

ISLAMIC DEVELOPMENT BANK  
ISLAMIC RESEARCH AND TRAINING INSTITUTE

**SHARI'AH RULING (HUKM)  
ON CONTEMPORARY BANKING  
TRANSACTIONS WITH INTEREST**

By  
*Hassan Abdullah Al Amin*

*Background paper  
No.7*

( Original in Arabic )

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بِسْمِ اللَّهِ الرَّحْمَنِ الرَّحِيمِ

*In The Name of Allah, the Most Merciful, Most Beneficent*



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## FOREWORD

*Riba* (usury) is an old problem which afflicted many peoples throughout history, of which were the Arabs during pre-Islamic era, and after the advent of Islam. However, from the outset, Islam took a clear and firm stand against *riba*, condemning it strongly and denouncing its practice. This abhorrence of it was unparalleled by any of the other forbidden practices, to the extent that *Allah* Almighty declared war against those dealing in it; as He Says in the Holy Quran: “ O you who believe! Be afraid of *Allah* and renounce what remains due to you from *riba* (from now onward), if you are truly believers. And if you do not do it, then take a notice of war from *Allah* and His Messenger.” It is for this reason that *riba* is absolutely prohibited and considered *haram* by all Muslims. In fact, all other heavenly religions and even non-Muslim intellectuals, have denounced it and asked their followers to steer clear of it.

However, there still remains some controversy over the real nature of *riba* that is forbidden and prohibited according to the texts of *sharia'h*. Does it include the interest paid to banks on loans, despite the fact that some people are of the opinion that this is in the mutual interest of both parties? Or despite the fact that others are of the opinion that this interest is permissible as it makes up for the low purchasing power resulting from deferred loans? Or is bank interest a kind of forward payment (*salam*) and not a loan? Does this also include the prefixed prize money paid on investment bonds – investment certificates – which exceed their fixed value? The argument in favor claims that this is an incentive towards increasing investments, or may be it is a kind of legally approved *modaraba* partnership?

Could it be that what may be regarded as blocking expediencies (Sadd al Zariah), such as *riba* sale, as has been put forward by Ibn-al-Qayyim Al-Jouziyah, is permissible if it entails benefits and avoids harm.

There are some who still put forward all or part of these arguments, despite the plethora of arguments and discussions in the numerous conferences and seminars dealing with these topics, and despite the many studies and books published on the subject.

The present study deals with all these issues and delves into the roots of the question of *riba*. It probes into its origins in *sharia'h*, makes comparisons between the various concepts related to the issue, and then infers its components and traces them back to their origins. Meanwhile, the study discusses all the issues put forward from all aspects, criticizing and analyzing them and refuting the arguments raised and doubts cast by some. It brings clear proof and conclusive evidence which are almost sufficient in dealing with this extremely important subject.

One of the functions of the Islamic Research and Training Institute (IRTI), which is an affiliate of the Islamic Development Bank, is to clarify and probe into the roots of the financial and economic issues from the point of view of Islamic *Shari'ah*. IRTI is therefore proud and pleased to present to the Muslim reader this study made by one of its experts specialized in this field, Dr. Hassan Abdallah Al-Amin. We pray to Allah the Almighty that this blessed work will dispel all doubts about this topic and all Muslims everywhere may benefit from this useful effort.

**Prof. Dr. Abdel Hamid Hassan Al-Ghazali.**  
**Director, IRTI**  
1414H ( 1993 )

## INTRODUCTION

One of the reasons for the selection of the subject of this research is that there are some Muslim intellectuals and researchers in the field of economics and banking who still believe that bank interest, in commercial and other banks, is permissible. They base their argument on the following:

1. This benefits both parties and entails no wrongdoing, and *Allah* hath ordained all that which is beneficial (*maslaha*) to mankind.
2. On the assumption that this is *riba*, then it is excess in barter (*riba al fadl*), which was not forbidden intentionally as Ibn-al-Qayyim says, but was forbidden in order to block the way (to the real *riba* i.e. excess charged on loan). They further claim that this kind of *riba* is permissible in cases of extreme necessity, or to realize benefit and negate wrongdoing. Their argument is based on the following: this is the type of loan *riba* in which the surcharge is conditional, as opposed to (*riba an-nasia*), *riba* by way of deferment, which is prohibited by the Quran.
3. There are also those who find no objection in fixing a certain percentage in advance, as profit, on money channeled to investments in the form of investment bonds or saving funds, as long as both parties are willing. This, they claim, would avoid conflict between the parties and allow each party to know its due right; thereby, there can be no *riba*, nothing forbidden in such transactions<sup>1</sup>. All these claims and arguments are a clear indication that the issue of (bank interest) which is practiced in ordinary commercial banks and other forms of investment mentioned earlier, is still in dire need of a more profound, serious and more comprehensive and detailed study, despite all the books and studies written on the subject which point out

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<sup>1</sup> This argument is discussed in detail in Chapter 1.

clearly to the fact that these types of transactions entail *riba* and are, therefore, forbidden.

Accordingly, the Islamic *Fiqh* Academy of the Organization of Islamic Conference – the highest Islamic authority in this field–has undertaken the task of conducting a study of the subject to reach a conclusive decision that would put an end to all arguments on the subject.

*The Fiqh* Academy has entrusted me, among other experts in this field, to study this subject in a scientific manner that would enable it to issue a decree in the light of these studies, I have accepted the assignment, as has the Head of the Research Division of the Islamic Research and Training Institute of the Islamic Development Bank, as part of the normal collaboration between the institute and the *Fiqh* Academy.

### **Methodology**

I have used the following scientific approach in order to achieve the desired aim:

**First** – Defining the meaning and concept of *riba* in the Arabic language, and its concept with regard to the Arabs and as related to their customs, as well as its connotation when they expressed the word. Then I clarified the meaning of the word *riba* when we add to it “al” as expressed in the Magnificent Quran: "**Allah has permitted selling and forbidden al-Riba**".<sup>2</sup> This was customary among them in certain types of transactions. I have expounded all this and quoted examples thereof in chapter one of the study.

