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# **Towards Genuine Shariah Products with Lessons of the Financial Crisis**

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## **Abstract**

The paper represents an unprecedented approach towards examining the compatibility of the current debatable Islamic banking and finance products with Shariah. This approach is rooted out from the lessons of the current financial crisis with all its causes and effects. Although the paper subjects only some of the existing financing products to this new methodology of Shariah scrutiny, it lays down the principles on the basis of which all financing products, whose legality has not been free from doubt, can be scrutinized. It is perceived that this new proposed methodology for judging Islamic banking products is indispensable especially nowadays as the current approach to Ijtihad, which is based on quoting and interpreting some juristic opinions from Fiqh schools as well as the individual assessment of Maslaha, has led to having conflicting stands on many Islamic banking products; something which definitely impedes growth and damages the image of Islamic banking. Thus, practical evidences and lessons of experience, when available, must be made the reference in this regard and be given the final say. The proposed approach is predicated on the well established Shariah principle of “Lawful is what is good and beneficial, and forbidden is what is bad and harmful”. Therefore, if upon analysis a particular debatable Islamic banking product is found to be resulting in the same harms of conventional products, and potentially contributing to creation of financial crises, then it must be undoubtedly ruled as unlawful. For treating the subject, the paper starts with highlighting the conventional transactions that are deemed to be responsible for the occurrence of the financial crisis, it then examines the debatable Islamic banking products to locate any similarities to the conventional ones that led to the crisis, and it briefly discusses the various justifications provided in their support. The paper then analyzes from both Shariah as well as economic perspective these products and determines their Shariah value considering their economic substance and potential implications. The paper concludes with formulating the benchmark that against which all current and future Islamic banking and finance products should be measured.

## Introduction

According to financial analyses, the current financial crisis is basically caused by excessive dealing in interest and trade of debt securities.

In fact, these two practices are unanimously prohibited in Islam and are related to Riba; one of the gravest sins a Muslim may ever commit. However, some Islamic banks have developed and marketed as Shariah compliant some products that are to observers and financial experts similar in substance and economic implications to the conventional interest-bearing loans. Developers and proponents of these products claim their legitimacy on basis of locating some juristic statements that indicate their acceptability. However, the opponents of these products argue that since its very establishment, Fiqh literature has not been free from irregular opinions; and it has also been, on the other hand, plagued with extreme and twisted interpretations by researchers in an attempt to seek legal grounds for their arguments. Sadly enough, the contemporary juristic debates and arguments over these issues have not yielded any substantial results nor solved the problem. This is evidenced by the ongoing persistence of Islamic banks with offering the same controversial products despite the many juristic criticisms raised, also by overruling the resolutions of the largest representative of contemporary Shariah scholars, namely the International Fiqh academy.

Therefore, it is perceived indispensable nowadays to depart from the classical juristic approach and adopt a new approach in tackling the so-termed controversial Islamic banking products. The suggested approach depends for judging the Islamic banking products on examining their implications and investigating any possible essential similarities with the prohibited conventional banking products.

This step is necessitated in fact by the perceived fatal implications of Islamic banking and finance having an evidenced convergence with conventional banking.

These implications on the emerging industry of Islamic banking include the followings:

- Vulnerability of Islamic banking to the same financial threats inherent in conventional banking.
- Having the Islamic financial law being reduced to one establishing itself on mere technicalities rather than reason and justice.

- Risking the public image of the Islamic Shariah in general and the Islamic financial system in particular.
- Losing the public's confidence in Islamic banking.

Undoubtedly, such implications are fatal enough to urge decision makers in Islamic finance to take urgent steps towards reevaluating the current Islamic products on basis of the described approach, so as for Islamic banks to remove the bad products from their shelves.

### **The proposed approach is rooted in the Shariah**

The essence of the entire Islamic law is predicated on the philosophy of retention of good and prevention of evil. This is evidenced by the Quranic verse { ويحل لهم الطيبات ويحرم عليهم { الخبائث } (Al-A'raf, 157), which means "Allah makes lawful for believers all that is good and prohibits for them all that is bad and harmful".

It is from this verse that a major principle of Islamic law has been derived, namely Al-Maslaha versus Al-Mafsadah<sup>1</sup>. The former means good or public benefit, and the later means bad and evil. Besides the above Quranic verse, reflection also on Shariah texts has led Shariah scholars to reach the conclusion that Shariah rules admit Maslaha and prohibit Mafsada.

