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"O Believers: devour not Riba, doubled and redoubled;
and fear Allah, in the hope that you may get prosperity."

Sura Ale-Imran (verse No. 130)

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Founder Chairman

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Quarterly Journal of Islamic Banking and Finance ISSN 1814-8042

Left us 15 years ago on March 10, 2005

For the Eternal Abode

Your Life – A Most Beautiful Memory, Your Death an Eternal Sorrow.
Your fond memories are still etched in our minds and hearts.
Your humility and steadfastness have always guided us.
Your principles are the reasons of our position today.
Your words of wisdom and paternal guidance would always be a source of inspiration for us, - today and forever.

May your soul rest in peace (Amen)

Please recite Surat-ul-Fatiha for his Soul.

Directors/
Management
JIBF/IAIB,
Karachi.
Editor’s Note

There is rapid penetration of cellular services across the country with 163 million cellular subscribers. There are as many as 73 million 3G/4G subscribers in the country. The fusion of finance with technology termed as ‘Fintech’ in popular discourse is promising to enable financial inclusion more rapidly than banks which have a scarce presentation in rural areas and which still by and large rely on brick and mortar model for expediting financial inclusion. This presents an opportunity for Islamic banks to compete afresh with new ground rules in digital space where they and conventional banks are equally new and inexperienced.

Given the rapid rise of payment facilitation through non-banking apps with more than 40 million mobile wallet accounts in Pakistan, banks are going to face increased commercial displacement risk and disruption to their payment facilitation function. It is interesting to see how and when they join the Fintech revolution by enabling online banking, mobile banking and offering spending incentives to retain customers on their payment gateways.

There are challenges with opportunities. One of the important challenges is in the domain of security and monitoring in allowing payment facilitation through mobile wallet accounts and how to still ensure know your customer (KYC) and anti-money laundering protocols in compliance.

Microfinance outreach in Pakistan is still below the requirement. As many as 50 million people in Pakistan are constrained by multidimensional poverty. The microfinance client base is roughly 6 million people at the moment. It is interesting to see how Fintech can help in increasing outreach, reducing the cost of administration and monitoring the financing side clients. Artificial intelligence can be used in client screening and suggesting the appropriate terms of financing to ensure financial stability and socio-economic mobility.

An important challenge going forward is geographical diversity in outreach. Given the high demand for microcredit in rural areas, it is interesting to see how the services and infrastructure of banks and telecommunication companies can be leveraged in increasing scale and outreach of microfinance in rural areas.

An important enabler in financial inclusion is financial literacy. How important is it that any mobile platform should be user-friendly, multi-lingual and foolproof against security breaches. For Islamic banks, the challenge is dual. People have a hard time
understanding financial terms, let alone Islamic terms which are readily used in Islamic finance products and services. Hence, there is a need for increased care and effort in popularizing Islamic finance and making it mainstream by reaching to the common people in ways convenient and comfortable to them.

Thus, it is hoped that Islamic banks with surplus liquidity will think of embedding technology in their products and services so that they are able to compete on cost with the large conventional banks that have economies of scale. Technology has provided an opportunity for smaller Islamic banks to change the path of their cost curves by achieving efficient delivery and operations and excelling in service quality. With growth in assets and capital, it is also expected and hoped that in future, Islamic banking services would also cater to the bottom of the pyramid population to actualize the vision of Islamic banking to be the banking of the first choice for everyone, including Muslims and non-Muslims and including all segments of population, regardless of their socio-economic status.

This issue of Journal of Islamic Banking & Finance documents scholarly contributions from authors around the globe. Contributions in this current issue discuss the theoretical underpinnings of an Islamic economy, contemporary issues in Islamic finance and performance based empirical studies on Islamic banking and finance. Below, we introduce the research contributions with their key findings that are selected for inclusion in this issue.

The article “Sukuk Takaful (Insurance) Model Rationality and Technical Know-How?” contributed by Mohd Ma’Sum Billah, PhD, Professor, Islamic Economics Institute, King Abdul Aziz University, Saudi Arabia discusses the Islamic financial instrument of Sukuk, what is involved in issuance of Sukuk and discusses at some length the inherent risks involved. He argues that due to the risks involved, some mitigating measures should be in place in form of Takaful.

In his article “Analysis of Theory of Contract As Being Subjective or Objective In Islamic Law” Mohammed Nawaz [al-Hasani, Professor of Islamic law, department of Islamic studies, The University of Lahore, in great detail discusses whether financial contracts in Islamic context are subjective or objective decisions. He presents viewpoints of the four main schools of fiqh and through their arguments decides that in fact the theory of contracts is a subjective matter.

The article “The Dana Gas Sukuk: An Example of why we Need The Proposed Sukuk Bankruptcy Tribunal (SBT)” contributed by Camille Paldi, This brief article explores what went wrong with the Dana Gas Sukuk and then leads into why we need a Sukuk Bankruptcy Tribunal (SBT). The article sets out a proposal for such a tribunal including a framework for operation.

The paper “Shariah Ruling of Bill Discounting and Its Alternative” by Dr. Uzair Ashraf Usmani explains the different alternatives of bill discounting in Islamic finance. The author covers the rationale behind the Shariah rulings of prevailing bill discounting
in conventional banks and discusses Bai Salam as an alternative. The paper discusses the different opinions of modern scholars regarding these issues.

In his article “Increasing Population and Housing Deficit in Nigeria: The Application of Islamic Finance as a Moderating Instrument” Ibrahim Mohammed Lawal, associated with Department of Economics, University of Maiduguri, Borno State writes about the role that Islamic finance can play in assisting the government in building and providing housing to state employees in Nigeria. He speaks of how instrument of Sukuk can be used to raise funds for housing and how Ijara and other Islamic instruments can be used to pass on the ownership of the housing units to eventual owners.

“Cryptocurrency for Commodity Futures Trade in Indonesia: Perspective of Islamic Law” contributed by Teddy Kasuma introduces the subject of crypto currency and discusses the permissibility in light of Islamic Shariah. He presents opinions of scholars of different fiqh, especially in context of the use of Bitcoin and concludes that while some forms of cryptocurrency have been declared permissible, majority scholars find Bitcoin as not acceptable.

The article “Shari’ah-Compliant Stock Screening: A Financial Perspective” contributed by Abdessamad Raghibi & Lahsen OUBDI, The present paper is an explanatory study which needs an empirical confirmation of the proposed methodology in order to measure its performance and efficiency against existing shari’ah-compliant indices. Hence, the main preliminary finding of our research is to enrich the academic debate on shari’ah-compliant screening methodologies through appealing to conventional corporate finance framework to enhance current methodologies.

**Disclaimer**

The authors themselves are responsible for the views and opinions expressed by them in their articles published in this Journal.

The opinions, suggestions from our worthy readers are welcome, may be communicated on e-mail: ia_ib@yahoo.com / facebook link: http://www.facebook.com/JIBFK
Sukuk Takaful (Insurance) Model 
Rationality and Technical Know-How?

By 
Mohd Ma’Sum Billah, PhD**

Abstract
For a sustainable growth of the sukuk industry, among the prime concerns is to ensure a confidence among investors by protecting them against any catastrophe and that is, why sukuk is issued as a safeguard for investors and beneficiaries. The common phenomena is that, in any sukuk structure, be one sovereign, corporate or social, investors, and or beneficiaries in the structure are protected by sukuk itself against any capital or beneficial risk or catastrophe. In reality, a legitimate question may be raised whether a sukuk itself is adequate safeguard for the investor or beneficiary against any defined risk? It is submitted that, a sukuk itself does not hold the capacity to offer adequate protection for the investor or beneficiary against risk, because the issuer may still have the legitimate right to escape the liability by a “limited liability clause” under the Company law or public policy. It may thus, be suggested that, the only way to ensure an adequate safeguard for the investor or the beneficiary in a sukuk structure is by a comprehensive insurance policy as an additional step to a sukuk certificate, may be termed as “sukuk takaful”. Today, we seek to share the emergence of sukuk takaful besides analyzing its rationality and technical know-how?

Keywords: sukuk, takaful, risk, investors, all risks policy

JEL Classifications Code: D82, E 22, F21, G22, G32, Z12

Sukuk Industry at Glance
Under modern practices, a bond is a debt security, which vests the holder with a right of a financial claim on the issuer. This claim protects the holder in circumstances in

* It is revised version of the original work of the author, which was published earlier, but due to furtherance demand the manuscript is revised by considering the current market niche and common benefits.
** Author: MohdMa’SumBillah is a Professor of Finance & Insurance, Islamic Economics Institute, KingAbdulaziz University, Kingdom of Saudi Arabia.
which the issuer is unable to pay the amount due. Bond bears certain similarities to saving account. When an investor deposits money in a saving account, in effect, that investor is lending the bank money. The bank pays the investor interest on the deposit. Similarly, the investor who subscribes bonds lends the issuer money in return for interest. When the bonds mature, the investor will receive the principle amount of the bonds back, as he would have if he had withdrawn the amount from the saving account.¹ In this case the bond functions as a security. The major difference between saving account and bonds is that investors can dispose their bonds in the secondary market before they are matured to the end investors. Savings accounts on the contrary can neither be sold in secondary market nor be disposed of to other investors.²

The formality for an enforceable bond with relevant documentations is required to specify the terms for both interest and principal payments. Interest can be paid monthly, bi-annually or yearly. This makes a difference to the compounding of the interest and will affect the trading of a bond. Most bonds are paid with bi-annually agreed interest in North America. "Eurobonds", which trade in Europe, are paid with interest annually. Mortgage-Backed Securities (MBS) and Asset-Backed Securities (ABS) are paid with monthly agreed interest reflecting the payment terms of the underlying mortgages and loans. The currency of payments is important. Some bonds have the coupon paid in one currency and the principal in another. Bonds which pay part of their principal before maturity are said to "amortize" their principal, this is the case with many mortgage bonds practiced in North America in particular³.

It is noted here that, the bond market is categorized into two - namely: the primary market and the secondary market. The primary bond market is where the bonds are initially issued, while the secondary market is where the bonds are resold to other investors. Islamic bonds also share the similarities with the modern practices conceptually by adapting primary and secondary markets as well, but practically they are contracting each other as to principles, technicalities, issuance and trading.

Sukuk is governed by the Shari‘ah principles as an alternative to the bond practiced under modern economy. Sukuk is a financial instrument (document or certificate), which evidences the undivided pro-rata ownership of underlying assets. Sukuk is an Arabic term derived from ‘Sak’ (singular of Sukuk), which literally means ‘freely tradable at par, ‘premium or discount’.⁴

The conceptual background of Sukuk typically involves the structuring of pools of Shari‘ah compliant assets or without credit enhancement into securities. It is structured based on specific contract of exchange that can be made through sales and purchase of an

³ Ibid
⁴ Id
The issuance of Islamic bonds requires an exchange of a Shari’ah compliant underlying assets for a financial consideration through the application of various Shari’ah instruments namely: *ijarah* (leasing), *mudharabah* (co-partnership), *musharakah* (partnership) and or others. The structure of Sukuk has to be approved by the Shari’ah advisors to ensure that the structures are in compliance. In addition the structuring process may also involve the provision of additional protection for investors against late payments, pre-payments, potential write-off and others. Such protection is often provided in the form of credit and/or liquidity enhancement scheme.5

In the process of Sukuk issuance the doctrine of *Tawarruq* (special purpose vehicle) is used to securitize the instrument in the primary market, while in the secondary market, *Bay’ al-Dain* is used in order to legalize reselling of the bonds. Such process is mostly used in the Malaysian market, while most of the Middle-Eastern countries do not accept it. The proposed alternative is Islamic bonds based on *Mugaradah* (profit sharing). Considering the fact that Sukuk issuance and trading are important means of investment in the modern economic system, Muslim jurists and economists are trying to find the Islamic alternative. However, to meet the various demands of investors Islamic Sukuk and certificates should be diversified. We have so far the *mudarabah* or *mugaradah* Sukuks, the *musharakah* Sukuk, the *Ijarah* Sukuk, the *istisna’* Sukuk, the *salam* Sukuk and the *murabahah* Sukuks. However, it should be noted that although some of these instruments have been generally accepted as being in compliance with Islamic principles so that they can be traded in the secondary market, the negotiability of certain others is still a point of debate and controversy due to their legal acceptability or compliance with shari’ah. Therefore, some of these Sukuk can be traded in the secondary market while the trade of others is limited to the primary market because they can be exchanged only at face value.