**Second** – I have explained the meaning of the word “*faidah*” and its synonyms which refer to various types of legal gain such as yield and profit, in the Arabic language and as a term in *fiqh*. Then I explained the meaning of bank interest, and drew comparison between it and legally accepted gain in *fiqh*, such as profit, yield, and lawful *faidah*. I also drew a comparison between bank interest and *riba* as a customary concept since pre-Islamic times, and which was forbidden in the Holy Quran. My purpose is to grant bank interest a legal and permissible standing if

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<sup>2</sup> *Surat Al- Baqarah*, V.275

it can be compared to the legal kinds of profit mentioned, or to consider it haram and prohibited if it compares to forbidden *riba*. The conclusion is that bank interest is totally different from the *faidah* referred to in Islamic *fiqh*, as it also differs from the other forms of legal gain, such as pay (wage) and yield. On the other hand, it is absolutely in concord with and is identical to the meaning and concept of pre-Islamic *riba* which is forbidden in the Quran in both forms as practiced by the Arabs, before the advent of Islam.

It has also been proven in the study that loan *riba*, which is conditional upon a surcharge, is a true form of pre-Islamic *riba* mentioned in the Quran, and which was known and practiced by the Arabs in that era. Contemporary bank interest is, however, a true incorporation of this form of *riba*, and is the same as the loan *riba* known in pre-Islamic times, and not related to *riba al-fadl* (commission) in any way. The reason for this is that it is not in tangent with sale *riba* which is forbidden by sunnah, as claimed by those who adhere to the permissibility of bank interest. This is chapter two of the study.

**Third** – I dealt with the claim that bank interest is by way of salam and not a surcharge on loans. I aired their opinion and evidence, then I put forward my criticism, corroborated with proof and evidence. This I made chapter three of the study.

**Fourth** – I clarified forms of bank transactions which entail *riba* interest, as well as other forms which are free of it. This is in chapter four of the study.

*Allah is the All-Knowing.*

*Dr. Hassan Abdullah Al-Amin*



***RIBA***



## MEANING OF *RIBA*

What is the implication of the word *riba* in the language of the Arabs? And what is its implication in their customs and traditions? And what does it mean as a term in *shari'ah*?

### First: The meaning of *riba* in the language

*Riba* in Arabic means excess or increase without specifying something in particular. *Allah* says in the Quran: “ So He took them (away) with a surpassing grip (exceeding);<sup>3</sup> “And you see the earth barren, but when We send down water (rain) on it, it is stirred to life and it swells [*riba*]. And puts forth every lovely kind of growth”<sup>4</sup>. In this sense it means it increases.

### Second: Meaning of *riba* as a term in *shari'ah*

As a modern term in *fiqh* it is divided into loan *riba* and sale *riba*. The former was known by the Arabs in pre-Islamic ages, while the latter is that clarified by the sunnah. This modern version is clearer than the former division into (*riba* al-nasia) or *riba* by way of deferment, and (*riba* al-fadl) or *riba* involved in barter (through unequal amounts). This is explained in more detail as follows:

#### First type- Pre- Islamic *riba*

This was forbidden by the Quran in a number of verses, such as : “O you who believe eat not *riba* doubled (and) redoubled, ”<sup>5</sup> and again: “Those who eat (up) *riba* shall not rise up (on the day of Resurrection) except as he rises up whom Satan ever smites him with the touch;

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<sup>3</sup> *Surat Al- Haqah*, V.10 E

<sup>4</sup> *Surat Al-Haj*, V. 5

<sup>5</sup> *Surat Al- Imran*, V.130

that is because they say: “surely selling is (just) like *riba*”, and Allah has permitted selling and forbidden *riba*.”<sup>6</sup>

This type of *riba* referred to in those verses is the loan *riba* known and practiced by the Arabs in two forms.

### **First form**

A surcharge on the amount due if the borrower is unable to pay when it is due and asks that it be deferred to a later date.

### **Second form**

A surcharge imposed on the loan from the outset.

These are the two forms of *riba* known during pre-Islamic times, and mentioned in many verses of the Quran and by many interpreters of the meaning of the Quran, although certain scholars and interpreters restricted themselves to the first form because of its renown during those times.

The second form is no less known than the first, because of its renown among the Jews throughout history. It is a fact that there were Jews living in *Yathrib* (Madinah) prior to the advent of Islam and during its early days before they were vacated therefrom. It, therefore, stands to reason that their practice of this form of *riba* was familiar at least to their Arab neighbors, who might have practiced it with the Jews or among themselves after they had learnt it from them.

It is, therefore, certain that the Quran was referring to a matter that was familiar to the Arabs living during that period.

### **Arguments put forward by the interpreters and scholars**

Following are some of the arguments of the interpreters regarding those two forms of forbidden pre-Islamic *riba*:

#### **The first form**

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<sup>6</sup> *Surat Al- Baqarah*, V. 275.

Ibn Jareer Al-Tabary said: (Qatada said that pre-Islamic *riba* was when a man sold (a commodity) on the understanding that he would be paid at a fixed later date; and if on the due date the buyer is unable to pay, then the seller defers and increases the amount due. Zayd Ibn-Aslam said: Pre-Islamic *riba* was based on doubling the amount due in a loan or raising the age in case what was owed was a camel. A person would have a loan outstanding, then when it became due the lender would tell the borrower: pay or pay in excess because of delay, if he has something to meet the debt, he would do so, otherwise he defers the payment due to the second year, and if it is a one year old he would turn it into a two-year old, then a four-year old, then a six year old (camel, sheep or goat). If the loan was in commodity – gold or silver – and was not paid at the due date, he would make it double, to be paid next year, which would be doubled again if not paid, every time doubling the amount due with the passage of each year. Thus hundred would become two hundred next year and four hundred the year after, and so on.

He added: Attaa said: (The tribe of Thaqaf was wont to lend the tribe of Bani-al-Moghira in pre-Islamic times. On the due date they would say: We shall pay you more if you postpone the payment. It was in reference to this matter that the following Quranic verse was revealed: “Eat not *riba* doubled and redoubled.”<sup>7</sup> Almost all interpreters who came after Ibn-Ishaq explained this form of pre-Islamic *riba* in the same way.

