forms of accounts in an Islamic Bank. They are: the current account, savings account, investment account and the special investment account. The following are explanation on these accounts:

#### **i) The Savings Account**

The deposits in a savings account are of a double edged sword. It is primarily to provide a safe custody of money of clients and to provide them with protection against unforeseen expenditures. The funds in this account may be invested by the bank at its own risk. If as a result of the investment, a profit is made, it may voluntarily be shared with the clients at the discretion of the bank. Moreover, if a loss is incurred, it would be at the peril of the bank. It should be noted that the customers could without prior notice make withdrawals from this account.

#### **ii) The Current Account**

Primarily, current account deposits are held for transactions and contingency motives. The investment motive of this account is secondary. Current account holders enjoy much services such as the provision of cheques, overdrafts and others. The Bank may levy Its client administrative or service charges for services provided in this account. The depositors do not receive any profit on this account because the funds here will not be invested in productive or profitable ventures. The funds in this account are only used in meeting short-term financial needs of other customers.

#### **iii) Investment Account**

Deposits in this account are primarily concerned with earning profits rather than holding funds for precautionary and transaction purposes. The funds mobilised in this account are invested on the principle of profit and loss sharing (PLS). The returns paid on these accounts are determined by the yield from the financial intermediation of the bank after deducting administrative costs. The bank gives the depositors a share in the net profit of transactions as determined by the bank. However, if a loss is recorded, the depositors do not share the administrative cost with the bank

#### **iv) Specific Investment Account**

This account is peculiar to the investment account as discussed above. However, there are areas of difference. The major areas of difference are that funds generated in each of these accounts are directed towards a specific project as agreed upon by the bank and the depositor. Consequently, the share of profit is negotiable between the bank and the depositor.

### **SELF ASSESSMENT EXERCISE 3.3**

Give an overview of the accounts maintained by Islamic banks.

## **4.0 CONCLUSION**

Islamic banking aims at providing the routine banking services of the conventional banks and realising the Islamic concept of socio-economic development. Its functions include contribution to the overall development of the less-developed states through support of all the programmes of such countries aimed at development. Broadly speaking, accounts kept in Islamic banks are either for safe-keeping or investment purposes.

## **5.0 SUMMARY**

- Islamic banking aims at socio-economic development.
- Functions of Islamic bank differ from one country to another.
- In Islamic banking, there are four kinds of accounts: savings, current investment and specific investment accounts.

## **6.0 TUTORIAL ASSIGNMENT**

- Examine the objectives of Islamic banking in a developing country like Nigeria.
- Highlight the goals of Islamic banking.
- Assess the functions of Islamic banks in less-developed countries of Sub-Saharan Africa.

## **8.0 REFERENCES FOR FURTHER READING**

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## **Unit 3: International Islamic Financial Institutions**

### **CONTENT**

- 1.0 Introduction
- 2.0 Objectives
- 3.0 Main Content
  - 3.1 The Islamic Development Bank Group
    - 3.1.1 Islamic Development Bank
    - 3.1.2 Islamic Corporation for the Insurance of Investments and Export Credit
    - 3.1.3 Islamic Corporation for the Development of the Private Sector
  - 3.2 Other International Financial Institutions
    - 3.2.1 Accounting and Auditing Organisation for Islamic Financial Institutions
    - 3.2.2 General Council of Islamic Banks and Financial Institutions
    - 3.2.3 International Islamic Centre for Reconciliation and Arbitration for Islamic Finance Industry
    - 3.2.4 International Islamic Financial Market
    - 3.2.5 Islamic Financial Services Board
    - 3.2.6 International Islamic Rating Agency
- 4.0 Conclusion
- 5.0 Summary
- 6.0 Tutor – Marked Assignment
- References / Further Reading

### **1.0 INTRODUCTION**

This unit informs you about how the Islamic financial services, including Islamic banking is tutored, monitored and regulated through a series of international Islamic financial institutions. Owing to that, this unit provides you with some of the international financial institutions responsible for easing the tasks of Islamic banks especially in an environment that is not too friendly to Islamic policies. Through these organisations, Islamic banks are able to transact and render normal international businesses with their clients.

### **2.0 OBJECTIVES**

At the end of this unit, the student should be able to:

- (i) Give a an overview of Islamic banking in the international scene,

- (ii) Examine the role of international institutions to the growth of Islamic banking, and
- (iii) Discuss how Islamic banks are being regulated.

### **3.0 MAIN CONTENT**

#### **3.1 The Islamic Development Bank Group**

This is a multilateral organisation comprising four (4) entities: the Islamic Development Bank (IDB) the Islamic Corporation for the Development of the private sector (ICI), the Islamic Corporation for the Insurance of Investment and Export Credit (ICIEC) and the Islamic Research and Training Institute (IRTI). These organisations, which have the IDB as their fountain-head, share the same vision and mission but have different objectives and operational strategies. The IDB group with its headquarters in Jeddah, Saudi Arabia, as at 2007 had three (3) regional offices and eight (8) field representatives in ten (10) member countries. The regional offices are: Kuala Lumpur in Malaysia, Rabat in Morocco and Almaty in Kazakhstan. The ten (10) member countries that shared field officers were Indonesia, Mauritania, Libya, Sierra Leone, Sudan, Bangladesh, Senegal, Guinea and Guinea Bissau. Of the four organisations forming the IDB Group, only one: IRTI is not a financial institution.

##### **3.1.1 Islamic Development Bank**

The Islamic Development Bank (IDB) was established in 1975 in pursuance of the Declaration of Intent (DI) which emanated from the 1973 Conference of Ministers of Muslim Countries held in Jeddah, Saudi Arabia. The main objective of this bank is to promote socio-economic growth and development among member countries and Muslim communities in non-member countries in line with the rules and dictates of the *Shari'ah*. At the helm of this bank is a Board of Governors. This Board of Governors comprises two (2) representatives in each member country. Depending on individual countries, representatives could be the Minister of Finance, Economy or the Governor of the Governor of the Central Bank. There is also Board of Executive Directors (BED) composed of fourteen (14) members – majority of whom their countries are major shareholders. It is worthy of note that all member countries of IDB are members of the Organisation of Islamic Conference (OIC).

The IDB gets its funding through subscription by member countries and its various innovative *Shari'ah* compliant schemes. The bank operates Investment Deposit Scheme through which investors deposit their funds for the bank's intermediation. It also mobilises capital from financial institutions and individuals through Islamic Banks Portfolio (IBP) for onward financing in member countries. There is also the Unit Investment Fund (UIF) that mobilises resource from the bank from the private sector. Furthermore, it has both the Export Financing Scheme (EFS) and the Import Trade Financing Operations (ITFO) Scheme, which is responsible for financing exports and imports in member countries respectively. Lastly, the IDB finances Small and Medium Enterprises in member countries through lines of financing through a National Development Financial Institution

(NDFI), the IDB extends equity funds to viable ventures in member countries. In this process, the provision of essential equipments for ventures is catered for through *'Ijārah* mode of financing.

### **3.1.2 Islamic Corporation for the Insurance of Investments and Export Credit**

This corporation was established by the IDB in 1994 to provide Islamic insurance for exports in member countries. The corporation functions as an instrument for the increase of the scope of commercial transactions being exported from OIC member countries. It is also instrumental to the enhancement of direct foreign investments into OIC member countries. This is in addition to its provision of Islamic reinsurance services to Export Credit Agencies (ECAs) in OIC member countries. The corporation's insurance and reinsurance services comprise non-payment of export receivables emanating from buyer (commercial) and country (non-commercial) hazards. The facility also extends to the provision of investment insurance and reinsurance against non-commercial hazards ensuing from breach of contracts by host governments, civil disturbances, wars, expropriation and foreign exchange constraints.

The ICIEC has a number of Islamic insurance services. Among these insurance services is the foreign investment insurance service (FIIS) which provides up to 20 years indemnity to investors from one member country to another against country hazards such as wars, nationalisation and foreign exchange challenges among others. There is the Export Credit Insurance Programme (ECIP) which is the most popular and often utilised service of the ICIEC. This programme aims at facilitating commercial transactions and project implementation among member countries of the OIC and the IDB. The customer-centred initiatives of this programme include Bank Master Policy (BMP), Comprehensive Short Term Policy (CSTP), Supplementary Medium Term Policy (SMTP), Documentary Credit Insurance Policy (DCIP) and Specific Transaction Policy (STP).

### **3.1.3 Islamic Corporation for the Development of the Private Sector**

The Islamic Development Bank established the Islamic Corporation for the Development (ICD) of the Private Sector in 1999. This was at a time when the economies of its member countries were transforming from public sector-driven economy to that of the private sector through reforms in the financial sector. Hence, the ICD aims at supplementing the efforts of the IDB by promoting Islamic compliant private sector economic development through the establishment, expansion and modernisation of business ventures. Consequently, the ICD identifies crucial opportunities in the private sector and enhances a variety of productive financial services and products. In addition, the corporation mobilises supplementary capital for the private sector in member countries of IDB and encourage the growth and development of viable Islamic financial services and *Shari'ah* compliant capital markets.

In line with the franchise expressed by a simple majority of the member countries of ICD, the corporation, with a minimum investment of \$2 million US Dollars, finances business projects to the tune of half of its cost (i.e. 50%) and not exceeding that

percentage. The grace period of projects are five (5) and eight (8) years but not exceeding twelve (12) years. Whereas ICD concentrates on private sector development, it also finances government enterprises undergoing the process of privatisation in IDB member countries once the share of the government would not exceed 49%. Lastly, concessionary agreements such as: Build Operate and Transfer (BOT), Build Own Operate and Transfer (BOOT) and Build Own and Operate (BOO) among others are structured and financed in member countries.

### **SELF ASSESSMENT EXERCISE 3.1**

Examine the activities of the Islamic Development Bank.

## **3.2 Other International Financial Institutions**

### **3.2.1 Accounting and Auditing Organisation for Islamic Financial Institutions**

In order to facilitate uniformity and healthy competition of financial statements, Islamic financial institutions entered into an Agreement of Association in 1990. This agreement started bearing fruits when in 1991, the Accounting and Auditing organisation for Islamic Financial Institutions was registered in the kingdom of Bahrain. This non-profit making organisation is saddled with the responsibility of preparing standards for Islamic financial institutions. These standards include: accounting, auditing, governance and ethical standards among others. The founding members of the AAOIFI are the IDB, Dar al-Māl al-Islamī, Al-Rajhi Banking and Investment Corporation, Bukhary Capital, Kuwait Finance House and Dallah Albaraka Group.

The AAOIFI consists of a General Assembly, Board of Trustees and Accounting and Auditing Standards Board and *Shari'ah* Board. The General Assembly is made up of the founding members, associate members, regulatory and supervisory authorities, supporting members and advisory members. The last two memberships partake in the General Assembly meeting without a franchise. The Board of Trustees includes a fifteen (15) man part-time members drawn from relevant professions. These members who are also from the general assembly are elected for a term of three (3) years in office. Its membership spread include: emanate from regulatory and supervisory authorities, accounting and auditing profession with affiliation to Islamic finance, Islamic financial institutions, scholars in Islamic jurisprudence and users of Islamic financial institutions' statement of accounts.

The Accounting and Auditing Students Board consists of fifteen (15) members elected for a period of four years. This technical board implements the most fundamental part of the duties of the organisation in question. Its membership is not only drawn from the various fields from which the Board of Trustees is drawn but also with an inclusion. This inclusion extends to a university professor specialising in accounting and financial studies. The last technical organ is the *Shari'ah* Board. Here, fifteen (15) members drawn from the *Shari'ah* advisory boards of Islamic financial institutions and that of central banks sit on this board. The jurists serve on the board for a four year term.



A point to note is that though the AAOIFI is basically advisory in nature, it has over the years taken rigorous steps to implement the use of its standards the world over. These efforts have led to countries such as Malaysia, Saudi Arabia, Qatar, Lebanon, Bahrain, United Arab Emirates, Lebanon, Jordan and Sudan to adopt its guidelines for financial transactions in their various countries.

### **3.2.2 General Council of Islamic Banks and Financial Institutions (GCIBF)**

This council was established in the kingdom of Bahrain in 2001. The body represents Islamic banks and the entire Islamic financial industry on the global level. As part of its objectives is furnishing the Islamic financial industry with the required information needed for the enhancement of its growth and development. It also enhances the image and promotes the Islamic Financial Industry (IFSI). Similarly, the council embarks and advisory and consultancy services together with research and development services in favour of the IFSI. Moreover, the council is involved in the Development of human resources on behalf of the IFSI.

### **3.2.3 International Islamic Centre for Reconciliation and Arbitration for Islamic Finance Industry**

The cost of financial litigation is put at 20% of the total amount in contention. This means that only 80% of disputed amounts are recovered by the financial industries when the financial disputes are handled in law courts. This then brought the idea of alternative dispute resolution initiative which is no doubt cost effective. In line with that, Islamic Development Bank, General Council of Islamic Banks and Financial Institutions jointly established this arbitration centre in 2005 with its headquarters in Dubai, UAE. The centre settles financial disputes between financial institutions and their clients through recourse to the *Sharī'ah* provisions of reconciliation and arbitration. The centre is composed of interested central banks with provisions and units for Islamic banking, Islamic financial institutions and conventional banks with Islamic banking windows (units). These financial institutions elect a Board of Trustees comprising fifteen (15) members for a period of three (3) years. It also has an Executive Committee and an Investigation Committee. The general secretariat of this centre is headed by a General Secretary.

### **3.2.4 International Islamic Financial Market (IIFM)**

The International Islamic Financial Market (IIFM) was established in 2001 by the financial authorities of a number of Muslim countries with Islamic financial services industries, and the IDB. The factors necessitating the establishment of IIFM include the need to address: liquidity management among Islamic Financial Institutions; the dynamic requirements of investors and systematisation and regulation of market procedure and laws.

### **3.2.5 Islamic Financial Services Board**

The uniqueness and the peculiarity of providing guidance on adequate supervision and regulation of Islamic financial industry necessitated the establishment of the Islamic Financial Services Board (IFSB). This Board was established in 2002 although it became operational the year after. The International Monetary Fund (IMF), the IDB and other monetary agencies and central banks including that of Bahrain and Malaysia jointly established the IFSB. The Board sets standards for regulatory and supervisory bodies of Islamic Financial Services Industry, including banks. Membership of the Board is open to any state that recognises the Islamic financial service industry in any form interested inter-governmental international bodies could also join the Board. The Board has a Council, which is its highest policy-making organ, a technical committee and working groups. The administrative body of IFSB is headed by a secretary-general.

### **3.2.6 International Islamic Rating Agency (IIRA)**

This Agency was incorporated in Bahrain in 2002 as a result of the need for a *Shari'ah* compliant rating system. The Agency undertakes researches and analyses aimed at ascertaining the compliance level of Islamic financial services industries to the principles laid down under the *Shari'ah*. The IIRA compliments other International Islamic organisations to give credence to Islamic financial services industry.

### **SELF ASSESSMENT EXERCISE 3.2**

With the exception of the Islamic Development Bank Group, give a general assessment of the international Islamic financial institutions.

## **4.0 CONCLUSION**

The Islamic financial services industry, to which Islamic banks belong, has over the years recorded tremendous growth. On the international scene, some Islamic financial institutions have been established to regulate and service the Islamic financial services industry. These industries provide a wide range of services. Some of these services include: banking, insurance, maintenance of standards, reconciliation, rating and dissemination of information.

## **4.0 SUMMARY**

- The IDB gives comprises of three financial institutions.
- The IDB supports socio-economic development of member countries.
- The ICIEC supports Islamic banking through the provision of Islamic compliant insurance and reinsurance services to clients of Islamic banks.
- The AAOIFI provides standards for Islamic financial industry. This enables the practicability of Islamic instruments.
- The GCIBF represents the interest of Islamic and financial institutions banks globally.
- There are a number of international Islamic financial institutions devoted to the service of Islamic banks and financial institutions.

## 6.0 TUTORIAL ASSIGNMENT

- Assess the impact of Islamic Development Bank Group in IDB member countries.
- Explain the importance of AAOFI and IFSB to Islamic banks.

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## **Module 2     Foundation of Islamic Banking System**

This second module would expose you to salient discussions on the Islamic law of commercial transactions which guide the operations of Islamic banks. To start with, the various undertakings embarked upon in Islamic financial transactions are based on contracts from which some items that can be termed “the forbidden fruits” are carefully isolated because of their oppressive and destructive features in the community. This module is principally aimed at discussing in details the Islamic version of financial contracts and their impediments.

The module on the foundation of Islamic banking system is made up of four units. In the first unit, you will be introduced to Islamic financial contracts, the essential elements, conditions and impediments to them. The second unit discusses the Islamic conception of interest a major impediment to an Islamic contract. In doing that, it delved into the meaning of interest, its types and its impact on the human society. The third unit continued from where the last units stopped wherein a closer look is paid to the manner interest was prohibited in Islam. This necessitated the study of relevant sections of the Qur’ān and *Sunnah* (traditions) of the Prophet. In the final unit, discussion centred on Islam’s prohibition of speculation which is another impediment to Islamic financial contracts.

In this module, all the four units that it contains are homogeneous and related in terms of the subject matter. By the end of this module, you would have acquainted yourself with the laws guiding Islamic financial transactions to which Islamic banks are necessarily subjected. Moreover, you would be afforded the opportunity of understanding the position of Islam on interest and speculation in financial transactions.

Unit 1:            Financial Contracts in Islam

Unit 2:            The Concept of *Ribā* in Islam

Unit 3:            Illegality of *Ribā* in Islam

Unit 4:            The Question of *Gharar* and *Maysir*

### **Unit 1: FINANCIAL CONTRACTS IN ISLAM**

#### **CONTENT**

- 1.0     Introduction
- 2.0     Objectives

- 3.0 Main Content
  - 3.1 Islamic Concept of Contracts
  - 3.2 Essential Requirements of Islamic Contract
  - 3.3 Conditions of Islamic Contract
  - 3.4 Impediments to Islamic Contract
- 4.0 Conclusion
- 5.0 Summary
- 6.0 Tutor – Marked Assignment
- 7.0 References / Further Reading

## 1.0 INTRODUCTION

This unit examines the concept of Islamic contracts which is a fundamental aspect of Islamic banking. Islam protects the interest of the less privileged and provides a comprehensive system by which such relationships could be maintained. In the area of finances, human beings could sometimes be tempted to oppress his/her fellow mates, but with Islamic regulation, this is not impossible.

## 2.0 OBJECTIVES

At the end of this unit, the student should be able to:

- (i) Assess the Islamic concept of contracts, and
- (ii) List the essential requirements, conditions and impediments to Islam contracts.

## 3.0 MAIN CONTENT

### 3.1 Islamic Concept of Contracts

Contract (*'aqd*) literally signifies tying, joining, knitting or locking of something. Generally, contract in Islam is an exchange of promises between two or more parties leading to an obligation on one or more of the parties to carry out a lawful act. Specifically, a contract is the legal unification of proposal (*'ijāb*) and acceptance (*qabūl*) in such a way that their mutuality will be clearly displayed. This presupposes that a contract is enforceable in a court of law.

The conception of contract in Islamic law is different from the point of view of western or conventional jurisprudence. In Islamic law, a contract may not necessarily involve an agreement as it is used to describe a unilateral juridical action that is binding and enforceable without the permission of another individual. An instance of this is manumission of a slave. The point here is that although the Western concept of contract may fit directly into its Islamic conception that of Islam could go beyond the western conception of it. In reality, an Islamic contract is simply a legal undertaking bearing features different from the conventional conception of it.

Contracts not only play a pivotal role in an Islamic economy but also stand as essential feature in it. These foregoing assertions necessitated Islam's protection of contracts Allah instructs Muslim to carry out their contracts. This instruction is contained in the Qur'ān which states:

يَا أَيُّهَا الَّذِينَ آمَنُوا أَوْفُوا بِالْعُقُودِ...

O you who believe! Fulfil (your) contracts... (Q5:1)

An immediate interpretation that would come to mind when considering the meaning of the above quoted verse is the necessity of Muslims to fulfil their promises or contracts. An implicit meaning, however, is that the government should enforce the fulfilment of contracts. To that end, Islamic jurists have skilfully determined the essential requirements and conditions of a valid and legally enforceable contract. The subsequent sub-sections feature some of the essential requirements and conditions of an Islamic contract.

### **SELF ASSESSMENT EXERCISE 3.1**

What is the Islamic conception of contracts?

### **3.2 Essential Requirements of Islamic Contract**

The validity of an Islamic contract and its enforcement in a court of law requires the presence of certain crucial requirements called *'arkān* (sing: *rukṇ*). Literarily, *rukṇ* means the most powerful pillar of a particular substance or thing. Technically, *rukṇ* signifies a thing which not only compliments other things but also takes part in the essence of those things it compliments. A good example is the case of one willing to buy an item and the person willing to sell such an item. The prospective buyer, after inquiring about the price of the item in an open and free market environment, proposes a price change (most likely lower than the initial cost price) for the item. If the seller accepts the proposal then a transaction takes place but if there is a disagreement a transaction fails to take place. Here the seller and the buyer are each in the position of the *rukṇ*. Despite the fact that their presence is crucial for the contract to take place, they also partake in the transaction and their consents are essential for the transaction to take place.

When a party makes an offer and the other party accepts such an offer, then an agreement automatically ensues. The parties to an agreement or contract must, in actual fact, genuinely intend to undertake the contract. This necessitates that parties to such an agreement should be mentally sound. Similarly, the consequence of the agreement should not negatively affect the society. The essential requirements of an Islamic contract are oral proposal and acceptance or their equivalents such as gestures and writings. The individual making an offer states what he will give and take in the contract while the receiver of such an offer has the right to reject or accept the offer. Therefore, in order to initiate an agreement, there must be the proposal and the acceptance. These two: proposal and acceptance form the basis of any contractual agreement. Also, the subject of transaction and the parties to the agreement constitute the elements for ending the contract.