In Malaysia for instance, almost all of the domestic Islamic debt papers issued so far have been based on the principles of *murabahah*, *bay’ bi al-thaman al-ajil*, *bay’ al-‘inah* and *bay’ al-dayn*, despite the controversy surrounding the issuance of tradable Sukuk in the secondary market based on the above two contracts. At the same time, there is a perceptible increase in the willingness amongst Malaysian issuers of Sukuk to explore other Islamic principles of financing, namely the profit-oriented based *musharakah* as well as the asset-backed mode of *ijarah*. Hopefully, the future issuance of Islamic Sukuk will focus on the widely accepted Sukuk such as *musharakah* Sukuk, *mudarabah* Sukuk and *ijarah* Sukuk.

However, the problem with Malaysian Islamic Sukuk has been the application of *bay’ al-‘inah* and *bay’ al-dayn*, which is not well accepted by the Middle-eastern investors. The contract of *bay’ al-‘inah* and *bay’ al-dayn* is seen as something similar to *riba* based financing. This will certainly pose a great challenge to the Malaysian companies seeking Islamic funds in the Middle-east via Sukuk issues.
Three Main Steps Involved In The Sukuk Issuance.

Securitization

Sukuk Issuance

Trading of dept certificates

Asset securitization is the essence of Islamic Sukuk issues, as a Sukuk must assume the role of al-mal or property to qualify as an object of sale. An object of sale in the Islamic law of contract must be a property of value. When a Sukuk certificate is supported by an asset as evidenced via the securitization process, it is transformed into an object of value and therefore qualifies to become an object of trade whereby it can be purchased and sold in both the primary and secondary market. Investors then will have the right to sell (haqq mali) these Sukuks. In the bay‘ al-‘inah asset securitization, the financier purchases an asset from the issuer and sells it back to the same party at a credit price. This buy-back agreement will ensure that the issuer will receive the money in cash while financier will be paid a prefixed or contracted amount in a future date. Debt payments will be made by installment through Sukuk issues. The difference between cash and mark-up price will represent the profit due to the financier.

(1) Sell an asset for deferred price 15 mil

(2) Sell the asset 14 mil

(3) Cash payment 14 mil

Issuance of Islamic Debt Certificate (Shahdah al-Dayn)

The underlying asset is therefore crucial in determining the Islamicity of these Sukuks. In the Malaysian experience these assets include factories, equipment, stock and inventory and even intangible asset such as a list including building and properties.
This usually takes place in the primary market where in settling its debt, the issuing company will sell debt certificates or Sukuks to investors. As mention above, debt certificates issues are valid only when it is supported by an asset. In other words, the Sukuks must be securitized. Here the underlying security is the BBA or al-murabahah asset. The underlying asset need not be BBA or al-murabahah alone. If the 1st stage involves a contract of Ijarah, then the debt certificate is called Sukuk al-Ijarah. If an Istisna’ contract is used, we can call it Sukuk al-istisna’. Islamic Sukuks new issues can be categorized into two, namely Sukuks issues with coupons and those with none. The former is known as the Islamic coupon Sukuk while the latter Islamic zero coupon Sukuk.

Sukuk investment activities under Shari’ah (Islamic law) principles had promisingly been attracting both Muslim and non-Muslim across the world ever since late 90s with a greater appreciation. Despite such an achievement status quo there are situations when the spirit of true Shari’ah (Islamic law) guidelines are not accurately observed in an Sukuk investment culture particularly in tackling the risk. This shortcoming might be due to lack of understanding, socio-political or eco-cultural influences or less priority to the spirit of natural risks. It is an essential factor for a true Sukuk investment to observe Shari’ah (Islamic law) standard and divine ethical principles accurately in all aspects of the investment activities including risk management with careful concern in creating a better confidence among the investors.

Degree of Risk Exposed by the Sukuk Industry

Risks faced by the Sukuk industry are namely; market risk, credit and counterparty risk, Shari’ah compliance risk, operational risk, and institutional rigidity. Also, we will state the challenges facing the management of financial risks of Sukuk that are the challenge of institutional reorganization. In addition, we will talk about the argument that most of Sukuk implementation is not following the Shari’ah rules. Undesirable risks affect the competitiveness of the pricing of assets. Therefore, the innovation of Sukuk essentially involves a higher exposure to certain market and financial risks. These risks are market risk, credit and counterparty risk, Shari’ah compliance risk, operational risk, and institutional rigidity. A further illustration is as follows:

Market Risk

Market risks are of two classes namely: Systematic and Unsystematic. A Systematic risk can arise due to public and economic policies whereas unsystematic risk arises because of different firms’ specific instruments are priced out by comparing with other firms’ instruments. Market risk is comprised of profit rate risks, foreign exchange risks, equity price risks and commodity risks. The profit rate risk is rate of return risk upon which Sukuk is based. Fixed rates that are exposed to this risk in the same manner as fixed rate bonds are exposed to the profit rate risk. Moreover, an increase in market

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7 Ibid
profit rates leads to a decrease in the fixed-income Sukuk values. However, all fixed return assets either from Ijarah, Istisna, Salam, Mudharabah, Qiradh or any other origin will face this risk.\(^8\) This also involves reinvestment risk and an opportunity cost of investing at the new rates, particularly if the asset is not liquid as in case of the zero-coupon non-tradable Sukuk.

**Credit Risk**

It is the probability that a bad-debt or an asset or loan becomes irrecoverable due to a default or delay in settlements while the counterparty risk is the probability that the counterparty retracts on the conditions of the contract if the relationship involves a contractual arrangement. The consequences can be severe with a decline in the value of a bank’s assets. The credit and counterparty risks inbuilt in Islamic finance are unique owing to the nature of Islamic financial instruments that become the foundation of the Sukuk asset pools. Unlike conventional financial institutions, Islamic banks do not have access to derivative instruments and other credit risk management mechanisms due to Shari’ah considerations.\(^9\)

**Risk as to Shari’ah Compliant**

The risk as to Shari’ah compliance is the loss of asset value as a result of the issuers’ breach of its fiduciary responsibilities with respect to compliance with Shari’ah. For example, if the Sukuk is based on a hybrid of Ijarah and Istisna’ assets, Ijarah must always be more than Istisna’ in the pool, otherwise the Sukuk deed will dissolve. Thus broadly speaking, Shari’ah compliance risk must be defined as a rate of return foregone in comparison to the market rates, as a result of complying with the Shari’ah. Moreover, fixed rate Sukuk faces serious market risks. So, to match the market requirements of Sukuk to be floating rate, and the Shari’ah requirements of rents to be fixed rate, the Ijarah Sukuk are based on a Master Ijarah Agreement with several subordinate Ijarah agreements. However, the investors could still face profit rate risk to a certain extent and since the originator can only guarantee the fixed return on the underlying asset pools, the issue of floating rate returns still remains contentious, particularly, in hybrid Sukuk.\(^10\)

Therefore, the association of Shari’ah supervisors with Sukuk issues will ensure investor confidence.

**Management and Operational Risk**

The management and operational risk, are inherent to the structure of the issuances rather than the underlying Shari’ah principles. The risks related specific to the operation are mirror to those existent in conventional bond markets and are Default Risk, Coupon Payment Risk, Asset Redemption Risk, Investor Specific Risks, and Risks Related to the Asset. Default Risk is when each party has provisions for the termination of the certificate in the event of a default by the obligor. Coupon Payment Risk is when the obligor may fail to pay the required coupons on time. Asset Redemption Risk is when the

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\(^\text{8}\) Ibid
\(^\text{9}\) Ibid
\(^\text{10}\) Ibid
originator has to buy back the underlying assets from the certificate holder. Investor Specific Risks is when the certificate holder is rendered to several risks relevant to Sukuk structures such as liquidity management issues in Islamic finance. Risks Related to the Asset is when the underlying assets of the Sukuk certificates are subject to numerous risks such that the risk of loss of the assets.\textsuperscript{11}

**Organizational Rigidity Risk**

The banking and financial infrastructure is weak in most emerging economies’ countries despite a significant move had been observed in some of these countries such as Bahrain, Saudi Arabia, Malaysia and Brunei, Indonesia among others. However, Sukuk requires unique Shari‘ah compliant structures which create a state that can be termed as one of institutional rigidity and that cannot be removed in the short run and always increasing the risks of Sukuk. Furthermore, the features of this state are lack of hedging and financial engineering processes, nonexistence of inter-bank money markets, lack of best practice uniform regulatory standards and regimes, weaknesses in litigation and legal framework support, particularly, in the treatment of default, non-uniform accounting, auditing and income and loss recognition systems, non-robust investment appraisal, promotion and monitoring infrastructure, ineffective external credit assessment systems, rudimentary state of financial markets, and weak inter-segmental support and linkages.\textsuperscript{12}

**Managing SukukTakaful**

Sukuk serves to replicate the functions of conventional bonds and tradable securities in resources mobilization from markets and injecting liquidity into the enterprise or government and in providing stable resource of income for investors. Moreover, investing in Sukuk issuances involves the funding of trade or production of tangible assets. So, this section will state the challenges facing the management of financial risks of Sukuk that are the challenge of institutional reorganization.\textsuperscript{13}

**Organizational Challenges**

Government Debt Management upon which the fixed income markets in developing countries rests is dominated by government bonds. Therefore, the single most important reorganization of the markets can come from the reorganization of the public debt management. The introduction of derivative markets has further consequences on market and financing dynamics. Furthermore, markets stabilizing role of futures and options markets depends on the speculator’s information. Futures and options markets can also serve to stabilize the value of underlying assets by acting in an insuring role and this can occur if these markets allow investors to pool risks more efficiently and share them. Therefore in short, the evolutionary changes of financial innovation, deregulation, globalization of financial services and introduction of novel financing instruments

\textsuperscript{11} Ibid
\textsuperscript{12} Ibid
\textsuperscript{13} Ibid
warrants the adoption of supporting risk management mechanisms, viable secondary markets and relevant regulatory bodies.  

The emergence of the market for asset backed securities over the past two decades has permitted banks around the world to free their capital by re-packaging and reselling portfolios of loans, assets and other receivables. This adjusts the criteria for lending by forcing financial institutions to meet the market’s standards for loan quality and sufficient pricing for risk. It helps decrease funding risk by diversifying funding sources. Financial institutions also employ securitization to purge profit rate mismatches. Also, it creates more complete markets by introducing formerly remote asset classes that better suit investor risk preferences and by increasing the potential for investors to achieve the benefits of diversification. Therefore, by meeting the needs of different market segments, securitization transactions can generate gains for both originators and investors. The same benefits can be attributed to Sukuk certificates. They allow the institution to manage balance sheet mismatches to securitize longer term assets. Moreover, investors are also given the option to invest in asset grades that are suitable for their investment needs. Also, financial markets are more complete as previously and untapped assets are now available for public sector resource mobilization.

The Liquidity and secondary markets, portray varying risk preferences and a secondary market should be developed to reflect this. Sukuk certificates are unique in that the investor becomes an asset holder and is directly tied in to the nature and functioning of the underlying asset pools so Sukuk certificate holders carry the burden of these unique risks. The primary concern of an Islamic secondary market is its marketability. All things being equal, a certificate holder would rather participate in a well-structured and well regulated secondary market instead of trading in a poorly run market. However, the challenges remain to provide increased risk management mechanisms, increase market liquidity, create a truer bond yield benchmark as well as expanding the issuer and investor platform.

Conclusion

It is has been observed that, the unfavorable risks faced by the Sukuk industry such as market risk, credit and counterparty risk, Shari’ah compliance risk, operational risk, and institutional rigidity that affect the competitiveness of the pricing of assets which lead to fact that is the innovation of Sukuk essentially involves a higher exposure to certain market and financial risks. However, I believe that we should take most care of unsystematic market risk and Shari’ah compliance risk in certain manner because they are related to each other in sense of that market risk will increase if the Shari’ah compliance risks increase. Furthermore, the current Sukuk margin or profit based on LIBOR is indicator only but still we depend on it which leads us to violate the Shari’ah compliance that will cause the market risk increase because most of Sukuk holder or investors are Muslims who search for Shari’ah compliant products to invest and avoid investing in

\[\text{\textsuperscript{14}}\textit{Ibid}\]
\[\text{\textsuperscript{15}}\textit{Ibid}\]
\[\text{\textsuperscript{16}}\textit{Ibid}\]
non-compliant product or questionable products, and in our case it could be questionable product unless we try avoid this risk.

