



UNIVERSITI SAINS ISLAM MALAYSIA

جَامِعَةُ الْعُلُومِ الْإِسْلَامِيَّةِ الْمَالِيزِيَّةِ

ISLAMIC SCIENCE UNIVERSITY OF MALAYSIA

# Islamic Law of Banking and Takaful

LAB3073

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# Content

- The Basis of the Introduction of Islamic Finance
- Riba
- Gharar
- Maisir
- Risk
- Islamic finance as a holistic ethical solution

- Umar b. al-Khattab said, "There are three things. If Allah's Messenger had explained them clearly, it would have been dearer to me than the world and what it contains: (These are) *kalala*, *riba*, and *khilafa*. [Sunan Ibn Majah]

# The Fall of the Ottoman Empire

- Ottoman Empire : 1299-1922
- High Interest Loan with British and France  
1854: £3M interest 6%,
- 1855, £5M interest 4%,
- 1858, £5M interest 6% and £8M interest 6%.

# Riba

- First: In Mecca Quran Al Rum 30: 39 Riba deprived wealth of Allah's blessing, charity raised it manifoldly
- Second: In Medina 1<sup>st</sup> H Quran Al Nisa: 161: Severely disapproved or riba
- Third: 2<sup>nd</sup> H. Al Imran: 130-131. Enjoining muslim to keep away from riba.
- Final: 9 days before the demise of the prophet. 2: 275-281.

## ■ *The Noble Qur'an - Al-Baqarah 275-281*

- 275. Those who eat Ribâ (usury) will not stand (on the Day of Resurrection) except like the standing of a person beaten by Shaitân (Satan) leading him to insanity. That is because they say: "Trading is only like Ribâ (usury)," whereas Allâh has permitted trading and forbidden Ribâ (usury). So whosoever receives an admonition from his Lord and stops eating Ribâ (usury) shall not be punished for the past; his case is for Allâh (to judge); but whoever returns [to Ribâ (usury)], such are the dwellers of the Fire - they will abide therein.
- 276. Allâh will destroy Ribâ (usury) and will give increase for Sadaqât (deeds of charity, alms, etc.) And Allâh likes not the disbelievers, sinners.
- 277. Truly those who believe, and do deeds of righteousness, and perform As-Salât (Iqâmat-as-Salât), and give Zakât, they will have their reward with their Lord. On them shall be no fear, nor shall they grieve.

- يَا أَيُّهَا الَّذِينَ ءَامَنُوا اتَّقُوا اللَّهَ وَذَرُوا مَا بَقِيَ مِنَ الرِّبَا إِن كُنْتُمْ مُؤْمِنِينَ
- فَإِن لَّمْ تَفْعَلُوا فَأْذَنُوا بِحَرْبٍ مِّنَ اللَّهِ وَرَسُولِهِ <sup>صَلَّى</sup> وَإِن تَابْتُمْ فَلَكُمْ رُءُوسُ أَمْوَالِكُمْ وَ
- لَا تَظْلِمُونَ وَلَا تُظْلَمُونَ

- 278. O ye who believe! Fear Allah, and give up what remains of your demand for usury, if ye are Indeed believers.
- 279. If ye do not, take notice of war from Allah and His Messenger: but if ye turn back, ye shall have your capital sums; Deal not unjustly, and ye shall not be dealt with unjustly.

- "Hakim relates on the authority of Ibn Mas'ud that the Prophet said, '*Riba* is of seventy three kinds, the lightest in seriousness of which is as bad as one's marrying his own mother; for the Muslim who practices *riba* goes mad.' " (Related by Ibn Majah)

# Riba

- Excess, expansion, increase, addition or growth
- Technically, unlawful gain derived from the quantitative inequality of the counter-values in any transaction purporting to affect the exchange of two or more species which belongs to the same genus and are governed by the same efficient cause.

**RIBA'**

**Riba Ad-Duyun**

**Riba Al-Buyu'**

**Riba  
Al-Qardh**

**Riba  
Al-Jahiliyyah**

**Riba  
An-Nasak**

**Riba  
Al-Fadhi**

# Riba on loan contract

- Riba al duyun- occurs in lending and borrowing.
- Riba al nasiah (to delay): excess due to delay in payment
- Riba al Quran
- Any unjustified increment in borrowing or lending money whether in kind or cash over and above the principal amount as a condition stipulated or agreed btm the parties.