This notion of recognition of good and prohibition of evil has been used by jurists as one of the Shariah sources valid for judging new matters that have no textual authority on their validity or otherwise. To explain, if a new matter on which the Shariah texts are silent is needed to be looked into in order to determine its Shariah value, then it can be judged against its own harms or benefits. Should it be found beneficial to the society, then it can be positively ruled as lawful. Conversely, if it is found harmful to the society or that it carries more harms than benefits, it then can be ruled as Haram.<sup>2</sup>

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<sup>1</sup> Ibn al-Subki, "*Al-Ibhaq*", 3/52 (Dar al-Kutub al-Ilmiyyah Beirut, Lebanon. 2004); Al-Shatibi, "*Al-Muwafaqat*", (Dar al-Fikr, Beirut, undated) 2/2.

<sup>2</sup> Amongst the major school of Islamic jurisprudence, Imam Malik is known to be the leading proponent of upholding Maslaha as one of the sources of Shari'ah. He uses the term "al-masalih al-Mursala" to connote interests which have not been covered by other sources of Shari'ah. On the other hand, the majority of other jurists reject it as a source of Shari'ah though; they practiced it without theoretically admitting its authority as an independent source of the Shari'ah. However, Al-Ghazali (who is from the Shafi'i school), uses the term Istislah (seeking the better rule for public

Beside the validity of the principle of Maslaha and Mafsada to function as a Shariah source for judging new matters, it can be used also by contemporary scholars as a benchmark against which conflicting juristic opinions with equal Shariah authority can be weighed and evaluated. If we want to opt for the strongest or the most appropriate past juristic opinion among the available conflicting ones, we can simply choose the one we may consider more conducive to realization of Maslaha and prevention of evil, since Shariah rules are naturally characterized by upholding good and avoiding evil.<sup>3</sup>

Similarly, the same benchmark can be used to examine the currents contemporary conflicting fatwas in Islamic banking and finance and the products designed on their bases. Any product which is found to involve evil more than good must be rejected, and the fatwa allowing it must be overruled. This is again nothing but an application of the above Quranic verse {ويحل لهم الطيبات ويحرم عليهم الخبائث} which all contemporary Shariah scholars have no choice but to submit to it.

However, the issue that may arise here relates to the practicality of this approach since the same banking product may be considered by some as beneficial whereas others may deem it harmful! It is here, in fact, where lessons of experience, like the ones derived from the current financial crisis manifest themselves as hard practical evidences that leave no room for disagreement or dispute. Once the conventional banking products that led to the crisis are identified, analysis of the controversial Islamic products can be made. If substantial similarities between the two are located, the same Shariah stand on these conventional products must be extended to the in-question controversial Islamic banking products.

### **Reasons for the occurrence of the financial crisis**

According to many analyses and reports on the current financial crisis, it can be concluded that the following are primarily the factors behind the occurrence of the financial crisis:

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interest) but never claims it as the fifth source of Shari'ah. He also restricts its application to situations which are deemed necessary to serve the interest of the public.

<sup>3</sup> See for details on the functions of Maslaha Abozaid Abdulazeem, "The Devotional Dimension in Interest-oriented Shari'a Rulings", p 52-53, Article in Arabic, Journal of Islam in Asia, Volume 3, No 1, July 2006.

1. Interest- based financing with all its forms and structures.
2. Dealing in bonds and circulation of debt securities.<sup>4</sup>

However, for sake of brevity, our study will discuss mainly issues related to the first factor, i.e. the interest-based financing, considering that debt represented in bonds and debt securities are the sub-products of the interest-based debts.

### **Locating similarities of Islamic banking products to the conventional interest-based financing**

A thorough and fair analysis of the current Islamic banking products will identify some products that are similar in their core and essence to conventional transactions. Eina and Tawarruq, for example, constitute in some Islamic banks the basis for many of their products although the essence of these two transactions can hardly distinguish itself from that of conventional loans. These products include personal financing, corporate financing, home financing, credit cards and over draft facility. Sale of debt, on the other hand, is practiced in some Islamic banks in a variety of products like “Islamic Private Debt Securities”, “Islamic Factoring” and “Islamic Accepted Bills”.