This can be through set fixed percentages not related to anything even if as indicators. It is true that the Sukuk issuers in some periods will face problems on their projects due to crises of economy or complexities on their project but they should do and sacrifice in order to avoid violating in Shari'ah compliances. Moreover, in order to develop the market of Sukuk and avoid the risks of Shari'ah compliance, capital authorities of all Muslims countries should establish and create Sukuk Authority Institution that report to organization of Islamic conference (OIC), and unify the rules and regulations of Sukuk issuing; price of Sukuk among others.

\(^{17}\) Ibid
Analysis of Theory of Contract As Being Subjective or Objective In Islamic Law

By

Dr. Mohammed Nawaz [al-Hasani] *

ABSTRACT

Background of the article: The Islamic banking system is growing day by day in the market of the world. There are many Shariah tools applied by Islamic banking to solve the problems of their clients but some of these tools are disputed among the classical jurists. The article is going to solve this problem by analyzing the evidences of Muslim jurists and providing preferred opinion regarding these disputed tools of Islamic banking.

Objective of the article: The article is going to elaborate the theory of contract as being subjective and objective. Objectivists are supporting the objective theory of contract and hold that whatever contrary to consent of Almighty Allah is null and void while subjectivists are supporting the subjective theory of contract and wherever, the elements of contract are found the contract is considered valid and enforceable.

Requirement: the article removes the ambiguity regarding the consent [رسا] of contracting party and it is first element of contract according to majority of Muslim jurist while it is only one element of contract according to Hanfi jurists and it is [rida] and it is hidden thing, so it is stipulated for contacting party to come with the [sigha] form and it means offer and acceptance and issuance of form is considered consent of contacting party whatever will be his intention behind it and the contract is considered concluded according to form of the contract.

Method of research: It is analytical method of research and evidences of each opinion are given accordingly and these are analyzed and whatever evidence remained protected from objection is preferred on other opinions of Muslim jurists.

* Author: Dr. Mohammed Nawaz [al-Hasani], Professor of Islamic law, department of Islamic studies, The University of Lahore.
Result of this research: This study is resulted that subjective theory of contract is preferable on the objective theory of contract and this theory supports the Islamic banking system and advised it to facilitates their clients by these disputed tools of financing and expand their business in all over the world.

Conclusion: The doctrine of [SaddayDaray] blocking lawful means to unlawful ends is not common and absolute principle but its applications are restricted with text of Quran or Hadith otherwise it is not capable to change the permissible rule approved by text of Shariah and declare it prohibited.

Key words: Contract, theory, Subjective, Objective, analysis.

Introduction:

It is agreed upon among all Muslim jurists that wealth is fifth necessity of human being. If wealth is not available mankind cannot survive in this world.

The contract of sale and purchase is major source for earning wealth. Prophet [صلى الله عليه وسلم] declared that: there are ten sources of earning wealth but nine of these are in business transactions.¹ There are many types of business transactions but weight is given to the contract of sale and purchase due to being more important than others because it is concluded by everyone though he is male or female or he is poor or rich or he is under the age of puberty or over the age of puberty while other transactions do not have such an involvement in the society of mankind. The sale contract is divided into several types. Some of them are agreed upon and others are disputed, so the attention is given to disputed types of sale contract. Disputed types of sale are further divided in to two types: some of them are applied as tools of Islamic banking and others are not applied as the tools of Islamic banking, so the concentration is given to those types of sale which are applied as a tool of financing. The dispute of Muslim scholars in such types of a sale is based on the theory of contract that it is subjective theory or it is objective theory, so the theory of contract is basic requirement of this article to define contract and discuss the theory of contract.

1- DEFINITION OF THEORY {نظرية}: There are two meanings of Nazriyyah:

1- literal 2- technical meanings.

a- Literal meaning of Nazriyyah: The word {Nazriyyah} is taken from the word nazar and there are two meanings of nazar:

i- Literal meaning and

ii- Technical meaning:

¹ It is narrated by al Hafiz al Iraqi Zainud Din: al Mughni an haml-al Asfar: hadith: 1576
i- **Literal meaning of nazar**: The word {ﻧﻈﺮ} is used in two meanings as follows: If there is word {إﻟﻰ} after nazar then it is used in the meaning of watching and seeing something as {ﻧﻈﺮإﻟﻴﻪ}. If there is word {ﻓﻲ} after nazar then it is used in the meaning of thinking about as {ﻧﻈﺮﻓﻴﻪ}.

2- **Technical meaning of nazar.** The scholars of logic {مﻨﻄﻖ} define it and said: It is arrangement of known things in such a sequence which causes to find out unknown thing.

So, the word Nazriyyah is component of Nazar and word [ya] and If this [ya] is [msdariyah], then it is in the meaning of masdar which is Nazar and whatever is the meaning of nazar, the same is the meaning of zriyyah. If this [ya] is for nisbat, then it is in the meaning of knowledge and this knowledge is defined as follows:

b- **Technical meaning of Nazriyyah {ﻧﻈﺮﻳﺔ}.** My respected renowned teacher Dr Ahmad Fahmi Abu Sinnah {may Allah bless him} defined it and said: The theory is general principle comprising from complete system with proper sequence, ruling over whatever is related to its subject.

2- **DEFINITION OF CONTRACT:**

There are two meanings of contract: 1- literal meaning of it, 2- technical meaning of it as:

a- **Literal meaning** of contract is fastening as Arab people said: fasten loop in the feet of camel.  

b- **Technical meaning** of contract is legal connection of two expressions {offer and acceptance} affecting legally in the subject matter.

Affecting in subject matter means the ownership of subject matter is transferred from seller to buyer and ownership of price is transferred from buyer to seller.

3- **SUBJECTIVE THEORY:**

The Subjective means the clear requisite of contract are its elements and basic conditions of each one of these. There are three elements of contract according to majority of Muslim jurists such a Malki, Shasfei and Hanbli jurists. These are as follows: 1- Form [صﻴﻐﺔ], 2- contracting Parties [ﻋﺎﻗﺪﻳﻦ] and 3- Subject matter[ﻋﻠﻴﻪ].

**CONDITIONS OF ELEMENTS:** the conditions for each one of these elements are as:

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2  Dr Ahmad Fahmi Abu Sinnah/ al Nazriyyat al Amah lilMuamlat al Maliyyah al Asariyyah al Islamiyyah /Cairo: Dar al Talif/ 1967/ 44
3  ReferIbn al Manzur / lisan al Arab:3: 296
4  Refer Mustafa Ahmad al Zarqa/ al Madkhal al Fiqhi al Aam/ 1: 291
a- CONDITIONS OF FORM: there are four conditions for form {صنيفة} and these are:
1- Conformity between offer and acceptance.
2- One session for the issuance of both offer and acceptance.
3- Survival of offer until the issuance of acceptance.
4- Form of contract should be in past tense or one of these two[offer or acceptance] must be in past tense.

CONCLUSION:
This article is concluded as:
1- Theory of contract is subjective but not objective.
2- Evidences of subjective theory of contract are stronger than the evidences of objective theory of contract.
3- Principle of blocking lawful means for unlawful ends [سد الذائعة] is not general principle.
4- Opinion of Hanfi and Shafei jurists in the principle of SaddayZray is preferred on the opinion of Malki and Hanbli jurists.
5- When elements of contract are found and its conditions are met the contract is found and validated.

b- CONDITIONS OF CONTRACTING PARTIES: there are two conditions for them:
Contracting parties should be pubescent persons and it means they must be {عاقل بالغ}.

c- CONDITIONS OF SUBJECT MATTER: there are six conditions for subject matter:
1- Legality of subject matter.
2- Existence of subject matter.
3- Knowledge of subject matter. It means it is known for both parties.
4- Ownership of subject matter. It means it should be owned by the party going to sell it.
5- It is deliverable. If it is not deliverable such as selling a missing camel, it is not sold.
6- Right of third party is not relating to it.

4- Meaning Of Subjective And Objective Theory:
a- Subjective Theory Of Contract:
It means: the contract should fulfil its all elements and conditions as mentioned above. When the elements of contract are found and the conditions of contract are met the
contract is found what will be the objective of contract and the occurrence of contract is based on the availability of its elements and conditions but it is not based on its objectives.

**b- OBJECTIVE {النية والغرض}:**

There are two words which are used in the meaning of objective but these are two different matters from each other.

1- **Objective means:** Intention causing for the conclusion of contract. {إرادة وإنشاء العقد}. It is always found before the conclusion of contract. There are further four words which are covered with the word of intentions as:

a- Iradah [إرادة] it is first stage of intention and it is also first situation of intention comes in the heart of mankind.

b- Azm [عزم] it means: establishment of intention but it is still change-able due to change of comfortable situation or due to the advice of reliable person.

c- Samm [صم] it is third situation of intention where it is determined and now, it is not change-able and intending person is not in position to listen or accept advice of someone. D- Hamm [هم] it is forth situation of intention where a person start his action and movement to implement his intended objectives and it takes place through following procedure: the heart which is the centre of intention and planning, has commanded to mind and the brain also has commanded to body parts which are workers, to perform required act to achieve the objectives. Holy Qur’an supports this fourth type of intention while saying regarding Yusuf [عليه السلام]: [وَلَمْ تَتَّبَعْنَهُ وَهُمْ نَفْسُهُمْ وَأَرْأَى رَبُّهُ].

This intention is called in Arabic language cause [sabab] and motive [baith] for creation of a contract {إنشاء العقد}. It is called in logic Illahfaeli {علة فاعلیة}. This intention is always shown through form {الصيغة} of contract.

2- **Objective means:** The purpose behind the conclusion of contract remained hidden. It is found after conclusion of contract. It is named in logic with Illahghaiyyah {علة غائیة}.

**OBJECTIVE THEORY:** The objective theory of contract means: The purpose from the conclusion of contract should be legally valid. This purpose is intended through conclusion of contract. The legality of objective of contract is also basic condition for the

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5 Doctor abdul Aziz Muhammad Izam/ Legal Mxims/ Cairo: Dar al Hadith/1426-2005/ 81
6 Surah Yusuf/ 24
7 This evidence of Quran is QiyasIstisnai Mowlana Fadal al Imam Khaiabadi, al Mirqat/ Din Muhammad and Sons: Lahore/ 43.
validity of contract according to this theory though it is shown or it is not shown. If the purpose from conclusion of contract is not valid the contract is void.

**SUBJECTIVE THEORY:** Subjective theory of contract emphasises on the existence of elements and conditions of contracts. If contracting party does not show his intended meaning from the conclusion of contract the contract is considered valid though the intending purpose from the conclusion of contract is illegal.

**THEORY OF CONTRACT IS SUBJECTIVE OR OBJECTIVE:**

It is disputed theory among Hanfi, Shafei and Malki, Hanbli Jurists. There are three opinions of Muslim scholars as follows:

**FIRST OPINION:**

a- Hanfi and Shafei jurists incline to the subjective theory of contract. They hold the legality of object of contract is not condition for the validity of contract and they argued on their viewpoint by following evidences:

**EVIDENCES OF FIRST OPINION:**

**FIRST EVIDENCE:** The contract is based on its elements and their conditions. When the elements of contract are found and conditions of these are met the contract must be found. It is agreed upon according to them.

**SECOND EVIDENCE:** Almighty Allah said: Almighty Allah permitted sale and prohibited interest. It is evidence for the permissibility of all types of sale except those types of sale which are declared prohibited by Quran or Sunnah. The number of prohibited sale contract is very limited. All other types of sale are permitted, so these will remain permitted on the basis of permissibility given by Shariah.

**THIRD EVIDENCE:** There is an agreed upon principle that: [الأصل في الأشياء الإباحة] the origin of all things is permissibility. It is regarding to rule given to contract of sale in Islamic law. The principle emphasises each and every thing is permissible in its origin.

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8 The opinion of Hanfi and Shafei jurists is given preference on the opinion of Malik and Hanbli jurists because of that: there are four types of Ilah in logic {Mantiq}:

1- IlahFaeli, It causing for the creation of anything. The Ilahfaeli of contract is contracting party or their intention to create contract.