### **SELF ASSESSMENT EXERCISE 3.2**

Discuss the essential requirements of a valid Islamic contract.

### 3.3 Conditions of Islamic Contract

The Arabic name for condition is *shart* (plural: *Shurūt*) which literally means a sign. Technically, *shart* connotes a thing on which the existence of other things lie upon but, unlike *rukn*, does not in itself partake in the essence of that thing. Rather, it is complementary to essence of the thing. The absence of a condition in an agreement means the absence of the rule whereas its presence does not necessary cause a contract to take place. Islam jealously guides the rights of parties to a contract. Owing to that, conditions must precede contracts to ensure that none of the parties is wronged at the time of reaching an agreement and during its implementation. Here are the concise descriptions of the major conditions of any contract.

- (i) Offer and acceptance should be in clear terms and not ambiguous.
- (ii) The party to whom an offer has been made must respond unconditionally to the offer or the request of the other party.
- (iii) The parties to a contract must communicate the proposal and acceptance of an offer in a manner agreeable to them.
- (iv) The agreement of a contract must be reached within a specific period of time (*majlis al- 'aqd*).
- (v) The party accepting the offer must be pleased with such an offer. This pleasure of his/hers could be expressed verbally through writing or gestures.
- (vi) The subject matter of the contract must be in existence or can at least exist in the future.
- (vii) The subject matter or the obligations of the contract must be delivered at the conclusion of the contract.
- (viii) The subject matter of the contract must be well defined. The knowledge of the subject matter could be obtained through description or direct observation.
- (ix) The subject matter must neither be against public interest nor contradict the law of the land.
- (x) The subject matter must be clean and pure. For instance dealing in alcohol or pork is not allowed since they are impure.

### SELF ASSESSMENT EXERCISE 3.3

Explain what is meant by *shart* in an Islamic contract.

### 3.4 Impediments to Islamic Contract

There are a number of factors that could nullify a contract in Islam. These factors are include:

- (i) Mistake in the discharge of the subject matter. An example of this is making a mistake in the delivery of the brand of a product not agreed upon in the contract.

- (ii) A contract undertaken under the duress of any of the parties is null and void.
- (iii) Generally, fraud (*tadlīs*) renders a contract null and void.
- (iv) If there is a gross (over 10%) misrepresentation or cheating (*ghabn*) in a contract, the party at the receiving end may opt out of the contract.
- (v) The contracts made by a child, the insane, the mentally deranged and those asleep or unconscious are null and void. Additionally, a prodigal may be restrained from entering into a contract.
- (vi) Contracts must not contain elements of interest and speculation. These two are discussed further in subsequent units.

### **SELF ASSESSMENT EXERCISE 3.4**

List some of the impediments to an Islamic contract.

### **4.0 CONCLUSION**

Islam consciously and carefully protects the interests of individuals in commercial transactions, which incidentally Islamic banking belongs. Also, any practice that does not run against the already accepted teachings of Islam is given some consideration in Islamic finance. Broadly speaking, an Islamic contract consists of necessary requirements and conditions.

### **5.0 SUMMARY**

- Contracts are necessary for legally enforceable Islamic transactions to take place.
- Islamic contracts are fundamentally different from contemporary contracts in terms of its essential requirements, conditions and impediments.

### **6.0 TUTORIAL ASSIGNMENT**

- Explain the differences between the terms: *rukṇ* and *shart*.
- List the *Shurūṭ*, *'arkān* and impediments to an Islamic contract.

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## **Unit 2: The Concept of *Ribā* in Islam**

### **CONTENT**

- 1.0 Introduction
- 2.0 Objectives
- 3.0 Main Content
  - 3.1 The Meaning of *Ribā*
  - 3.2 Classifications of *Ribā*
  - 3.3 Rationale for Prohibiting *Ribā*
- 4.0 Conclusion
- 5.0 Summary
- 6.0 Tutor – Marked Assignment
- References / Further Reading

### **1.0 INTRODUCTION**

The last unit mentions *ribā* as one of the impediments to an Islamic contract. Following that, this unit examines the attitude of Islam towards *ribā* through giving a comprehensive definition of it. This unit also describes the classical and the contemporary interpretations of *ribā*. This is followed by its classifications and the various provisions of the *Sharī'ah* prohibiting dealings in it. Consequently, the rationale for the eradication of *ribā* in any given society is explained.

### **2.0 OBJECTIVES**

At the end of this unit, the student should be able to:

- (i) Give a comprehensive meaning of *ribā*,
- (ii) Mention and explain the types of *ribā*, and

- (iii) Explain the rationale for the prohibition of *ribā*.

### 3.0 MAIN CONTENT

#### 3.1 The Meaning of *Ribā*

*Ribā* is an Arabic word derived from the verb “*raba-wa*” which literally means to increase; to grow; to grow up or to exceed. *Ribā*, therefore, means an increase or a growth. *Ribā* could either mean an increase in itself or one resulting from comparison of differentials between two entities. Aside from the linguistic meaning of *ribā* as stated above, there is also a customary meaning. Although this relates to the linguistic meaning, it does not entirely connote it. This customary meaning relates to its being an increase over and above the principal amount lent to a borrower over a specific period.

*Ribā* connotes both interest and usury. While Interest is the rental payment for the use of credit by borrowers in return for parting with liquidity by lenders, usury is the practice of charging an illegal rate of interest for the loan of money. The aspect of the meaning of *ribā* that is addressed in this study has to do with its customary Arabian connotation and contemporary western view, which see it as the surplus of income that the lender collects from the creditor over and above the principal fund as a reward for waiting or parting with the liquid part of his capital for a specific period of time.

There were three kinds of this customary interpretation in the *Jahiliyyah* (the period of ignorance) and early Prophetic era. The first of these results from a transaction where an individual borrows some money from a relatively richer person and when the time to settle the debt comes, the creditor would propose to him to either pay at that time or the loan will incur *ribā* (i.e. an increase). Consequently, if the debtor requests for an extension of the time of payment, the creditor would request for *ribā* and this would occur year in year out until the little capital of the creditor becomes multiplied many times. In this first case, the coming to play of *ribā* occurs only when the debtor on the request of the creditor asks for more time to repay his/her debt. In essence, one who is not unable to pay a simple loan at its appointed time due to various reasons ranging from disaster to loss will then have to pay an increase which will eventually double or almost double up.

The second customary meaning has to do with a person advancing a loan on the condition that the creditor will each month receive a fixed sum while the principal sum remains intact. At the maturation of the loan period, the creditor claims the principal sum from the debtor. However, if it was not possible for the debtor to pay, the creditor would increase the principal sum and extend the term. Here, the increase paid by the debtor serves as a reward for the extra time given him/her by the creditor to redeem the debt. This second application of *ribā* is similar to the first one except for the fact that a monthly interest on the principal is included.

There is also the last customary interpretation wherein Arabs considered *ribā* to be an illegitimate or an unwholesome means of appropriating wealth. Giving credence to

this is the incident that took place before the mission of Prophet Muhammad (SAW) when the *Ka'bah* was being rebuilt. It is on record that during the process of reconstructing the *Ka'bah* 'Ā'id bn 'Imrān bin Mukhzūm picked up a stone from the *Ka'bah* point and thereafter this stone fell from his hand and rolled back to its former position. Then he said to all present that:

O you (community of the) Quraysh, do not invest (your money) into its building except what is good. Do not invest prostitution fees, gains made from transactions based on *ribā* and property accrued through oppression of fellow men.

From the above explanations, you will note that *ribā* comprises three features. These features are that:

- i) It involves excess or surplus over and above the loan capital,
- ii) The condition of the transaction on the payment of predetermined surplus, and
- iii) The determination of the surplus over and above the capital or the principal in relation to time.

### **SELF ASSESSMENT EXERCISE 3.2**

Give a comprehensive explanation of the meaning of what is meant by *ribā*.

### **3.2 Classifications of *ribā***

*Ribā* is by its form divided into two parts although some scholars divide it into three parts. The first of this division is *ribā al-nasī'ah* (*ribā* on loan) while the second is *ribā al-faḍl* (*Ribā* on barter). These two kinds of *ribā* are discussed in succession.

#### **i) *Ribā al-nasī'ah* (Interest on loan)**

This kind of *ribā* is the kind that has been discussed under the meaning of *ribā* above. In essence, this kind of *ribā* comes into play when a loan is advanced to an individual for a specific period with the agreement among parties that the debtor would either pay a percentage of the principal at specific periods before settling it or the payment of excess on the principal when the debtor is incapable of fulfilling his pledge at the expiration of his term of payment. This leads to the payment of excess amount over and above the principal by the debtor as a reward to the creditor for granting more time to him.

Majority of Islamic jurists and economists have in line with revelations from the Qur'ān, *sunnah* and historical facts, as against contemporary financing, prohibited transactions involving interest (*ribā*) in all its forms. However, it is acceptable and preferable for the debtor to increase the payment of loan funds when returning it to the creditor without any pre-discussions or desire for increase from the creditor. This is in

line with the *Shari'ah* (Islamic law) as the Prophet did the same to his creditor when he (the Prophet) borrowed a young camel from him. When eventually the camels of *zakāh* were brought to the Prophet, he ordered that a young camel be given back to the creditor. Unfortunately, the Prophet's aid in charge of this, Abū Rāfi' reported that he could not find a camel of the same age as was borrowed by the Prophet and that the least of the camels was in its seventh year, which was far above what was borrowed. Following that, the Prophet ordered Abū Rāfi' to give the camel in its seventh year adding that "the best among people are those who repay their debts in the best way".

## ii) *Ribā al-faḍl* (Interest on barter )

This is the exchange of two articles of the same kind with the obligation of an increase of one of them over the other irrespective of whether the exchange is done at a sitting or is delayed till a future date. In the olden days, the practice of trade by barter was prevalent not only in the Arabian Peninsula but all over the world. In line with this practice, there used to be the exchange of goods for goods and commodities for other commodities. Then, a common practice was for the less privileged ones to borrow some quantities of cereals or foodstuffs from the well to do with an agreement that at a future date, they would return more than the same kind of cereals or foodstuffs they had borrowed.

Islam is not against trade by barter, however, for such to take place, the articles to be exchanged must be of the same scale or measurement, depending on what is compatible with it. This is irrespective of whether one of these articles is of better quality or not. Transactions must also be concluded at once. This means that there should be no delay in fulfilling the exchange of any one of the articles. The Following *hadīth* emphasises the ban on *ribā al-faḍl*.

الذَّهَبُ بِالذَّهَبِ وَالْفِضَّةُ بِالْفِضَّةِ وَالْبُرُّ بِالْبُرِّ وَالشَّعِيرُ  
بِالشَّعِيرِ وَالتَّمْرُ بِالتَّمْرِ وَالْمِلْحُ بِالْمِلْحِ مِثْلًا بِمِثْلٍ سَوَاءٌ بِسَوَاءٍ  
يَدًا يَدًا فَإِذَا اخْتَلَفَتْ هَذِهِ الْأَصْنَافُ فَيُعَوَّضُ كَيْفَ شِئْتُمْ إِذَا  
كَانَ يَدًا يَدًا

(The selling of) Gold for gold, silver for silver, wheat for wheat, malt for malt, date for date salt for salt, same for same, weight for weight (equal), from hand to hand (at the same time). And if goods are of different types, you can sell as much as you want provided it is from hand to hand.

## SELF ASSESSMENT EXERCISE 3.2

Explain the two classifications of *ribā*.

### 3.3 A Critique of *Ribā*-Based Financial Transactions

*Ribā* once established in a system continues to increase without stopping as it has several colours and forms. The most important thing to bear in mind is that it destroys the psychology and ethics in the society. In addition, it destroys the structure of the economy and the political atmosphere while it negatively affects the masses thereby playing a negative role in destroying the fabrics of the society. The current economic meltdown in the world is a product of this destructive phenomenon.

*Ribā* gives rise to two kinds of moral evils. First, it generates self centeredness among its devourers. Secondly, the givers feel a strong feeling of hatred, jealousy, resentment and spite for its devourers. Islam intends creating a model society where everyone will live with sound physic, social, political and economic system. In addition, it desires a system that will be free of hatred, greed, rancour and wickedness. Hence, *ribā* was banned through the revelation of the '*ayāh*' in question although there was no yet punishment for its devourers.

It has been observed that in the most industrialised countries, people live amidst a number of problems due to their dealing excessively in *ribā*. They are still struggling to achieve their goals. A view at these *riba* devouring countries reveals their struggle for want and battle with socio-economic and psychological problems. An economist, John Maynard Keynes, who propounded the theory of "Free Economy" in the world, states that money will not be able to perform its monetary functions effectively except when the rate of interest is reduced to zero percent. In the 1950s, Dr Hjalmar Schacht, a renowned economist and former Director of Riechsbank of Germany, commented on the defects and the evils in *ribā*. He concluded that *ribā* reduces the poor to abject poverty and increases the means of the rich. The rich thus gets richer at the expense of the poor who gets poorer.

Schacht, in his 1953 lecture in Damascus, used arithmetical calculations to conclude that the world's money will diminish due to the amassing of wealth by a few through the use of *ribā*. This evil is capable of sparking-off dispute in the relationship between the lender and the borrower. The lenders will continue to inflate interest rates until traders among the borrowers are forced to fold up due to little money in circulation leading to market deficiencies and consequently unemployment. It should be noted that for every *ribā* based loan, the masses are made to pay the illegal excess.

There exists the view by dealers in *ribā* that since the lender had the opportunity of investing the lent funds into productive and profitable business but made it an opportunity cost and opted for the choice of benefiting others at his own expense, he is entitled to a return on the investment. This return on investment now comes in form of interest on the loan. In response to this, it has been observed that there are questions still unanswered. The first is the question of risk taken by the borrower in which the lender is not subjected to either directly or indirectly. Moreover, the argument for minimum interest rate as reasonable is illogical. In fact, a rational and impeccable economic

principle capable of justifying investment for energy, time, resources and capacity is the one with the sole aim of making resources thrive and without a guarantee of fixed interest as such a holistic system will be at ease and fully indemnified against all forms of risks.

Further, a mockery of an economic system is made when a financier of whatever form fixes his funds over a long period of time with a pre-conceived idea of accumulating interest at a time when entrepreneurs are incapable of foretelling the changes in prices or their profits due to market imperfections. There are four major differences between trade and interest. First, it is normal for transactions to come to a logical conclusion when there is an exchange of mutual benefits. This is not the case with interest or *ribā* on loan. Here, borrowers initially utilise the loan funds on a specific area of interest and thereafter repay it with a surplus through his/her relentless effort.

Secondly, *ribā* bearing loans are not equitable in the exchange of mutual benefits among parties. To the entrepreneur, he may gain or lose in the business. However, the financier will always gain even when the business fails. Also, if the loan is utilised on consumption purposes, the issue of profit does not arise, even though the financier is not concerned with this fact. Thirdly, in *ribā* bearing loans, the “profit” of the financier is continuous and on-going while that of the entrepreneur is limited. There are cases where the enterprises, due to economic, social or political challenges, operational activities are put on hold while the thirst of the financier is still being watered without pity or consideration for the business or the entrepreneur.

Lastly, it is normal to utilise time, effort and intelligence in any business venture. However, in *ribā* bearing transactions, the financier simply gives out his surplus funds without any effort being put in place. It should be noted that, this leads to redundancy, laziness, unemployment and economic backwardness in any given society.

### **SELF ASSESSMENT EXERCISE 3.3**

Explain the major reasons why Islam prohibits *ribā*.

## **4.0 CONCLUSION**

Islam regards money as a medium of exchange rather than being a commodity. This is with the aim of putting an end to the various forms of injustices and economic exploitation in the world. *Ribā* has been identified by experts as the cause the current economic difficulties confronting the world

## **5.0 SUMMARY**

- Interest and usury are other names for *ribā*.
- *Ribā* has from time immemorial been seen as unwholesome.
- *Ribā* is divided into two: *Ribā an-nasī’ah* (*ribā* on loan) and *Ribā al-faḍl* (*Ribā* on barter)
- The prohibition of *ribā* in Islam is in four stages.
- The continued dealing in *ribā*-based transactions in a cause of socio-economic turbulence.

## 6.0 TUTORIAL ASSIGNMENT

- Examine the relationship between *ribā* and interest
- Elucidate on the view of Islam on trade by barter.
- Critically examine the socio-economic effect of transacting in *ribā*.

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## Unit 3: Illegality of *Ribā* in Islam

### CONTENT

- 1.0 Introduction
- 2.0 Objectives
- 3.0 Main Content
  - 3.1 First Quranic Injunction on *Ribā*.
  - 3.2 Second Quranic Injunction on *Ribā*.
  - 3.3 Third Quranic Injunction on *Ribā*.
  - 3.4 Fourth Quranic Injunction on *Ribā*.
- 4.0 Conclusion
- 5.0 Summary
- 6.0 Tutor – Marked Assignment
- References / Further Reading

### 1.0 INTRODUCTION

The last unit introduced you to *ribā* as a concept. This unit starts where the last one stopped. Here, texts in the Qur'ān mentioning *ribā* are to be studied in accordance with their order revelation. *Ribā* was already endemic in the lives of Arabs before the mission of the Prophet. Whereas the Arabs recognised the evils of this habit of theirs but lacked the courage and the will power to eradicate it. The legality or otherwise of any issue in Islam is determined by the pronouncements in the primary sources of Islam namely the Qur'ān and the *Sunnah* of Prophet Muhammad (SAW). In bringing about these rules, the Law Giver, as part of His clemency, considers the conditions and circumstances of the Muslims, who are to implement the law. In line with this, the law regulating the ban on *ribā* is in graduation. *Ribā* occurs in four different places in the Qur'ān. The first reference was revealed in Makkan while the others were revealed in Madinah. The first of these is in *Surah ar-Rūm* while the last of them is in *Surah al-Baqarah*. The various revelations on *ribā* will thus, be treated in line with their chronology of revelation. In addition, the comments on these relevant portions of the Qur'ān are examined from the point of view of the *Sunnah* and scholastic analysis.

### 2.0 OBJECTIVES

At the end of this unit, the student should be able to:

- (i) Describe the manner at which *ribā* was prohibited,
- (ii) Explain how the spirit of greed leading to *ribā* was discouraged,
- (iii) Describe the manner in which Allah reprimanded the Jew on their dealing in *ribā*,
- (iv) Examine how emphatic tones were placed on the prohibition *ribā*.



### 3.0 MAIN CONTENT

#### 3.1 First Quranic Injunction on *Ribā*

The first relevant text on *ribā* states that:

وَمَا آتَيْتُمْ مِّن رَّبًّا لِّيَرْبُو فِي أَمْوَالِ النَّاسِ فَلَا يَرْبُو عِنْدَ اللَّهِ  
وَمَا آتَيْتُمْ مِّن زَكَاةٍ تُرِيدُونَ وَجْهَ اللَّهِ فَأُولَٰئِكَ هُمُ الْمُضْعِفُونَ

That which you lay out for increase through the property of (other) people will have no increase with Allah but that which you lay out for charity, seeking the countenance of Allah (will increase). It is these, who will get a recompense multiplied. (Q.30:39).

This above stated '*āyah* was revealed to address a particular social problem. During the *Jahiliyyah* Period and in the early part of the Prophet's mission, some groups of people had a practice. This practice was the giving of gifts in forms of material things or even non-material things such as honouring or greeting others, in anticipation of a greater material or non-material thing at an unspecified future date. Although this '*āyah* addresses the above social problem specifically, it also in general, addresses all forms of primitive accumulation of wealth. It stresses that increase in wealth can only be achieved through the giving of *zakāh*.

To this end, 'Alī bin Abī-Talib (R.A.), the fourth Caliph of Islam, was reported to have once commented on three kinds of intentions underlying the giving of gifts. These include the intension of seeking the pleasure of Allah alone (*li wajhillah*), the seeking of pleasure of fellow humans and lastly, to seek recompense from the person receiving such gifts. The giving of gifts for Allah's sake is encouraged while the giving of such to seek the pleasure of fellow human beings is discouraged. As for the last one which denotes giving of gifts for recompense, Islam encourages it as it is a means of balancing the scale of retribution and clearing the burden of wrong doing which may cause punishment on the Day of Judgement. Scholars are of the opinion that whoever gives a gift expecting more from the receiver of such a gift will not be rewarded by Allah.

#### SELF ASSESSMENT EXERCISE 3.1

In the light of the first revelation on *ribā*, examine the practice of giving to receive more from others and how this has prepared the Muslim for a ban of *ribā*.

#### 3.2 Second Quranic Injunction on *Ribā*

The second place in the Qur'ān which addresses *ribā* is as follows:

فَبِظُلْمٍ مِّنَ الَّذِينَ هَادُوا حَرَّمْنَا عَلَيْهِمْ طَيِّبَاتٍ أُحِلَّت لَّهُمْ  
وَبَصَدَّهُمْ عَنِ سَبِيلِ اللَّهِ كَثِيرًا وَأَخَذَهُمُ الرِّبَا وَقَدْ نُهُوا عَنْهُ  
وَأَكَلِهِمْ أَمْوَالَ النَّاسِ بِالْبَاطِلِ وَأَعْتَدْنَا لِلْكَافِرِينَ مِنْهُمْ عَذَابًا  
أَلِيمًا

For the iniquity of the Jews We (Allah) made unlawful for them certain wholesome foods which had been lawful for them in that they hindered many from Allah's way. That they took *ribā* though they were forbidden and that they devoured men's sustenance wrongfully. We have prepared for those among them who reject faith a grievous punishment. (Q.4: 160-161)

This second part of the *Qur'ān* specifically addresses the Muslims on the disobedience of Allah by the Jews and how they were punished by Him. The language used in this *'āyah* has changed from "giving of *ribā* " to "taking or consuming of *ribā* ". This indicates an advancement in the tone used by Allah for addressing those who deal in *ribā*. Aside from that, it also denotes that *ribā* had once been made forbidden for some people and therefore, it is desirable not to deal in it since revelation comes from the same source (Allah). Hence, it prepares Muslims for its eventual prohibition.