# Riba in Exchange Contracts

- Riba al Buyu: occurs from trading or exchange transactions in which a commodity is exchanged for the same commodity from the ribawi commodities in unequal amount and/or delay for the delivery of one of the commodities.
- Riba al fadl
- Riba al Sunnah

# Riba al Buyu

- Ubadah b Samit that the Prophet said: Gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates and salt for salt, like for like, equal for equal and hand to hand, if the commodities differ, then you may sell as you wish provided that the exchange is hand to hand (Sahih Muslim)

# Riba al Buyu

- 1. It must be a spot transaction: If one of the commodities are delayed, riba al buyu occurs
- 2. It must be equal counter-value. 2kg of wheat with 2 kg of wheat.

# Hadith Ubadah

- 1. Medium of exchange: gold and silver and currency
- 2. Food stuff: Barley, dates and salt.
- Shafie: Edible
- Hanafi: saleable by the measurement of weight or capacity
- Maliki: staple foodstuffs and preservable

# Hadith Ubadah

- If gold for gold: Equality and spot delivery
- If wheat for wheat: E and S.
- If gold for silver: Spot delivery
- If wheat for dates: Spot delivery
- If gold for wheat: Willing seller willing buyer

# Illustration for currency

- RM100 and RM100= on the spot =No riba
- RM100 and RM100=delay=Riba
- RM100 and RM150=excess=Riba
- RM380 and USD100= on the spot=No riba
- RM380 and USD100=delay=Riba
- Money is not a commodity. Money is a medium of exchange, store and measure of value.

# Illustration for Food

- 10kg Rice and 10 kg rice=on the spot=No riba
- 10kg rice and 10 kg rice=delay=riba
- 10kg rice and 15 kg rice=on the spot=Riba
- 10kg rice and 15 kg wheat=spot=No riba
- 10kg rice and 15kg wheat=delay=riba

# Reason or Rationale

- 1. Violate the equity aspect of economic organization.
- 2. The inflexibility of an interest-based system is a loss situation can lead to a bankruptcies in loss of productive potential and unemployment.
- 3. Security oriented vs growth oriented.
- 4. discourage innovation.
- 5. Wrongful appropriation of other's property. (Allow through contract eg partnership, muawadhat, ibra, hibah, waqf, will and inheritance).

# Gharar

- Risk, uncertainty and hazard
- Ibn Qayyim: as a sale in which the vendor is not in position to hand over the SM to the buyer whether the SM is in existence or not.
- WZ: Contract which contains a risk to any of the parties which could lead to his loss of properties.

# Gharar

- Surah al Nisa:29 “ O you who believe? Eat not your property among yourselves unjustly by falsehood and deception, except it be a trade amongst you by mutual consent”.
- The world batil unjustly include all categories of illegal and defective elements in commercial contracts, including that of a gharar.

# Hadith

- Abu Hurayrah narrated that the Prophet prohibited all sales on gharar.

# Rationale

- Rule of justice and fair dealings
- To avoid oppression and injustice and loss of properties
- May infringe the rule of mutual consent, due to inadequate knowledge.
- To avoid future disputes.

# Types of Gharar

- Non-existence of the exchanged counter-values or the control of the parties over the SM to be exchanged.
- Inadequacy or inaccuracy of information: Non disclosure. Eg characteristics of the exchanged counter value, its species, quantities, data of future delivery,.
- Undue complexity of the contracts. Eg two sales in one.

# Degree of Gharar

- Gharar yasir: Minor gharar: unavoidable gharar due to the nature of the subject matter without causing considerable damage to one of the parties will not affect the validity of the contract.
- Gharar fahish: Major gharar: Important and material information. Contract is void.

# Maysir

- Qimar
- Involves betting whereby the winner will take the entire bet and the loser will lose his bet.
- Games of pure chance where any party might gain at the expense of the loss of the party.

undesirable and detestable.

يَسْأَلُونَكَ عَنِ الْخَمْرِ وَالْمَيْسِرِ قُلْ فِيهِمَا إِثْمٌ  
كَبِيرٌ وَمَنْفَعَةٌ لِلنَّاسِ وَإِثْمُهُمَا أَكْبَرُ مِنْ نَفْعِهِمَا

- They ask thee concerning wine and gambling.  
Say: In them is a great sin and some benefit for men. The sin is greater than the benefit. (2:219)