### **The second form**

The second type of pre-Islamic *riba* i.e., loan *riba* is mentioned by a number of interpreters when dealing with the verses referring to *riba*. In this context I quote my book entitled “Bank deposits and their investment according to Islam” pp. 261. [In his book *Ahkam Al-Quran*, Abu Bakr Al-Jassas in his interpretation of the Quranic verse which says: “Those who eat (up) *riba* shall not rise up (on the day of Resurrection) except as he rises up whom Satan ever smites with the touch. That is because they say: “Surely selling is just like *riba*,” and Allah has permitted selling and forbidden *riba*,” he says: The *riba* known and practiced by the Arabs was a money loan (dirhams and dinars) for a fixed period of time with a surcharge agreed upon by

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<sup>7</sup> Ibid.

both parties. That is the reason for the verse which says: “And whatever you bring in usury, that it may augment upon (other) persons; wealth, then it does not augment in the Providence of Allah.” He explains that this increase was in property, because it cannot be compensated for in the loan. Then he says: (Their *riba* transactions were restricted to the form mentioned, lending (dirhams or dinars) for a fixed date, but was conditional upon a surcharge<sup>8</sup>. In his interpretation, Al-Fakhr Al-Razy says: [What was known at the time was *riba an-nasia*. They would loan the money on the understanding that they would get a monthly sum while the capital (principal) remained the same. When payment of the capital was due and the debtor was unable to pay, they would increase the capital sum and extend the date for its payment].<sup>9</sup>

Ibn Hajjar Al-Haythamy said almost exactly the same thing but added: This is called *nasia* (on credit). You lend an amount of money to someone for a certain period of time and he pays an amount thereof but the principal remains intact. If he is unable to pay on due date, he delays payment in return for a sum of money. He said that it is called credit *riba* even though it could be characterized as *riba al fadl* (excess in exchange), because it is *nasia* that is intended. This form is quite common among the people at present.<sup>10</sup>

#### **Opinions of jurists (*faqih*)**

Many jurists regard the loan which is conditional upon a surcharge from the outset as another form of pre-Islamic *riba* forbidden in the Quran. Al-Kamal Ibn-al-Hammam says: [All that which is in excess is considered *riba*, for Allah the Almighty says: “Do not eat *riba*,” which is the amount in excess of the sum lent or the credit advanced. This applies to the same surcharge, as made clear in the verse which says: “... and Allah has permitted selling and forbidden *riba*.” This means that He forbade any excess on the loan or the credit given].<sup>11</sup>

This is a clear indication that the surcharge on the loan when it is being contracted is the pre-Islamic *riba* forbidden by the Quran.

Ibn Rushd, the grandson, divided *riba* into loan *riba* and sales *riba*. In this context he says: [Ulema have agreed that *riba* is present in two transactions:

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<sup>8</sup> *Ahkam al- Quran* Vol. 1 p. 465.

<sup>9</sup> *Mafateeh Al Geib*.

<sup>10</sup> *Al-Zawajer An Iktiraf Al- Kabair* Vol. 2 p. 226 printed by Mustafa Al- Hilmy.

<sup>11</sup> *Fath Al- Qadir Alal Hidayah* Vol. 5 p. 274, Al- Amiriyah.

in sales, and in acknowledged debts concerning sales or loans (advance) or others].<sup>12</sup> This is a precise distinction which a number of present-day ulema have adopted. Loan *riba* applies to the two forms of pre-Islamic *riba* forbidden in the Quran – which come under *riba an-nasia*. This is the surcharge made in return for payment on credit. This applies both to loans made conditional upon the surcharge from the outset, and on a sale with deferred again to a later date because the debtor was unable to pay when it was due. Accordingly loan *riba* is restricted to (*nasia*) alone and does not apply to (*riba al-fadl*).

On the other hand, sales *riba* includes both *riba al-fadl* and *riba an-nasia*. An example of *riba an-nasia* alone is the *riba* sale of a commodity for one of the same kind, to be paid at a later date, such as the sale of an ounce of gold for an ounce of gold and deferment of the payment of one of them. On the other hand, *riba al-fadl* alone refers to the *riba* sale of a commodity in exchange for the same commodity with a surcharge of the same kind. Those two types of *riba* were sometimes combined together at one and the same time, such as the *riba* sale of a commodity for one of the same kind to be paid at a later date with a surcharge upon payment. For example the sale of an ounce of gold for an ounce and a quarter to be paid in a month's time.

Again Ibn Rushd says: The *riba* specified in the debt is made up of two types: one type is uncontestably the forbidden pre- Islamic *riba*. In this type they would loan money with a surcharge for deferred payment. The borrower would say: defer payment and I will pay you more. This is the type alluded to by Prophet Mohammad (PBUH) when he said in the Farewell Haj speech: “Pre-Islamic *riba* is annulled, and the first such *riba* I annul is the one owed to Al-Abbas ibn Abdel Mottelib.”<sup>13</sup> Accordingly, Ibn Rushd considers borrowing with a surcharge as the type of pre- Islamic *riba* forbidden in the Quran – which is a loan with a surcharge, and which he describes as being uncontestably the type referred to.

Ibn Qudamah says: [Every loan conditional upon a surcharge is uncontestably *haram*. Ibn Al-Mundhir said: The consensus is that if the lender places a condition of a surcharge or a gift, then this excess is considered *riba*].<sup>14</sup>

### **Loan *riba* is not *riba al-fadl***

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<sup>12</sup> *Bidayat Al- Mujtahid* Vol. 2 p.128. Dar el- Maaref.

<sup>13</sup> I bid.

<sup>14</sup> *Al- Mughny* by Ibn Qudamah Vol. 4 p. 360.

Thus it is clear from the opinions of the interpreters and *faqihs* which we have mentioned that the loan which is conditional upon a surcharge when being concluded is one of the two forms of pre-Islamic *riba* forbidden by the Quran. This was the type known by the Arabs and understood by them when the word “*riba*” was mentioned. This was the type, debt *riba*, known by the *faqihs* as *riba an-nasia* (and not *riba al-fadl*) which was forbidden by the sunnah, and which is applicable only in sales and is in no way connected to debt *riba*.