Below is a brief description of these sales along with some examples of the products structured on their basis.

#### **1. Eina Sale**

##### **Meaning of Eina (back-to-back sales)**

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

Such mechanism suggests that the article itself is not meant for purchase, but rather it is used only as a tool to provide cash with some return. To illustrate, it makes no difference to the one seeking finance to conclude the sale contract on a car, a house or anything else.

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<sup>4</sup> See for details, reports and analyses “*Financial crisis of 2007–2010*” from Wikipedia. Link: [http://en.wikipedia.org/wiki/Financial\\_crisis\\_of\\_2007](http://en.wikipedia.org/wiki/Financial_crisis_of_2007).

Furthermore, Eina sale is conducted sometimes on assets which one party may not be effectively willing to sell or buy, like the bank's premises or equities in cases when the bank is financier. This confirms the fact that this sale contract is fictitious and not real. Moreover, practically, Eina transactions rarely involve actual possession of the item sold or official documentation of the contract.

Proponents of Eina argue that its permissibility can be attributed to the Shafi'i Fiqh school. However, this is not true as the Shafi'i Fiqh school has ruled on the validity of the Eina contract and not its permissibility, and a valid contract is not necessarily permissible.<sup>5</sup>

### **Applications of Eina**

Eina is the underlying contract in products like cash financing, home financing, overdraft facility and credit cards. The following is a description of both Eina-based home financing and personal financing

#### **Home Financing**

Some Islamic banks offer Eina-based home financing under the term of BBA; an Arabic term for 'Bay' Bithaman Ajil' which means "deferred payment sale". Technically, BBA refers to a sale contract (practiced mainly in Malaysia) whereby a person "A" who does not have enough cash to pay the full price of his house of choice will pay only around 10% of the full price. In return, "A" gets from the seller of the property a 'Beneficial Ownership', which reflects a commitment on the part of the owner to conclude the sale upon payment of the balance (90%). After paying the 10% and obtaining the beneficial ownership, "A" sells the house as represented by the beneficial ownership to the Islamic bank for a cash price equivalent to the outstanding amount (90%) of the house price. So, if the total price was \$100,000, then the selling price between "A" and the Islamic bank would be \$90,000. Afterwards, the Islamic bank immediately sells the house, which is represented by the beneficial ownership, back to "A" on deferred payment basis at a mark up, say for \$120,000 over a period of 5 years.

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<sup>5</sup> For details on this matter see Abozaid Abdulazeem "*Contemporary Eina is it a sale or usury*" a book published in Arabic by Dar Al-Multaqa, Aleppo, Syria, 2004.

The \$90,000 paid by the Islamic bank as the purchase price will be extended to the property developer in conclusion of the sale contract with "A". "A", however, remains indebted to the Islamic bank for the \$120,000; the price in the last sale contract.

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

This mode of finance, apart from the technicalities followed therein, is hardly differentiated from the conventional mortgage used in home financing. The only difference an observer may locate is the way cash is advanced from the bank to the client. In the conventional mortgage it is through an explicit conventional loan, while in BBA it is through the technicalities of Eina. Further examination of BBA contract particulars and terms of agreement will even enhance convergence of BBA with Mortgage.<sup>6</sup>

Had the bank acquired the house first from the property developer or its original owner and genuinely taken the property risk then sold it to the client, the financing would then be construed as a real trade business and thus, it would lawfully entitle the bank for profit. However, the bank in BBA home financing acquires the house from the customer and then immediately sells it back to him at a higher price without taking any property risk.

### **Eina-based Personal Financing**

Conventionally, personal financing simply functions on the concept of interest-bearing loans. However, since charging interest on loans is prohibited in Islam, some Islamic banks have resorted to Eina as a presumably lawful alternative. To explain the mechanism, the Islamic bank would sell an asset to the client seeking finance on credit basis, and then it would immediately repurchase the same asset on cash basis. The amounts of the two prices depend on the required financing and the bank rate of profit for the repayment period. The cash price would be handed to the client who will become indebted to the bank for the credit price.

### **Similarity of Eina to the interest-based financing**

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<sup>6</sup> See for mortgage mechanism: Abozaid Abdulazeem, "*Fiqh Al-Riba*", p.576. (Al-Risalah, Beirut, 2004).