2- IlahSuri and it is shape of thing after being created and madden and ilahSuri of contract is form of contract {offer and Acceptance} and different types of sale are different forms of contract also.

3- Ilah {madi} material cause of anything and Illahmadi of contract is subject matter.

4- IlahGhai, the objective of creation of anything and the illahghaei of contract is purpose of contract and it is agreed upon among the logic scholars that: when Ilahfaeli, IlahSuri and Illahmadi of anything are found the thing is found and some time the purpose of thing is attained after existing of thing and some time it is not obtained but it does not mean the thing is not found, so the contract is found when its IlahFaeli, IlahSuri and IllahMadi are found though Illahghai of contract is not found till now.

9 Surah al baqarah | 275
when Almighty Allah revealed Islamic law. All those things which were harmful for mankind were declared prohibited and all those things which were necessary for mankind were declared obligatory and binding for mankind and all those things which were neither harmful nor necessary remained permissible according to the principle mentioned above and sale contract is neither harmful nor beneficial because it has possibility of being harmful or being beneficial, so it is remained valid and permissible according to its origin  

FOURTH EVIDENCE: There is another legal maxim supporting subjective theory of contract  
The words always are given their original and figurative meaning not their secondary and metaphorical meaning unless the original meanings are not possible to be intended from these words. The words are used in their original meaning will be the intention of person. If a person said: I sold you my car for four hundred thousand and other party accepted during the same session the sale contract is concluded and these words are considered the purpose of the seller and it is due to principle that original meaning of the words are preferred over their metaphorical meanings.

FIFTH EVIDENCE: The subjective theory of contract is supported by another legal maxim: no acknowledgement is given to implicit meaning of words as against their explicit meaning. When contract is concluded by proper words and elements are fulfilling all conditions the contract is considered executed whatever be the purpose behind this contract.

SIXTH EVIDENCE: The subjectivist jurists support the theory of contract by legal maxim: The acknowledgement in the contracts is given to words and spellings not to objectives and meanings. The last evidence is very clear about the theory of contract that it is subjective not objective.

SECOND OPINION OF MUSLIM JURISTS: Malik and Hanbli jurists are inclined to the objective theory of contract. They made the legality of objective a condition for the validity of contract. They argued on their viewpoint by the following evidences:

FIRST EVIDENCE: The tradition of Prophet {صلى الله عليه وسلم} All acts are based on their intention. Those who migrated for Almighty Allah and his messenger their migration is for Almighty Allah and his messenger {صلى الله عليه وسلم} and who migrated to

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10 Abdu l Aziz/ Legal Maxims/ 109  
11 Majallah al Ahkam al Adaliyyah/ 12, al Kurdi al Hajji Ahmad/ al Madkhal al Fiqhi/  
13 Abuz Aziz/ Legal Maxims/ 3370.  
14 Majallah al Ahkam al Adaliyyah / maxim no: 12  
15 Al Kurdi Hamad hg Hajji/ al Madkhalhgtrid/ Syria: Matba al Insha/ 1404- 1984/78,  
16 Majallah/ Legal Maxims/ No:13  
17 Majallah, Maxim: 2  
18 Abdul Aziz/ Legal Maxims
marry a woman or for world {الدنيا} to obtain it, his migration is for what he migrated.\textsuperscript{17} It means the purpose of act. If the purpose of act is legally valid the act is valid. If the purpose of act is illegal the act is illegal and the contract is also an act, so it too is based on the legality of objective of contract. If the objective of contract is legally valid the contract is valid otherwise it is null and void.

**OBSERVATION ABOUT:**

The rules of Islamic law always are relating to acts of pubescent persons {aqil -baligh} and acts of such persons are divided in to three types in Islamic law: 1- Pure worship acts. 2- Pure crimes. 3- Permissible acts.

a- The pure worship acts these are always based on their intention and purpose. If intention is legally valid the worship act is valid and if intention of the act of worship is mala-fide the act of worship is not valid.

b- The pure acts of crimes: these are prohibited in Islamic law whatever will be the objectives of these acts, so good objectives of criminal acts do not validated the offences as someone committed theft to help needy person, such an objective does not validate the act of theft.\textsuperscript{18}

c- The permissible acts in Islamic law: all permissible acts such as all contracts and dispositions are considered legally valid and permissible depending upon the intentions and objectives behind performance of these provided all the elements of these acts are found valid and their conditions are met based on the evidence of Holy Quran while declaring that Almighty Allah permitted the sale contract and prohibited the {riba} interest.\textsuperscript{19}

**QUESTION:**

Now question is that: what about the tradition mentioned above? Because it declared that the intention plays the vital role in the validity of all acts. The contract is also an act.

**ANSWER:**

Seven answers are given for this question:

1- All permissible acts are legally valid regardless of the intention by performing of them because these are made permissible by Islamic law and the intention of Lawgiver is known from the law formulated by law giver. He permitted sale contract as stated in verse of Holy Quran mentioned above. So, intention of man does not have any weigh while clashing with intention of Almighty Allah.

\textsuperscript{17} It is narrated by Imam al Bukhari, Sahih al Bukhari/ hadith: 2529, 3898.

\textsuperscript{18} Ifk-e-Nujaim/ zain al Din/ al Ashbahwa al Bazair/ beirut:Dar al kub alImiyyah/ 19-25

\textsuperscript{19} Sura al Baqarah / 275
The tradition mentioned above is only related to worship and it means all acts of worship are not valid without good intention. Worship matters promoting the relationship between Almighty Allah and mankind and here too the intention is stipulated by law giver, so the worship acts are not valid without their good intention and objective.

The reason is that Almighty Allah Himself stipulated good intention for the validity of worship and He said: [وَمَا آمَرُوا إِلَّا لِيَعْبُدُوا اللَّهَ مُخْلِصَيْنِ لَهُ الدُّنِٰٰян]. They are not commanded but to worship Almighty Allah keeping intention for Him.\textsuperscript{20} It means: worship of Almighty Allah should be made with clean and neat intention which is careless from reward and fearless from punishment.

Intention is hidden thing and Almighty Allah knows the hidden things, so intention plays the role in the worship matters which are performed for Almighty Allah while intention does not play any role in all other acts such a crimes and dispositions and contract because these matters are related to mankind. Human being does not know the hidden things. It is intending meanings of hadith mentioned above.

The Muslim person is always required to intend the consent of Almighty Allah by performing any permissible act because when he comes with such intention with performing the permissible act, this act is converted from simple act to worship act by this intention and he gets reward on this act due to this intention and it is supported by legal maxim: [لاَّثَوابٍ إِلاَّ بِالنَّية]\textsuperscript{21} There is no reward without the intention to consent of Almighty Allah.

It is known from the hadith mentioned above because the migration for woman or for world is not made prohibited but this migration is not considered worship causing for reward from Almighty Allah because it is not made with the intention for the consent of Almighty Allah.

The rule of law is given in crimes and disposition to the acts not to the intention because the judge gives his judgement according to the matter supported by evidence and testimony. The testimony can prove the watchable matters because testimony means providing information about any event watched through the eyes. The intentions and objectives of any act are not watchable by eyes due to being hidden, so the intention and objectives cannot be proved by testimony and witness. Shariah court cannot give the verdict in the favour of matter which is not proved with any evidence.

If someone is taking riba for charity purposes. This intention does not validate the riba made prohibited by Lawgiver. The same is the rule for whatever is made permissible by Lawgiver.\textsuperscript{22}

\textsuperscript{20} Surah al Bayyinah/5
\textsuperscript{21} Ibn-e-NujaimZain al A’bidin/ al Ashbaha al Nazair/ 19.
\textsuperscript{22} Al Kurdi/ hg Madkhalhgtrid/ 23, Abdul Aziz/ 370
SECOND EVIDENCE: Malki and Hanbli jurist supported their objective theory of contract by legal maxim and it is: The acknowledgement in contracts is given to objectives and meanings not to words and spellings. This legal maxim is very clear that the objectives of contract play very important role for the validity of contracts.

OBSERVATION: It is observed that this legal maxim is acceptable and applicable when it fulfils three conditions as follows:

a- The words of contract are to be used in intended meaning of contract. If these words cannot be used in the intended meaning of contract, then objective of contract does not play any role in the validity of contract, for example as seller said to buyer: I did not sell you this book for two hundred rupees and he intended: I sold him this book for two hundred rupees. The contract is not concluded because the words are not having as per intended meaning of contracting party.

b- The words can possibly be used in clear meaning and intending meaning, for example one party said to other: I donated you this book for two hundred rupees and he intended sale contract by these words. It is considered sale contract.

c- The rule of intended meaning is not less in status than the rule of clear meaning of words. For example: party said to other: I donated you this book for two hundred rupees. It is considered sale contract though he intended by these words donation. The reason is that: the ownership obtained by donation and sale but ownership obtained by donation is lesser than the ownership attained by sale contract because donation [hibbah] disposition is revocable while sale contract is not revocable.

If one party said to other: I sold you this book without price and he intended by these words donation. It is void sale contract and it is not considered donation because the ownership obtained by donation is less in standard than the ownership obtained by sale contract because of that the donation is revocable while sale contract is not revocable.

RESULT OF THE CONFLICT:

This conflict of opinions in the theory of contract as being subjective and objective has resulted in other disputes between them in the principle of [SaddayZray] [سد الذرايع] [blocking lawful means for unlawful end] and several types of sale contract. This principle is as follows:
a- **PRINCIPLE OF SADD-ZRAY:**

The principle of {Sadd-e-Draye} means: blocking lawful means for unlawful end.\(^2\)

It is intended by this phrase that: the lawful acts are prevented to be performed when these are causing commission of any unlawful act.

**DIFFERENCE OF OPINION IN THIS PRINCIPLE:**

This principle Saday Zaray [سد الثراظ] is general or it is not general. There are two opinions of Muslim classical jurists as follows:

a- **FIRST OPINION:** Those scholars who hold that theory that contract is objective such as Malki and Hanbli jurists say it is general principle.

b- **SECOND OPINION:** Those scholars who hold that theory of contract is subjective such as Hanfi and Shafei jurists say it is not a general principle but it is valid principle where is supported by text of Quran or Hadith otherwise it is not valid and applicable.

**EVIDENCES OF FIRST OPINION:**

Malki and Hanbli jurists argued with the verse of Holy Quran: {أيمانون الذين أمنوا لاقولوا راعتنا ولاقولوا انظرنا} O believers do not say to prophet [صلى الله عليه وسلم] Raina but say: glance to us.\(^2\)

**ANSWER:** It is answered that the argument by this verse is not valid because Hanfi and Shafei admit also that the principle of Sadd-e-Zray is applicable wherever the text of Quran or Hadith is supporting it and the lawful means to unlawful end are blocked by text but wherever text of Quran or Sunnah made means lawful, then these means cannot be blocked by any other evidence against the text of Quran and Hadith such as principle of Sadd-e-ray.

**EVIDENCES OF SECOND OPINION:**

Hanfi and Shafei classical jurists argued their viewpoint by following evidences as:

a- Principle of Sadd-e-Zray is only applicable in those cases wherever text of Quran or Sunnah is found. Wherever text of Quran or Sunnah is not found, then implementation of this principle is null and void because it is contrary to basic


\(^2\) Surah al Baqarah/ 104
sources of Islamic law and these are Quran and Sunnah because these both declared these means lawful and permissible while principle of Sadday-e- Zray is prohibiting them and it is causing for the abrogation of the rule ascertained by Quran and Sunnah and abrogation of rule given by Quran and Sunnah after closing the revelation is not allowed by the consensus of Muslim jurists.29

b- Principle of Malki and Hanbili jurists is conflicting with the objective of Lawgiver because He made these means lawful while this principle made them unlawful and this principle was formulated to protect the objective of Lawgiver while it is going to destroyer the objective of Lawgiver, so it is rejected as a general principle.

c- Malki and Hanbli jurists are champions of objective theory, particularly Shaikh Ibn-e-Taimiyyah and Abu Is‘haq al Shatbi and they hold that whatever is contrary to objective of Lawgiver, is rejected according to them, so principle of [SadayZray] should be rejected according to them.

PREFERENCE: Hanifi and Shafei view point is preferred to the view point of Malki and Hanbli jurists because the evidences are stronger than the evidence of first view point.

b- DISPUTED SALES CONTRACT:
The conflict of opinions in the theory of contract is resulting in following sales contract

1- Selling weapons in the hand of terrorist is prohibited according to Malki and Hanbli jurists while it is valid according to Hanfi and Shafei jurists provided the terrorist did not show his intention by any way at the time of purchasing weapons.