As I have already mentioned, some contemporary *ulema* have tried to categorize the loan *riba* which is conditional upon a surcharge from the outset, into *riba al-fadl*. Their purpose is to make it permissible for reasons of extreme necessity. They base their argument on the fact that *riba al-fadl* is a way of blocking expediencies, as mentioned by Ibn Al-Qayyim, and that as such it is permissible provided there is a pressing need for it.<sup>15</sup>

This opinion is not correct because of what has already been said about regarding the loan *riba*, conditional upon a surcharge, as a kind of debt *riba* which is one of the two types of *riba* customary in pre-Islamic times and prohibited in the Quran. It is not a form of sales *riba* – which encompasses *riba al-fadl*. The reason for this is that a surcharge plus deferred payment of the loan is not merely *fadl*, but it is also a compensation for the delay in payment. *Fadl* only applies when there is no set date for payment. This type, therefore, combines both *riba an-nisa* for the delayed payment, and *riba al-fadl*.

These various texts revealing what people did in pre-Islamic times concerning loan *riba*, show clearly that the surcharge was conditional from the outset – or what is known today in the world of banking as interest.

How then can it be said that the surcharge added to the sum of money after it is due and then payment is deferred is *riba*, regardless whether the principal of the debt is a loan or the price of a commodity, whereas the surcharge imposed on the debtor upon contracting a loan is not haram and not *riba*? [We are, hereby, confronted with two alternatives: either we acknowledge

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<sup>15</sup> *Riba* and transactions in Islam – Sheikh Rashid Rida p.15 and his fatwas Vol. 2 p 607-608; Sheikh Abdel Wahab Khallaf (Liwa Al- Islam magazine) Vol.11, 4<sup>th</sup> Yr; Prof. Abdel Karim Al- Khatib [Islamic Banks magazine] published by the International Association of Islamic Banks: Prof. Maarouf Al-Dawalibi in his research submitted to 2<sup>nd</sup> session of the Islamic *Fiqh* Academy, Jeddah 10-17 Rabi Akhar 1409H. pp. 1-8.

both surcharges as being haram: the first type which imposes a surcharge on the consumer from the onset of the loan, and the second type which places a surcharge on the money after payment is due and then deferred. In this way the ruling of *shari'ah* becomes compatible. The other alternative is that the ruling of *shari'ah* is contradictory – Allah forbid – and which is impossible...].<sup>16</sup> Therefore, there is no other possibility but to equate both surcharges and to regard the Quranic text and judgement as applicable to both.

On the other hand, as we are all agreed that what was the pre- Islamic loan was interest free and that some pre-Islamic loans were made with a conditional surcharge from the outset and that this surcharge is similar to the successive surcharge which occurs after payment is due and the debt is deferred for another period of time, then there is no alternative but to pass the same judgment upon both. The only exception could be the presence of evidence regarding any one form. As no such evidence is available to us, then any form of distinction between them would be arbitrary. Likewise, the opinion which says that there is no objection to specifying the so-called profits in advance, is incorrect. This opinion made those profits allowable on the pretext that both parties to the transaction agree to them, and that there is no text prohibiting them in either the Quran or the sunnah.<sup>17</sup> This opinion is incorrect because of the following:

**First:** This type of transaction is not trade and, therefore, the returns ensuing from it cannot be termed as profits, because according to the faqihs “profits” are the outcome of a commercial transaction. In fact, it is a monetary loan with interest, which is in excess and which is, therefore, *riba*. Facts do not change when certain people term this as “profit” because the essence, according to fiqh rule, is in the meaning and not the term.

**Second:** Presuming that this is a commercial transaction with a fixed profit guaranteed in advance then this contradicts a *shari'ah* ruling stated clearly in a *shari'ah* text. Amr ibn-Shoaib narrated from his father and his grandfather, as verified by Abu Daoud, At-Tirmidhy and Ibn Majah, who said: The Prophet (PBUH) said: “Debt and sale simultaneously cannot be *halal*, nor two conditions in the same sale, nor profit without a guarantee.” Ash-Sawkany explained the words of the Prophet (PBUH)

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<sup>16</sup> *Riba* nature of bank interest by Sheikh Othman Safi, - Al- Maktab Al- Islami 28- Beirut.

<sup>17</sup> October magazine Vol. 687, Cairo, Sunday December 24, 1989.

“nor profit without guarantee” as meaning that a person should not receive profits for a sale which he does not guaranty. A case in point is when a person buys a commodity and then sells it to another before settling its payment with the original seller, this is invalid and its profits are not permissible. The reason is that the true sale is linked to the guaranty provided by the one who bought from him, because payment has not been settled.<sup>18</sup>

In his explanation of this sentence in the *hadith*, the author of Tuhfat Al-Ahwazy said in his explanation of Sahih Al-Tirmidhy: [What is meant is the profit accruing from the sale of the commodity which he bought before paying its price, whereby the guaranty would be transferred from the original seller to him, which renders the sale incorrect in (the book) *Sharh al sunnah* it is said. This means that any profit cannot be considered *halal* unless the seller assumes responsibility for loss if any. If he does not assume responsibility for the loss, as in the case of the sale of a commodity which is damaged before its price is paid, then in case of damage, the guarantee is the responsibility of the seller. The buyer, therefore, cannot recover the benefits from which the seller benefited before paying the price, because the commodity sold was not guaranteed by the seller who never possessed it. Accordingly, the profit accruing from the sale of the commodity before paying the price is not *halal*].<sup>19</sup>

In view of this clear refutation in the text, how can we say that it is permissible to specify the profits and guarantee the principal in advance in the investment bonds and certificates, savings funds? Hopefully, those who put forward this argument will retract it in the light of the text we have quoted, which is clear-cut in this regard.

## **Second form – Sales *riba***

### **Prelude**

We have already mentioned the modern division of *riba* into debt *riba* and sales *riba*. We said that this is by far simpler and clearer than the old categorization into *riba an-nasia* and *riba al-fadl*, which caused a lot of confusion and ambiguity.

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<sup>18</sup> *Nayl Al- Awtar* by Ash- Shawkany Vol. 5 p. 282, Dar Al-Jeel, Beirut.

<sup>19</sup> P. 431 Vol. 4, Dar Al- Fikr.

We have also dealt with debt *riba*, saying that it was the type known in pre- Islamic times and which was later forbidden in the Quran. This included loan *riba* conditional upon a surcharge from the outset.

We shall now move on to sales *riba*, which we shall deal with in brief to compare it to debt *riba*. However, we are not in great need for it as regards (the position and legality of interest in bank dealings) which is the subject matter of our study, because this comes within the scope of debt *riba*, as we shall see later, *Allah* willing.