There are various things classified as *ẓulm* (iniquity). However, here in the *'āyah* of the *Qur'ān* in question, it refers to the taking of *ribā* which was later forbidden to them by Mūsā, who happened to be the only prophet the Jews believed in and accepted. Allah, through him, prohibited the Jews from not only taking *ribā* from fellow Jews but from others (i.e. non-Jews). This is contrary to the belief that the prohibition is limited to transactions among the Jews. It has been alleged that this latter claim is part of the original distortions of the Jews to the *Tawrah* (Old Testament). Scholars are of the opinion that these distortions crept into it when the Jews were captured and resettled in Babylon. The reference to their consumption of other people's wealth wrongfully (*bi al-bāṭil*) signifies their collection of bribe (*rishwah*) in order to intentionally falsify their scripture, thereby extorting funds from people.

### SELF ASSESSMENT EXERCISE 3.2

How can you argue that this second portion to be revealed on *ribā* is not confined to the Jews?

### 3.3 Third Quranic Injunction on *Ribā*

The third place in the Qur'ān shows its prohibition and a graduation in the tone used for those dealing in *ribā*. It was first “give” followed by “take” but now “eat”. The 'āyah states:

يَا أَيُّهَا الَّذِينَ آمَنُوا لَا تَأْكُلُوا الرِّبَا أَضْعَافًا مُضَاعَفَةً وَاتَّقُوا  
اللَّهَ لَعَلَّكُمْ تُفْلِحُونَ

O you who believe: Devour not *ribā* doubled and multiplied but fear Allah that you may (really) prosper.  
(Q3: 130)

A number of reasons have been given for the cause of the revelation (*Sabab an-Nuzūl*) of this 'āyah. However, the most probable one was that the major cause of casualties to the Muslims during the Battle of 'Uhud was their love for worldly materials. This became evident when the Muslims who were placed at strategic positions on Mountain 'Uhud during the Battle of 'Uhud left their positions in order to catch some spoils of war, thereby opening up a strategic space for the enemies to give them a big blow, although they (Muslims) eventually won the war. This was why Allah revealed this 'āyah urging Muslims to keep-off from excessive adoration of material things including *ribā*. Another part to this 'āyah is that was revealed in the wake of the battle of 'uhud when the Muslims, owing to paucity of funds, were struck by the thought of dealing in *ribā*, in order to make enough gains to successfully prosecute a war just like the Quraysh were able to raise much funds through this culturally impure source.

On the concept of simple ('*ad'āf*) and compound (*mudā'afah*) interests as contained in the 'āyah in review, table 1 below describes the multiple and double nature of interest. If a loan is to be settled in phases, in each phase, simple interest is utilized, while as the phases increase, the imposition of simple interest here leads to a cumulative interest on the initial capital. This cumulative interest in no time doubles the principal. Therefore, both simple and compound interest are economic technical terms, which are entirely prohibited in Islam.

**Table 1      The table showing the workings of *ribā* over a specific period**

Years	Principal /Loan (₹)	Interest at 20%	Principal plus compound Interest
1	100	20	120
2	120	24	144
3	144	28.8	172.8
4	172.8	34.56	207.36
5	207.36	41.472	248.832

The Prophet corroborated this ban on *ribā* with a number of his sayings. The first to be explained classifies *ribā* as one of the fatal sins (*kabā'ir*). It states:

اجْتَنِبُوا السَّبْعَ الْمُؤْبَقَاتِ قَالُوا يَا رَسُولَ اللَّهِ وَمَا هُنَّ قَالَ  
الشِّرْكُ بِاللَّهِ وَالسَّحَرُ وَقَتْلُ النَّفْسِ الَّتِي حَرَّمَ اللَّهُ إِلَّا بِالْحَقِّ  
وَأَكْلُ الرِّبَا وَأَكْلُ مَالِ الْيَتِيمِ وَالتَّوَلَّى يَوْمَ الزَّحْفِ وَقَذْفُ  
الْمُحْصَنَاتِ الْمُؤْمِنَاتِ الْغَافِلَاتِ.

Keep away from seven fatalities. They (companions) asked, and what are they O Messenger of Allah? He replied: Associating partners with Allah, magic, taking of life that Allah has made sacred except with a just cause (e.g. passing of judgment or war), consuming the wealth of *ar-ribā*, consuming the wealth of the orphan, fleeing from the battle and accusing innocent chaste believing woman (of adultery or fornication)

He again says:

درهم من الربا أشد من بضع وثلاثين زنية

A dirham of *ribā* is surely more (sinful in the sight of Allah) than committing *zina* (fornication or adultery) between thirty three and thirty nine times.

Similar, he says:

الربا سبعون حوباً أيسرّها أن ينكح الرجل أمّه

*Ar-Ribā* as a sin is divided into seventy degrees; the least of them (in sin) is comparable to a man committing incest with his mother.

The Prophet in his statement has not only warned the world and particularly the Muslims on the evils of *ribā* and its gravity in the sight of Allah, but has also described it in the manner that can be properly comprehended. For instance committing *zinā* (fornication) could lead to stoning of its perpetrator to death if married otherwise imprisonment for a year and public disgrace will suffice (if unmarried). A crime which if when committed, could lead to the termination of life is being compared to the

consumption of *ribā* of whatever quantity. Worse still, is its comparing to *zinā* committed within the realm of incest.

Moreover, incest which is universally abhorred is one of the highest grades of shameful deeds in that it is committed with the one that bears the womb that bore him, the mother. This picture paints the dealer in *ribā* as a beast. He also bears the picture of one who is psychologically unfit and whose lower desires are in the realm of the animal kingdom. He/she should in view of these be considered as a mean and shameless person who is only after satisfying his carnal and lower desires irrespective of his victim. He/she is seen as a spreader of curse and corruption in the community. In my own opinion, the perpetrator of *ribā* does not deserve to live.

Also, the curse borne on *ribā* extends to those who witness it and the scribes that write it down. This means that all those involved directly and indirectly in *ribā* are punished. This may be the reason why *ribā* as a phenomenon has seventy degrees depending on the persons involvement in it. The *ḥadīth* (Prophetic saying) that discusses the curse of Allah on those involved in *ribā* states:

لَعَنَ اللَّهُ آكِلَ الرِّبَا وَمُوكِلَهُ وَشَاهِدَهُ وَكَاتِبَهُ

Allah has cursed the devourer of *ribā*, the giver, its witness and the scribe that writes it down.

### SELF ASSESSMENT EXERCISE 3.3

How has the 'āyah in question prohibited *ribā*?

### 3.4 Fourth Quranic Injunction on *Ribā*

The fourth place on *ribā* in the Qur'ān not only re-emphasises the ban on *ribā* as stated in the third place, but also mentions the repercussion awaiting one who deals in it. This set of 'āyāt, annul all forms of confusion in terms of proper understanding and comprehension of the preceding revelation concerning it. The 'āyāt are as follows:

الَّذِينَ يَأْكُلُونَ الرِّبَا لَا يَقُومُونَ إِلَّا كَمَا يَقُومُ الَّذِي يَتَخَبَّطُهُ  
الشَّيْطَانُ مِنَ الْمَسِّ ذَلِكَ بِأَنَّهُمْ قَالُوا إِنَّمَا الْبَيْعُ مِثْلُ الرِّبَا  
وَأَحَلَّ اللَّهُ الْبَيْعَ وَحَرَّمَ الرِّبَا فَمَنْ جَاءَهُ مَوْعِظَةٌ مِّن رَّبِّهِ  
فَانْتَهَى فَلَهُ مَا سَلَفَ وَأَمْرُهُ إِلَى اللَّهِ وَمَنْ عَادَ فَأُولَٰئِكَ  
أَصْحَابُ النَّارِ هُمْ فِيهَا خَالِدُونَ يَمْحَقُ اللَّهُ الرِّبَا وَيُزِيلُ  
الصَّدَقَاتِ وَاللَّهُ لَا يُحِبُّ كُلَّ كَفَّارٍ أَثِيمٍ إِنَّ الَّذِينَ آمَنُوا

وَعَمِلُوا الصَّالِحَاتِ وَأَقَامُوا الصَّلَاةَ وَآتَوْا الزَّكَاةَ لَهُمْ أَجْرُهُمْ  
عِنْدَ رَبِّهِمْ وَلَا خَوْفٌ عَلَيْهِمْ وَلَا هُمْ يَحْزَنُونَ يَا أَيُّهَا الَّذِينَ  
آمَنُوا اتَّقُوا اللَّهَ وَذَرُوا مَا بَقِيَ مِنَ الرِّبَا إِن كُنتُمْ مُؤْمِنِينَ فَإِن  
لَّمْ تَفْعَلُوا فَأْذَنُوا بِحَرْبٍ مِّنَ اللَّهِ وَرَسُولِهِ وَإِن تُبْتِغُوا فَلَکُمْ  
رُؤُوسُ أَمْوَالِکُمْ لَا تُظْلَمُونَ وَلَا تَظْلَمُونَ

Those who devour *ribā* will not stand except as stands one whom Satan by his touch has driven to madness. That is because they say: "Trade is like *ribā*, but Allah has permitted trade and forbidden *ribā*. Those who after receiving direction from their Lord, desist, shall be pardoned for the past, their case is for Allah (to judge). But those who repeat (the offence) are companions of the fire. They will abide therein (for-ever). Allah will deprive *ribā* of all blessings, but will give increase for deeds of charity. For He does not love ungrateful and wicked creatures. Those who believe and do deeds of righteousness, and establish regular prayers and regular charity, will have their reward with their Lord, on them shall be no fear nor shall they grieve. O you who believe, fear Allah and give up what remains of your demand for *ribā*, if you are indeed believers. If you do it not, take notice of war from Allah and His messenger but if you turn back, you shall have your capital sums: deal not unjustly so that you shall not be dealt with unjustly. (Q.2: 275-279)

On the cause of revelation, history has it that during the time of the Prophet when Makkah had been taken over by the Muslims, the *Banū* 'Amru bin 'Umayr from Thaqīf clan accepted Islam late when compared to other clans. They had borrowed the *Banū* al-Mughīrah from the Makhzūm clan some amount of money that was *ribā* compliant. At this time, the *Banū* al-Mughīrah had accepted Islam. Furthermore, the Prophet had appointed Mu'adh bin Jabal to explain Islamic jurisprudence to them. When the *Banū* 'Amra bin 'Umayr of Thaqīf clan accepted Islam, they still demanded for both their principal and accompanying *ribā* from the *Banū* al-Mughīrah. Then a further enforcing ban and threat of war was revealed. Supporting this reinforcement on the ban, the Prophet, on the day of the conquest on Makkah said:

أَلَا وَإِنَّ كُلَّ رَبَّا كَانَ فِي الْجَاهِلِيَّةِ مَوْضُوعٌ وَإِنَّ اللَّهَ عَزَّ وَجَلَّ  
قَضَى أَنْ أَوَّلَ رَبَّا يُوضَعُ رَبَّا الْعَبَّاسِ بْنِ عَبْدِ الْمُطَّلِبِ لَكُمْ  
رُءُوسُ أَمْوَالِكُمْ

Surely, all (cases of) *ribā* in *Jahiliyyah* are placed under these my (two) feet. (i.e annulled). Surely, Allah has decreed that the first *ribā* to be annulled is that of ‘Abbās (Prophet’s uncle) the son of Abdul Mutallib (but) for you (all) is your principal.

A critical examination of the above stated *’āyāt* reveals that the devourers of *ribā* will stand up on the day of Resurrection in a state of agitation. This state of agitation also means beating of something in an unorganised manner. An instance is the saying by the Arabs that “a camel is walking haphazardly”. This occurs to camels with weakness in the eyes. In this case, it means a man walking haphazardly as if he has a weakness in his eye-sight and also driven into madness by *Shayṭān* (Satan).

On the Day of Judgement (*yawm al-Qiyāmah*) when people would rise from their graves, all would rise with stability except the devourers of *ribā*. This is because their stomach will be big and as such, makes them heavy, leading to their falling down constantly and moving about without balance. Their rising up in this unbalanced manner is peculiar to the hereafter. However, in the life of this world, the state of haphazard behaviour similar to that of an insane person still abides with them as they are never at rest, even in their sleep.

Allah in His infinite mercies, decided to forgive those who were still dealing in *ribā* until the revelation of the *’āyah* in the question. He was however quick at informing those who were obstinate in it despite this last grace, a threat of punishment in the Hereafter. The following tradition of the Prophet demonstrates some of the punishments especially as it relates to the state of *barzakh* (an interstate position between death and resurrection). It is as follows:

قال النبي (صلى الله عليه وسلم): رَأَيْتُ اللَّيْلَةَ رَجُلَيْنِ أَتَيَانِي  
فَأَخَذَا بِيَدِي فَأَخْرَجَانِي إِلَى الْأَرْضِ الْمُقَدَّسَةِ فَاَنْطَلَقْنَا حَتَّى  
أَتَيْنَا عَلَى نَهْرٍ مِنْ دَمٍ فِيهِ رَجُلٌ قَائِمٌ عَلَى وَسْطِ النَّهْرِ رَجُلٌ  
بَيْنَ يَدَيْهِ حِجَارَةٌ فَأَقْبَلَ الرَّجُلُ الَّذِي فِي النَّهْرِ فَإِذَا أَرَادَ أَنْ

يُخْرِجُ رَمَى الرَّجُلِ بِحَجَرٍ فِي فِيهِ فَرَدَّهُ حَيْثُ كَانَ فَجَعَلَ كَلِّمَا  
جَاءَ لِيُخْرِجَ رَمَى فِي فِيهِ بِحَجَرٍ فَيَرْجِعُ كَمَا كَانَ فَقُلْتُ مَا  
هَذَا قَالَا الَّذِي رَأَيْتَهُ فِي النَّهْرِ أَكَلُوا الرِّبَا

This night, I dreamt that two men came and took me to a holy land where we proceeded on till we reached a river of blood, where a man was standing and at its middle was standing another man with stones in his possession. The man in the middle of the river tried to come out, but the other threw a stone in his mouth and forced him to go back. So whenever he tried to come out, the other man would throw a stone in his mouth and force him to go back to his former place. I asked, “Who is this?” I was told “The person in the river was a *ribā* consumer.

Allah also made a statement of contrast between charity and *ribā*. For *ribā yamhaqu* (He will destroy) is used while *Yurbi* (He will increase) is used for charity. This is in line with the *ḥadīth* which states:

الرِّبَا وَإِنْ كَثُرَ فَإِنَّ عَاقِبَتَهُ تَصِيرُ إِلَى قُلْ

*Ribā*, even if much, for sure, will at the end become little.

Allah warns of war from Himself and the Prophet with the dealers in *ribā*. This war is a double-edged sword; that of this world on one hand and that of the hereafter. The soldiers of Allah in this world could be in form of anything; living or non-living. This is because everything is under His control and He may decide to use them against any of His creatures, including man, at any point in time. As for the hereafter, the dealers in *ribā* will be asked to take up arms against their Creator, Allah. This is impossible, but it only signifies their destruction in the presence of Allah.

On the soldiers of the Prophet, they are surely the Muslims who will always stand up against injustice and implement the wish of Allah on earth. Part of this is the punishment meted to a dealer in *ribā* in an Islamic society after such a person must have been warned.

### SELF ASSESSMENT EXERCISE 3.3

Describe the intensity of the last phase of the Qur’ān prohibiting *ribā*.



#### 4.0 CONCLUSION

Islam regards money as a medium of exchange rather than being a commodity. This is with the aim of putting an end to the various forms of injustices and economic exploitation in the world. Therefore, Islam unequivocally prohibits *ribā*-based transactions. The sanction placed by Allah on whoever is involved in *ribā* is quite colossal. Consequently, conscious Muslims have no choice but to refrain from transactions involving *ribā* in all its ramifications.

#### 5.0 SUMMARY

- The prohibition of *ribā* in Islam is in four stages.
- The first stage in the prohibition of *ribā* was in the form of discouraging greed.
- The second stage in the prohibition of *ribā* was as a piece of information to Muslims about Allah's punishment of the Jews for their inequities and their transaction in *ribā*.
- The second stage in the prohibition of *ribā* came as an outright prohibition in transacting in it.
- The last verse on *ribā* is a reinforcement of the former prohibition of it albeit in a stronger tone.

#### 6.0 TUTORIAL ASSIGNMENT

- In the light of the current global economic realities, examine the last verse of the Qur'ān prohibiting *ribā*.

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#### **Unit 4: The Question of *Gharar* and *Maysir***

##### **CONTENT**

##### **1.0 Introduction**

2.0	Objectives
3.0	Main Content
3.1	The Concept of <i>gharar</i>
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3.3	The Prohibition of <i>Maysir</i>
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## 1.0 INTRODUCTION

The last two units have concentrated on the prohibition of *ribā* in Islam. The present unit examines other major impediment to any Islamic contract which is *gharar* and *maysir*. Even though, *gharar* and *maysir* have become the order of the day in the secular society, they remain the means of exploiting the weaker segments of the society. This unit explains how these practices are viewed from the angle of Islam and how they can be identified and avoided in the financial transactions of the Muslim community.

## 2.0 OBJECTIVES

At the end of this unit, the student should be able to:

- (i) Define the terms: *gharar* and *maysir*,
- (ii) Explain the workings of *gharar* in business transactions,
- (iii) List the precautions to take to avoid *gharar*, and
- (iv) Explain why *maysir* is forbidden in Islam.

## 3.0 MAIN CONTENT

### 3.1 The Concept of *Gharar*

*Gharar* is from the root verb “*gharra*” which means to mislead, deceive, beguile, delude, gull or to dazzle someone. *Gharar*, as a verbal noun, denotes risk, deceit or exposure to loss. It is usually perceived as something which is desired when the exterior is considered but detested when studied critically. This meaning is alluded to in the Qur’ān where Allah says:

كُلُّ نَفْسٍ ذَائِقَةُ الْمَوْتِ وَإِنَّمَا تُوَفَّقُونَ أُجُورَكُمْ يَوْمَ الْقِيَامَةِ  
فَمَنْ زُحْزِحَ عَنِ النَّارِ وَأُدْخِلَ الْجَنَّةَ فَقَدْ فَازَ وَمَا الْحَيَاةُ الدُّنْيَا  
إِلَّا مَتَاعُ الْغُرُورِ

Every soul shall have a taste of death and only on the Day of Judgement shall you be paid your full recompense. Only he who is saved far from the fire and admitted to the Garden will have attained the object (of life) for the life of this world is but goods and chattels of deception (*ghurūr*). (Q3:185)

Various scholars and schools of Islamic jurisprudence have given their own definitions to the concept of *gharar*. All the various definitions are however, interlocked. For instance, Al-Qarāfī of the Malikī School of thought says, *gharar* as a principle, relates to what is known and what is unknown irrespective of whether such a thing exists or not. Also, Al-Sarakhsī of Ḥanafīyyah School defines it as what has a veiled end. Further, As-Shayrāzī of the Shāfi‘ī’s School views it as what is hidden in its affairs and in its end.

Ibn Taymiyyah opines that it is what has an unknown end. Joining him, his most celebrated student, Ibn al-Qayyim defines it as “incapability to deliver, irrespective whether the object of sale exists or not”. He gave instances of a runaway slave and a strayed camel. Lastly, Ibn Hazm views it as lack of knowledge of the buyer or the seller about the object of purchase or the actual sale. Similarly, *gharar* is the sale of a probable article without certainty as regards its existence or its features are not totally disclosed. It extends to all transactions concerning exchanges in which its comprehensive implications are not clearly unveiled to the parties concerned. It also applies to any sale contract in which there is uncertainty in either the genus, quality or the species of the object, its existence, identity, price and the time of payment.

*Gharar* is a contract between two parties wherein one of the parties may decide to cheat or exploit the other party through giving a wrong description of the subject matter or ignorance of goods which the seller is not able to deliver. It also applies to the making of a contract conditional upon an unknown event. Islamic jurists and economists have agreed on the prohibition of such a contract.

Although *gharar* is not directly contained in the Qur’ān, the use of the term *bāṭil* (vanity) in it is agreed by some scholars as connoting *gharar*. Going by that, the prohibition of *gharar* could be seen in two different ‘āyāt of the Qur’ān. These ‘āyāt are as follows:

وَلَا تَأْكُلُوا أَمْوَالَكُمْ بَيْنَكُمْ بِالْبَاطِلِ وَتُدْلُوا بِهَا إِلَى الْحُكَّامِ  
لِتَأْكُلُوا فَرِيقًا مِّنْ أَمْوَالِ النَّاسِ بِالْإِثْمِ وَأَنْتُمْ تَعْلَمُونَ

And do not eat up your property among yourselves through *bātil* (for vanities), nor use it as bait for the judges, with intent that you may eat up wrongfully and knowingly, a little of (other) people's property. (Q. 2:188).