Obviously Eina is implemented in some Islamic banks for the purpose of providing clients with cash yet in a securely profitable manner to the bank. Therefore, as far as the substance of Eina is concerned, this transaction is similar to the interest-based loan.

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

Moreover, the sequence of contracts in Eina is not accidental, but rather it is something predetermined in order to reach the end set in advance, i.e. to legalize charging clients upon providing them with cash. Obviously, sale contract is used in Eina for what it was not originally designed for. Sale contract is originally designed to acquire things for their own use, to trade in order to generate profit and even as a means to obtain cash through the disposal of some properties. However, with Eina, sale contract is used for a different purpose all together. Since its very initiation, it involves a known and deliberate determined loss in the asset acquired. So, the loss is known to materialize at the time the asset is acquired, and not only when the asset is sold as is the case in selling one's own property when cash is needed. In other words, it is not a genuine sale contract the one that is designed to be immediately followed by a subsequent sale contract to reverse and so cancel the legal consequences of the former sale. Transfer of title from the seller to the buyer and price from the buyer to the seller is the major legal consequence of sale contract, and it is immediately reversed by the following sale contract in the Eina transaction. What remains out of the two consecutive sale transactions in Eina is only the indebtedness of one contractor to the other.

Had this flow of action been lawful in Islam, Islam, the practical and rational religion, would have legalized loan with interest from the first place, not bothering individuals with the need to follow certain technicalities to reach the same end result. Obviously, Eina cannot be construed as the Shariah substitute to loan with interest, because Eina places no input or value whatsoever in economy and has one single implication similar to

that of a conventional loan, which is the creation of debt liability against the extension of cash.

## **2. Tawarruq-based financing**

The meaning of Tawarruq is to purchase a commodity from one party on credit then sell it immediately to another for cash. Thus, Tawarruq shares the same objective of Eina as both are meant for extending cash money. However, Tawarruq remains technically distinguished from Eina as in the later the commodity is resold to its original seller, while in Tawarruq it is sold to a third party. Its proponents basically claim its permissibility on the ground that it comprises two independent and non-related sale contracts, and sale contract is unanimously permissible.<sup>7</sup>

### **Tawarruq in Islamic banks**

The mechanism of Tawarruq which is practiced in some Islamic financial institutions<sup>8</sup> is a slightly modified version of the original form of the Tawarruq described above. In this institutional Tawarruq, the bank purchases some commodity from the market, typically a metal from London Metal Exchange (LME), and then sells it to the customer on Murabaha basis (at cost plus a mark-up) for deferred payment. Subsequently, the bank, as the customer's agent, sells the metal on LME for immediate cash. In result, the bank gains Murabaha profit and agency fees, the customer obtains immediate cash and remains committed to repay the outstanding debt that he has incurred when acquiring the commodity from the bank on Murabaha basis.<sup>9</sup>

### **Similarity of Tawarruq to interest-based financing**

Like in Eina, the bank in Tawarruq acts as a financier who makes a secured profit from the clients he finances, and not as a real trader who takes market risks, although taking

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<sup>7</sup> For Fiqh discussion on the permissibility of Tawarruq see Abozaid Abdulazeem. “*Contemporary Islamic Financing Modes between Contracts Technicalities and Shari’ah Objectives*”. Eighth Harvard University Forum on Islamic Finance, Harvard Law School – Austin Hall, USA, April 19-20, (2008).

<sup>8</sup> -This transaction is mostly practiced in some Islamic banks of Arab Gulf countries.

<sup>9</sup>- See for example mechanism of Tawarruq in Abu Dhabi Islamic Bank.

market risk is, as commonly known, the dividing line between sale and Riba, profit and interest. Moreover, in both transactions, Tawarruq and Eina, bank knows that the client has no interest in the commodity but to resell it immediately; either to the bank as in Eina, or to a third party but through Bank's mediation as in Tawarruq. These facts about Tawarruq and Eina eliminate real differences between the two; and more generally, they eliminate differences between both of them on one side and the interest-bearing loan on the other, reducing differences to only technicalities followed in the execution of the two. Has Eina or Tawarruq not been Haram, it would then be easily and comfortably resorted to by people in order to circumvent the prohibition of Riba. Anyone wishing to legitimately provide interest-loaded loans would simply execute Eina or Tawarruq with people seeking finance, so Riba would be 'lawfully' practiced! Therefore, claiming the permissibility of such transactions contradicts the Shari'ah objective meant from the prohibition of Riba.