2- Selling a gun in the hand of person intending to kill any innocent person is invalid according to Maliki and Hanbli jurists while it is valid according to Hanfi and Shafei Jurists provided the offender did not show his false intention at the time of contract.

3- Selling grapes in the hand of winery is not valid according to Malki and Hanbli jurists while it is valid according to Hanfi and Shafei jurists.

4- Hiring house in the hand of person who runs brothel in this house is not valid according to Malki and Hanbli jurists while it is valid contract according to Hanfi and Shafei jurists provided the mala-fide intention is not shown at the time of contract.

5- Marriage contract with woman to facilitate her remarriage with her ex-husband is invalid according to Malki and Hanbli jurists while it is valid according to Hanfi and Shafei jurists provided this intention is not disclosed at the time of contract.

Note: All permissible acts can be restricted by legislation of government to fulfil the requirements of society.
6- Paper marriage with woman though she is Muslim or Christian or Jewish in Muslim country is not valid according to Malki and Hanbli jurists while it is lawful according to Hanfi and Shafei jurists provided mala-fide intention is not shown at the time of contract.

CONCLUSION:
This article is concluded as:

a- Theory of contract is subjective but not objective.
b- Evidences of subjective theory of contract are stronger than the evidences of objective theory of contract.

3- Principle of blocking lawful means for unlawful ends سد الذرائع is not general principle.

4- Opinion of Hanfi and Shafei jurists in the principle of SaddayZray is preferred over the opinion of Malki and Hanbli jurists.

30 This is rule of paper marriage for those countries where Islamic personal law is enforceable and those countries where Islamic personal law is not enforceable the paper marriage will be treated as their local law.
The Dana Gas Sukuk: An Example of Why We Need the Proposed Sukuk Bankruptcy Tribunal (SBT)

By
Camille Silla Paldi*

ABSTRACT:
It is time for the Islamic finance industry to create a unique and independent dispute resolution mechanism equipped with standardized legal contracts in order to modernize and harmonize dispute resolution across the Islamic finance industry. This brief article explores what went wrong with the Dana Gas Sukuk and then leads into why we need a Sukuk Bankruptcy Tribunal (SBT). The article sets out a proposal for such a tribunal including a framework for operation.

Keywords: Islamic Finance, Dispute Resolution, Sukuk Bankruptcy

Introduction
According to S&P Global Ratings, one of the main faults of the Islamic financial system in 2019 is the lack of standardization of legal contracts. The lack of standardization expels potential investors as they are uncertain about the dispute resolution process and outcome in the event of a dispute or for example a sukuk bankruptcy or default. As the Islamic finance industry is nearing US$2.4 trillion in assets, it is about time that the Islamic finance industry created a unique and independent dispute resolution mechanism, which would boost investor confidence and solidify the Islamic industry for many years into the future. This brief article aims to show how the Dana Gas debacle reveals that the Islamic finance industry is ill-equipped to handle sukuk defaults and introduces the concept of the Sukuk Bankruptcy Tribunal (“SBT”), which is

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part of the wider ("DWIFAC") or Dubai World Islamic Finance Arbitration Centre dispute resolution mechanism.

**The Dana Gas Sukuk**


In 2013, Dana Gas issued a dual-tranche Mudarabah sukuk with an aggregate principal amount of approximately US $950 million listed on the Irish Stock Exchange. (Cleary Gottlieb, 2018) Each tranche of the sukuk was subsequently reduced to US $350 million following sukuk buyback and conversion, bringing the total principal amount to US $700 million due in October 2017. (Cleary Gottlieb, 2018)

On May 3, 2017, Dana Gas asked sukuk-holders to form an Ad Hoc Committee to engage in talks on May 8, 2017 to discuss the restructuring of the debt. (Wikipedia, 2019) On June 13, 2017, Dana Gas presented an offer to the Ad Hoc Committee to restructure the $700 million sukuk. Dana Gas also explained that according to Dana Gas and its advisors, the sukuk were no longer Shari’ah compliant. (Wikipedia, 2019) Dana Gas declined to make payment on the sukuk. (Wikipedia, 2019) Dana Gas offered to exchange the sukuk with a new one, which would ‘confer rights to profit distributions at less than half of the current profit rates and without a conversion feature.’ (Wikipedia, 2019) The sukuk holders declined this offer. (Cleary Gottlieb, 2018)

According to White and Case, the move by Dana Gas to declare its approximately US$700 million of outstanding sukuk certificates unlawful and unenforceable on the grounds that in the company’s view and that of its advisors, the sukuk had ceased to be Shari’ah compliant is a potentially destabilizing development for the international sukuk market and to the Islamic Finance Industry as a whole with implications for the sukuk industry’s future survival. (White and Case, 2017) Conventional investors may come to view sukuk as ‘high-risk’ and uncertain financial instruments and the Dana Gas debacle may encourage other issuers to use the argument that their instruments are not Shari’ah compliant to force creditors into debt-restructurings in the future. (White and Case, 2017) There is an obvious and immediate need for a central Sukuk Bankruptcy Tribunal ("SBT") to adjudicate all of the world’s sukuk disputes in one location under one mechanism according to a standardized sukuk dispute contract.

The key question in this case according to White and Case is whether non-compliance with Shari’ah principles effects the legal enforceability of these instruments. (White and Case, 2017) The outcome of this case may impact whether or not conventional investors wish to continue investing in Islamic sukuk versus conventional bonds in the future. The alternative is to implement the Sukuk Bankruptcy Tribunal or SBT with immediate effect to avoid this type of sukuk default dispute in the future.
Rather than splitting jurisdiction between the UAE and the UK, a centralized Sukuk Bankruptcy Tribunal in Dubai, UAE would provide one jurisdiction with a standardized dispute resolution contract for the adjudication of all sukuk disputes under the auspices of the Higher Shari’ah Authority. The streamlined sukuk dispute mechanism would provide investor confidence in the sukuk instrument and encourage sukuk investing well into the future.

On June 14, 2017, Dana Gas obtained an injunction from the Sharjah Federal Court of First Instance restraining anyone from taking any action, inside or outside the UAE, to enforce against any of the securities Dana Gas and its affiliates under Dana Gas’s Security Agreement until a final determination was made by the Court in the lawsuit. (Wikipedia) This was followed by an injunction in the English High Court of Justice and the British Virgin Islands. (Wikipedia, 2019) On July 5, 2017, Dana Gas and the CEO held a scheduled call to explain to the sukuk holders why this deal offered to them was to their benefit. (Wikipedia, 2019)

In September, 2017, a creditor’s committee supported by 70% of the sukuk holders offered Dana Gas a restructuring proposal involving a US $300 million cash payment and a three-year extension of the outstanding sukuk’s life. (Cleary Gottlieb, 2018) Dana Gas rejected the proposal and the dispute between Dana Gas and the sukuk holders was left to the courts to resolve. (Cleary Gottlieb, 2018)

Dana Gas brought an action in the High Court of London requesting that the English law governed purchase undertaking between Dana Gas and the SPV (the “Purchase Undertaking”) be declared void and unenforceable. (Cleary Gottlieb, 2018) Simultaneously, Dana Gas brought an action in the UAE seeking to challenge the validity of the UAE law governed Mudarabah documents for their non-compliance with the Shari’ah law. (Cleary Gottlieb, 2018)

In November 2017, the High Court rendered a preliminary judgment rejecting the arguments put forward by Dana Gas and ruling the English law governed Purchase Undertaking to be valid. (Cleary Gottlieb, 2018)

On May 13, 2018, Dana Gas announced that it had reached an agreement with the Ad Hoc Committee of sukuk holders to restructure and refinance the Dana Gas Sukuk. (Wikipedia, 2019) Investors could exit the sukuk at 90.5 cents on the dollar or roll over into a new three-year US$530 million sukuk with a four percent profit rate, while receiving final profit payments owed to them before the old sukuk matured. (Reuters, 2018) On May 23, 2018, Dana Gas launched the tender. (Wikipedia, 2019)

In this case, while the Purchase Undertaking was subject to English Law and the non-exclusive jurisdiction of English Courts, and had been determined by the High Court to be valid under English Law, the Mudarabah Agreement was subject to UAE law and to the non-exclusive jurisdiction of UAE courts. (Cleary Gottlieb, 2018)
The UAE courts could have refused to apply English law to the Purchase Undertaking or denied enforcement of an English court judgment based on the enforceability of the Purchase Undertaking on the basis that the terms of the Purchase Undertaking violated the Shari’ah law and are contrary to the public order.

It is quite confusing and against the administration of justice that the terms in the Dana Gas prospectus stipulate that the governing law and jurisdiction are predominantly split between English and UAE law. The Declaration of Trust, the Agency Agreement, the Purchase Undertaking, the Sale Agreement, the Security Agreement, the Security Agency Agreement, the Ordinary Certificates, and the Exchangeable Certificates were governed by English law and subject to the non-exclusive jurisdiction of the English Courts. The Mudarabah Agreement, the UAE Share Pledges, and the UAE mortgage were governed by the laws of the UAE. The courts of the UAE had non-exclusive jurisdiction to hear all disputes relating to the UAE mortgage. (Hekmatyar and Parkar, 2018)

A question arises, if the Dana Gas Sukuk is partially or fully non-compliant with Shari’ah, does this entail it unlawful under UAE law? Secondly, does this negate the obligation of profit payments, rescinding the terms of the contract and making it unenforceable legally? (Hekmatyar and Parkar, 2018) These are serious questions for potential investors in future sukuk offerings and questions, which are essentially split between two possibly conflicting jurisdictions, the UK and the UAE. The time is ripe to create the Sukuk Bankruptcy Tribunal and the future of the sukuk industry depends on it.

**Sukuk Bankruptcy Tribunal (“SBT”)**

The author proposes that for 2020 the Islamic finance industry aims to create (“DWIFAC”) or the Dubai World Islamic Finance Arbitration Centre and (“DWIFACJO”) or the Dubai World Islamic Finance Arbitration Centre Jurisprudence Office complete with a Sukuk Bankruptcy Tribunal (“SBT”) and a Takaful Tribunal (“TT”) and that DWIFACJO issue a standardized dispute resolution contract for each DWIFAC, SBT, and TT, which may be attached to the main contract. The DWIFACJO standardized dispute resolution contracts may contain a similar built-in dispute resolution mechanism as the FIDIC contract containing three stages including (1) the Dispute Resolution Board (DAB), (2) amicable settlement, and (3) final referral to DWIFAC, SBT, and TT arbitration. Within thirty days of the occurrence of the subject-matter of a dispute, any party to the contract may submit a claim to the DAB, addressed to the chairman of the DAB and with a copy to all parties of the contract. However, if any of the parties to the contract considers that there are circumstances, which justify the late submission, she may submit the details to the DAB for a ruling. If the DAB considers that it, in all the circumstances, is fair and reasonable that the late submission be accepted, the DAB shall have the authority to override the relevant thirty-day limit and if it so decides, it shall advise both the parties accordingly.

The DAB shall have sixty days to issue a binding ruling, which must be implemented immediately. If either party is not satisfied with the DAB ruling, either party can give notice of dissatisfaction to the other before the thirty days after the day on which she received the decision on or before the thirty days after the day on which the said period of sixty days expired. If there is no dissatisfaction within thirty days after the
day on which she received the decision, the DAB’s decision shall become final and binding upon both parties. The DAB’s decision may then only be overturned by settlement or arbitration at DWIFAC, SBT, or TT.

The DAB shall consist of three people who must be suitably qualified in law, Islamic finance, and Shari’ah. Each party shall nominate one member for the approval of the other party. The parties shall consult both these members and shall agree upon the third member, who shall be appointed to act as chairman. However, if a list of potential members is included in the contract, the members shall be selected from those on the list, other than anyone who is unable or unwilling to accept appointment to the DAB.

The agreement between the parties and either a sole member (adjudicator) or each of the three members shall incorporate by reference the General Conditions as written by DWIFACJO, with such amendments as agreed between them. The composition of the DAB shall be by nomination and then joint-selection. DAB members are to be re-numerated jointly by the parties with each paying half of any fees. DAB members may only be replaced by mutual agreement. The appointment of any member may be terminated by mutual agreement of both parties, but not by any party acting alone. Unless otherwise agreed by both parties, the appointment of the DAB shall expire when the discharge of the matter shall have become effective. Where the parties fail or are otherwise unable to agree upon the appointment, nomination or replacement of any member of the DAB, then the appointing official so named in the contract shall make the appointment.