The second 'āyah states:

يَا أَيُّهَا الَّذِينَ آمَنُوا لَا تَأْكُلُوا أَمْوَالَكُمْ بَيْنَكُمْ بِالْبَاطِلِ إِلَّا أَنْ  
تَكُونَ تِجَارَةً عَنْ تَرَاضٍ مِّنْكُمْ وَلَا تَقْتُلُوا أَنْفُسَكُمْ إِنَّ اللَّهَ  
كَانَ بِكُمْ رَحِيمًا

O you who believe, eat up not your property among yourselves in *bātil* (vanities), but let there be among you traffic and trade by mutual good-will, nor kill (or destroy) yourselves: for verily, Allah has been to you most merciful. (Q. 4:29)

### SELF ASSESSMENT EXERCISE 3.1

In view of the definition of scholars, explain the term *gharar*

### 3.2 *Gharar* in Business Transactions

In the business world, *gharar* explicitly connotes the undertaking of a business contract with little or no knowledge of the intricacies of the business. It can also mean indulging in risky transactions where their essential conditions are either hidden or not completely and properly defined. In other words, the knowledge of the existence of the subject matter, its accessibility to contracting parties when occasion demands, its features, quantity and whether condition these would be satisfactory to its buyer or not. All speculative transactions are forbidden in Islam. *Gharar* can be noticed in transactions where the seller is not in possession, whether physically or constructively, of the subject matter or object of sale. It can also occur if the subject matter is inaccessible to the seller. An instance of this is the sale of a fish in the water, a bird in the air and unripe fruits among others.

The rationale for the prohibition of transactions involving *gharar* is to protect the interest of the weaker party and prevent disputes within the society. If in a sale contract, an agreement is reached to sell an item to another party and that payments for that item

would be made immediately while, though the item is in the direct or constructive possession of the seller, the item for sale would be released to the buyer at a future date, there are likely to be problems. The first challenge is that the market price for the item may drop by the future date while he/she regrets paying in arrears. The same condition could happen to the seller if the price of the item appreciates substantially by the appointed future date. Another part to the issue is that the subject matter may have changed negatively causing the disgust of the buyer. Islamic jurists have mentioned several cases where *gharar* is eminent. For the avoidance of *gharar*, the following conditions need to be fulfilled.

- a) To ascertain that the object of sale is not only in existence but available and in the constructive possession of the seller at the time of sale. Joined to this is the determination of the price of the object before its sale,
- b) The date of delivery must be defined if there is need necessitating the delay of the object's delivery, and
- c) The characteristics of the object should be fully declared to both the seller and the buyer before the sale contract.

### **SELF ASSESSMENT EXERCISE 3.2**

Examine the socio-economic reasons behind the prohibition of *gharar*.

### **3.3 The Concept of *Maysir***

Closely related to *gharar* is *maysir*, which is derived from the word '*usr*' meaning ease and convenience. *Maysir* originated from a *Jahiliyyah* game of arrow wherein few individuals gamble for slaughtered and quartered camels. This game entails the shuffling of ten (10) arrows with values allotted to them in a specially made sack. A neutral person gradually picks out the arrows through a small opening on behalf of each gambler. Through this process winners of the various values on each arrow are allotted their share of the camel meat as indicated on each arrow. You can deduce from this description that *maysir* is another name for gambling which entails two or more individuals partaking in a game of chance that usually culminates in the redistribution of stakes made up by all among a few individuals. Gamblers are often encouraged by the hanging hope in the lucrative pay-off at the completion of the game.

A critical look at this word (*maysir*) reveals the attainment of a material thing with little very effort. *Maysir* leads to amassing wealth with minimal effort. In the contemporary society, *maysir* is regarded by the majority of jurists as gambling or any form of games of chance. These games of chance include lotto, betting on the outcome of games, lotteries and casino-type of games. All forms of gambling and games of chance are forbidden in Islam as the Qur'an read:

يَا أَيُّهَا الَّذِينَ آمَنُوا إِنَّمَا الْخَمْرُ وَالْمَيْسِرُ وَالْأَنْصَابُ وَالْأَزْلَامُ  
رِجْسٌ مِّنْ عَمَلِ الشَّيْطَانِ فَاجْتَنِبُوهُ لَعَلَّكُمْ تُفْلِحُونَ

O you who believe, intoxicants and gambling (dedication of) stones and (divination by) arrows, are an abomination of Satan handiwork: eschew such (abomination) that you may prosper (Q5:90)

Another 'āyah states that

يَسْأَلُونَكَ عَنِ الْخَمْرِ وَالْمَيْسِرِ قُلْ فِيهِمَا إِثْمٌ كَبِيرٌ وَمَنْفَعَةٌ  
لِّلنَّاسِ وَإِثْمُهُمَا أَكْبَرُ مِنْ نَّفْعِهِمَا وَيَسْأَلُونَكَ مَاذَا يُنْفِقُونَ قُلِ  
الْعَفْوُ كَذَلِكَ يُبَيِّنُ اللَّهُ لَكُمْ الْآيَاتِ لَعَلَّكُمْ تَتَفَكَّرُونَ

They ask you concerning wine and gambling, say in them is great sin and some profit for men. But the sin is greater than the profit. They ask you how much they are to spend. Say: what is beyond your needs. Thus does Allah make clear to you His signs in order that you may prosper. (Q2:219)

Scholars have tried to proffer reasons why it is necessary for *maysir* to be banned in the society. They pointed out the high risk involved in this illegal and illegitimate transaction. They substantiate their claims with the fact that while few individuals gain, the majority suffer loss and sometimes become bankrupt due to the loss, a factor that could engender disunity and violence in the society. Aside from this problem of financial and social inadequacies, it is also not necessary as it adds no value to the society. Islamic economists and jurists have extended the prohibition of *Maysir* to include all forms of speculative contracts. It also includes dealings in which merits and the demerits of either party are not properly defined at the time of the contract.

### SELF ASSESSMENT EXERCISE 3.3

Reflect on the application of *maysir* on the socio-political life of Nigerians.

#### 4.0 CONCLUSION

*Gharar* and *Maysir* are like a double edged sword in their workings it both the economic and the social lives of people. These two terms engender inequality, personal grudges and confusion in the society. Islam abhors *gharar* and *maysir* in all aspects of our lives including financial transactions. These prohibitions are in a bid to maintaining a just society where everyone is equal.

#### 5.0 SUMMARY

- Any risky business where parties do not command the proper knowledge of the contract is *gharar*.
- *Gharar* destroys the bond of brotherhood in the community.
- *Gharar* allows for the strong to cheat the weak.
- *Maysir* is another name for gambling.
- Rather than redistributing wealth, *maysir* concentrates wealth in the hands of a few.

#### 6.0 TUTORIAL ASSIGNMENT

- Explain the dimensions utilised in the practice of *maysir* in your environment and the resultant effect of that on the conditions of the masses.
- Examine how social and economic justice can be introduced in your country through banning *gharar* and *maysir*.
- Elucidate on the opinion of Islamic jurists and economists on *maysir* and *gharar*.

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### **Module 3    Islamic Banking Instruments and Techniques**

In the second module, you were been taken through some intensive discussions on the foundations of Islamic banking. I am sure you that you found it quite informative. Having had a grasp of the rudiments of Islamic financial contracts, it would be proper for you to move a step further in the direction of applying these Islamic laws of financial transactions to financial intermediation, the main function of a bank.

This module treats the various Islamic financial instruments affords Islamic banks the ability to effectively perform their obligations. These include the effective use of collateral security and guarantee as instruments of authentication of clients in event of any possible moral hazards when situation demands. Also, you would encounter the Islamic instrument of debt transfer. There is also the institution of agency from which the bank obtains its power of intermediation. In addition to that, is the principle of safe-keeping and partnership which serve major roles in Islamic banking. Further, two major Islamic banking techniques: equity participation and trustee project financing that derive their origin in the ancient Arabian society were comprehensively analysed.

As you can see, this module is made up four units with similar themes. The first unit introduces the concept of collateral security, guarantee and debt transfer. This is followed by then next unit which discusses the concepts related to services such as agency, safe-keeping and partnership. Flowing from that is the third unit that discusses equity participation financing as a mode of financing. The final unit examines trustee project financing as another potent mode of project financing in Islamic banking.

Unit 1: Instruments of Authentication in Islamic Finance

Unit 2: Instrument of Service and Investment in Islamic Finance

Unit 3: Islamic Financial Techniques I: *Mushārah* (Equity Participation) Contract

Unit 4: Islamic Financial Techniques II: The *Muḍārah* (Trustee Project Financing)

## **Unit 1: Instruments of Authentication in Islamic Finance**

### **CONTENT**

#### **1.0 Introduction**

2.0	Objectives
3.0	Main Content
3.1	The Concept of <i>Rahn</i> (Collateral Security)
3.1.1	Meaning of <i>Rahn</i>
3.1.2	Conditions of <i>Rahn</i>
3.2	The Concept of <i>Ḍamān</i> (Guarantee)
3.2.1	Meaning of <i>Ḍamān</i>
3.2.2	Regulations Guiding <i>Ḍamān</i>
3.3	The Concept of <i>Ḥawālah</i> (Debt Transfer)
4.0	Conclusion
5.0	Summary
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## 1.0 INTRODUCTION

This unit examines three concepts which form part of the instrument necessary for proper intermediation of an Islamic bank. These instruments include the collateral security, social guarantee, and debt transfer. Although, some of these terms are used in the conventional system, they differ in some aspects of their operation. These instruments are explained in a manner that they could be utilised in Islamic financial transactions, especially, in Islamic banking.

## 2.0 OBJECTIVES

At the end of this unit, the student should be able to:

- (i) Explain the meaning of *Rahn*, *Ḍamān* and *Ḥawālah*, and
- (ii) Examine the rules guiding *Rahn*, *Ḍamān* and *Ḥawālah* in Islamic finance.

## 3.0 MAIN CONTENT

### 3.1 The Concept of *Rahn* (Collateral Security)

#### 3.1.1 Meaning of *Rahn*

*Rahn* is the placing of a particular property under suspension and detention due to a right temporarily made available against its owner and which may be compensated for out of that property. In other words, it is a collateral security placed for a debt. This can be in form of either movable or immovable properties. It can also be defined as the placing down of a valuable thing to the creditor indemnifying him/her against the return of the borrowed money. If he/she is not able to repay his debt, the security is then sold with the permission of the debtor. Thereafter, the principal fund is removed while the remaining fund is returned to the debtor.

There are some points of difference between the Islamic and conventional ways of managing collateral security. In the latter, the whole security is sold without the consent of its owner while the excess profit made on it over and above the principal and its

attendant *ribā* are not only kept but are also consumed by the creditor. However, in the Islamic system, collateral securities are not sold without the consent of the debtors. In case a collateral security is sold with the consent of its owner and excess money over and above the principal is made, this excess fund is returned to the debtor. Islam gives credence to collateral security through Allah saying that:

وَأِنْ كُنْتُمْ عَلَى سَفَرٍ وَلَمْ تَجِدُوا كَاتِبًا فَرِهَانٌ مَّقْبُوضَةٌ فَإِنْ  
أَمِنَ بَعْضُكُم بَعْضًا فَلْيُؤَدِّ الَّذِي أُؤْتِمِنَ أَمَانَتَهُ وَلْيَتَّقِ اللَّهَ رَبَّهُ  
وَلَا تَكْتُمُوا الشَّهَادَةَ وَمَنْ يَكْتُمْهَا فَإِنَّهُ آثَمٌ قَلْبُهُ وَاللَّهُ بِمَا  
تَعْمَلُونَ عَلِيمٌ

If you are on a journey and cannot find a scribe, a pledge with a possession (may serve the purpose). And if one of you deposits a thing on trust with another, let the trustee faithfully discharge his trust and let him fear Allah His Lord. Conceal not evidence; For whoever conceals it, his heart is tainted with sin. And Allah Knows all that you do. (Q. 2:283)

Adding to this assertion, the Prophet once bought barley on credit from a Jew. He then placed his armour as collateral security with this woman. The *hadith* on this state:

عَنْ عَائِشَةَ رَضِيَ اللَّهُ عَنْهَا قَالَتْ اشْتَرَى رَسُولُ اللَّهِ (صلى  
الله عليه وسلم) مِنْ يَهُودِيٍّ طَعَامًا بِنَسِيئَةٍ وَرَهْنَهُ دِرْعَهُ

Aisha narrated That the Prophet (SAW) bought food items from a Jew (on credit) and pledged his armour (as collateral security).

### SELF ASSESSMENT EXERCISE 3.1.1

Give the Islamic view of collateral security in financial transactions.

#### 3.1.2. Conditions of *rahn*

The concept of collateral security cannot be legally binding in Islam unless certain conditions are fulfilled. Part of these conditions is that the *rāhin* (pledger) and the *murtahin* (pledgee) must be sane and of good frame of mind. They must also not be under-aged. This will make them liable and responsible for whatever they have done under the *Sharī'ah*. It will also make them to be committed to their agreements.

On the form in which *rahn* should take, Maliki School of thought is of the opinion that verbal expression can serve the purpose. In sharp contrast to this view, the Shāfi‘ school holds that it has to be a valuable material which must be seen as taking effect from the time it has come to the possession of the *murtahin*. This stand has been supported by Allah in the Qur’an when He says “a pledge with a possession” (Q2:283).

In a contract of exchange involving the placement of *rahn*, the contract will only be deemed completed after there has been an exchange of the *rahn* collateral (security) for the funds or commodities demanded by the *rāhin* (pledgor). This security must also have been submitted before funds are released. Further, the contract is expected to be comprehensive and not beclouded by uncertainties. For instance, it could come in form of the saying that: “I give out this *rahn* for a loan of this and this for a period of three months”. The *murtahin* should then say in return: “I accept”.

Moreover, the *marhūn* (security) should be among the various items which are allowed in Islam (*ḥalāl*) and not those things that are forbidden (*ḥarām*). It should also be a tangible item. Another condition that must be met by the *Marhūn* is that, it must not be a perishable item especially before the specific date of return of borrowed item. An exemption to this in the contract is when the *rāhin* gives an instruction stating that when the item is about getting destroyed, it could be sold with its gains serving as the security.

A situation could arise, when the *marhūn* (security) due to some factors disappears from the custody of the *murtahin* or a trustee commissioned to keep it in custody. In the event of this, if the *rāhin* is pleased with this event, the collateral security will not be replaced except it is proved that the *marhūn* got lost as a result of carelessness. During the period when the *murtahin* takes possession of the *marhūn*, he is not expected to make use of the item or property without giving a share of the proceeds to the *rāhin* in return. To this end, the Prophet was reported to have stated that:

الرَّهْنُ يُرْكَبُ بِنَفَقَتِهِ إِذَا كَانَ مَرْهُونًا وَلَبَنُ الدَّارِ يُشْرَبُ بِنَفَقَتِهِ  
إِذَا كَانَ مَرْهُونًا وَعَلَى الَّذِي يَرْكَبُ وَيَشْرَبُ النَّفَقَةُ

(An animal used as a collateral security may be ridden for spending on it when it is pledged and the milk of a camel may be drunk for spending on it when in pledge. And the responsibility of caring for it is upon the one who rides (it) and drinks (its milk).

Finally, the *rahn* should not be liquidated simply because the fixed date of payment has expired. The *murtahin* is under moral and religious obligation to give some time to the *rāhin* to pay back his debt. If the debtor is unable to redeem his/her pledge, then the *rahn* could be sold with his/her permission. This is in line with the *Sunnah* of the Prophet which states that:

لا يغلق الرهن من صاحبه الذي رهنه له غنمه وعليه غرمه

A pledge does not become lost to its owner when he does not redeem it on time. Any increase in its value goes to him and any loss must be borne by him.

### SELF ASSESSMENT EXERCISE 3.1.3

Explain the conditions guiding *rahn* in Islam.

## 3.2 The Concept of *Ḍamān* (Guarantee)

### 3.2.1 Meaning of *Ḍamān*

*Ḍamān* (guaranty) is the voluntary placing of liability of another person into one's affair. This makes it necessary for such a liability to be discharged by one if the original person with the liability fails to discharge it. Allah, in the Qur'ān, supports this where He says:

قَالُوا نَفْقَدُ صُوعَ الْمَلِكِ وَلَمَنْ جَاءَ بِهِ حِمْلُ بَعِيرٍ وَأَنَا بِهِ زَعِيمٌ

They said: We miss the great beaker of the king; for him who produces it, is (the reward of) a camel load; I will be bound by it. (Q. 12:72)

In the 'āyah above, Prophet Yūsuf (AS) had asked that his servants place his golden bowl in his brother's (Binyāmīn's) bag while he and his brother were unaware. This was followed by someone heralding that Binyamin and his brothers were thieves. Yusuf's brothers now asked with surprise whether the Egyptians had lost anything, then the man replied that they had lost the bowl of the king. The man then went further to promise whoever was able to produce the golden bowl, a camel load of foodstuffs which was then scarce. He concluded by saying that he will be *za'im* which means a guarantor for such a handsome reward. The Prophet in contributing to this also said:

The one liable is a debtor (bound to pay) الزعيم غارم

This *ḥadīth* was said regarding a companion who died owing some debts without leaving funds or property to repay his debt. Hence, the Prophet refused to pray *janāzah* (*salat* for the dead) over him except someone paid or stood as guarantor for paying his debt.

### SELF ASSESSMENT EXERCISE 3.2.1

Explain what is meant by the term *Damān*.

#### 3.2.2. Regulations Guiding *Ḍamān*

There are a number of regulations guiding being a guarantor in Islam. They include the condition that the guarantor must be sane and mature. This is necessary because one who does not possess these two qualities cannot be held responsible for such

important and enormous function which necessitates an obligation upon him. It is also necessary that these obligations are pleasing to him as he should not be under duress in taking such a responsibility. Otherwise, this contract remains null and void.

Besides, the guarantor must also not demand for a fee or a compensation from the guaranteed for taking up this sensitive role and obligation otherwise it becomes a loan (*qarḍ*) in which an increase is paid *ribā*. This kind of loan is forbidden (*ḥarām*) under the *Shari'ah*. In addition, the agreement must be comprehensive. It should be noted that the owner of the property (*sāhib al-haqq*) being given out has the right to in addition to this guarantee, collect a security (*rahn*) from either the guarantor or the guaranteed. In event of failure to redeem the pledge on the part of the guaranteed in returning the borrowed property to its owner, the guarantor (*dāmin*) will be made to redeem the unfulfilled obligation. This is because of the Prophet's saying referred to earlier that:

الزَّعِيمُ غَارِمٌ

The guarantor is a debtor

However, the majority of scholars (‘*ulamā*’) postulate that both the guarantor (*dāmin*) and the guaranteed (*madmūn ‘anh*) will share in the payment of the debt. The guarantor (*dāmin*) is not free until the guaranteed pays back his debt or fulfils his obligations. In addition, guarantors can be more than one in a single transaction. This means that they are equally responsible as in the case of one guarantor in the event of a failure in the fulfilment of the obligation. In conclusion, just as it is permissible for a guarantor to guarantee what he/she knows, he/she could also do the same for what he/she does not know. This is justified by the saying in the Qur’anic ‘*āyah* (Q12:72) quoted above.

### SELF ASSESSMENT EXERCISE 3.2.2

Examine the Islamic regulation guiding guarantee in Islam.

### 3.3 The concept of *Hawālah* (Debt Transfer)

This is the transfer of the obligation of paying a debt to another person who owes the initial debtor a similar amount with the consent of the initial creditor. This principle is acceptable when the original debtor refers the debt to his rich debtor. It has a basis in the *ḥadīth* which states:

مَطْلُ الْغَنِيِّ ظُلْمٌ فَإِذَا أَتَبَعَ أَحَدُكُمْ عَلَى مَلِيٍّ فَلْيَتَّبِعْ

Procrastination (delay) in paying by a wealthy person is injustice, so if your debt is transferred from your debtor to a rich debtor, you should agree.

Also another *ḥadīth* demonstrates the transfer of debt owned by a dead person to a living individual. The *ḥadīth* goes thus:

عَنْ سَلَمَةَ بْنِ الْأَكْوَعِ رَضِيَ اللَّهُ عَنْهُ قَالَ كُنَّا جُلُوسًا عِنْدَ النَّبِيِّ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ إِذْ أُتِيَ بِجَنَازَةٍ فَقَالُوا صَلِّ عَلَيْهَا فَقَالَ هَلْ عَلَيْهِ دَيْنٌ قَالُوا لَا قَالَ فَهَلْ تَرَكَ شَيْئًا قَالُوا لَا فَصَلَّى عَلَيْهِ ثُمَّ أُتِيَ بِجَنَازَةٍ أُخْرَى فَقَالُوا يَا رَسُولَ اللَّهِ صَلِّ عَلَيْهَا قَالَ هَلْ عَلَيْهِ دَيْنٌ قِيلَ نَعَمْ قَالَ فَهَلْ تَرَكَ شَيْئًا قَالُوا ثَلَاثَةَ دَنَانِيرَ فَصَلَّى عَلَيْهَا ثُمَّ أُتِيَ بِالثَّالِثَةِ فَقَالُوا صَلِّ عَلَيْهَا قَالَ هَلْ تَرَكَ شَيْئًا قَالُوا لَا قَالَ فَهَلْ عَلَيْهِ دَيْنٌ قَالُوا ثَلَاثَةَ دَنَانِيرَ قَالَ صَلُّوا عَلَى صَاحِبِكُمْ قَالَ أَبُو قَتَادَةَ صَلِّ عَلَيْهِ يَا رَسُولَ اللَّهِ وَعَلَيَّ دَيْنُهُ فَصَلَّى عَلَيْهِ

Salamah bin Al-Akwa‘ narrated that: Once, while we were sitting in the company of the Prophet (SAW), a dead man was brought. The Prophet was requested to lead the funeral prayer for the deceased. He said, “is he in debt?”. The people replied in the negative. He said: “Has he left any wealth?”. They said “No”. So he led his funeral prayer. Another dead man was brought and the people said, “O Allah’s Apostle!” lead his funeral prayer”. The Prophet said: “is he in debt?” They said: “Yes”, He said: “Has he left any wealth?” They said: “Three *dīnārs*”. So he led the prayer. Then a third dead body was brought and the people said (to the Prophet), please lead his funeral prayer”. He said: “Has he left any wealth?” They said “No”. He said, “is he in debt?” “They said (yes: he has to pay) three *dīnārs*”. He (the Prophet refused to pray and) said “Then pray for your (dead) companion”. Abu Qatadah said, “O Allah’s Apostle; lead his funeral prayer and I will pay his debt”. So he led the prayer.