We say that sales *riba* is the one prohibited by the sunnah as narrated by Obada Ibn – Al Samet who quoted the Prophet PBUH as saying : “Gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates, salt for salt, like for like, same for same, hand to hand, and if those types differ then sell as you will, if it is hand to hand.”<sup>20</sup> This was narrated by Ahmad and Muslim and all other narrators of the sunnah, with the exception of Al-Tirmidhy. In the narration of Abu – Said Al- Khodry – May *Allah* be Pleased with him –, he quoted the Prophet (PBUH) as saying: “Do not sell gold for gold but that it be like for like, and do not allow one to encroach upon the other, and do not sell silver for silver but that it be like for like, and do not allow one to encroach upon the other; and do not sell something in which a part is missing for something that is complete.” Narrated by all the six Sihah.<sup>21</sup>

These two corroborated *hadiths* as well as others in this chapter have forbidden a certain type of sale which it termed *riba*. It is called *riba al-fadl* as being better than *riba an-nasia*, whereas in fact it combines both in certain forms as we have seen earlier.

This type of sale was not known by the pre- Islamic Arabs as *riba* either linguistically or as a custom, even though they practiced it.<sup>22</sup> However, it became *riba* when it was described as such in the sunnah and the *hadiths* we have mentioned. It is all connected to the types of sale *riba*, whether sale of gold and silver as well as *riba* forms as described in corroborated *sunnah*, and the analogies drawn upon it regarding other dealings as stated by those *foqaha* who supported this opinion. This type of *riba* is unanimously forbidden, same as the debt *riba* prohibited by the Holy Quran. The only exception is in the opinion of Ibn Abbas, may Allah be Pleased with them, who exempted *riba al-*

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<sup>20</sup> *Nayl Al- Awtar* by Ash- Shukany Vol. 5 p. 300.

<sup>21</sup> *Ibid* p. 297.

<sup>22</sup> Abu Bakr Al- Jassas- *Ahkam Al- Quran* Vol. 1 p. 464, and Mohammad Abu Zahra- *Studies in Riba* p. 33.

*fadl* on the basis of the narration of Osama ben Zayd who said: “*riba* only applies to *an-nasia* (i.e. deferment of payment).” It is said that Ibn Abbass retracted this exemption of *riba al-fadl*.<sup>23</sup>

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<sup>23</sup> *Takmilat al Majmou, Sharh Al- Muhathab* by Al- Subky Vol. 1 p.31-34.

***BANK INTEREST***



# BANK INTEREST

## The Meaning of Bank Interest

We previously mentioned that we had to explain fully the concept of the word “*riba*” and the word *faidah* (interest) in order to reach a sound legal verdict regarding bank dealings in interest. This would allow us to draw a status comparison between them to see whether they were completely, or partially, compatible or not at all. If they are completely compatible then bank interest would be regarded in the same light as the “*riba*” which we have explained at length. Otherwise, it would be considered in another light.

We have already explained in full the meaning of the word “*riba*”. We shall now move on to the word *faidah* (interest), and explain its meaning linguistically, and as a term in *fiqh* and as a term in banking. To make matters even clearer we shall explain the meanings of synonyms of the word “interest”, which denote legitimate earnings, such as “yield” and “profit” to see if “interest” is similar to one of these words.

## The meaning of the word *faidah* (interest) in the Arabic language

Taj Al-‘Arous defined interest (*faidah*) as meaning the benefits which **Allah** Almighty has bestowed upon His worshippers.<sup>24</sup> On the other hand, in *Tarteeb Al- Qamous*, he defined it as being what a person has benefited by way of knowledge or money, its plural form is interests.<sup>25</sup> This is a general meaning comprising money etc., regardless of whether the money is legally earned or not.

## Faidah (Interest) as a term in *shari’ah*

As a term in *fiqh* it means the outcome produced by or accrued not from money, such as an inheritance or gift, or non-increasing wealth such as money accruing from the sale of property for more than its original price, or the sale of wool, milk or dates if they were originally bought with the intent of ownership.

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<sup>24</sup> *Taj Al-‘Arous Min Zawaher Al- Qamous* Vol. 8 p. 517.

<sup>25</sup> *Tarteeb Al- Qamous Al- Muheet* Vol. 3 p. 478.

All this outcome is termed “*faidah*”.<sup>26</sup> It is therefore, clear that as a term in *fiqh* its meaning is more specific than its linguistic meaning.

On the other hand, its definition as a term in banking is as follows: interest is the price paid for the use of money. Although it is far from its meaning in *fiqh*, it can be included in the general linguistic meaning of the word *faidah*.

### **Difference between interest and profit**

**Meaning of Profit:** Another aspect of legitimate earnings is profit, which the *faqih*s define as follows:

That which is in excess of the original price in any commercial exchange, whether in silver or gold].<sup>27</sup> This means that the term “profit” refers to that which is in excess of the price of the commodity bought with the original intention of reselling it as a commercial transaction. However, if the commodity is not bought with the intention of reselling it as a commercial transaction, then the excess over the original price is not called profit, but would be termed as “interest”, as we have seen, or as “yield”, as we shall see. The definition of “profit” by Ibn Qudama Al-Hanbaly is similar to Maliki definition. In his commentary on the *zakat* due on the forms of incremental trade, Ibn Qudama says that *zakat* is not due except on assets that grow and that the increment in trade occurs when there is a turnover.<sup>28</sup> This increment, which is the result of the turnover of buying and selling in trade, is doubtless “profit.” Thus we see that both Ibn Qudama and the Maliki faqih term it as “profit” that which is the outcome of a commercial exchange, in which the money is turned over into commercial offers, which are resold at a price exceeding their original price.

### **Difference between interest and yield (*ghalla*)**

Yield in *fiqh* is that which is the outcome of trade prior to the sale of the capital asset. This includes wool, milk, palm dates bought for trade. It also

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<sup>26</sup> *Jawaher Al-Iklil- Shark Al- Risala* by Sheikh Saleh Al Aby father. Vol. 1 p. 128, printed by Issa Halaby; footnotes by Al- Desouky of Al- Sharh Al- Kabir Vol. 1 p. 431. Also see Hudud by Ibn Arafa and explanations of Al-Rassal al Tunisi p. 72/73, first edit, by Tunisian Press in Nahj Souk- el- Balat 1350H.