DWIFAC, SBT, and TT may establish an Ambassador’s List similar to the FIDIC President’s List, from which arbitrators and DAB members may be selected, if not specified in the contract. Persons who have successfully completed a DWIFAC Adjudication Assessment Workshop and International Arbitrator’s Islamic Finance Contracts Course and applied for entry to the DWIFAC Ambassador’s List of Approved Dispute Adjudicators are entered on the List for five years. Successful attendees at an Adjudication Assessment Workshop are required to be fluent in English and to be thoroughly familiar with Islamic finance, law, and Shari’ah.

There may be situations where a party fails to comply with a DAB decision. In such cases, the other party may refer the failure to DWIFAC, SBT, or TT arbitration. Where notice of dissatisfaction has been given, both Parties shall attempt to settle the dispute amicably before the commencement of arbitration. However, unless both Parties agree otherwise, arbitration may be commenced on or after the fiftieth day after the day on which notice of dissatisfaction was given. The attempt to obtain an amicable settlement during this prescribed period of fifty days is a condition precedent to a referral to arbitration. There is no given time frame to refer a dispute to arbitration, however, it should be without undue delay. Once the arbitration procedure has been initiated, the DWIFAC arbitration shall commence according to the DWIFAC arbitration rules, the SBT arbitration shall commence according to the SBT arbitration rules, and the TT arbitration shall commence according to the TT arbitration rules.
The arbitrator(s) shall have full power to open up, review, and revise any decision of the DAB relevant to the dispute. Neither party shall be limited in the proceedings before the arbitrator(s) to the evidence or arguments previously put before the DAB to obtain its decision or to the reasons for dissatisfaction given in its notice of dissatisfaction. Any decision of the DAB shall be admissible in evidence in the arbitration. Arbitration may be commenced prior to or after completion of the contract. The obligations of the Parties and the DAB shall not be altered by reason of any arbitration being conducted during the progress of the contract.

The arbitration at DWIFAC, SBT, and TT shall be conducted in the English language and any arbitral decision shall be final and binding. All of the DWIFAC, SBT, and TT decisions are to be published in English, French, and Arabic and the arbitration itself to be conducted in English. In the event of a conflict of laws, the Shari’ah shall prevail. A valid arbitration decision should lead to a verdict that conforms to the rules of the Shari’ah (AAOIFI 2004:559). The Shari’ah and legal basis of the arbitration decision shall be mentioned in the decision (AAOIFI 2004:559).

In the context of DWIFAC, SBT, and TT, the centers may make arrangements with the Dubai and DIFC courts and Abu Dhabi Courts and the ADGM or Abu Dhabi Global Markets Courts for enforceability of DWIFAC, SBT, and TT arbitration awards. However, parties to the dispute must realize that the arbitration award issued by DWIFAC, SBT, and TT may be overturned or enforced in other jurisdictions (International Bechtel Co. Ltd. v. Department of Civil Aviation of the Government of Dubai 300 F. Supp. 2d 112 (DDC. 2004)) or challenged in UAE courts based on Article 216 of the Civil Procedure Law (Now Article 53 of the Arbitration Law). Higher Shari’ah Authority decisions shall act as a source of precedent and shall be binding, thus providing legal certainty to Islamic finance and sukuk dispute adjudication. The Higher Shari’ah Authority shall act as the highest Shari’ah authority for DWIFAC, SBT, and TT arbitration, the UAE, and the DIFC and ADGM.

Conclusion

If the Sukuk Bankruptcy Tribunal was in existence at the time of the Dana Gas sukuk dispute, there would have been a contractual, streamlined, and standardized dispute resolution mechanism in place to resolve the dispute while the contract continued. Using a built-in-contractual dispute resolution mechanism such as the afore-mentioned system allows the contract to continue while solving the dispute through the Dispute Adjudication Board and if necessary, ultimately through arbitration. I believe the Islamic Finance Industry should seriously consider the implementation of the Sukuk Bankruptcy Tribunal as part of the wider DWIFAC dispute resolution mechanism.
The Dana Gas Sukuk: An Example of Why We Need.....

Bibliography


Shariah Ruling of Bill Discounting and its Alternative
(Bai Salam in currency)

By
Uzair Ashraf Usmani *

Abstract:
With the growing use of financial services in international trade, the importance of bill discounting is not beyond comprehension. It is undoubtedly one of the most important tools of trade financing. Now, it has become very easy for importers and exporters to sale any product to a complete stranger anywhere in the world and get the bill against it discounted before its maturity date. That is why; this tool is in the practice of all conventional banks. But, regarding Shariah rulings, the prevailing practice in conventional banks is not Shariah compliant as this transaction consists of debt sale and interest. But, due to its vital need, Islamic Shariah jurists have stepped forward with its different alternatives based on Murabaha, Wakalah, Musharkah and Bai Salam in currency. In this article, we have covered the rationale behind the Shariah rulings of prevailing bill discounting in conventional banks and addressed the Bai Salam as an alternative in currencies and its executive model in Islamic banks. Furthermore, we have discussed the different opinions of modern scholars regarding these issues.

Keywords: bill discounting, letter of credit, alternative of bill discounting, bai Salam in Currency.

1. Significance of bill discounting
With the rapidly growing economy, the importance of bill discounting is not obscured any more. This bill has just not only become almost mandatory in trade financing but it is also a very important business tool among traders in the current round

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of world trade. Undoubtedly, the traders who deal in imports and exports have to use this product constantly. Through this product, the traders get the benefit of not only staying at home and selling their commodities to a completely unknown part of the world but also have an opportunity to get their bills discounted against the payable amount before their maturity, and then with that amount they generate more earnings and profit by investing and placing it in different financial institutions. That is the reason why this tool is in the practice of all conventional banks. According to the practice in vogue the exporter sells his goods at an agreed price to someone living in other country in exchange of a bill for payables. As soon as the trader loads his goods on the ship, the importer signs a bill to transfer it to the exporter from his bank; the bill actually is a promissory note on behalf of the importer that he will pay the amount on mutually agreed date to the exporter. This bill is known as a letter of credit or bill of exchange in Arabic and the date at which amount will be paid is the maturity date known as نقض الكمبيال in Arabic. After that, most of the time, the exporter is in a hurry to get the amount as soon as possible so that he can make further investments, therefore, the bill is taken to a bank for discounting. This process is called endorsement and known as تظريح in Arabic and the person who signs is known as endorser and is known as مظريح in Arabic. Bank accepts this receipt against the receivable amount, and reimburses some amount which is much lesser to the amount receivable (depending upon the outstanding number of days left from the maturity date) to exporter at that time. This procedure is identified as Bill discounting and in Arabic it is called or خصم الكمبيال. Banks most often take its profit according to the corresponding number of days left from the maturity date.

Bill discounting’s Mechanism which is prevailing and is in practice under all conventional banks in summarized from is that suppose a manufacturer name Zaid manufactures shoes and imports and sells them to importer Umar who lives in America on mutually agreed price, let’s say one lac dollars. They finalize this deal on first of January and they already have decided that with mutual understanding Umar, the exporter, is going to pay him on 1st of March, now Zaid gets the shoes shipped, let’s say on 15th January and informs Umar about it. Umar upon being informed sends a bill on behalf of his bank to the Zaid in which he undertakes the promise to pay the amount on 1st march as mutually agreed in the contract of sale, this bill is called bill of exchange or letter of credit which mostly is of two types: usance LC and sight L.C. It is termed as الكمبيال in Arabic, now after receiving the bill Zaid wants financial assistance to make more investments he takes the bill to the bank and signs on the back of receipt of the bill and asks bank to pay him some money let’s say 90,000 dollars and in exchange bank keeps receivable amount which is 100,000dollars from the exporter. Bank mostly pays him the lesser amount as compared to the amount to be received, and the discounted amount
which is 10000 dollars, in our case, is bank's profit. Mostly it depends upon the number of days which are left from the maturity date. Bank discounts Supplementary money if the number of days are more to the date of maturity, this discounting is called bill discounting and it is termed as حسم الكمبال in Arabic and person who signs who is exporter in our case is called endorser and it is called ﺟﻤﺸ in Arabic and this process is termed as endorsement . In Urdu this process is called ﻗﺎن۔ ﻧﻔڑ ﻧﮨ辇．

We can divide bill discounting into two types:

1.1 First type

In first type the bill holder (مﻈﮩﺮ) receives the amount from the bank and gets himself free from any kind of liability. In other words if the importer did not pay amount to the bank, he would not be questioned to pay. This is called without recourse.

1.2 Second type

In second type of bill discounting after receiving the amount from the bank the bill holder or the exporter doesn’t get himself from the liability of payable of importer. So he will be questioned if importer defaults. This is called with recourse.

1.3 Shariah rulings of first type

The first step will be the proper understanding of debt. Debt is discussed in the book “ALMOSUATUL FIQHIYYA ALKUWETIYA”6 according to which in a summarized form debt means an indemnity which becomes mandatory in the liability of the person due to the execution of the transaction or due to dispose of the property or due to taking loan from someone Suppose if a person has bought something like wheat in exchange of Rs.100 from the shopkeeper, now on because of this transaction providing 10Kg wheat is debt on the shopkeeper and paying Rs.100 is debt on the buyer.

If we observe bill discounting closely we conclude the result that it is mandatory for the importer to pay debt to the exporter, but exporter therefore sells the debt to the third party which is the bank lower than the face value, and we already mentioned that the bill of exchange is actually the promise of importer which shows that he will pay the due debt on him in the future. So, following the Shariah rulings of first type, we can say that it’s a debt sale to third party transaction. We consider first type as sale because the liability of exporter gets over after he receives the amount from the bank. According to Islamic law of sale, sale possess the same feature because after the sale the responsibility of the vendor from the subject-matter gets finished until or unless subject-matter appears

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4,5 ...Uniform commercial code 3.145 if an instrument is dishonored, an endorser is obliged to pay the amount due on the instrument (i) according to the terms of the instrument at the time it was indorsed, or (ii) if the endorser indorsed an incomplete instrument, according to its terms when completed, to the extent stated in Sections 3-115 and 3-407. The obligation of the endorser is owed to a person entitled to enforce the instrument or to a subsequent endorser who paid the instrument under this section.
to be defected or anyone else’s share appears in the subject-matter. So it will be called
debt sale.

So in other words it’s a debt sale to third party and regarding the debt sale to third
party, the jurists have given their words by which laws of bills of exchange can be used
for a verdict.

1.3.1 Hanafi school of thought

By observing the religious text of Hanafi school of thought, it is evident that near the
Hanafi jurists selling the debt to a third party is not admissible because uncertainty is
being found in it. And according to hadith such sale and purchase, in which uncertainty is
being found, is prohibited.

Therefore the Holy Prophet (pbuh) said:

Translation: Hazrat Abu Hurairah (RA) said: Holy Prophet (pbuh) has prohibited
the sale and purchase of gravel and uncertainty.

The description of uncertainty is that the seller is legally obliged to do in terms of
buying and selling that the subject matter which is being sold or purchased should be
given in the risk of the buyer. Therefore, if the seller sells subject matter without giving
in risk to the buyer then because of this unaffordable delivery, the sale becomes void. In
aforementioned situation the person who has to receive the debt sells the debt to the third
party then the third party has no idea that whether the debtor (the one who pays the debt)
will pay the debt or not. Therefore, ambiguity is being found in it and that debt is an
unaffordable delivery. Hence, uncertainty is found in it so selling or purchasing of this
debt is not permissible.

We also come to know that the actual reason behind the illegitimacy of debt sale to
third party is the uncertainty therefore if the debt is sold on the face value or more than or
lesser than the face value, debt sale to third party will remain illegitimate.