For *hawālah* to take place, the creditor must have confirmed from the person on whom the debt is being transferred whether he truly owns the debtor the amount owned the creditor. Furthermore, the debt must be of the same kind, description and payment schedule. Also the creditor and the debtor must consent to the arrangement. The creditor could insist on the debtor’s paying back the debt on his own without a third party being involved. This arrangement is only a privilege and not a right.

### SELF ASSESSMENT EXERCISE 3.3

With the aid of the Qur’ān and *Sunnah*, explain the Islamic concept of debt transfer.

### 4.0 CONCLUSION

In any financial transaction, there must be incentives to keep awake the attention of parties. These include collateral security (*rahn*) and mutual guarantee (*ḍamān*). These have conditions which are different from the conventional conception of them. Finally, is the *hawālah* which affords the transfer of debt from one person to another through a



systematic process. All these have their backings in both the Qur'ān and the *Sunnah* and can be applied to contemporary financial transactions.

## 5.0 SUMMARY

- *Rahn* is another name for collateral security.
- *Damān* is also known as guarantee.
- Both *rahn* and *damān* are useful instruments for the effective operation of the Islamic financial system.
- The conditions guiding the application of *rahn* and *damān* are more humane than their conventional counterparts.
- *Hawālah* is a kind of system whereby debt could be transferred from one person to another with the consent of parties involved.

## 6.0 TUTORIAL ASSIGNMENT

- Assess collateral security from both the points of view of conventional and Islamic banks.
- In your own opinion, how do you think *damān* can be used to enrich the poor.
- *Hawalah* could serve as an instrument in the modern financial industry. Discuss.

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## Unit 2: Instruments of Service and Investment in Islamic Finance

### CONTENT

- 1.0 Introduction
- 2.0 Objectives

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## 1.0 INTRODUCTION

This unit examines some fundamental issues in Islamic banking. These issues are Agency, Safe-keeping and Partnership. These cardinal principles propel Islamic banks to function reasonably. Although Islamic banks keep funds for its customers, it acts as a middle man between the customer and the investors. This underscores its role as an agent. Profits accruable from Investment are thereafter shared by the bank and its depositors. Notwithstanding, these have to be guided by some rules.

## 2.0 OBJECTIVES

At the end of this unit, the student should be able to:

- (i) Explain the Islamic posture on Agency,
- (ii) Examine the Islamic concept on safe-keeping, and
- (iii) Describe the Islamic view on partnership.

## 3.0 MAIN CONTENT

### 3.3 The concept of *Wakālah*(Agency)

#### 3.3.1 The meaning of *Wakālah*

*Wakālah* is a derivative from the verb *wa-ka-la* which means to entrust, assign, commission, charge (with) or put someone in charge of something or somebody. *Wakālah* on its own means representation, deputyship, proxy, full power of attorney, management and agency. It is the acting or managing of an individual, group of individuals or corporate organisation on behalf of others in designated affairs which require representation. This could be in the area of politics, litigation and commerce among others. Allah permits *wakālah* in the Qur'ān while discussing the recipients of *zakāh* (almsgiving). There, He mentions the agents of the Imams who assist him in administering *zakāh*. He says:

إِنَّمَا الصَّدَقَاتُ لِلْفُقَرَاءِ وَالْمَسْكِينِ وَالْعَامِلِينَ عَلَيْهَا وَالْمُؤَلَّفَةِ قُلُوبُهُمْ وَفِي  
الرِّقَابِ وَالْغَارِمِينَ وَفِي سَبِيلِ اللَّهِ وَابْنِ السَّبِيلِ فَرِيضَةً مِّنَ اللَّهِ وَاللَّهُ عَلِيمٌ حَكِيمٌ

Alms are for the poor and the needy and those employed  
to administer it (the funds). For those whose hearts have  
been (recently) reconciled (to truth), for those in  
bondage and in debt, in the cause of Allah and for the  
wayfarer (Thus is it) ordained by Allah and Allah is full  
of knowledge and wisdom. (Q9:60).

Prophet Yūsuf (AS) also demonstrated the work of *wakālah* after his release from prison. He was reported to have told the king of Egypt to make him an agent (*wakīl*) in charge of the stores in order for him to faithfully discharge the work of storing and managing windfalls during the green or raining years against the famine period expected to befall Egypt in the future. This request of his was granted by the King. The text of this story states:

قَالَ اجْعَلْنِي عَلَى خَزَائِنِ الْأَرْضِ إِنِّي حَفِيظٌ عَلَيْكُمْ وَكَذَلِكَ مَكَّنَّا لِيُوسُفَ فِي الْأَرْضِ يَتَّبِعُوا  
مِنْهَا حَيْثُ يَشَاءُ نُصِيبُ بِرَحْمَتِنَا مَنْ نَّشَاءُ وَلَا نُضِيعُ أَجْرَ الْمُحْسِنِينَ

(Yūsuf) said: “Set me over the store-houses of the land: I will indeed guard them, as one that knows (their importance). Thus did We give established power to Yūsuf in the land, to take possession therein as, when or where He pleased. We bestow of Our mercy on whom We please and We suffer not, to be lost, the reward of those who do good. (Q12:55-56)

There is also the case of the *aṣḥab al-Kahf* (people of the cave) who fled from the township where they lived in order to escape from persecution of the unbelievers. They were later made totally unconscious of their environment for a specific period and thereafter woken up from their sleep and state of unconsciousness. Then they were hungry and had to delegate the responsibility of buying food for them to one of them as Allah says:

وَكَذَلِكَ بَعَثْنَاهُمْ لِيَتَسَاءَلُوا بَيْنَهُمْ قَالَ قَائِلٌ مِّنْهُمْ كَمْ لَبِثْتُمْ قَالُوا لَبِثْنَا يَوْمًا أَوْ  
بَعْضَ يَوْمٍ قَالُوا رُبُّكُمْ أَعْلَمُ بِمَا لَبِثْتُمْ فَابْعَثُوا أَحَدَكُمْ بِوَرِقِكُمْ هَذِهِ إِلَى الْمَدِينَةِ  
فَلْيَنْظُرْ أَبَيْهَا أَزَكَىٰ طَعَامًا فَلْيَأْتِكُمْ بِرِزْقٍ مِنْهُ وَلْيَتَلَطَّفْ وَلَا يُشْعِرَنَّ بِكُمْ أَحَدًا

Such (being their state), We raised them up (from sleep)  
that they might question each other. Said one of them,

“How long have you stayed (here)? They said, “We have stayed (perhaps) a day, or part of a day? (At length) They (all) said, “Allah (alone) knows best how long have you stayed here now send one of you with this money of yours to the town: Let him find out which is the best food (to be had) and bring some to you, that (you may) satisfy your hunger therewith: and let him behave with care and courtesy, and let him not inform anyone about you. (Q18:19)

In the above quoted *’āyah*, it should be noted that the commissioned was also given some terms of reference. These were that; the best food should be bought for them, he should be careful and courteous in his conduct, and finally not to inform anyone about them. On the consent of the Prophet as regards *kafālah* (agency), a *ḥadīth* states:

عَنْ أَبِي هُرَيْرَةَ رَضِيَ اللَّهُ عَنْهُ قَالَ وَكَّلَنِي رَسُولُ اللَّهِ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ بِحِفْظِ زَكَاةِ رَمَضَانَ

Abu Hurayrah narrated that: “Allah’s Apostle (SAW) made me the agent to keep *ṣadaqah* (al-Fitr) of Ramadan...

A similar case of *wakālah* applies to the implementation of penal law (*ḥadd*). The *ḥadīth* that teaches on how this is done states that the Prophet instructed ‘Unays to, on his behalf, verify from a woman the truth of an accusation of adultery levelled against her by her husband. On another occasion, the Prophet was said to have delegated some individual to help deliver slaughtered sacrificial animals to Makkah in company of Abū Bakr, his friend.

### 3.1.2 Conditions of *wakālah*

There are certain conditions guiding *wakālah* in Islam. As part of these, the *muwakkil* (mandator) must be sane and mature. He must also be in full possession of the *muwakkil fih* (property). Also, the *muwakkal* (agent) must be sane and mature. Nevertheless, the Ḥanafīyyah School is of the view that he does not necessarily have to be mature in age. He could be a young but intelligent and mature in nature.

This last view seems to be the better one. This is because there are instances where a young person is more gifted than the elderly ones. In that case, to abandon the young one with intellect, bold heart and piety for an elderly one who does not possess such qualities or who is irresponsible will not augur well for the *Muwakkil* (mandator) and indeed the society. This was why ‘Umar bin Abdul-‘Azīz, popularly known as ‘Umar II, when confronted with a similar situation made a comment that:

تعلم فليس المرء يولد عالمًا # وليس أخو علم كمن هو جاهل  
وإن كبير القوم لا علم عنده # صغيرٌ إذا التفت عليه المحافة

Learn, for man is not given birth to with knowledge and a knowledgeable one is not comparable to an ignorant person. If the elderly ones of a people are not knowledgeable, they become the young ones (incapacitated) when they have to give an address in public.

The property to be entrusted (*Muwakkil fih*) to the agent must be made known to him and must be absolutely permitted (*ḥalāl*) under the *Sharī'ah*. Agency should start with any word that confirms it by the mandatory. It applies to every personal right such as marriage (*nikāḥ*) and commercial activities (*buyū'*). It is equally permitted to be done on some acts of *'ibādah* such as *hajj* (holy pilgrimage), *'umrah* (lesser pilgrimage) and distribution of *zakāh*. Agency applies to the investigation and enforcement of *hudūd* (penal laws).

*Wakālah* is not permitted on some acts of *'ibādah* (worship) such as *ṣalāh* (prayers) and *ṣawm* (fasting). If it concerns commercial activities, an agent should not transact businesses with very close relations such as his spouse, parents, children and all those whom he will normally not serve as witnesses for in an Islamic court of law due to suspicion of favouritism. He can also not deal with himself. The agent is not held liable for properties which either get lost or damaged in his possession as long as he is not found negligent in its upkeep. He should not go against the terms of reference of his mandator. He is also under obligation to act in his mandator's best interest in all his official undertakings. For this function of agency, he/she is entitled to a fixed amount of pre-determined reward agreed upon between him/her and his/her mandator.

*Wakālah* comes to a halt with the passing away of either of the parties involved. The successful completion of the terms of reference of the contract also put an end to it. Scholars hold that the agent can be sacked or removed at any time and without his knowledge. However, the Ḥanafīyyah postulate that it has to be with his knowledge. It is also not compulsory for the mandator (*muwakkil*) to be present when the agent declares his quitting from the contract. It should be noted that his non participation in the task of agency automatically excludes him from the contract. In conventional transactions, however, the issue of sacking the agent or his declaration to quit the contract may be reviewed through an agreement by both parties.

### SELF ASSESSMENT EXERCISE 3.1.2

Examine the legality or otherwise of agency in Islam.

### 3.2 The Concept of *Wadī'ah*

*Wadī'ah* means to put down, lodge or deposit. Technically, it is a thing kept with someone who is not the real owner for safe-keeping. In Islamic law, a thing kept in trust can be utilised by its keeper subject to the express permission of the real owner. This implies that a property kept in trust, subject to the permission of its owner, can be leased or lent to some other people. However, if the consent of the owner is not sought before this action is carried out, then the risk is on its keeper/trustee. If the property gets damaged or it is not returned during the process of taking a risk by the trustee, the real owner is not affected as the property must be returned to its real owner in good shape. Moreover, if without due permission, this risk becomes successful and fruitful, the gains go to the trustee alone. The trustee could however out of his/her volition give out some profit to the real owner of the property.

*Wadī'ah* is practised by Islamic banks in the sense that depositors keep and invest their money through the bank which acts as a trustee or deposit house for the owner of the fund. Due to a prior agreement between the bank and owner of the fund, the bank invests the funds and shares the profit made on such transactions with the depositor in addition to returning the principal fund to him/her. In Islam, during the process of keeping a property under the principle of *wadī'ah*, if the property gets damaged due to natural causes or some other factors beyond the control of the trustee, then there is no compensation for the owner of the property. The Qur'ān serves as a reference point for *wadī'ah*. The verses of the Qur'ān supporting *wadī'ah* are as follows:

وَإِنْ كُنْتُمْ عَلَى سَفَرٍ وَلَمْ تَجِدُوا كَاتِبًا فَرِهَانٌ مَّقْبُوضَةٌ فَإِنْ أَمِنَ بَعْضُكُم بَعْضًا فَلْيُؤَدِّ  
الَّذِي أَوْثُمِنَ أَمَانَتَهُ وَلْيَتَّقِ اللَّهَ رَبَّهُ وَلَا تَكْتُمُوا الشَّهَادَةَ وَمَنْ يَكْتُمْهَا فَإِنَّهُ آثِمٌ قَلْبُهُ  
وَاللَّهُ بِمَا تَعْمَلُونَ عَلِيمٌ

If you are on a journey and cannot find a scribe, a pledge with possession (may serve the purpose). And if one of you deposits a thing on trust with another, let the trustee (faithfully) discharge his trust and let him/her fear his/her Lord. Conceal not evidence; for whosoever conceals, his heart is tainted with sin. And Allah knows all that you do. (Q2: 283)

The second verse reads

إِنَّ اللَّهَ يَأْمُرُكُمْ أَنْ تُؤَدُّوا الْأَمَانَاتِ إِلَىٰ أَهْلِهَا وَإِذَا حَكَمْتُمْ بَيْنَ النَّاسِ أَنْ تَحْكُمُوا  
بِالْعَدْلِ إِنَّ اللَّهَ نِعِمَّا يَعِظُكُمْ بِهِ إِنَّ اللَّهَ كَانَ سَمِيعًا بَصِيرًا

Allah does command you to render back your trusts to those to whom they are due. Be just when you judge between people. Verily, how

excellent is the teaching which he gives you. For Allah is He who hears and sees all things. (4: 58)

### SELF ASSESSMENT EXERCISE 3.2

Examine *wadī'ah* as the bedrock of Islamic banking.

### 3.3 The Concept of *Sharikah* (Partnership)

*Sharikah* is derived from the Arabic verb *shā-ra-ka* which means “to share”. Hence, *sharikah* means sharing. This is a general term used for modes of financing in Islam. *Shirkah* is the coming together of parties to realise a particular objective. This kind of dealing is well established under the *Sharī'ah*. To this end Allah says in the Qur'ān:

قَالَ لَقَدْ ظَلَمَكَ بِسُؤَالِ نَعَجْتِكَ إِلَىٰ نِعَاجِهِ وَإِنَّ كَثِيرًا مِّنَ الْخُلَطَاءِ لَيَبْغِي بَعْضُهُمْ عَلَىٰ بَعْضٍ إِلَّا الَّذِينَ آمَنُوا وَعَمِلُوا الصَّالِحَاتِ وَقَلِيلٌ مَّا هُمْ وَظَنَّ دَاوُودُ أَنَّمَا فَتَنَّاهُ فَاسْتَغْفَرَ رَبَّهُ وَخَرَّ رَاكِعًا وَأَنَابَ

He (Dāwud), said: “He has undoubtedly wronged thee in demanding your (single) ewe to be added to his (flock of) ewes: truly many are the partners (in business) who wrong each other. Not so do those who believe and work deeds of righteousness, and how few are they? And Dāwud gathered that We had tried him. He asked for forgiveness of his Lord, fell down, bowing (in prostration) and turned (to Allah in repentance) (Q38:24).

Allah corroborated this verse of the Qur'ān with His saying which is contained in an *ḥadīth Qudsī* that:

أَنَا ثَالِثُ الشَّرِيكَيْنِ مَا لَمْ يَخُنْ أَحَدُهُمَا صَاحِبَهُ فَإِذَا خَانَهُ خَرَجْتُ مِنْ بَيْنِهِمَا

I (Allah) am the third partner (in a business), as long as one of the (two) partners does not betray his partner. If however, one of them embarks on betrayal, I will quit from them (i.e. from the business).

There is a consensus of opinion (*ijmā'*) on the legality of *shirkah*, however they differ on its kinds. Generally, there are two kinds of *sharikah*. These are *Shirkah al-'amlāk* (property partnership) and *Shirkah al-'Uqūd* (Contract partnership). *Shirkah al-'Amlāk* is prohibited on Islam while *Sharikah al-'Uqūd* (contract partnership) is permitted under the *Sharī'ah*. *Shirikah al-'uqūd* is further divided into five types. These various types of partnership contracts are explained below.

#### (i) *Shirkah al-'Inān*:

This is a kind of partnership contract that exists as a result of the desire to assist each other. The contract is built on agency (*wakālah*) and trust (*'amānah*). It is built on agency because partners work for each other while that of trust arises as a result of funds contributed by the partners for the purpose of business.

**(ii) *Shirkah al- 'Abdān:***

In this kind of partnership contract wherein partners contribute in kind through labour and manage the business jointly with the sole aim of assisting each other. Profits are thereafter, shared equally or as agreed by them before starting the business. They could as well render different services. The key aim here is their coming together for mutual assistance.

**(iii) *Shirkah al-Wujūh:***

This is the kind of partnership contract in which a person out of respect for his partner contributes the capital for a business, participates in its management and also shares in its profit according to previously agreed ratio. It could also come in form of the financier employing another person to manage the business. The employed is duty bound to make reports to the financial contributor who is also involved in its management. Profits and losses are thereafter shared by the two partners at an agreed period.

**iv) *Shirkah al-Muḍārabah***

This entails a person leaving his capital to another to manage in a business venture while they both share its profit. However, the contributor of capital loses his capital in the event of loss.

**v) *Shirkah al-Mufāwāḍah:***

This is the contribution of both labour and capital on the part of partners into a business. Partners in this business jointly share both the profit and the loss in the business.

### **SELF ASSESSMENT EXERCISE 3.3**

Examine the attitude of Islam towards partnership.

## **4.0 CONCLUSION**

Agency, trusteeship and partnership are some of the major principles on which Islamic banking system is based upon. The bank is an agent and a trustee to its depositors and a business partner to its clients who are entrepreneurs. An Islamic bank plays all these roles within the ambit of the *Shari'ah*.

## **5.0 SUMMARY**

- Islamic banks act as agents in the investing of their customers' funds.
- An agent is entitled to a compensation for the work done.
- The bank is not allowed to go against the terms of reference of its customers.



- *Wadī‘ah* is another platform on which the bank works.
- Under the principle of *wadī‘ah*, the bank shares the profits and losses in business transactions with its depositors.
- The investment of customers’ funds is related to the Islamic principle of *Sharikah*.

## 6.0 TUTORIAL ASSIGNMENT

- Write comprehensively on how the principles of *wakālah*, *wadī‘ah* and *Sharikah* affords an Islamic bank to perform its role of financial intermediation effectively.

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## Unit 3: Islamic Financial Techniques I: *Mushārakah* (Equity Participation)

## **Contract**

### **CONTENT**

- 1.0 Introduction
- 2.0 Objectives
- 3.0 Main Content
  - 3.1 Starting a *Mushārah*
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  - 3.4 Termination of *Mushārah*
  - 3.5 *Mushārah* as a mode of Financing
    - 3.5.1 Working Capital Financing
    - 3.5.2 Diminishing *Mushārah*
- 4.0 Conclusion
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### **1.0 INTRODUCTION**

This unit examines how equity participation (*Mushārah*), wherein two or more parties come together in a joint commercial enterprise through the contribution of both capital and labour as a general rule, can be utilised as an Islamic mode of financing. *Mushārah* had been in place before the mission of the Prophet. It is similar to the conventional partnership system whereby individuals jointly own a business venture. However, in serving as a means of financing, the partnership is made a terminating one wherein the bank would be able to pull out into some other activities after empowering its client and making some reasonable profits.

### **2.0 OBJECTIVES**

At the end of this unit, the student should be able to:

- (i) Explain the workings of *Mushārah* as a financing technique, and
- (ii) Examine how *Mushārah* can be used in contemporary financial transactions.

### **3.0 MAIN CONTENT**

#### **3.1 Starting a *Mushārah***

A *Mushārah* contract can be either in the form of the contribution of liquid capital or merchandise. This view is however controversial among Islamic jurists. While the Maliki School of thought is of the opinion that merchandise can be contributed into a business and not necessarily liquid capital, the Hanafiyyah and the majority of Hanbaliyyah are of a contrary opinion. Proponents of liquidity postulate that the acceptance of merchandise gives rise to lack of uniformity in the goods or commodities

contributed by parties. If for instance in a soap manufacturing business, a partner contributes the building for the business, another one contributes his truck with which their products would be marketed while another or more people exclusively contribute the funds, it could happen that the one who contributed his building for the business may decide to sell it. If this happens, the funds cannot be shared by all but by him alone since the property belongs to him. This situation is also applicable to the one who contributes his truck.

It should be noted that this situation could be applicable in the classical times but may not be so in contemporary times since properties can be valued at the market prices at the time of contract. Once this valuation is done, the property and goods contributed becomes quantifiable like liquid cash. The business, therefore, belongs to the partners according to the ratio of individual contributions to it. The Ḥanafīyyah and the Ḥanbalīyyah also postulate that there could be situations wherein partners may have to redistribute their individual share capital in the business. If this situation should occur, it will become extremely difficult to do this except the goods or properties are liquidated. In the same vein, if such goods depreciate in value, then the contributor of such is at a loss, while others are gaining. Moreover, if it is a property, the market price would have increased. The situation would then turn him/her into a gainer to the detriment of others partners. However, the validation of such commodities and property at the inception of the contract as explained above solves the problem expressed by these schools.