Furthermore, the absence of substantial differences between Eina/Tawarruq based financing in Islamic banks on one hand, and conventional loans on the other, annuls the justification for burdening clients seeking finance from Islamic banks with extra costs due to extra procedures. For clients of Islamic banks willingly accept bearing extra cost in return for obtaining Shari'ah compliant products, but with a product like Eina or Tawarruq they ultimately end up paying the cost of the useless technicalities followed by some Islamic banks to unjustifiably claim legitimacy of these products!

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

### **Economic analysis of Eina & Tawarruq**

Both Eina and Tawarruq create in favour of the Islamic bank a debt liability out of a transaction in which the bank advances to the client an amount less than the amount the client has to repay in the future. This is exactly the economic purport of conventional

loans as therein the client repays to the conventional bank an amount larger than the advanced lent money. In fact, it is wrong to consider Eina and Tawarruq as similar to the acceptable debt-creating commodity financing instruments, like the Shariah compliant Murabaha. In other words, the debt Eina or Tawarruq creates is not similar to the debt a genuine commodity-based financing creates. This is because the later is a result of a real economic activity in which the bank sells to customers their desired commodities in a manner that involves risk and provides no guarantee of return. In other words, the bank in a Shariah compliant Murabaha functions as a real trader mediating between the commodity suppliers and their consumers, which is not the case with either Eina or Tawarruq as their clients are not real consumers.

Prof. Anas Zarka, a prominent Islamic economist, points out the similarity in the economic results and implications between Eina and Tawarruq on one hand, and the practices of Riba on the other by saying: “Tawarruq leads to the same end results of the usurious practices of Riba before Islam, which involved increasing debts in return of their postponement, so debts were given the power to increase and multiply by themselves without them being associated with genuine sale of commodities or services. This, in turn, creates a gap between the real economic sector and the financial sector, which is one of the characteristics of the Riba-based economics”.<sup>10</sup>

Commenting on the technicalities-driven nature of Eina and Tawarruq sales, Zarka says: “Eina involves a temporary engagement with a commodity which is immediately resold to its original owner, rendering the outcome a mere conventional financing. Tawarruq also involves the same thing except that the commodity is resold to a third party. Obviously, in both Eina and Tawarruq the commodity in exchange is not meant for itself, rather any commodity that can be easily resold with minimum loss will do”.<sup>11</sup>

Another bitter fact about Eina and Tawarruq is that the Islamic banks practicing them and their likes have not been helpless to design some instruments through which they could restructure debts with increase or roll them over, though Shariah does not allow creditors to increase the debt on debtors. As a matter of fact, Eina and Tawarruq have mainly been

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<sup>10</sup> Zarka Anas, “*Tawarruq Train*”, unpublished paper in Arabic, p 3.

<sup>11</sup> Zarka Anas, “*Tawarruq Train*”, unpublished paper in Arabic, p 2.

the tool adopted to reschedule nonperforming debts, which may themselves have resulted from former Eina or Tawarruq! However, interestingly enough, increasing debts via rolling them over or rescheduling have been some of the practices of conventional banks that contributed to the occurrence of the credit crisis originated in the United States.<sup>12</sup> In result, such application of Eina and Tawarruq further reflects their convergence with conventional loans.

In relation to this point, Zarka stresses that the most important Shariah reason behind prohibiting conventional borrowing, or Riba, is to block the means to the practice of rolling over or rescheduling of debts with increment: “Linking permissible indebtedness to genuine sales mainly helps block the means to the creation of new debts in repayment of old debts. However, Eina and Tawarruq are potential means to create larger debts for the mere purpose of settling old smaller debts and thus, they are similar to Riba-based borrowing”.<sup>13</sup>

Dr. Mabid Ali Al-Jarhi, another prominent Islamic economist, points out that “Tawarruq, like Eina, opens the doors for the debts resulting from Islamic financing to acquire the same characteristics of conventional debts. This is because debts resulting from Islamic financing are not tradable by nature and cannot increase in case of temporary insolvency. They can only be rescheduled without any extra charge. However, by virtue of Twarruq, banks will be able to increase debts on defaulters via initiating Tawarruq transactions with them, and this process may be repeated over and over, so one Tawarruq may give birth to subsequent Tawarruq(s). **This will potentially expose Islamic financial industry to the same credit crises of conventional financial industry**”.<sup>14</sup>