The Hanafi text, in a summarized form, is mentioned below:

In MOUTA Imam Muhammad, Imam Muhammad (May Allah bless his soul) said
that a person who has a debt on another person, it is inappropriate for him to sell the debt

المؤلف: مسلم بن الحجاج، إِبْن الحسن القشيري، المنسوب إلى (السنوي 262 هـ) صحيح مسلم (3/1153) الناشر: دار
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 Müftü üçebaci 15. ص: 338 من الفقه البيروعي، يقول إبراهيم سليمان في كتابته معارف القرآن الكريم
المؤلف: طأمة بن عمرو بن عمرو الأصحي، المنسوب إلى (السنوي: 179 هـ) موظفًا لمالك رواية محمد بن الحسن بن
ال Чт: 292، الطبعة الثانية، مركزية متوقعة الإشارة: الكتبة العلمية 2015

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because the other person doesn’t know that whether the debtor will pay debt or not. This is also the opinion of Imam Abu Hanfia (May Allah bless his soul).

Allama Kasami\(^{10}\) (May Allah bless his soul) narrates in his famous book that the sell or purchase of the debt is forbidden to any third person, because either the meaning of debt is the amount receivable or delivering the debt to under the ownership of someone else, both the cases are not allowed regarding to Shariah because in both the cases the vendor cannot give it to the customer since he doesn’t have the debt.

1.3.2 Hanbali school of thought

By looking at the text and narration of the Hanablah, it can be said that debt sale to third party is not allowed because uncertainty is being found in it; the details of which are given in the explanation of Hanafi religion above.

However it is said in the book “Masail Ishaqbnurahveh” that the selling or purchasing of debt is permissible to the debtor for example dowry is to be paid by husband to wife which means that except the debtor, no one else is permissible to pay it. Hence it is permissible to the debtor to sell the debt.\(^{11}\)

It is said in the book ALMUHARRAR that except to the debtor, no one else is permitted to be sold the debt to.\(^{12}\) It is said in the book SHARUL KABIR\(^{13}\) that except to the debtor no one else can be sold the debt to because regarding to this chapter narration of Hazrat Ibn Umar used to sell camels in the grave yard of Baqi and sometimes he used to decide dirham for it and used to take dinar and vice versa so interrogated once this to Holy Prophet (P.B.U.H) about it and the Holy Prophet (P.B.U.H) said that there is nothing wrong in it. Through it we came to know that sell or purchase was done in dananir and that was mandatory to be paid but in exchange to that, dinar or dirham were being received from the debtor. Therefore, except to the debtor no one else is allowed to sell the debt to.

\(^{10}\)المؤلف: علاء الدين، أبو يكيمن بن مسعود بن أحمد الكهاني الحكيم. المبطن: 587، الطبعة: الثانية (1406 هـ، 1986 م).

\(^{11}\)المؤلف: إسحاق بن منصور بن بكر بن يعيم الحبشي. المبطن: 251، الطبعة: الأولى (1425 هـ) الناشر: عمادة البحث العلمي، الجامعة الإسلامية بالسعودية.

It is said in the book ALINSAF that according to right opinion debt sale to third party is forbidden.\textsuperscript{14}

**Zawahri school of thought**

Allama Ibnul Hazam writes about debt sale its summary is that debt sale is not allowed to third party whether this sale is done in the cash or against any commodity because ambiguity is there and this sale which produces uncertainty, regarding its brief explanation we already have mentioned before.\textsuperscript{15}

**1.3.3. Maliki School of Thought**

In Malki school of thought, the following context is followed:

It is discussed in the book Manhul Jaleel\textsuperscript{16} its summary is basically it is not allowed to sell any debt to any one (third party) except for the debtor himself. However, they allow to sell debt with certain restrictions.

Debtor should be available and should not busy in travelling. If the debtor is not available in council contract where selling and purchasing is going on than this selling is not permissible. Debtor admits the due able debt on him. Debt should be something which is permissible to be sold before taking its possession of it. If debt is wheat then it is not permissible to sell it to the third party before taking its possession as it is not permissible to sell or purchase anything before taking possession. In Maliki school of thought short sale is allowed in everything except in the wheat. Hence, except wheat debt sale upon anything is permissible if other corresponding conditions are followed too.

Debt sale should not be in form of homogenous goods consequently as a result of it if debt is in the form of dirham and transaction is also executing in dirham then this transaction will be illegitimate, at this point Allama Dasouqi further added if both subject matter and consideration are homogeneous then uniformity on both the counter values will be prerequisite in order to make this transaction legitimate.

Sale purchase of silver and gold against each other or against their selves should not be allowed despite from the fact that they are not homogeneous when it comes to sale against one another, but because aforementioned transaction is SARF and in sale of SARF taking possession on both subject matter and consideration in the council contract is one of the two stipulations, and in this case this condition is not getting full filled so this transaction is void.
There should not be prevailed any hostility among the vendor and the debtor so the customer could not able to get the debt. Allama Dsouqi further added two more conditions which have been explained by mufti Taqi Usmani in his latest book name “fiqhu biyoo”.

Consideration against debt should be in cash and in spot otherwise if we consider consideration as loan or debt then transaction becomes *bai alkali bilkaali* which is not permissible in the eyes of shariah.

Debtor should be from those who can be enforced by law and regulative authorities so if he defaults from paying his debt then debt can be recovered through the mean of court.  

1.3.4 Shaafi school of thought

On this issue, we may find contradiction among shawafy’s narrations in some books we find legitimate to sale the debt to a third party, some narrations suggest that it is allowed if customer and the vendor take the possession on both consideration and the subject matter respectively in the council contract and then customer sells to the third party. Their opinion has been described in the book Raouzatu Talibeen. And the book of Imam Abu Zakriya Mahyoddin may Allah bless his soul MUHAZZAB

The summary of this is that according to Shawafa, the selling of debt except to the debtor which is the third party is not permissible if customer takes the possession on the debt in the council contract, the fact is that this condition is indicating the illegitimacy of debt sale as when the debt has been taken under possession it will not remain debt according to Shariah that is the reason why Allama Nawavi has written the opinion of inadmissibility of this transaction in his book MINHAJ UL TALIBEEN

But number of Shaafi scholars and jurists did not mention this condition in their books even Allama Sherazi did not mention this condition on the context of MUHAZZAB one of his written books.

**Summary Of Shaafi School Of Thought**

Justice retd Mufti Taqi Usmani after mentioning all the opinions and the brief research study, which have been made on Shaafi school of thought, says that Shawafy has 3 opinions:

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Permissibility of debt sale

Impressibility of debt sale

Permissibility of debt sale with condition of taking possession in the council contract on the compensation and the debt

However, it means that all Shafi jurists who mention the permissibility of debt sale are basically adopting this view with condition of taking the possession on the debt and its compensation in the at the meeting of the contract, therefore uncertainty which is the basic reason of getting this transaction impermissible does not exist in the aforementioned case, therefore in other words if uncertainty exist then Shafi jurists would not allow the debt sale to the third party too.

Summary of the research study is jurists have three opinions regarding to this issue:

According Hanafi, Hanbali and one of the opinions of shawafy debt sale is not a Shariah-compliant activity as this sale is based on uncertainty as it is unknown in the transaction whether debt will be received or not after it is being purchased.

**Permissibility of debt sale according to some shawafy**

According to some Shaafi and Malki jurists debt sale is Shariah-compliant with some specific conditions, Malki jurists allow this sale if debtor accepts the due able debt on him and he is present in the court, so it means that receiving of debt is absolute so there will not remain any more uncertainty in the transaction.

Sheikhul Islam Mufti Taqi Usmani, after addressing above mentioned issues and opinions, says that argument of majority jurists is very strong because debtor admits due able debt when there is an actual debt on him but conviction of paying debt will not be achieved just by admitting as there are number of debtors who admit the payables but do not pay their payables but they rather mostly default and work with deferment and several debtors not only default but refer back their admission and declaration, so then this issue leads towards the court with all the fights and disputes, so when the conviction of paying debt is not achieved it will become uncertainty.

**Shariah rulings of first type:**

According to the above mentioned views and opinions of jurists fist type of bill of exchange is not allowed according to Hanafi, Hanbali Zawahri and of the opinions of Shafi school of thought even if it is sold on the face value as that sale will be based on uncertainty, jurists has mentioned another document in their books which resembles with the bill of exchange it was called *JAMKIYAA*, this document used to be issued on behalf of baitul maal or on the half of supervisor of the Waqf in the favor of the person whom had any financial right on them. Jurists of ahnaf and HANABILAH do not allow sale of that document as this sale is actually the sale of debt to the third party, just like that they also do not allow the sale of first type of bill of exchange. But ALLAM Ibn UL HATTAB one of the jurists of Malkiya has allowed sale of that document:
But regarding to the conditions that malkiyaa impose on the debt sale we observe that they allow the sale of the debt with condition of in homogeneity of both the consideration and subject matter however if they are homogenous then they should have to be equal in the quantity, in the aforementioned case there isn’t any equality in the transaction of bill discounting so bill discounting should be impermissible according to malkiyaa too.

Regarding to shawafy and their opinions some of them allow the debt sale or sale of jamkiyaa with the condition of having the possession on both the consideration and subject matter in the council contract however if we take that specific opinion then bill discounting will be not allowed too according to them as they also impose the condition that consideration should be equal to the face value of the debt and in the aforementioned case consideration is less than face value of bill of exchange so its sale is forbidden too. So our discussion proves that first type of bill discounting is impressible near all authentic jurists.

1.4 Shariah rulings of Second Type

If we observe closely the second type of bill discounting we come to the result that the liability in the favor of exporter does not get over when the he discounts the bill and receives the amount from the bank, in fact still bank shall has the right to receive his amount if the importer defaults from paying the amount, regarding its Shariah adaptation it is actually the combination of loan and hawala as bank first lends loan to the exporter with the condition that he will do the hawala (transfer of loan) towards the importer means the importer must repay the loan that had lent to the exporter and then bank will take that loan given to the exporter plus the extra amount as its fee. Therefore it can be assumed as hawala acting upon the Hanafi school of thought.

(What is hawala?)

وفي اصطلاح الفقهاء تحويل الدين من زمة الأصيل إلى زمة المتحال عليه على سبيل التوثق به

Hawala is the transfer of debt from the transferor (muheel) to the payer (muhalalaithe) suppose if 100 rupees are payable in the liability of Zaid as debt and he has to pay this debt to the Umar then Khalid comes and says I will reimburse the debt on the Zaid to the Umar then this transaction is called hawala according the Islamic jurists. In the aforementioned case Zaid ismuheel, aseel or the debtor, Umar is the person who has to be paid the debt is muhtallahoo and Khalid who has taken the responsibility of paying the debt is muhtalalaithe.
Basic principal of Ahnaf is if the debt gets lost then muhtal can receive the payable debt from the muheel. In the aforementioned case muheel is the exporter bank is the muhtal who has lent the loan to the exporter and exporter has transferred the loan towards the importer who is the muhtalalihi. Reason of saying this adaption hawala is that there is a law in number of countries that if the importer didn’t pay the debt then bank would have been granted a right to receive the debt from exporter, so according the following type of hawala liability of the exporter does not get over so if the bank didn’t get its debt received from the importer he would have been received it from the exporter. This is exactly the same situation that Ahnaf has mentioned in their books. According to that if the debt gets lost then the creditor can receive the debt from debtor.

Although ahnaf allows hawala itself but the aforementioned type of bill discounting is illegitimate as it is necessary if the debt is in the form of loan then the receivable amount from the importer should have to be equal to the amount paid to the exporter (means as much loan has paid the bank as much he should receive from the importer) but the ongoing practice of all conventional banks is to receive extra amount of money from the exporter which is Riba. So this type is also impermissible and that is the reason why second type of bill discounting is also declared as illegitimate in the AAOIFI standards.

2. Alternative of Bill Discounting

Apart from being its impermissibility, its importance is undoubtedly not obscured anymore. For the development of society the bill of exchange financially plays an extra ordinary role. Therefore, it was an exigency of the time for the contemporary scholars and jurists to present its alternative and they have come up with the following alternatives:

- Murabaha model
- Wakalah model
- Salam model

We will discuss the main framework and structure of Salam model in our ongoing discussion and conclude this research with the legitimacy of this model.

2.1 Salam Based Currency Model

To get fully understand Salam based currency model it would be better for us to understand bai Salam and bai Sarf first. We also have to understand the meaning of fuloos and Shariah rulings of executing Salam in the currency and fuloos as well.
2.1.1 Definition of Salam

Salam may be defined as:

"بِعِيدِ الأَجَلِ بِالنَّاظِرِ"

In Salam, the seller undertakes to supply specific goods to the buyer at a future date in exchange for some advance price fully paid on the spot. The price is in cash but the supply of purchased goods is deferred.