# Declared Unlawful

يَأْتِيهَا الَّذِينَ ءَامَنُوا إِنَّمَا الْخَمْرُ وَالْمَيْسِرُ وَالْأَنْصَابُ وَالْأَزْلَامُ رِجْسٌ  
مِّنْ عَمَلِ الشَّيْطَانِ فَاجْتَنِبُوهُ لَعَلَّكُمْ تُفْلِحُونَ ﴿٩٠﴾ إِنَّمَا يُرِيدُ  
الشَّيْطَانُ أَنْ يُوقِعَ بَيْنَكُمُ الْعَدَاوَةَ وَالْبَغْضَاءَ فِي الْخَمْرِ وَالْمَيْسِرِ  
وَيَصُدَّكُمْ عَن ذِكْرِ اللَّهِ وَعَنِ الصَّلَاةِ فَهَلْ أَنْتُمْ مُنْتَهُونَ ﴿٩١﴾

- O you who believe! Intoxicants and gambling, (dedication of) stones and arrows are abomination of Shaytaan's handiwork: Abstain from it so that you may prosper. Shaytaan's plan is (but) to excite enmity and hatred between you, with intoxicants and gambling, and binder you from the remembrance of **Allah**, and from prayer: Will you not then abstain? (5: 90,91)

# Risk (Khatar)

- Not every risk-taking is prohibited
- Islam had Permitted sale due to fairness in risk and return.
- Sale: assumes risk-taking (market risk the seller deserves the profit from the sale). Riba is prohibited because it involves profiting without taking or sharing in related risk.

# Rationale

- Majallah al Ahkam Al Adliyah in 1876.
- Article 85: the benefit of a thing is a return for the liability for loss arising from that thing.
- Art 87: The detriment is as a return for the benefit.
- Arti 88: the burden is in proportion to the benefit and the benefit in proportion to the burden.
- Al kharaj bidhaman: the right to the return is justifiable by assuming the risk of loss.

# Types of Risks (Fiqh)

- 1. Entrepreneurial risk which might occur as part of the normal course of business:  
Praiseworthy
- 2. Risk due to possibility of the occurrence of natural disasters and calamities: Allowed if by way of cooperative.
- 3. Unnecessary risk. Arise from game of chance.  
Prohibited.

# Types of Risks

Board and  
Senior  
Management

- Credit Risk
- Equity Investment Risk
- Market Risk
- Liquidity Risk
- Rate of Return Risk
- Operational Risk

Shari'ah Board

- Shari'ah Non-compliance Risk

Types of Risk	Roles of BOD and Senior Management
Credit Risk	<ul style="list-style-type: none"> <li>•Strategy for financing and recognize the potential credit exposures.</li> <li>•Carry out due diligence review</li> <li>•Appropriate methodologies for measuring and reporting credit risk exposure</li> <li>•Shariah-compliant credit risk mitigating techniques</li> </ul>
Equity Investment Risk	<ul style="list-style-type: none"> <li>•Strategy for risk characteristics of equity investments</li> <li>•Appropriate valuation methodologies</li> <li>•Establish exit strategies in respect of equity investment activities</li> </ul>
Market Risk	<ul style="list-style-type: none"> <li>•Appropriate framework for market risk management in respect of all assets held</li> </ul>
Liquidity Risk	<ul style="list-style-type: none"> <li>•Appropriate liquidity management framework</li> <li>•Able to assume that liquidity risk commensurate with their ability to have sufficient recourse to Shariah-compliant funds to mitigate such risks</li> </ul>
Rate of Return Risk	<ul style="list-style-type: none"> <li>•Comprehensive risk management and reporting process to assess the potential impacts of market factors affecting rates of returns on assets in comparison with the expected returns for IAH</li> </ul>
Operational Risk	<ul style="list-style-type: none"> <li>•Adequate system and controls to ensure Shariah compliance</li> <li>•Appropriate mechanism to safeguard the interest of all fund providers.</li> </ul>

# Ethics

- Tenet bound:

- **Fundamental tenets are derived from Shariah**

- Absence of interest-based transactions

- Avoidance of economic activity involving speculation

- Prohibition on production of goods and services which contradict the values of Islam

- Principles based:

- **Concept is grounded in ethics and values**

- Principles akin to ethical investing

- Emphasis on risk-sharing and partnership contracts

- Credit and debt products are not encouraged

# Cont...

- Real economy linked:

- **Islamic finance offers an alternative financing paradigm**

- Asset-backed transactions with investments in real, durable assets
- Stability from linking financial services to the productive, real economy
- Restrains consumer indebtedness as credit is linked to real assets

- Society Service

- **Islamic banking is community banking**

- Serving communities, not markets
- Open to all-faith clients
- Instruments of poverty-reduction are inherent part of Islamic finance (zakat & qard hasan)