<sup>27</sup> *Sharh by Al- Khorashy* on Khalil, Vol. 2, p. 183.

<sup>28</sup> *Al- Mughny*, Vol. 3, p. 43.

applies to the excess realized from the sale of the capital asset itself, if a person buys it for say twenty when it is young and resells it for fifty when it is full grown.<sup>29</sup> This excess or increase is not termed as “profit” but is termed “yield.”

### **Variation in the common meaning of bank interest**

From the preceding explanations of the meaning of some of the forms of legitimate earnings, we can see that the meaning of bank interest is different from its meaning in *fiqh* terminology, as it also varies from the other forms of legitimate earnings. As we have already stated, interest is (the price paid for the use of money), that is the price paid for borrowing it for a surcharge in return for using it for a fixed period of time. Thus it does not correspond to the meaning of legal profit, nor to the meaning of legitimate yield as a term in *shari'ah*.

### **Conformity of the concept of *riba* to bank interest**

If the concept of bank interest which is practiced today is not applicable to the concept of *faidah*, or yield, or profit in *fiqh* terminology; is it then compatible with the concept of *riba*, which we have mentioned? Should we apply to it the same *shari'ah* rulings as those meted out to *riba*, or should it be treated differently?

We have said earlier that bank interest is defined as the price paid for the use of money, which is the surcharge paid for loaning the money for a certain period of time. This is also the surcharge conditional in a loan from the outset, which we have shown to be one of the two forms of debt *riba* known in pre-Islamic times and forbidden in numerous verses in the Quran.

This becomes clearer when we know that the sums used by the banks to give credits to traders and businessmen, and for which it takes previously agreed upon sums of money in excess of the original sum, and which are called “interest”, come mostly from savings and term deposits.

These savings and term deposits are regarded as loans in the legal statutes, *fiqh* and *shari'ah* interpretations by most contemporary *faqihs*. Moreover, banks themselves pay to the owners of these accounts who deposit them, sums in excess of the original sum placed with them.

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<sup>29</sup> Al- Khorashy, *Jawaher Al- Iklil*, and footnotes of Al- Desouky on Khalil.

Accordingly, interest is the increment paid by virtue of a pre- condition in a loan deferred for the benefit of the depositor, in the cases of term deposits and savings accounts. The proof of this is that this interest does not apply to current accounts, in which the money is on demand, although they are also regarded as loans by the law. In the event that interest is paid for current accounts, then it customarily becomes conditional, and is, therefore, regarded as a pre-fixed condition, in *fiqh*. Moreover, this interest is a conditional increment in a deferred loan which benefits the bank when it grants credits to other borrowers.

Either way it is a conditional increment in a deferred loan, and is, therefore, completely concomitant with the form known in Islamic *shari'ah* as the increment in a loan from the outset. It is, therefore, one of the two forms of pre- Islamic *riba* definitely forbidden by the Quran. As a matter of fact, it is the most outstanding form, which was exaggeratedly confirmed by Abu Bakr Al-Jassass, who said that pre- Islamic Arabs only dealt in *riba* in this form of lending dirhams and dinars for a period of time on condition of a surcharge.<sup>30</sup>

The interest paid as a price for the use of money was also regarded as usury (*riba*) by the western world as well. However, commercial and industrial evolution, and the need for credit to keep pace with this evolution made them renounce their aversion to accept interest, and to confine the term usury (*Riba*) to that which exceeds the limits placed by the law or general custom.<sup>31</sup>

There are today some prominent western economists who still call bank interest, regardless of how low it may be usury, Dr. Eissa Abdou quoted Lord Keynes, one of the pillars of western economy, as saying that when capital is available in plenty for placement in the form of private savings, the interest rate naturally drops to zero. Then there is no means for the idle investor to live at the expense of society from what he extracts from the usurious surplus in the form of interest, or excessive profit.<sup>32</sup>

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<sup>30</sup> *Ahkam Al- Quran*, vol. 1, p. 465.

<sup>31</sup> Developing of bank operations by Dr. Sami Hassan Hamoud, p. 294.

<sup>32</sup> Position of *riba* in the Islamic economic structure, p.185/186.

### **Clarity of issue**

From the preceding, it has thus become extremely clear that bank interest is a form of debt *riba* resulting from loans contracted with a conditional increment from the outset, and agreed upon by both parties from the start. As such, it is definitely forbidden as a form of pre- Islamic *riba*, condemned and forbidden by the Quran, which warned that *Allah* and His Messenger would wage war against those who practiced it, and this is the most serious warning.



***BANK INTEREST AND  
SALAM (FORWARD BUYING)***



## **BANK INTEREST AND SALAM (FORWARD BUYING)**

Some scholars and researchers claim that bank interest is by way of *salam* and not an increment on the loan. They base their claim on the following:

1. Money received by banks from depositors or paid to creditors on credit, is not really a loan because payment is deferred, and deferment is not permissible in a loan according to the Shafites, as Dr. Safiy Eddine says.
2. This money is by way of a *salam* contract, because *salam* allows deferment of payment according to the Shafites.
3. That *riba* in *salam* only applies to specified usurious assets (gold, silver, wheat, barely, etc...) and as paper money is not an usurious asset, such as coin money, according to the Shafites, then bank interest cannot be considered as sales *riba*, and is, therefore, *halal*.<sup>33</sup>

### **Refutation of the claim that bank interest is by way of *salam***

This claim, as presented, is not correct for the following reasons:

**First:** The issue of credit in loans, which is the subject of controversy among *faqihs* (jurisprudents), and on which this scholar has based his opinion of regarding the money dealings by banks with their clients – whether giving or taking – as *salam* is as follows: Is payment of a loan on a fixed date binding or not? In other words, is the borrower bound to repay the loan whenever it is requested by the lender, even if it should be repaid at a pre-determined date and this date is not yet due? All *faqihs*, including the Shafites with the exception of Malikis, agreed that the borrower is bound to repay the loan as soon as it is requested, regardless of the date fixed for its repayment, because the loan is a kind of benevolent and charitable act. “There is no way against the fair doers.” The Malikis disagreed, saying that time is of the essence, and

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<sup>33</sup> Ahmad Safiy Eddine in an article published in the Sudanese Al- Sahafa newspaper, 4/9/1979.

the lender should not return the loan except on the pre-determined date. Their argument is that non-adherence to the date fixed could be harmful to the borrower, which is in contradiction with the purpose of the loan, which is to help the borrower and be charitable towards him and not otherwise.