The Shāfi‘ school maintains a middle position in this issue. This school divides goods and commodities into *dhawāt al-’amthāl* and *dhawāt al-qīmah*. The former are goods and commodities which can be compensated for by similar ones (goods and commodities) if they get destroyed. The latter on its part, are goods and commodities which, due to their individual and peculiar features, cannot be compensated for in the event of destruction. The first type above can be contributed for raising a business while the second one cannot.

The capital for the business should be determined and not overshadowed by any form of ignorance or uncertainty. Otherwise, it would be difficult not only to determine profit and loss that accrued to the particular person involved but his true share in the capital in the event of liquidation. The funds to be contributed to a *Mushārah* should also be in the possession of the party concerned. He/She is not allowed to pledge contributing a debt he has incurred for the *Mushārah* business. Similarly, he/she may not pledge an amount he is expecting to gain from another business as that would be tantamount to *gharar*.

Just as funds may not be the same as “fingers”, they say, “are not equal”, it is not mandatory that such funds to be contributed by partners be of the same currency. This is easy in modern transaction as a currency can easily be valued in another currency. For instance, for a business in Nigeria, some partners may contribute naira, while some others may contribute United States Dollars or British Pounds Sterling. The most important step is that all must be given immediate value in naira which is the local currency of the place

where the business is based. This must necessarily be done at the time of sealing the contract.

### **SELF ASSESSMENT EXERCISE 3.1**

Explain the guideline involved in a *Mushārah* contract.

### **3.2 Management of *Mushārah***

In a *Mushārah* contract, partners do not only contribute to a business but jointly labour for and manage the business. This notwithstanding, partners may reach a mutual agreement that the management of the business be shouldered by one of them. This is because the Prophet is reported to have said:

الصُّلْحُ جَائِزٌ بَيْنَ الْمُسْلِمِينَ إِلَّا صُلْحًا حَرَّمَ حَلَالًا أَوْ أَحَلَّ حَرَامًا  
وَالْمُسْلِمُونَ عَلَى شُرُوطِهِمْ إِلَّا شَرْطًا حَرَّمَ حَلَالًا أَوْ أَحَلَّ حَرَامًا

Reconciliation is allowed between Muslims except such which makes unlawful something which is lawful or makes lawful something which is unlawful and Muslims must keep to the conditions they have made except for a condition which makes the unlawful lawful or makes the lawful unlawful

This arrangement gives rise to the active partner and the sleeping partner. The active partner may now be compensated for his labour through his sharing of profit exceeding his percentage share in the business but losses will be according to his liability. However, the sleeping partner will not receive profit exceeding the percentage of his share in the business.

In the management of the venture, these partners who are seen as one another's agents should not mix-up their personal funds with that of the business. None of them should also incur a debt on the business without the knowledge and consent of others. If this is done at any time in the business, the liability of such debt remains exclusively on the unilateral debtor and as such, he takes all the profit made from such an unauthorised fund. Parties must always agree on the use of their common funds through identifying the specific businesses to which their funds are subjected in the daily management of the business venture.

### **SELF ASSESSMENT EXERCISE 3.2**

Explain the management of a *Mushārah* business contract.

### **3.3 Sharing of profit and loss in a *Mushārah***

The ratio of capital invested in the business by each partner is also the individual's ratio of profit to be shared on the investment. Although this is controversial among jurists, the Malikī and the Shāfi' Schools hold that this condition is necessary for the validity of a *Mushārah* contract. For instance if Messers Audu and Uthman are into a

business contract in which Mr Audu contributed 60% of the capital while Mr Uthman contributed only 40%, Mr Audu should own 60% of the business profits while the rest should go to Mr Uthman. Any profit sharing agreement which differs from this is according to them not valid.

The Ḥanbaliyyah School does not concur with this above stated view. The school holds that the ratio of investment may differ from the ratio of profit. In the example given above for instance, Mr. Uthman with 40% may share 65% or more of the profit if dully agreed upon by them. Nevertheless, Ḥanafīyyah, while taking a middle course, argues for disparity in the ratio of investment and profit. This will remain so except he puts an express condition into the contract such as him never working for the venture. Then he will not receive more than his percentage of investment. Islamic jurists have agreed that in case of loss, partners lose only their various properties in the venture. In the above stated example, Uthmān will only lose 40% while Audu loses 60%.

### **SELF ASSESSMENT EXERCISE 3.3**

Give details of how profits and losses are shared in a *Mushārakah*.

### **3.4 Termination of *Mushārakah***

In the event of insanity or loss of life of any of the partners in a *Mushārakah*, the contract automatically comes to an end. However, if the dead partner had an heir who is mature enough to carry on with the business, he could stand in as a partner with the consent of his or her late parent's original partner. If this heir, due to lack of maturity or some other factors, is not able to directly take charge of the business, his guardian (*walī*) could temporarily stand in for him/her. It is noteworthy that the heir could decide to pull out of the business with his or her late parent's share of the capital and profit if any is put in his custody.

Furthermore, the deceased might have willed part or whole of his share in the *Mushārakah* contract to a particular person. In that case, the person whom part or whole of the business has been willed to will stand in the position of the heir earlier discussed. In addition, if the deceased had willed to an unspecified group of people such as the poor, then the partner is duty bound to follow his instructions.

If the deceased partner in this *Mushārakah* contract had incurred some debts, his share capital will be liquidated and part of this will be utilised in paying this debt. Also, the family members of the deceased could repay the debt from another source, thereby retaining the deceased's share in it. If the family is not able to undertake this task independently of the business, the *Mushārakah* becomes void after following the due process

Any of the partners in a *Mushārakah* contract has the right to terminate the business at any time after giving some notice to his partner. Nevertheless, if while one partner wants liquidation but the other wants to continue with the business, the partner who intends continuation may, through mutual consent, buy out the share of his other partner who wants to liquidate the business. Moreover, the liquidating partner has the

right to compel others to wind up the business in case of dispute about the value of the *Mushārah*.

Partners may also agree from the onset that the termination may not affect the venture except a majority of them intend embarking on such business termination. It could also be within the agreement that a liquidity partner should sell off his shares to others without forcing them to liquidate the business. These may be necessary in contemporary times due to the necessity of continuity in business.

### **SELF ASSESSMENT EXERCISE 3.4**

Explain the intricacies involved in termination of a *Mushārah* contract.

### **3.5 *Mushārah* as a mode of financing**

*Mushārah* contracts can be utilised in financing projects in two ways. The first of these is in the finance of working capital which itself comes in two forms. This could be for a short period or be a continuous one which lasts till the end of the project. This latter one is called *Mushārah ad-Dā'imah* (permanent partnership). The other major way of utilising this financial instrument is called *Mushārah al-Mutanāqishah* (diminishing partnership). These two major models of *Mushārah* financing are presented below.

#### **3.5.1 Working capital financing**

Working capital financing model of *Mushārah* is utilised in financing businesses which already have a working capital but needed to increase their capital bases. The management staff of any business willing to benefit from this mode of financing would have to approach the financial institution for funds. Consequently, the assets of interested businesses, both liquid and solid are evaluated. The result of this evaluation forms the entrepreneur's share of the business. This amount is further broken down into manageable units. The funds provided by the financial institution are also turned into units with an agreement that after a period, the partnership will cease to exist. Assets would then be evaluated to reflect the new position of funds while the business will continue to exist.

Where a firm makes profit within the stipulated period, the working capital would have increased substantially. Accordingly, the financier, in addition to his principal, would base his profit on the net profit of investment. In addition, the entrepreneur would take his percentage of profit according to his working capital as evaluated at the inception of the business. By this, the business must have achieved a substantial increment in her working capital. In case of loss, each of the partners will bear the liability in it to the extent of their units in the working capital of the business.

### **SELF ASSESSMENT EXERCISE 3.5.1**

Explain how an existing business venture could increase its capital in line with *Mushārah* financing.

### 3.5.2 Diminishing *Mushārah*

This is a financing technique under *Mushārah*. Here, the financial institution advances funds to a client with some capital to undertake a joint ownership business for a specified period of time. The share of both the financial institution and the client are then broken down into units. Thereafter, the client gradually and systematically buys out the units of the financial institution during which the ownership on the part of the institution diminishes while that of the client increases until the entrepreneur attains full ownership of the business.

During this exercise, profits that accrued from the business are divided according to pre-determined ratio between the financial institution and the client. The share of the financial institution, which naturally is a sleeping partner, will not exceed its percentage of ownership at any point in time in the sharing of profit. This technique, otherwise known as *Mushārah al-Mutanāqishah* as discussed above, can be utilised in financing businesses which include: services, trade and mortgage.

In the case of mortgage financing, the client approaches the financial institution for some percentage of counterpart funding to purchase or build a house. This means that the client already has some funds. If for instance, he has 20% of the total cost of purchasing or building the house, the financial institution provides 80% of the funds. Hence, if the total cost of undertaking this task is one million naira (₦1,000,000), the financial institution will provide eight hundred thousand naira (₦800,000) while the client only provides two hundred thousand naira (₦200,000).

Consequently, the total amount required for purchasing or building the house is converted into units. It could here be one thousand (1,000) units consisting of one thousand naira (₦1,000) each. The house is thereafter rented out to the client at the market price with a reduction of 20% from his rent as his share in the total capital. He will subsequently pay back a specific pre-agreed percentage to the financial institution based on the status of the units over a specific period.

Once the client pays back the agreed unit over a period, his house rent reduces by the percentage he has paid back. This means, as his debt reduces, the ownership of the financial institution on the property reduces while that of the client increases. This process continues until the whole of the fund is repaid and the client is presented with the Certificate of Occupancy as the sole owner of the property. The rent that must have been paid over time serves as the financial institution's profit in the business.

Similarly, an arrangement for the purchase of machinery meant for providing services for people can be entered into with the financial institution for a specific pre-determined period. The share of the financial institution is divided into units for systematic re-payment until the fund is totally repaid. As such, as he/she pays, his/her share increases while that of the financial institution reduces. This is also suitable for financing agriculture, manufacturing, trade and services.

### SELF ASSESSMENT EXERCISE 3.5.2

Explain the workings of diminishing *Mushārah*.

#### 4.0 CONCLUSION

*Mushārah* as a mode of financing in Islamic banking is simply a systematically terminating partnership business where the bank and the client jointly contribute capital to finance a venture. This is useful in financing all sorts of businesses. These businesses include but are not limited to manufacturing, agriculture, trade and services.

#### 5.0 SUMMARY

- *Mushārah* contract is similar to the conventional partnership.
- Capitalisation of *Mushārah* can be in form of liquid and materials.
- Management of *Mushārah* can be saddled on one of the partners.
- Profits and losses are usually shared in accordance with the level of financial commitment.
- In the case of a party to *Mushārah* contract serving as a manager, his/her normal share in the business. However, loss is constant.
- *Mushārah* can be utilised in financing new and old businesses.

#### 6.0 TUTORIAL ASSIGNMENT

- Examine the intricacies involved in a *Mushārah* business.
- Explain how *Mushārah* can be used by banks in reducing unemployment in Nigeria.

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## **Unit 4: Islamic Financial Techniques II: The *Muḍārabah* (Trustee Project Financing) Contract**

### **CONTENT**

- 1.0 Introduction
- 2.0 Objectives
- 3.0 Main Content
  - 3.1 Meaning of *Muḍārabah*
  - 3.2 Starting and Ending *Muḍārabah*
  - 3.3 Distribution of Profit and Loss in *Muḍārabah*
  - 3.4 Combination of *Muḍārabah* and *Mushāarakah*
- 4.0 Conclusion
- 5.0 Summary
- 6.0 Tutor – Marked Assignment
- References / Further Reading

### **1.0 INTRODUCTION**

While the last unit examined the *Mushāarakah* contract and its application to contemporary times, the present unit goes a step forward to examine an equally important Islamic financial instrument called *Muḍārabah*. *Muḍārabah* would afford one lacking in capital innovative to eventually gather his/her own capital. *Muḍārabah* is capable of elevating the downtrodden in the community. This technique is being used by Islamic banks worldwide.

### **2.0 OBJECTIVES**

At the end of this unit, the student should be able to:

- (i) Give the meaning of *Muḍārabah*,
- (ii) Explain the rules guiding the *Muḍārabah*, and
- (iii) Apply *Muḍārabah* to modern financial transactions.

### **3.0 MAIN CONTENT**

#### **3.1 Meaning of *Muḍārabah***

*Muḍārabah* is a contract entered into between two individuals in which one of them provides the working capital while the other provides the labour with the profit earned shared among the two parties in a pre-determined ratio. It aims at sharing profit and loss among the two parties. In the event of loss, the financing party loses his capital while the managerial party loses his reward for labour. Reference is made to *Muḍārabah* in the Qur’ān where Allah states that:

إِنَّ رَبَّكَ يَعْلَمُ أَنَّكَ تَقُومُ أَدْنَىٰ مِنْ ثُلُثِي اللَّيْلِ وَنِصْفَهُ وَثُلُثَهُ وَطَائِفَةٌ مِّنَ الَّذِينَ مَعَكَ وَاللَّهُ يُقَدِّرُ اللَّيْلَ وَالنَّهَارَ عَلِمَ أَن لَّنْ نَّحْصُوهُ فَتَابَ عَلَيْكُمْ فَاقْرَءُوا مَا تَيَسَّرَ مِنَ الْقُرْآنِ عَلِمَ أَن سَيَكُونُ مِنكُم مَّرْضَىٰ وَآخَرُونَ يَضْرِبُونَ فِي الْأَرْضِ يَبْتَغُونَ مِن فَضْلِ اللَّهِ وَآخَرُونَ يُقَاتِلُونَ فِي سَبِيلِ اللَّهِ فَاقْرَءُوا مَا تَيَسَّرَ مِنْهُ وَأَقِيمُوا الصَّلَاةَ وَآتُوا الزَّكَاةَ وَقَرِّضُوا اللَّهَ قَرْضًا حَسَنًا وَمَا تَقَدَّمُوا لَأَنفُسِكُمْ مِّنْ خَيْرٍ تَجِدُوهُ عِنْدَ اللَّهِ هُوَ خَيْرٌ وَأَعْظَمُ أَجْرًا وَاسْتَغْفِرُوا اللَّهَ إِنَّ اللَّهَ غَفُورٌ رَّحِيمٌ

Your lord does know that you stand (for prayer) near to two-thirds of the night or half the night or a third of the night, and so does a party of those with you. But Allah does appoint night and day in due measure. He knows that you are unable to count thereof. So He has turned to you (in mercy): read therefore of the Qur'an as much as may be easy for you. He knows that there may be (some) among you in ill-health (and) others travelling through the land, seeking Allah's bounty. Yet others fighting in Allah's cause. Read therefore, as much of the Qur'an that may be easy (for you) and establish regular prayers and give regular charity and loan to Allah a beautiful loan. And whatever good you send forth for your own souls, you shall find it in Allah's presence, better and greater in reward. And seek the grace of Allah: for Allah is Oft-Forgiven, Most Merciful. (Q73:20)

This practice of *Muḍārabah* as explained above existed among the Arabs before the mission of the Prophet. The Prophet also practised this model with Khadijah, who later became his wife, before his call to Prophethood. Besides, some scholars are of the opinion that it was founded in the prophetic era and not the *Jahiliyyah* period.

During the time of the companions, Ibn Mundhir said 'Umar bin Khaṭṭāb, the second Caliph of Islam, gave him some funds belonging to an orphan based on *Muḍārabah*. These funds were to be used in Iraq. Similarly, his children also borrowed some funds in which they practised *Muḍārabah* with it. The *'āthār* (sayings of the companions of the Prophet) providing evidence for this practice state:

أن عبد الله وعبيدة الله ابني عمر بن الخطاب (رضي الله عنه) خرجا في جيش إلى العراق، فتسلفا من أبي موسى مالا. وابتاعا وقداً به إلى المدينة، فباعاه، وربحا فيه، فأراد عمر أخذ رأس المال وربح كله، فقالا لو تلف كان ضمانه علينا فلم لا يكون ربحه لنا؟ فقال رجل يا أمير المؤمنين، لو جعلته قراضاً؟ قال: قد جعلته وأخذ منهما نصف الربح

‘Abdullah and ‘Abidah the sons of ‘Umar bin al-Khaṭṭāb, both joined an army to Iraq. Then, both of them borrowed a sum of money from Abu Musā. They bought (some marketable items with this loan) and returned to Madīnah. They then sold them (i.e. the items) and made (some profit) in it. Thereafter, ‘Umar decided to collect both the whole of the principal and the profit from them. They said (to him) “had it led to loss, would the liability not be upon us? Then why would its profit not be for us?”. Then a man said, O Commander of the faithful, you should have made it *qirād* (*Muḍārabah*). Then he made it (*qirād*) and subsequently took half of their profit.

This arrangement is significant due to the provision of funds to one with affinity and talent for a particular trade or profession that requires fund to embark upon, particularly when such funds are not available with the talented individuals. Hence, the individual or organisation with excess investable funds could partner with the talented individual and as such creating jobs and wealth.

The person or institution providing funds for a *Muḍārabah* is called the *rabb al-māl* while the manager of the business is called the *muḍārib*. There is a saying that “he who pays the piper dictates the tune”. This wise saying fully applies to the *Muḍārabah* contract. As a consequence of this, the *rabb al-māl* can dictate to be *muḍārib* the particular business that he/she intends with the fund he/she has provided. If he does this, the business is called *al-Muḍārabah al-Muqayyadah* (Restricted *Muḍārabah*). As a direct opposite of this, if he gives the *muḍārib* a free hand to choose the kind of business he intends, it is called *al-Muḍārabah al-Muṭlaqah* (unrestricted *Muḍārabah*).

### SELF ASSESSMENT EXERCISE 3.1

- What is the meaning of *Muḍārabah*?

### 3.2 Starting and Ending *Muḍārabah*

*Muḍārabah* contract may involve a *rabb al-māl* and more than one *muḍārib*s to help carry out the business in a single transaction. In other words, he/she may offer his/her funds to the *muḍārib*s at the same time in order to carry out the joint task of *Muḍārabah*. On or before the time of provision of funds by the *Rabb al-māl* to the *muḍārib*, there must be proposal (*‘ijāb*) and acceptance (*qabūl*) among the two parties. This signifies their consent to the *Muḍārabah* contract. In the same vein, the capital provided by the *rabb al-māl*, must be a legal tender that is generally acceptable in the area of transaction. Otherwise, the agreement will not be valid. Moreover, this capital must not be a debt incurred by the *rabb al-māl*. It should instead be his personal money.

In addition, the exact amount for the *Muḍārabah* contract must be definite and known to the partners. All agreements reached can also not be changed in the course of business. Also, the *muḍārib* is saddled with the technical know-how of the fundamentals

of the project feasibility which will provide cash flows and earnings. The *rabb al-māl* could, however, guard against operational risk such as un-availability of raw materials, poor quality and low quantity of products, instability in regulatory and environmental condition, inadequate infrastructure and unavailability of qualified and skilled manpower and management.

There are differences of opinion as to whether a specific time can be fixed for the termination of a *Muḍārabah* contract. While the Māliki and the Shāfi‘ Schools hold that it cannot be confined to a particular period of time, the Hanafis and the Hanbalīs do not share this view as they opine that it may be restricted to a particular period of time.

In addition, any of the parties in a *Muḍārabah* has the right to terminate the contract at any given time. However, if there are more than one *mudārib*s, the other one may continue with the business. Other factors that can lead to the termination of a *Muḍārabah* include death of a partner and a deceit by one or both of the partners. Several Islamic jurists (*fuqahā’*) are of the opinion that at the time of the termination of a *Muḍārabah* contract, all goods and capital owned by the business venture must be liquidated.

### SELF ASSESSMENT EXERCISE 3.2

- Describe the starting and ending of *Muḍārabah* contract.

### 3.3 Distribution of profit and loss in *Muḍārabah*

If profit is made in a *Muḍārabah* contract, it must be distributed among parties in proportions specifically agreed upon before the start of the *Muḍārabah*. This could be equal or deferred proportions of profit. Accordingly, the *rabb al-māl* must not, with the intention of exploiting, lay the *mudārib* under difficult obligations at the time of the contract.

As a rider to the above, the sharing formula for the parties should not be based on any percentage of the capital but that of the profit. Also, a lump sum of money cannot be allotted to any of the partners as profit. Rather, it must be based on a percentage of profit as mentioned above. Finally, the *mudārib*, for any reason, must not take any part of the profit, either to plough it back into the business or for his personal use without prior permission of the *rabb al-māl* and his partner if they are two or more as *mudārib*.

The *Shari‘ah* permits that at the inception of a *Muḍārabah*, parties must agree on different proportions of profit for different kinds of businesses undertaken by the *mudārib*. Nevertheless, the *mudārib* cannot draw salaries for his role as the manager, even though, he is permitted to draw his daily expenses of food if on a business trip outside the location of the business. If the *mudārib* runs more than one business for the *rabb al-māl*, and there is a loss in some where there is gain in another, the gain can be used to alleviate the effects of the loss incurred in one or some of the businesses. In the event of a loss, the *rabb al-māl* loses his capital to the extent of the loss while the *mudārib* loses his labour cost only if it is discovered that the loss was not as a result of

negligence or mismanagement. Otherwise, he will have to return the loss back to *rabb al-māl*.

### SELF ASSESSMENT EXERCISE 3.3

- Explain the division of profit and loss in a *Muḍārabah* contract.

### 3.4 Combination of *Muḍārabah* and *Mushārah*

A *Muḍārabah* contract may turn into a *Mushārah* contract if the *Muḍārib* seeks from the *rabb al-māl*, the permission to invest some amount of funds into the business. If this is granted, the *muḍārib* will not only earn on his management of the business if he turns out profit, but on the percentage of his business capital. The rule is that in the business which is combination of *Muḍārabah* and *Mushārah*, the initial *rabb al-māl* who does not participate in the management of the business will not earn a profit which is more than the percentage of his share capital in the business.