Considering the economic implications of a product like Eina or Tawarruq, Dr. Al-Jarhi says: “If Tawarruq spreads, economy will have an act of money market, where spot money commands higher value over deferred money, the difference in value being in fact nothing but interest though it is not given the same name. As a result, people, motivated by the price of money, will economize on the use of money, and they will substitute the real productive resources for money, though the later is inherently non-productive. This

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<sup>12</sup> “*Financial crisis of 2007–2010*”, Link: [http://en.wikipedia.org/wiki/Financial\\_crisis\\_of\\_2007](http://en.wikipedia.org/wiki/Financial_crisis_of_2007).

<sup>13</sup> Zarka Anas, “*Tawarruq Train*”, unpublished paper in Arabic, p 3.

<sup>14</sup> Al-Jarhi Mabid Ali, “*The Organized Tawarruq*”, unpublished paper in Arabic, p 24.

in turn will reduce the economic efficiency and will let the society forgo production through the real productive resources”.<sup>15</sup>

In final analysis, if excessive conventional lending is deemed, among other things, potentially responsible for economic downturns as evidenced by the recent financial crisis, then Eina and Tawarruq, and any similar Islamic banking product, being economically no different from conventional loans in essence and practices, are potentially factors for creation of financial crisis. Undoubtedly, the market implications would have been the same if the conventional banks in America had used Eina or Tawarruq for financing their customers instead of the standardized conventional loans, and then traded the debts resulting from Eina and Tawarruq locally and overseas on the same terms the original debts were traded. For debt trading has also been practiced in Islamic finance as discussed below.

### **Debt Trading Practices in Islamic Finance**

Debt trading that involves sale of debt at discount or a mark-up is held unanimously<sup>16</sup> unlawful in Islam.<sup>17</sup> However, there are some opinions in the modern literature of Islamic banking and finance that unjustifiably differentiate, in prohibition, between commercial debts, i.e. debts resulting from sale or any other commutative contract, and non-commercial debts, i.e. debts resulting from loan contracts. So, according to this opinion which is rooted in the Malaysian model of Islamic banking and finance, the debts resulting from Eina and Tawarruq are tradable. Consequently the complete scenario of the debt creation and then its trading can be surprisingly given a Shariah clearance and be labeled as Shariah compliant!

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<sup>15</sup> Al-Jarhi Mabid Ali, “*The Organized Tawarruq*”, unpublished paper in Arabic, p 24.

<sup>16</sup> Some juristic stands on the matter, like the Shafi’i school has been misinterpreted. For details on this matter see Abozaid, Abdulazeem. “*Examining the New Applications of Sale of Debt in the Islamic Financial Institutions*”, Journal of Islam in Asia, Volume 5, No 2, December 2008.

<sup>17</sup> Ibn Abideen, “*Hashiyat Ibn A’bideen*”, 4/160 (Dar Ihya’ al-Turath al-Arabi, Beirut, 1987); Al-Dasuqi, “*Hashiyat al-Dasuqi*”, 3/61 (Dar Ihia’a al-Kutub al-Arabiyyah, Undated); Al-Hattab, “*Mawahib Al-Jalil*”, 4/368 (Dar al-Fikr, Beirut, 1987); Al-Bahuti, “*Kashaf Al-Qina*”, 3/307, (Dar Al-Fikr: Beirut, 1402 A.H); Al-Sherbini, “*Mughni Al-Muhtag*”, 2/71 (Dar al-Fikr, Beirut. Undated).