Whether the Malikis or the others are correct, they are all agreed that whether a loan should be conditional upon repayment on a pre-determined date or not, this does not affect the soundness of the loan, or cause it to be transformed into another contract, such as a *salam* contract, as the scholar suggests.

**Second:** The claim that deferred payment of loans is not permissible according to Shafites is not correct as well. The issue of deferred payment on a pre-determined date, in the views of Shafites and others, is whether it is binding or not, as we have mentioned, and not whether it should be put as a condition or not. There is a great difference between a binding condition and an allowable one. Accordingly, a loan on credit and its ensuing effects remains sound, according to all faqihs, and is not transformed into a *salam* contract, whether it should be paid on a pre-determined date or not.

***Salam* does not apply if the two items exchanged  
(*Al Badalan*) are *naqdayn* (gold and silver)**

On the other hand, *salam* does not apply if the capital of the *salam* (forward buying) as well as the goods consigned, are both cash money, even if the cash is coin money, unless the amount and the category are one and the same, and it should be denoted clearly as a “loan” on credit. This would then constitute a loan, but would never be considered as *salam*. Al-Sawy said in his footnotes on Al- Sharh Al Saghir: (He said: Unless it is a matter of the exchange of two kinds of food or gold and silver, then it is not permissible for you to tell another: I have taken from you on consignment (*salam*) a measure of wheat for a measure of wheat, nor a dinar for an amount of gold or silver unless the category and the amount are specified, and they should be termed as a loan or advance – in which case it would be allowable. Know then that the new money here is considered as property (*ayn*) and it is not allowable to take part of it on consignment or *salam*).<sup>34</sup>

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<sup>34</sup> Vol. 3 p. 366, Dar Al- Ma’aref Press, Egypt.

In the answer of Al-Mukhtar came the following: (Dirhams and dinars cannot be given on consignment because they are both used for pricing the value of goods). Ibn Abdin commented saying that if the capital is dirhams or dinars as well, then it is agreed that the deal is invalid.<sup>35</sup>

Thus we see that the allegation that money exchange between banks and clients comes under the heading of *salam* deals and is not loans, and thereby its interest is halal, because *riba* does not apply to *salam* if the money used (paper money and coins) is not one of the six usurious assets listed. I say this allegation is absolutely unsustainable because it is incorrect as we have shown.

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<sup>35</sup> Footnotes by Ibn Abdin Vol. 5 p. 209/210. See also my book (Bank interest and *Riba*) p. 28/32 published by the International Association for Islamic Banks.



***TYPES OF BANKING  
TRANSACTIONS***



## TYPES OF BANKING TRANSACTIONS

We have already dealt in detail with the meaning of *riba* and of bank interest. We have come to the conclusion that they are one and the same, with no difference between them. What then are the types of bank operations which involve interest, and what are the types of bank operations which do not involve interest?

The answer is that the basic function of banks is made up of two types of transactions which are as follows.

### First Type – Services

These comprise the services offered by the bank to its clients and others in return for certain charges. They include the following:

1. Acceptance of current account deposits, which are placed in safe keeping for their owners to be given to them upon request. Sometimes the bank charges the depositor for this service, especially if the deposited amount is small. However, if the amount is large then the bank does not usually charge the depositor, because it benefits from those amounts which provide it with the liquidity required for its various activities. It is a well-known fact that current deposits make up the bulk of bank's resources.
2. Safe-keeping of securities, bonds etc.
3. Sale of securities, bonds, etc.
4. Issuing letters of credit which are covered. However we have to be very careful concerning uncovered letters of credit, and bank operations in the field of safe-keeping and sale of securities and bonds, and collecting bills. We have to be certain that the activities in question are in conformity with Islamic *shari'ah*, whereby the bank dealings would not be considered in any way *haram*.
5. Credit vouchers in which the bank does not grant any cash sums of money.

6. The bank also deals in currency exchange, that is buying and selling various currencies.
7. These are the most outstanding operations of banks carried out by way of services. The charges paid in return for these services represent an allowable wage, because it is not interest.

### **Second Type – Loans and Credits**

Most such bank operations involve interest and are called credit awards. We say “most” operations because there are some loans and credits which are interest free. Here are some of the most common operations:

1. Interest paid by banks for the money deposited with them, especially for those accounts, which are fixed by a period of time, whatever the period, whether it is a month, several months or a year. We have already defined interest so we shall not deal with it again.
2. Interest paid for a direct loan. This is clear and simple because it concerns limited dealings between the bank and its clients.
3. Bank credits, which are defined by Dr. Mohammed Shafik as follows: (A contract between a bank and a client, in which the bank commits itself to place a sum of money at the disposal of the client for a certain period of time).<sup>36</sup> By the virtue of this contract the client can draw from it at will, all at once or in installments during the specified period of time. Moreover, this amount is not subject to interest except as regards the sum actually withdrawn and starting from the date of withdrawal. For these reasons, it is the most appropriate means for commercial operations, contrary to the direct loan, for which interest is due as soon as it is contracted, even if the client does not benefit from it at the time.

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<sup>36</sup> *Al Wasseet* in the Egyptian Commercial Law, Vol. 2, p. 390, Dar Nashr al-Thaqafa Press.

4. Deducting commercial papers – bills of exchange – and negotiable promissory notes. Deduction is defined as: [An agreement according to which the deducting bank speeds up the value of a commercial paper or a negotiable promissory note or any other right for the benefit of the person requesting the deduction, from which is deducted a sum suited to the remaining period of time, until the value of the paper or note or right is due. In return, the person requesting the deduction gives this right to the bank in ownership, and guarantees payment on the date due.<sup>37</sup> The interest due on deducting commercial papers is regarded in the context that the deduction, according to its legal qualification, is by way of a loan with interest. It is not considered as a transfer of rights, because of the inequality between the debt transferred and the debt against which it is transferred – which is the prerequisite condition for a rightful transfer.