There may be cases where the *rabb al-māl* could decide to vacate the business. This could be done by his selling out of his share in the business to the *muḍārib*. Thus, the modern financial system which normally does not intend to be a perpetual partner, in order to return its depositors' funds, sells out its share in the business to the client running the business and who already has a share in it on instalment basis through turning the investment of the financial institution into units. As the client buys out a unit, his ownership increases while the financial institution's share reduces. This continues until he/she successfully buys out all the units, thereby turning the firm wholly to his/her own.

This technique can also be useful in the financing of working capital. Already functioning business may be given some investment funds after evaluating its total working capitals which will serve as the *muḍārib*'s own share of the various businesses. This contract will be agreed to terminate after a specific period. When the appointed time comes, the business in question will be re-valued. The revaluation represents "constructive liquidation". The increase over the initial working capital and the funds representing the profit are thereafter distributed according to pre-determined ratio. However, the bank should not collect an increase over its own share of the businesses and the *Muḍāribs* are equally entitled to an extra share of the profit due to their roles as managers.

### SELF ASSESSMENT EXERCISE 3.3

Examine how *Muḍārabah* can serve as a mode of financing in an Islamic bank.

## 4.0 CONCLUSION

Unlike the capitalist system wherein the rich get richer while the poor get poorer, the Islamic system affords the poor the opportunity to also get rich once he/she is hardworking and innovative. *Muḍārabah* as a financial technique raises the poor from a very humble background to a remarkable and tangible position in the society. The use of *Muḍārabah* as a financial technique would reduce unemployment to a bearable limit.

## 5.0 SUMMARY

- *Muḍārabah* contract involves a financier and a manager who is not financially involved.
- *Muḍārabah* predates the Prophets mission.
- The manager (*Muḍārib*) manages the business on behalf of the financier.
- Partners in a *Muḍārabah* contract agree on the ratio of profit before starting the contract.
- In case of loss, the financier loses his/her capital while the manager loses his/her sweat money.
- To finance businesses, *Muḍārabah* could be turned into *Mushārah* until the business eventually becomes that of the initial manager.

## 6.0 TUTORIAL ASSIGNMENT

- Enumerate the laws guiding a *Muḍārabah* contract.
- How can *Muḍārabah* contract be used by Islamic banks to reduce unemployment in your community?

## 7.0 REFERENCES FOR FURTHER READING

### 7.0 REFERENCES FOR FURTHER READING

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## Module 4 Islamic Banking Products

Having discussed about the two most prominent financial techniques in Islamic finance, this module goes a step further by ventilating on some other Islamic financial techniques. These financial techniques include: cost-plus financing, leasing or hire purchase, forward sale and manufacturing or construction contracts. These aforementioned financial techniques are basically for profit making. However, Islam also caters for consumption needs of individual through benevolent loans which are not concerned with profit making but rather with solving immediate social needs of individuals in the community.

This module consists of three units that are linked to each other. The first unit discusses about the utilisation of leasing as a viable mode of finance. The second unit combines in its discussion three Islamic modes of financing. These modes of financing are cost-plus financing, forward sale and manufacturing or construction modes. The last unit treats the only loan in Islamic banking which basically serves non-economic roles in the community. At the end of this module, you would have been acquainted with the major modes of finance in Islam. The last unit rounds up this module and invariably your course material.

Unit 1: Islamic Financial Techniques III: *Ijārah* Contract

Unit 2: Islamic Financial Techniques IV: *Murābahah*, *Salam* and '*Istiṣnā'* Contracts

Unit 3: Consumption Loan (*Qarḍ Ḥasan*)

### **Unit 1: Islamic Financial Techniques III: '*Ijārah* Contract**

## CONTENT

- 1.0 Introduction
- 2.0 Objectives
- 3.0 Main Content
  - 3.1 Meaning of *'Ijārah*
  - 3.2 Conditions of *'Ijārah*
  - 3.3 *'Ijārah* as a Mode of Financing
- 4.0 Conclusion
- 5.0 Summary
- 6.0 Tutor – Marked Assignment
- References / Further Reading

### 1.0 INTRODUCTION

This unit deals with another method of financing in Islam. This method is leasing (*'ijārah*). Like *Muḍārabah* contract, *'Ijārah* could uplift an industrious person from the state of penury to the level of affluence. It does not involve a client having funds before starting a business. This technique could be used in for empowerment in the area of the procurement of equipments and provision of services.

### 2.0 OBJECTIVES

At the end of this unit, the student should be able to:

- (i) Expatiate on the practice of *'ijarah*,
- (ii) Explain the conditions for *'ijārah*, and
- (iii) Assess the workability of *'ijārah* as a financing method.

### 3.0 MAIN CONTENT

#### 3.1 The Concept of *'Ijārah*

*'Ijārah* is an Arabic word which is derived from of the verb *'ā-ja-ra* which means to let out, hire out, rent or lease something. Its verbal noun (*maṣḍar*) is *'ijārah* which means renting or hiring. Under the *Sharī'ah*, this is divided into two. The first is the hire of a labourer or a professional to undertake a service for a specific period of time. Here, the employer is called the *musta'jir* while the labourer is called the *musta'jar* or the *'ājir*. The wage or compensation to be given to him for undertaking such a service is called the *'ujah* or *'ujr*.

The second type of *'Ijārah* is the situation where a particular item is leased out to another. This is usually the “transfer of ownership of a legitimate and a well defined usufruct for a specific period against a specific return”. In this case, the lessor is called the *mu'ajjir* while the lessee is called *mu'ajjir* or *ma'jūr*. This second type is our concern in this unit as it is the one that can be used as a mode of finance. *'Ijārah* is well



established under the *Shari'ah* law as it is contained in both the *Qur'an* and the *Sunnah* of the Prophet. Evidence in the *Qur'an* states:

أَهُمْ يَقْسِمُونَ رَحْمَةَ رَبِّكَ نَحْنُ قَسَمْنَا بَيْنَهُمْ مَعِيشَتَهُمْ فِي الْحَيَاةِ  
الدُّنْيَا وَرَفَعْنَا بَعْضَهُمْ فَوْقَ بَعْضٍ دَرَجَاتٍ لِيَتَّخِذَ بَعْضُهُمْ بَعْضًا سُلْخِيًّا  
وَرَحِمْتُ رَبِّكَ خَيْرٌ مِّمَّا يَجْمَعُونَ

Is it they who would portion out the mercy of your Lord? It is We who portion out between them their livelihood in the life of this world. And We raise some of them above others in ranks, so that they may command work from others. But the mercy of thy Lord is better than the wealth which they amass. (Q. 43: 32).

Some scholars have interpreted “so that they may command work from others” in this verse to mean that some may employ others to carry out some work. This is due to mutual reliance of human beings on one another. The employment of any one by another to carry out some tasks is regarded as *Ijārah*. Another set of verses states:

قَالَتْ إِحْدَاهُمَا يَا أَبَتِ اسْتَأْجِرْهُ إِنَّ خَيْرَ مَنِ اسْتَأْجَرْتَ الْقَوِيُّ الْأَمِينُ قَالَ إِنِّي أُرِيدُ  
أَنْ أَنْكِحَكَ إِحْدَى ابْنَتَيَّ هَاتَيْنِ عَلَى أَنْ تَأْجُرَنِي ثَمَانِي حَجَّجٍ فَإِنْ أَتَمَمْتَ عَشْرًا  
فَمِنْ عِنْدِكَ وَمَا أُرِيدُ أَنْ أَشُقَّ عَلَيْكَ سَتَجِدُنِي إِنْ شَاءَ اللَّهُ مِنَ الصَّالِحِينَ

Said one of the (damsels) “O my (dear) father! Engage him on wages! Truly the best of men for thee to employ is the man who is strong and trusty”. He said: “I intend to wed one of these my daughters to thee, on condition that you serve me for eight years. But if thou complete ten years, it will be (grace) from thee. But I intend not to place thee under a difficulty. Thou will find me indeed if Allah wills one of the righteous. (Q.28: 26-27)

The above quotation describes what transpired between Prophet Musa (A.S) and his employer. It further describes the art of hiring a person skilled in a profession to do a particular work for a period of time and specifies the reward or wages for same. As for the backing of the *Sunnah*, the Prophet was reported to have said:

مَا بَعَثَ اللَّهُ نَبِيًّا إِلَّا رَعَى الْغَنَمَ فَقَالَ أَصْحَابُهُ وَأَنْتَ فَقَالَ نَعَمْ كُنْتُ  
أَرْعَاهَا عَلَى قَرَارِيطٍ لِأَهْلِ مَكَّةَ

“Allah did not send any Prophet but as shepherd of sheep” His companions asked him, “Did you do same,

the Prophet (S.A.W) replied. “Yes, I used to shepherd the sheep of the people of Makkah for some qirāts.

Another one states:

أَعْطُوا الْأَجِيرَ أَجْرَهُ قَبْلَ أَنْ يَجِفَّ عَرْقُهُ

Give the hireling his wages before his sweat dries.

### SELF ASSESSMENT EXERCISE 3.1

While referring to the Qur’ān and *Sunnah*, explain the meaning of *Ijārah*.

### 3.2 Conditions of *Ijārah*

In a contract of *Ijārah*, both parties to the contract must be sane and of sound mind. Shāfi‘ and Ḥanbalī Schools are of the opinion that the parties to an *Ijārah* contract must be mature (*bulūgh*). The contract should also be of mutual benefit to all parties. In addition, they must be pleased with the agreement, otherwise the contract automatically becomes null and void. This is in view of Allah’s saying that:

يَا أَيُّهَا الَّذِينَ آمَنُوا لَا تَأْكُلُوا أَمْوَالَكُمْ بَيْنَكُمْ بِالْبَاطِلِ إِلَّا أَنْ تَكُونَ  
تِجَارَةً عَنْ تَرَاضٍ مِّنْكُمْ وَلَا تَقْتُلُوا أَنْفُسَكُمْ إِنَّ اللَّهَ كَانَ بِكُمْ رَحِيمًا

O you who believe, do not eat up your property among yourselves in vanity but let there be among you traffic and trade by mutual good-will nor kill (or destroy) yourselves, for verily, Allah has been to you most merciful (Q 4: 29)

The item of hire *mu’ajjar* or *ma’jūr* must not be an item which *Sharī’ah* classifies as *harām* (forbidden). Moreover, it must not constitute disobedience (*ma’siyah*) to either Allah or the laws of the land. To hire another based on sin and wrongdoing such as committing of murder, the confiscation of another person’s property or even the transportation of alcoholics (*khamr*) is un-Islamic. It is also not proper to hire for the purpose of fortune telling among other un-Islamic practices. On the duration of hiring, it can either be prompt or delayed. This is based on the agreement reached by the parties involved and which they are bound to follow. This is because of the prophetic statement which says:

قَالَ الصُّلْحُ جَائِزٌ بَيْنَ الْمُسْلِمِينَ إِلَّا صُلْحًا حَرَّمَ حَلَالًا أَوْ أَحَلَ حَرَامًا  
وَالْمُسْلِمُونَ عَلَى شُرُوطِهِمْ إِلَّا شَرْطًا حَرَّمَ حَلَالًا أَوْ أَحَلَ حَرَامًا

All forms of reconciliation are allowed between Muslims except one that forbids what is permissible or permits what is forbidden. Muslims must, therefore, keep to the conditions they have made,

except for a condition which make unlawful something which is lawful or make lawful something which is unlawful.

Abu Hanīfah is of the view that the agreement for either delay or promptness must be made definite between the two parties. Shāfi‘ added that, if it happens that a part payment has been made, the other part must also be paid at the appropriate time.

### SELF ASSESSMENT EXERCISE 3.2

What are the conditions of *’Ijārah*?

#### 3.3 *’Ijārah* as a Mode of Financing

In utilising *’Ijārah* as a means of modern financing, it starts by the parties involved, negotiating the contract for a future date on the condition that the leased asset be first delivered to the client. The client might be employed as an agent (*wakīl*) to help purchase the item to be leased. The relationship at this level is that of a principal and his agent. After delivering the item, the contract will be signed by both parties.

As such, all costs in respect of the purchase, safe delivery and Islamically acceptable insurance on the item will be borne by (financial institution) and not the client. After the delivery of the asset, the lessee will be held responsible for loss, misuse or negligence caused to the asset. He will despite all that, not be held responsible for any of these when it is beyond his control. This is because Allah says:

لَا يَكْلِفُ اللَّهُ نَفْسًا إِلَّا وُسْعَهَا لَهَا مَا كَسَبَتْ وَعَلَيْهَا مَا اكْتَسَبَتْ رَبَّنَا لَا تُؤَاخِذْنَا  
إِنْ نَسِينَا أَوْ أَخْطَأْنَا رَبَّنَا وَلَا تَحْمِلْ عَلَيْنَا إَصْرًا كَمَا حَمَلْتَهُ عَلَى الَّذِينَ مِنْ قَبْلِنَا  
رَبَّنَا وَلَا تُحَمِّلْنَا مَا لَا طَاقَةَ لَنَا بِهِ وَاعْفُ عَنَّا وَارْحَمْنَا أَنْتَ مَوْلَانَا فَانصُرْنَا  
عَلَى الْقَوْمِ الْكَافِرِينَ

On no soul does Allah place a burden greater than it can bear. It gets every good that it earns and it suffers every ill that it earns. (Pray) “Our Lord, condemn us not if we forget or fall into error; our Lord, lay not on us a burden like that which You did lay on those before us: Our Lord, lay not on us a burden greater than we have the strength to bear. Blot out our sins and grant us forgiveness. Have mercy on us. You are our Protector; help us against those who stand against faith. (Q2:286).

The annual increase in rent of the *’Ijārah* object may vary with inflation or fluctuation in government tariffs if expressly stated in the agreement. In event of default in the time of payment, penalty may be imposed but funds from such should be paid into a charitable fund and not consumed by the financier or lessor.

Besides, sub-leasing is allowed if the leased item is not used independently by different users, otherwise the permission of the lessor must be granted for such. On the

percentage of profit to be charged as sub-lease, some schools hold that it must not exceed the percentage of the first lease except he has improved on the condition or functionality of the item or he charges in a different currency. Otherwise the excess must be deposited in a charity fund. The lessor can unilaterally sign a promising note to sell or give the item to the leasee. This is however, subject to the leasee making adequate profit and notice of good behaviour. This agreement called '*Ijārah Wa al-'Iqtinā*' should not involve a promise to buy the leased item by the lessee he/she may as well refuse to accept or buy the item.

If the lessee decides to purchase the item, he/she could make payments in instalments. As he/she pays for the item, the financial institution's share of it reduces while that of the client increases until the item is eventually transferred to the client. A point to note is that as the client pays in instalments, the rent payable to the owner of the item bank drops by the percentage transferred to the client. In Islamic banking, the rents paid serve as profit for the bank.

### **SELF ASSESSMENT EXERCISE 3.3**

How can '*Ijārah*' serve as a modern financial technique?

### **4.0 CONCLUSION**

'*Ijārah*' is a means of boosting production through financing the purchase of industrial machinery for business ventures. It can also serve the purpose of purchasing necessary equipments for the service industry. '*Ijārah*' is useful for financing both new and ongoing businesses.

### **5.0 SUMMARY**

- '*Ijārah*' means leasing. This is divided into two: hiring of professionals and leasing/renting of an item.
- '*Ijārah*' should not involve *harām* or going against the laws of the land.
- A leased item can be sold to the lessee.
- The leasee can pay for the item in instalments.
- As the lessee pays up for the item, his/her share of ownership increases while that of the bank reduces.

### **6.0 TUTOR MARKED ASSIGNMENT**

- Examine the legality or otherwise of leasing in Islamic finance.
- Explain the Islamic rule guiding the '*ijarah*' contract as against conventional leasing.
- Assess '*ijarah*' as a contemporary financial product.

### **7.0 REFERENCES FOR FURTHER READING**

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## Unit 2: Islamic Financial Techniques IV: *Murābaḥah* (Mark-up), *Salam* (Forward Sale) and '*Iṣṭisnā*' Contracts

### CONTENT

- 1.0 Introduction
- 2.0 Objectives
- 3.0 Main Content
  - 3.1 The *Murābaḥah* Contract
  - 3.2 The *Salam* Contract
  - 3.3 The '*Iṣṭisnā*' Contract
- 4.0 Conclusion
- 5.0 Summary
- 6.0 Tutor – Marked Assignment
- References / Further Reading

### 1.0 INTRODUCTION

This unit focuses its attention on three other modes of financing in Islamic banking. These modes of financing are: *Murābaḥah*, *Salam* and *Iṣṭisnā*'. *Murābaḥah* and *Salam* were formally sales contract while *Iṣṭisnā*' was derived from the wisdom of *Salam* contract. *Murābaḥah* is of all the modes of finance, the easiest one while *Salam* is useful in financing small scale farmers. *Iṣṭisnā*' is capable of boosting manufacturing and enhancing infrastructural development.

### 2.0 OBJECTIVES

At the end of this unit, the student should be able to:

- (i) Give the workings of a *Murābaḥah* contract,
- (ii) Describe *Salam* a mode of financing, and
- (iii) Explain an *Iṣṭisnā*' contract.

### 3.0 MAIN CONTENT

#### 3.1 The *Murābaḥah* (Mark-up) Contract

*Murābaḥah* is an Arabic word derived from the verb *rā-ba-ha* which means “to gain” (from something). *Murābaḥah* was originally a particular kind of sale. It denotes a contractual agreement between two parties (seller and buyer) for the sale of a commodity from the seller to the buyer at its original price plus a specified mark-up or a certain percentage over and above the previous price. Although *Mushārakah* and *Muḍārabah* are the two major modes of financing, *Murābaḥah* is also permitted as a means of finance. *Murābaḥah* when used, should be practised with care as there is a thin line between it and *ribā* (interest). For *Murābaḥah* to occur, all the requirements of sale under the *Sharī'ah* must be met.

The conditions of *Murābaḥah* include that: there must be proposal and acceptance ('*ijāb wa qabūl*') between the parties involved in it. This forms the basis for the

transaction. In the process, they must be able to settle their conscience. This means that they must be pleased with the business. The agreement may not necessarily be by direct speech but could be by indication (*'ishārah*) by the parties. It is important that the sale agreement be done at a sitting or at once. If the seller wants to sell but the buyer is not ready, the sale will not be valid. The price of the object of sale must also be agreed upon by parties. In addition, in a sale agreement, parties must be sane and sound in mind. The seller is also expected to be at the possession of the object of sale with clarity of its ownership. Besides, it must also be of mutual benefit to parties concerned. It should also be added that such transaction must not involve interest (*ribā*).

In a *Murābahah* contract, the buyer must be made to know the original price of the product including all the expenses made on it. These include: its freight and custom duties. These shall be included in the original price before an additional mark-up can be applied to it. This mark-up may be determined through mutual consent by parties. It should be noted that *Murābahah* contract can only exist when the original cost of the item can be established. The absence of this verification of the original price of the item, the contract becomes *Musawwamah* (bargaining) where bargaining occurs without reference to the original price. Moreover, if the commodity has any defects, it must be made known to the buyer who has the choice to buy or not to buy it. This is because a *Murābahah* contract is a trust sale and the seller should not betray this trust. If betrayal occurs in respect of either the product or its original price, the buyer has the choice to either collect or return the product.

*Murābahah* may be used in a purchasing order whereby the sale is based on a mutual promise contract which precedes the actual *Murābahah* contract. In this case, the item of sale must be in physical or constructive possession of the seller. He also bears the various risks associated with the item, such as loss or rejection due to concealment of defect. Promise from any of the two parties in this contract is binding on the promisor unless there is a valid excuse to brake such. In conclusion, each party in a mutual promise must have his opinion.

In utilising *Murābahah* as a means of financing, it should be borne in mind that it was originally a sale contract. Therefore, it should be used only when *Mushārahah* and *Muḍārahah* are not practicable. In this case, the client and the institution sign a promissory note. The client therein promises to buy goods or commodities from the financial institution from time to time. In purchasing the commodities, the client acts as an agent (*wakīl*) of the bank and an agreement of agency (*wakālah*) is signed to that effect. After the client has informed the institution of the fulfilment of his/her task, it offers to buy same from the institution. The ownership and the risk are thereafter transferred to the institution.

The product of sale must have been bought from a third party and not the client whereby debt buy-back is used. Otherwise, this will become *ribā* which, as earlier discussed, is un-Islamic. The institution may also require collateral security from the client to push for prompt payment of the deferred price. He (the client) could also sign a bill of exchange or a promissory note. This must come after the actual sale has been

concluded. If there is a default in the time of payment, the institution cannot increase the price of the product, but could demand for some amount of money if it had been part of their agreement. Such fine must not form part of the institution's profit but must be spent on charity.

The restriction of *Murābahah* to extreme cases where *Mushārahah* and *Muḍārahah* are not practicable will afford the sub-urban populace the opportunity to know how Islamic finance works. It will also expose to them the benefits accruable in *Mushārahah* financing if properly implemented. It should be noted that lack of expertise in project management and financing is one of the fundamental reasons why various Islamic financial institutions have adopted *Murābahah* mode of financing, which is normally short termed.

Although *Murābahah* is widely utilised as a mode of financing, several scholars of Islamic economics have held that though its falls under permissible business, it should be avoided and restricted. This is with the fear that it could legally open a “backdoor” to interest. There is also the concern that it may stunt economic growth through constraining investors from engaging in new businesses.

### SELF ASSESSMENT EXERCISE 3.2

What is a *Murābahah* contract?