In an attempt to justify such arbitrary differentiation between these two categories of debt, it has been argued that when the holder of commercial debt securities sells them at discount, he is effectively relinquishing part of the profit he previously made in the commercial transaction that created the debt, so the buyer of this debt securities is in reality getting a profit and not an interest!<sup>18</sup>

To refute this argument it can be simply said that in the whole Fiqh literature there exists no single opinion that supports such division of debts. On the contrary, jurists assert that the debt to which Riba injunctions are applicable is any financial liability that has been created as a result of loan, commutative contract or damage done to others' properties.<sup>19</sup>

Besides, to exclude commercial loans from prohibition is against the very Shariah objectives of subjecting sale of debt to Riba rules. This is because Shariah rejects the very principle of exchanging a sum of money for more or less sum of money in consideration of time, and this irregular opinion breaks this rule.<sup>20</sup>

Furthermore, if seller of the commercial debt is allowed to relinquish part of his profit, then why not seller of the non-commercial debt be also allowed to relinquish part of his principle?! And what if the seller of the commercial debt had made no profit to relinquish in the underlying transaction, would not he be allowed then to sell his commercial debt?!

Effectively, both the seller of a non-commercial debt and the seller of a commercial debt are doing the same thing, i.e. leaving to the buyer part of their debts in return for cash payment of debt. The buyer of either debt, in his turn, holds the debt security until maturity to claim its nominal value or sell it at a later time with a profit margin.

To summarize, both debts are the same, and the Shariah has subjected sale of debt, in general, to certain rules that would nullify the common market practices of debt securities trading. Excluding commercial debts from prohibition renders selling debt arising from sale-based financing legitimate. This means that debts arising from the controversial Islamic financing products like Eina and Tawarruq, which are, as proven above, no

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<sup>18</sup> See for debt trading justifications “*Resolutions of the Securities Commission Syariah Advisory Council*”, Malaysia; Sano Mustapha. “*The Sale of Debt as Implemented by Islamic Financial Institutions in Malaysia*” p 50.

<sup>19</sup> Ibn A'bideen, “*Hashiyat Ibn A'bideen*”, 4/160; Al-Dasuqi, “*Hashiyat al-Dasuqi*” 3/61

<sup>20</sup> See for Fiqh details on this matters Abozaid Abdulazeem, “*Fiqh Al-Riba*”, p.275.

different from conventional lending, would be lawfully tradable. Consequently, both identified crisis-causing elements, i.e. Riba-bearing lending and debt trading would be somehow labeled Shariah compliant!

## **Conclusion**

### **The Criterion of the Non-Shari'ah Compliant Transaction**

The past discussions conclude that Islamic banking and finance has harboured some products that failed to show real differences from conventional financing, with differences being reduced to only the terminology used and the technicalities followed in their execution. In other words, they share the same essence and economic implications. However, it is the essence of conventional financing, not its terminology nor its technicalities that has caused the financial crisis.

Therefore, in order for an Islamic financial product to be rightly and logically labeled as Shariah compliant, it must be genuinely distinguishable from the prohibited conventional financing products. However, conventional financing is mainly characterized with the absence of risk taking and with principal as well as profit being guaranteed, which is the meaning of Riba. Consequently, a genuine Shariah compliant product must admit risk and never provide the financier with any capital or profit protection. In other words, any financing mode is unlawful if it is structured in such a way that secures a guaranteed return to the financier without taking any risks, or when the financier acts in reality as a creditor who merely provides money without being involved in the investment process; i.e. when the economic substance is interest-bearing debt. This will render the product non-Shariah compliant regardless of any Islamic name it may be given, and regardless of its legal form and any sound technicalities followed in its execution.

In fact, the current financial crisis has proven beyond doubt that conventional products are not defect free. Hence, Islamic banks must be extremely cautious when borrowing or mimicking conventional concepts and products, and they have to realize that some conventional products are not possibly able to be Islamized, and any attempt to Islamize the un-Islamizable will yield a conventional product but under an Islamic cover.



The current financial crisis has indeed presented Islamic banking with a priceless lesson; a lesson that helps it to identify its non-genuine Shariah products. For the relative success Islamic banks have achieved should not close their eyes from the fact that among its products exist ones that are hardly distinguishable from the conventional products which took the blame for the occurrence of the crisis. If the good performance of Islamic banks and other circumstantial conditions have temporarily veiled these threatening products, this does not mean they do not exist.

Indeed, Islamic banks do not need a financial crisis of their own in order to reform their products, and the time has really come for Islamic banks to take a lesson from the current financial crisis, not on the level of filtering their clients, but rather on the level of filtering their products in light of their essence as explained above.

Finally, the recent crisis should also make Muslims more appreciative of the teachings of their religion and more observant about their right applications, as this crisis has manifested itself as practical evidence that what Islam has prohibited is nothing but evil.

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