Likewise, it is not the sale of a fixed debt in return for the deducted papers, because the sale of a debt to other than the debtor, according to the *faqih*s who allow it, requires an exchange on the spot which does not involve disparity between the two amounts.

These are the clearest types of contemporary bank operations which involve interest, which is the forbidden *riba* as we have seen clearly in the preceding pages. There are still some other minor weaknesses in bank operations which do not need in- depth studies as they are well-known.

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<sup>37</sup> Dr. Aly Gamal Eddine Awad “The practical aspect of bank operations” p. 469, and Baqer Al- Sadr “The *Riba*- free Bank” p. 155.



# ***ANNEX***



## ANNEX

### Decree Issued By The Islamic *Fiqh* Academy

In the name of Allah, The All-Merciful, The Ever-Merciful.

Praise be to Allah, the Lord of the worlds, and peace be upon

Prophet Muhammad, the last messenger, his family and companions.

### Decree No. 3

#### The Legal Status of Interest in Bank Operations And Of Islamic Banks Transactions.

The Council of the Islamic *Fiqh* Academy, an affiliate of the Organization of Islamic Conference, in its second session held in Jeddah, 10-16 Rabi Thani 1406H., (22-28 December, 1985;)

After reviewing various studies and papers on contemporary banking operations;

After consideration of what was presented, and subjecting it to intensive discussions which exposed the harmful impact of such operations on the world economic order, and on its stability, especially in Third World countries;

After examination of the destruction brought on by this system as a result of its shunning of the words of Allah's Book which clearly prohibited *Riba*, in part or entirely, and call for repentance by those who practice it, and exhorts (people) to confine themselves to retrieve the principal of loans without any loss or gain, whether large or small, and the threat of a destructive war against usurers by Allah and His Messenger;

**“Decrees” the following:**

**First** – Any increment or interest on debt in return for postponing payment of the loan that is due and which the debtor is unable to pay; as well as the increment (or interest) that is pre-determined on the loan from the outset: both these are forms of *riba* forbidden by shari’ah.

**Second** – The alternative which guarantees liquidity and promotes economic activities according to the dictates of Islam, is dealing in the manner prescribed by the provisions of shari’ah.

**Third** – The Academy has decreed to reiterate its call upon Islamic governments to encourage the banks which operate in accordance with the dictates of Islamic shari’ah, and to make possible their establishment in every Islamic country to cover the needs of the Muslim population, so that the Muslim would not live in a state of contradiction between his reality and his creed.

Allah is the most Knowledgeable.

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## **THE ISLAMIC DEVELOPMENT BANK (IDB)**

### **Establishment of the Bank**

The Islamic Development Bank is an international financial institution established in pursuance of the Declaration of Intent issued by the Conference of Finance Ministers of Muslim countries held in Jeddah in Dhul Qa'da 1393H (December 1973). The Inaugural Meeting of the Board of Governors took place in Rajab 1395H (July 1975) and the Bank formally opened on 15 Shawwal 1395H (20 October 1975).

### **Purpose**

The purpose of the Bank is to foster the economic development and social progress of member countries and Muslim communities individually as well as jointly in accordance with the principles of *Shari'ah*.

### **Functions**

The functions of the Bank are to participate in equity capital and grant loans for productive projects and enterprises besides providing financial assistance to member countries in other forms of economic and social development. The Bank is also required to establish and operate special funds for specific purposes including a fund for assistance to Muslim communities in non-member countries, in addition to setting up trust funds.

The Bank is authorized to accept deposits and to raise funds in any other manner. It is also charged with the responsibility of assisting in the promotion of foreign trade, especially in capital goods among member countries, providing technical assistance to member countries, extending training facilities for personnel engaged in development activities and undertaking research for enabling economic, financial and banking activities in Muslim countries to conform to the *Shari'ah*.

### **Membership**

The present membership of the Bank consists of 53 countries. The basic condition for membership is that the prospective member country should be a member of the Organization of the Islamic Conference (OIC) and be willing to accept such terms and conditions as may be decided upon by the Board of Governors.

### **Capital**

The authorized capital of the Bank is six billion Islamic Dinars,. The value of the Islamic Dinars, which is a unit of account in the Bank, is equivalent to one Special Drawing Right (SDR) of the International Monetary Fund. The subscribed capital of the Bank is now 3654.78 million Islamic Dinars payable in freely convertible currency acceptable to the Bank.

### **Head Office**

The Bank's Headquarters is located in Jeddah, the Kingdom of Saudi Arabia and the Bank is authorized to establish agencies or branch offices elsewhere.

### **Financial Year**

The Bank's financial year is the Islamic lunar Hijra year.

### **Language**

The official language of the Bank is Arabic, but English and French are additionally used as working languages.

## ISLAMIC RESEARCH AND TRAINING INSTITUTE

### Establishment

The Islamic Research and Training Institute was established by the Board of Executive Directors of the Islamic Development Bank (IDB) in 1401H (1981). The Executive Directors thus implemented Resolution No. BG/14-99 which the Board of Governors of IDB adopted at its Third Annual Meeting held on 10 Rabi Thani 1399H (14 March 1979). The Institute became operational in 1403H (1983).

### Purpose

The purpose of the Institute is to undertake research for enabling the economic, financial and banking activities in Muslim countries to conform to *Shari'ah*, and to extend training facilities to personnel engaged in economic development activities in the Bank's member countries.

### Functions

The functions of the Institute are:

- a- To organize and coordinate basic and applied research with a view to developing models and methods for the application of *Shari'ah* in the fields of economics, finance and banking;
- b- To provide for the training and development of professional personnel in Islamic Economics to meet the needs of research and *Shari'ah*- observing agencies;
- c- To train personnel engaged in development activities in the Bank's member countries;
- d- To establish an information center to collect, systematize and disseminate information in fields related to its activities; and
- e- To undertake any other activities which may advance its purpose.

### Organization

The President of the IDB is also the President of the Institute. The IDB's Board of Executive Directors acts as its supreme policy-making body. The Institute is headed by a Director responsible for its overall management and is selected by the IDB President in consultation with the Board of Executive Directors. The Institute consists of three technical divisions (Research, Training, Information) and one division of Administrative and Financial Services.

### Location

The Institution is located in Jeddah, Saudi Arabia.

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