### 3.2 The *Salam* (Forward) Contract

*Salam* means forward buying. *Salam* is also called *Salaf* (loan). *Salam* contract is the prompt payment of the price against a well defined item or commodity which is to be delivered at a future date. The Ḥanafī and the Hanābilah Schools define *Salam* contract in terms of a sale contract whose subject matter is well defined and whose delivery at a future date against a prompt price to be delivered on the spot as an obligation on the seller.

The seller of the commodity or item is known as the *al-Muslam ilayh*, while the buyer is called *rabb as-salam*. This kind of sale entails the seller, selling goods before their delivery. This will afford him the opportunity to spend such funds on meeting his immediate business needs and also prevent him from running into loans especially when such loans are un-Islamic. This practice has basis in the Qur'ān where Allah says:

يَا أَيُّهَا الَّذِينَ آمَنُوا إِذَا تَدَايْتُمْ بَدَيْنَ إِلَى أَجَلٍ مُّسَمًّى فَاكْتُبُوهُ وَلْيَكْتُب بَيْنَكُمْ كَاتِبٌ بِالْعَدْلِ وَلَا يَأْبَ كَاتِبٌ أَنْ يَكْتُبَ كَمَا عَلَّمَهُ اللَّهُ فَلْيَكْتُبْ وَلْيُمْلِلِ الَّذِي عَلَيْهِ الْحَقُّ وَلْيَتَّقِ اللَّهَ رَبَّهُ وَلَا يَبْخَسَ مِنْهُ شَيْئًا فَإِنْ كَانَ الَّذِي عَلَيْهِ الْحَقُّ سَفِيهًا أَوْ ضَعِيفًا أَوْ لَا يَسْتَطِيعُ أَنْ يُمِلَّ هُوَ فَلْيُمْلِلْ وَلِيُّهُ بِالْعَدْلِ وَاسْتَشْهِدُوا شَهِيدَيْنِ مِنْ رِجَالِكُمْ فَإِنْ لَمْ يَكُونَا رَجُلَيْنِ فَرَجُلٌ وَامْرَأَتَانِ مِمَّنْ تَرْضَوْنَ مِنَ الشُّهَدَاءِ أَنْ تَضِلَّ إِحْدَاهُمَا فَتُذَكِّرَ



إِخْدَاهُمَا الْأُخْرَى وَلَا يَأْبَ الشُّهَدَاءُ إِذَا مَا دُعُوا وَلَا تَسْأَمُوا أَنْ تَكْتُبُوهُ صَغِيرًا أَوْ كَبِيرًا إِلَىٰ أَجَلِهِ ذَلِكُمْ أَقْسَطُ عِنْدَ اللَّهِ وَأَقْوَمُ لِلشَّهَادَةِ وَأَدْنَىٰ أَلَّا تَرْتَابُوا إِلَّا أَنْ تَكُونَ تِجَارَةً حَاضِرَةً تُدِيرُونَهَا بَيْنَكُمْ فَلَيْسَ عَلَيْكُمْ جُنَاحٌ أَلَّا تَكْتُبُوهَا وَأَشْهَدُوا إِذَا تَبَايَعْتُمْ وَلَا يُضَارَّ كَاتِبٌ وَلَا شَهِيدٌ وَإِنْ تَفْعَلُوا فَإِنَّهُ فُسُوقٌ بِكُمْ وَاتَّقُوا اللَّهَ وَيُعَلِّمُكُمُ اللَّهُ وَاللَّهُ بِكُلِّ شَيْءٍ عَلِيمٌ

O you who believe, when you deal with each other, in transactions involving future obligations in a fixed period of time, reduce them to writing. Let a scribe write down faithfully as between the parties: let not the scribe refuse to write as Allah has taught him, so let him write. Let him who incurs the liability dictate but let him fear His Lord, Allah and not diminish aught of what he owes. If the party liable is mentally deficient or weak, or unable himself to dictate, let his guardian dictate faithfully. And get two witnesses out of your own men, and if there are not two men, then a man and two women, such as you choose for witnesses so that if one of them errs, the other can remind her. The witnesses should not refuse when they are called upon (for evidence). Disdain not to reduce to writing (your contract) for a future period, whether it be big or small: it is just in the sight of Allah more suitable as evidence, and more convenient to prevent doubts among yourselves. But if it be a transaction which you carry out yourselves, there is no blame on you if you reduce it not to writing. But do take witnesses whenever you make a commercial contract; and let neither scribe or witness suffer harm. If you do (such harm), it would be wickedness in you. So fear Allah that teaches you. And Allah is well acquainted with all things. (Q2:282)

In the 'āyah of the *Qur'ān* above, '*ajalin ma'lūm*' refers to forward sale or *salam*. The Prophetic tradition also puts impetus into the validity of *salam* from the *Sharī'ah* point of view. One of such traditions states that:

قَدِمَ النَّبِيُّ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ الْمَدِينَةَ وَهُمْ يُسْلِفُونَ بِالتَّمْرِ السَّتِينَ وَالثَّلَاثَ فَقَالَ مَنْ أَسْلَفَ فِي شَيْءٍ فَفِي كَيْلٍ مَعْلُومٍ وَوَزْنٍ مَعْلُومٍ إِلَىٰ أَجَلٍ مَعْلُومٍ

The Prophet (SAW) came to Madinah and the people used to pay in advance the price of dates to be delivered within two or three years. He said to them, "whoever pays in advance

the price of a thing to be delivered later should pay it for a specified measure at specified weight for a specified period.

There are also lot of evidences that this practice continued long after the death of the Holy Prophet, Muhammad (SAW).

In a *Salam* contract (*salam fih*) must be easy to describe in such a way that it will leave no room for doubt. All the minute details concerning the type, sex and value of the product must be well described. There is a consensus of opinion that the lender is under compulsion to explain fully, the features of the item or commodity to be sold out. Even when the buyer has seen what he is to purchase. Jurists are of the opinion that its sex (*jins*), type (*naw'*) goodness (*jawdah*) and its defects (*rada'*) must be well described to the buyer. An object of *salam* must be measureable or capable of being weighed. Also, its number must be known. This is in view of the Prophetic saying that:

فَفِي كَيْلٍ مَّعْلُومٍ وَوَزْنٍ مَّعْلُومٍ إِلَى أَجَلٍ مَّعْلُومٍ

For a known specified measure and a known specified weight and known specified period.

There is no disagreement as to the proper measurement of weight in a *salam* contract. Nevertheless, the scale or measurement used must be generally acceptable. If the measurement is not generally known and accepted, it can be dangerous.

A *Salam* contract must also be based upon a specific date of delivery. The Ḥanafīyyah and Ḥanbalīyyah Schools postulate that the time of delivery should be at least one month after the agreement. This is meant to give enough opportunities to the petty farmers and traders to meet their immediate needs and acquire the commodity. Also, the price in *salam* is usually lesser than that of a normal sale. This may be due to the giving of a long period. Imam Mālik reduces the period to fifteen (15) weeks with the reason that the period is enough to accommodate market fluctuations. In contrast, other schools fail to fix a time limit since the Prophet never fixed one. This last view fits more to changes in time and the contemporary times.

The owner of the *Salam* item or commodity must be in full possession of the item (*salam fih*) before the contract is reached. This does not include: a foetus in the womb of an animal or a crop within the heaps. This is because it has not yet come to the possession of the owner and again cannot be described with certainty. Moreover, to undertake to supply the fruits of a tree or the produce of a farm is not acceptable as they may be destroyed before harvest and are covered with uncertainty (*gharar*). This applies to all items that are not certain.

On the period for the completion of a *Salam* contract, majority of schools of the Islamic jurisprudence insist that it must be completed in a sitting. Shāfi' and Ḥanafīyyah Schools are of the opinion that if parties to this *Salam* contract separate without concluding the contract, the *Salam* is still valid to the extent agreed upon by parties.

Imam Mālik added that the validity can extend to about three days. Finally, majority of the schools of Islamic jurisprudence hold that the buyer of a *Salam* item should not resell the product to another until he has taken its delivery of the goods from the original seller. Contrary to this view, the Ḥanafīyyah School allows that a product can be resold on the condition that it is an immovable property such as a building.

*Salam* can be utilised in the modern sense as a means of financing small scale farmers and traders. This is done by the financial institution trading in commodities and not money alone. The institution buys commodities from its clients through *Salam*. In the same way, a parallel *Salam* agreement, which is to take effect not long after taking delivery of the commodities is reached with another client. Nevertheless, the first *Salam* contract will not be made contingent on the second contract. Since the price of commodities will be lower in the first agreement and will be higher in the second agreement due to shorter gestation period, the difference in price between these two transactions will serve as profit for the financial institution.

Moreover, the second parallel contract may be in form of promise to purchase by the third party. Consequently, payments will be made after the product has been made ready without any advance payment. It is expected that the commodities will go for a higher price. The difference in price between the two transactions will serve as the profit for the financial institution. It is important to note that the initial seller, who is also a client to the financial institution, cannot be the final buyer of the product. If this is done, it will lead to product buy-back which is not acceptable in Islam. However, he is allowed to share in the equity holding of the final buyer.

### **SELF ASSESSMENT EXERCISE 3.2**

How can an Islamic bank apply *Salam* as a financial product?

### **3.3 *Istiṣnāʾ* Contract**

*Istiṣnāʾ* is from the root verb *is-ta-s-na-ʾa* which means to make something. *Istiṣnāʾ* is its verbal noun (*maṣḍar*) which means manufacturing of something for someone. *Istiṣnāʾ*, according to the Ḥanafīyyah School, is a sale contract which has its subject as a well defined item to be manufactured and whose delivery is a future obligation on the seller who is the manufacturer.

Even though, an *Istiṣnāʾ* contract creates a moral obligation on the manufacturer to deliver the product at a future date, the contract can be unilaterally terminated before the production of the item takes place. *Istiṣnāʾ* not only requires the price of the commodity to be paid in advance, but also a well defined delivery date. In this case, the manufacturer is expected to command all the raw materials to be used for the manufacturing.

The owner of the yet to be manufactured item must be informed about the procedures for manufacturing the product. Similarly, the end-user is allowed to inspect the product. Once the item meets the buyer's initial specification, he/she will have no option to reject such an item. Even though no date of delivery can be fixed, the maximum

date of delivery may be fixed and a penal clause for exceeding the time may be determined as jointly agreed upon by them.

*Istiṣnāʿ* may be used in financing capital-intensive projects such as housing, machine production and allied matters. It can be used for “Build Operate and Transfer” (BOT) of various government projects. It can equally be used for mortgage. The price and profit for the items produced can be paid in instalments.

### **SELF ASSESSMENT EXERCISE 3.3**

Describe the process involved in an *Istiṣnāʿ* contact.

### **4.0 CONCLUSION**

*Murābaḥah* could be used in financing trade activities but should be done with great care. *Salam* is useful in the financing of small scale agriculture while *Istiṣnāʿ* is more useful in the area of manufacturing and construction. The government could borrow funds for construction of social infrastructures based on Build Operate and Transfer (BOT) through this means.

### **5.0 SUMMARY**

- The client to a *Murābaḥah* contract could act as an agent in purchasing commodities.
- *Murābaḥah* is more applicable where *Mushārakah* and *Muḍārabah* are not easily applicable.
- *Murābaḥah* should be handled with care for its closeness to *ribā*.
- *Salam* contract is an exception to the established rule meant to cater for small scale farmers and businesses.
- In *Salam*, the seller of commodities to the financial institution cannot buy back those commodities he/she has sold to the bank.
- The *Istiṣnāʿ* contract is similar to the *Salam* contract although it is basically for manufacturing or construction.
- *Istiṣnāʿ* mode of financing would not only aid the manufacturing company but would also assist in the area of infrastructural development.

### **6.0 TUTOR MARKED ASSIGNMENT**

- Describe how *Salam* contract could boost food security in Nigeria.
- The *Murābaḥah* contract is the most popular means of financing in Islamic banks. Explain how this product works.
- Expatriate on how the manufacturing industry and public infrastructures would be improved using *Istisnaʿ* contract.

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### **Unit 3: Consumption Loan (*Qarḍ Ḥasan*)**

## CONTENT

- 1.0 Introduction
- 2.0 Objectives
- 3.0 Main Content
  - 3.1 Meaning and Importance of *Qarḍ Ḥasan*
  - 3.2 Conditions of *Qarḍ Ḥasan*
- 4.0 Conclusion
- 5.0 Summary
- 6.0 Tutor – Marked Assignment
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### 1.0 INTRODUCTION

The last four units explained the various financial techniques in Islam. The financial techniques discussed are concerned about investment of funds for the purpose of making profit and the empowerment of the clients of Islamic banks. This unit discusses another financial technique. Nevertheless, this financial technique is different from the preceding ones in the sense that it is a loan while others are not. In line with the Islamic injunction on loans, the Islamic bank advances this loan without any iota of profit. It then forms part of the Islamic banks' way of meeting the consumption needs of its customers. This stand is strange to the conventional banking system. Here, the bank sets aside a percentage of its profit for this benevolent service.

### 2.0 OBJECTIVES

At the end of this unit, the student should be able to:

- (i) Establish the meaning of *Qarḍ Ḥasan*,
- (ii) Assess the Importance of *Qarḍ Ḥasan*, and
- (iii) Explain the conditions of *Qarḍ Ḥasan*.

### 3.0 MAIN CONTENT

#### 3.1 Meaning of *Qarḍ Ḥasan*

*Qarḍ* is an Arabic word from the root verb qa-ra-ḍa which means to cut, to sever, cut off, or to gnaw. Technically, *qarḍ* is called loan. Loan is called *qarḍ* because the lender normally cuts parts of his wealth to give to someone who is in need of it. *Qarḍ* is the transfer of a specific amount of wealth (*māl*) from one person to another with a promise that the latter (debtor) will restore the borrowed fund to the former (creditor) in full whenever he demands for it. An exception to this is when they both agree on a specific date of return. This kind of lending contract is approved under the *Shari'ah* law as Allah, in the Qur'ān, says:

مَنْ ذَا الَّذِي يُقْرِضُ اللَّهَ قَرْضًا حَسَنًا فَيُضَاعِفَهُ لَهُ وَلَهُ أَجْرٌ كَرِيمٌ

Who is he that will loan to Allah a beautiful loan? For (Allah) will increase it manifold to his credit and he will have (besides) a liberal reward. (Q 57: 11)

Allah also say:

مَنْ ذَا الَّذِي يُقْرِضُ اللَّهَ قَرْضًا حَسَنًا فَيُضَاعِفَهُ لَهُ أَضْعَافًا كَثِيرَةً وَاللَّهُ يَقْبِضُ وَيَبْسُطُ وَإِلَيْهِ تُرْجَعُونَ

Who is he that will loan to Allah a beautiful loan, which Allah will double unto his credit and multiply many times? It is Allah that gives (you) want or plenty, and to him shall be your return. (Q 2: 245)

The Prophet also supported the giving of loans through his practical examples and a number of his authentic sayings. He is reported to have said:

مَا مِنْ مُسْلِمٍ يُقْرِضُ مُسْلِمًا قَرْضًا مَرَّتَيْنِ إِلَّا كَانَ كَصَدَقَتِهَا مَرَّةً  
No Muslim gives out loan to another Muslim  
twice except it becomes like giving charity once.

This above *ḥadīth* shows that even though the giver of loan will eventually retrieve his capital in full, it will still be recorded for him as charity if undertaking twice. This is because he has been able to meet the need of that borrower at the point of distress. This lends credence to the next *ḥadīth* which states that:

مَنْ نَفَّسَ عَنْ مُؤْمِنٍ كُرْبَةً مِنْ كُرْبِ الدُّنْيَا نَفَّسَ اللَّهُ عَنْهُ كُرْبَةً مِنْ كُرْبِ  
يَوْمِ الْقِيَامَةِ وَمَنْ يَسِّرْ عَلَى مُعْسِرٍ يَسِّرَ اللَّهُ عَلَيْهِ فِي الدُّنْيَا وَالْآخِرَةِ

Whoever relieves a believer of a distress, Allah will relieve him of a distress on the Day of Judgment. Whoever is harsh on the debtor, Allah will be harsh on him in this life and the hereafter.

The Prophet also narrated his experience when he went on a night journey to the heavens. He said:

رَأَيْتُ لَيْلَةَ أُسْرِي بِي عَلَى بَابِ الْجَنَّةِ مَكْتُوبًا الصَّدَقَةُ بِعَشْرِ أَمْثَالِهَا وَالْقَرْضُ  
بِثَمَانِيَةِ عَشَرَ فَقُلْتُ يَا جِبْرِيلُ مَا بَالُ الْقَرْضِ أَفْضَلُ مِنَ الصَّدَقَةِ قَالَ لِأَنَّ  
السَّائِلَ يَسْأَلُ وَعِنْدَهُ وَالْمُسْتَقْرِضُ لَا يَسْتَقْرِضُ إِلَّا مِنْ حَاجَةٍ

I saw written on the door of *al-Jannah* when I was taken on night journey: *As-Ṣadaqah* (charity) is ten times in reward and (giving of) loan is eighteen times (in reward). Then I said “O (Angel) Jibrīl (i.e. the Arch Angel) why is loan more rewarded than *as-ṣadaqah*? Then he (Jibrīl) said: the beggar asks for what he possesses while the one seeking for loan does not seek for loan except when in need.

### SELF ASSESSMENT EXERCISE 3.1

Explain the meaning and importance of benevolent loans in Islam.

### 3.2 Conditions of *Qarḍ Ḥasan*

In giving out a loan, the lender or creditor must have total ownership of the fund or item to be given out. It must not be a property or a fund in trust such as the property of an orphan in his possession. The item to be loaned must be describable or must be definite if in liquid (money) form. The *Sharī‘ah* law forbids the creditor to charge any rental due or interest on the borrowed funds. As such, he must not derive any form of benefit on the loan in his capacity as the lender except parties to the loan agreement have hitherto been deriving mutual benefit from each other. Nevertheless, it is acceptable under the *Sharī‘ah* that the creditor may derive non-financial benefit because they cannot easily be turned into *ribā*. However, as explained in our discussions under *ribā*, the borrower is allowed to unilaterally and without any pre-determined agreement pay in excess of the principal as a sign of gratitude to the lender. This is in line with the saying of the Prophet that says:

كل قرض جر نفعا فهو ربا

Every loan that brings about benefit (to the lender) is *ribā*.

It should be noted that this voluntary and unilateral payment in excess of loaned funds in expressing appreciation for meeting one’s needs at a crucial time is not *ribā*. This is because *ribā* is usually pre-agreed upon by parties before funds are loaned to the creditor and such a person is duty bound to fulfil such an agreement. *Ribā* is also directly based upon the amount of money loaned, whereas, this voluntary payment of excess fund is not based on the principal and it is totally at the discretion of the borrower. The debtor may as well decide not to pay this excess fund. Finally, the creditor does not at all expect this gesture. Hence, it is totally different from *ribā*. However, if the loan is from a



financial institution, service charges which are not directly proportional to the loan could be charged. This is to cater for administrative expenses on such a loan and not a profit.

Besides, the debtor is not expected to deliberately exceed the time they both agreed for the payment of the debt. Otherwise, the creditor has the right to publicly embarrass him or even drag him to a court of law. This in view of the saying of the Prophet that:

لِيُؤْجِدَ يُحِلُّ عُقُوبَتَهُ وَعِزُّهُ

Delay in payment on the part of one who possesses the means makes it lawful to dishonour and punish him.

Similarly, he says:

مَطْلُ الْغَنِيِّ ظُلْمٌ وَإِذَا أُتْبِعَ أَحَدُكُمْ عَلَى مَلِيٍّ فَلْيَتَّبِعْ

The delay (of payment) of the rich is oppression. Whenever the time to repay reaches anyone of you should repay to time.

In addition, the amount to be paid by the debtor should not be less than the borrowed amount. If due to situation beyond the control of the debtor, the debt could not be paid at the stipulated time, the debtor should be given some time to recover before paying, otherwise the debt could be regarded as charity. This is in tune with Allah's injunction that:

وَإِنْ كَانَ ذُو عُسْرَةٍ فَنَظِرَةٌ إِلَىٰ مَيْسَرَةٍ وَأَنْ تَصَدَّقُوا خَيْرٌ لَّكُمْ إِنْ كُنْتُمْ تَعْلَمُونَ

If the debtor is in difficulty, grant him (time) till it is easy for him to repay. But if you remit it by way of charity, that is best for you if ye knew. (Q 2:280)

Buttressing the above condition of payment, the Prophet notes that:

مَنْ أَنْظَرَ مُعْسِرًا أَوْ وَضَعَ عَنْهُ أَظَلَّهُ اللَّهُ فِي ظِلِّهِ

Whoever delays (payment for one in) difficulty or leave (the debt) for him (as charity), Allah will place him under his shade (on the day of judgement).

### SELF ASSESSMENT EXERCISE 3.2

What are the conditions guiding benevolent loans in Islamic finance?

## 4.0 CONCLUSION

Social and economic well-being is the primary concerns of Islam. Mans needs sometimes go beyond his/her immediate income. This sometimes necessitates borrowing to meet some pressing social needs. Since this loan is not channeled into productive purposes, no pecuniary gains result from it. It would then be an act of oppression to charge a costumer on what has no direct economic benefit.

## 5.0 SUMMARY

- *Qarḍ Ḥasan* is another name for loan in Islamic finance.
- *Qarḍ Ḥasan* is more beneficial to charity.
- Debtors are allowed to unilaterally refund loans in excess of the principal.
- In *Qarḍ Ḥasan*, the bank could demand for a service charge not directly proportional to the loan funds.

## 6.0 TUTOR MARKED ASSIGNMENT

- Examine the Islamic attitude the advancement of loan.
- Differentiate between loans in Islamic and conventional banking system.

## 7.0 REFERENCES / FURHTER READING

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