Suppose if a vendor sells wheat and says that he will undertake to supply the specific quantity of wheat, let’s say 100 tons, after 6 specific months and customer agrees and pays the amount as consideration in advance on the spot then this type of transaction is called bai Salam. As at the time of transaction the subject-matter is not available, consequently, according to the qayas, this sale should be void ab initio because it is necessary in the contract of sale for the subject matter to be available at the time of sale but this sale has been proven by the hadith. So, shariah has allowed to use this as a mode of financing with some certain unambiguous conditions. Under such a sale contract the subject matter is called muslamfih and the consideration is termed as rasulmaal.

2.1.2 What is the Role of Sarf

The author of one of the famous books of Ahnaf Allama Kasaani (may Allah swt bless him) says in his book BADIAE ALSANAAIE:

الأول فالفصرف في متعارف الشرع " اسم لبيع الأثمان المطلقة بعضها بعض وهو بيع الذهب بالذهب والفضة بالفضة وأحد الجنسين بالأخر 27

Sarf means the exchange of some Athman e mutlaqa with some other, Athman mutlaqa is the term that means exchange or sale and purchase of gold against gold or silver against silver or sale purchase of one of the genus is against one another, according to Islamic jurisprudence if both commodities are homogenous then there should be prevailed uniformity among the both commodities and taking possession on both the commodities should be necessary and if they are not homogenous like exchange of silver against gold then it is allowed to execute it without uniformity but taking possession is still necessary.

To know the Shariah rulings of currency we have to understand the meaning of fuloos and we also have to understand whether rulings of sarfare implemented on the fuloos too or not because if the rulings are implemented on fuloos then it means execution of Salam in the fuloos will be forbidden as in sarf it is necessary to take the possession on both the counter values and where as in Salam it is only necessary to take possession on the rasulmaal only.

2.2 What are Fuloos

It is written in the book ALMOSUATUL FIQHIYAA ALKUWETIYA:

وفي الاصطلاح: كل ما يتخذ الناس ثمنا من سائر المعادن عدا الذهب والفضة 28

المؤلف: علاء الدين، أبو يكير بن مسعود بن أحمد الكاساني الحنفي ( المتوفي: 587هـ) الطبعة: الثانية، 1406هـ -

1986/1دائع الصناع في ترتيب الشراع (5/215) الناشر: دار الكتب العلمية

الموسوعة الثقافية الكويتية (204/32) صادر عن: وزارة الأوقاف والشؤون الإسلامية - الكويت

الطبعة: (من 1404 - 1427هـ) الأجزاء 1 - 23: الطبعة الثانية، دار السلاسل - الكويت 28
Fuloos means anything from the metals except silver or gold which have been made Thaman (consideration) by people. So ‘fals’ is not itself is a Thaman but it has been made and treated as Thaman due to custom of the people or the orders of the government, so if that custom has changed or the government has stopped treating as legal tender then the actual status of fuloos will be revoked too and it will remain not more than a metal which has its own made up value. On the other hand gold and silver both are Thaman itself as they are genetically Thaman whether people or government call it Thaman or not. That is why silver and gold are called genetically Thaman.

2.2.1 Shariah Ruling of Fuloos Based Salam

From the four schools of thoughts it is not allowed to execute the Salam in the fuloos near Imam Malik may Allah swt bless him because according to him verdicts of Sarf are implemented on fuloos and it is compulsory in Sarf to take possession on both the counter values whether they are homogenous or not where as in Salam it is not compulsory for the subject matter to be taken in possession, so the execution of Salam based fuloos is not allowed near to him.

- Hanbali School of Thought

There are two narrations of Imam Ahmad bin Hanbal (may Allah swt bless his soul) regarding the issue of the implementation of the verdicts of sarf on the fuloos, according to the first narration its verdicts are not implemented on fuloos and according to second narration its verdicts are implemented on the fuloos. Following the second narration some of the Hanabila jurists say that it is allowed to execute the fuloos based Salam if the rasulmaal is in the form of goods, in other words it should not have to be in the form of cash no matter the transaction is executing as in weights or in numbers, execution is allowed, and this is the right narration and the opinion regarding to this issue.

- Shaafi School of Thought

According to Imam Shaafi may Allah swt bless him fuloos genetically is not Thaman so the rulings of sarf are not implemented on the fuloos and when the rulings are not implemented then the execution of fuloos based Salam and its transaction is legitimate too.

- Hanafi school of thought
According to Ahnaf, to prove Riba in any commodity, availability of homogeneity with volume is indispensable. Volume means weight of gold and silver. So weight is one of the prerequisites of having Riba in gold and silver. Therefore it means verdicts of Sarf are not implemented on fuloos according to the Hanafi school of thought as fuloos are countable numerical object, therefore this opinion demands the legitimacy of sale purchase of excessiveness of fuloos with one another and the non-prerequisites of taking possession on both the counter values. But HANFI somehow impose the condition of taking possession with another angle i.e. fuloos are basically from the ATHMAN (consideration) and the ruling of Thaman is that they are not get specified with specification but they get specified with taking the possession. So if they are sold without specification, then it will expose to usury or Riba. It can be explained with an example. For instance, Zaid sold Umar 2 fals against one fals. And this sale was just executed verbally not physically then Zaid said: now I have to pay you two fals and you have to pay me one fals therefore I execute the settlement agreement with you as two payable fals on mine are settled against one fals payable on you therefore there remain one fals only which is in my liability and now I have to pay you only one fals, so in the end without any physical actual sale purchase paying of fals has become liability of Zaid and this one fals is not against any compensation which is usury and Riba and clear violation of Shariah rulings. Therefore to avoid the transaction without any compensation Hanafi impose the condition of taking possession in the council contract so the fuloos get specified.

And if specified fuloos are sold against one another with excessiveness then issue will be disputed and debatable among Hanafi jurists, according to Imam Abu Yousuf and Imam Abu Hanifa (may Allah swt bless them) sale purchase of fuloos with excessiveness is legitimate because specified fuloos are like goods therefore as selling of goods with excessiveness is legitimate so the selling of fuloos is legitimate too, fuloos are like goods because they are actually made up of metals like paper, steel etc, they are not genetically Thaman so they are called Thaman due to the custom of the people consequently if both the counter parties are agreed for the revocation of custom then a fals will not remain more than a thing made up of metals and its value will be the equivalent to the value of goods. And both counter parties can revoke the custom as no one else has the authority on them. So it means that fuloos can be sold after getting specified with excessiveness.
On the other hand Imam Muhammad says that fuloos cannot be sold after getting specified with excessiveness because fuloos are declared Thaman due to the convention and custom of the people so it cannot be revoked with the revocation of both counter parties therefore they will remain Thaman and when they will remain Thaman then will not be specified with the specification so their sale purchase will be like the sale purchase of non-specified fuloos with excessiveness which is forbidden near Ahnaf so the aforementioned situation will be forbidden too.

However apart from the aforementioned disputed issue Hanafi jurists agree that rulings of sarf are not implemented on the fuloos because the transaction is not sarf therefore if they both the counter values are exchanged and they are homogenous then their excessiveness will be illegitimate and taking possession of both the counter parties on the counter values in the council contract will be the condition. Because every single value is Thaman and Thaman cannot be specified with the specification but it can be specified with taking the possession, therefore taking possession is the stipulation otherwise sale of debt against debt will be exposed which is a non-Shariah-compliant. And if both counter values of fuloos are not homogenous then taking possession on one of the counter values will be prerequisite.35

From the above mentioned research study we conclude the result that according to hanafi rulings sarf are not implemented on fuloos, regarding the Salam based fuloos transaction it is written in the books of Ahnaf that its sale purchase is permissible if it is sold numerically, there is no doubt it is legitimate near Imam Abu Hanifa and Imam Abu Yousuf (May Allah swt bless them) but near Imam Muhammad (May Allah swt bless him) it is written in different books of jurisprudence of Ahnaf that its sale numerically is not allowed near him because fuloos do not get specified so they will remain in the ruling Thaman and will not become a good therefore its sale as Salam is illegitimate.

But Allama Ibnul Hummam 36 and the author of the book of Inayah have written his opinion as legitimate and said that for the legitimacy of Salam it is necessary that muslimfihi (subject matter) should have to be a thing which should not be Athaman but a thing that can be purchased by the Thaman means it should be a subject matter. And common rule regarding the contract of sale is that it should have to be kept legitimate as far as possible. Therefore to make the aforementioned transaction legitimate it will be
assumed that both the counter parties have revoked custom and convention of fuloos as Thaman and made them in the ruling of goods, therefore as the execution of Salam is legitimate in the goods so as its execution legitimate too near imam MUHAMMAD.

We also came to know from the above mentioned result that if fuloos are not specified like the currency is admitted as legal tender by the government on government level therefore regarding the execution of Salam based fuloos sale purchase of specified and unspecified of fuloos following types are achieved:

Fuloos are unspecified and homogeneous, regarding this type transaction is illegitimate because fuloos when they are homogenous then taking possession on both the counter values from subject matter and consideration is prerequisite and in the execution of Salam based fuloos counter values are not taken in the possession. So the following type is illegitimate.

Fuloos are unspecified and inhomogeneous ,the clear verdict regarding to this type isn’t found in the books of fiqah but following the rules and regulations set by the jurists regarding to this chapter demand that their transaction with excessiveness should be legitimate and taking possession on one of the counter values should be stipulation, because this is not transaction of sarf where lending debt is forbidden subsequently it proves excessiveness and taking possession just on one value is legitimate too in this type.37

Transaction of gold and silver against fuloos whether are they are specified or unspecified. Execution of Salam is legitimate in this type as gold and silver are measured with weightage whereas fuloos are numerical countable object so the both counter values are inhomogeneous as a result of that lending loan for the future and the excessiveness in the counter values are allowed and legitimate in this transaction so the execution of Salam based fuloos is allowed too.

Transaction of fuloos against gold and silver, like the clause no three this type and execution of Salam is allowed too.38 39 40

SUMMARY

Execution of Salam is not legitimate in fuloos near Imam Malik (may Allah swt bless him) because according to him verdicts of Sarf are implemented on fuloos and it is prerequisite in Salam to take possession on both the counter values.
Following that right narration of Imam Ahmad bin Hanbal (may Allah swt bless him). Execution of Salam in fuloos will be legitimate if the rasulmaal is in the form of goods because verdicts of Sarf are not implemented on fuloos according to him.

Execution of Salam based fuloos is legitimate because fuloos are not genetically Thaman as mentioned earlier therefore verdicts of Sarf are not implemented on fuloos.

According to Ahnaf verdicts of Sarf are not implemented on fuloos, hence, execution of Salam in numbers will be legitimate. And if they are sold against one another then transaction will be illegitimate if both counter values are homogenous because in this situation taking possession on both counter values is prerequisite and in transaction of Salam possession is not be taken in the council contract. And if they are sold against their opposite genus then taking possession on one single counter value will be prerequisite however excessiveness will be allowed.

3. Currency based Salam Transaction

From the above mentioned brief research study we conclude that, if fals of one genus is sold against fals of another genus then transaction will be legitimate if one of the values is taken in the possession therefore in this situation execution of Salam is legitimate. Furthermore it should be made clear that modern jurists have three point of views regarding the issue of prevailed currency:

According to first point of view the prevailing currency is not generic Thaman but its verdict is like verdict of fuloos. So, if the verdict of the fuloos is implemented on the currency then concerning the opinions of Imam Shaafi and Imam AHAMD BIN HAMBAL in which verdicts of sarf doesn’t implement on the fuloos, therefore execution of Salam should have to be legitimate near to them.

Whereas, according to imam Malik execution of Salam should not have to be legitimate; and according to Ahnaf execution of Salam should have to be legitimate if they are dealt numerically, but this opinion also demands the legitimacy of the excessiveness in the exchange of currency too. Subsequently, if opinion of IMAM SHAAFI and right opinion IMAM AHMAD BIN HANBAL in addition to the opinion of SHEKHAIN were also taken as fatwa then door of Riba shall open because the current practice in all the conventional banks and in the world is taking back the currency with interest after lending it to the borrower which falls under the category of Riba. So this opinion has not gotten any acceptance from the modern jurists

Second point of view concerning the Shariah status and the verdict of prevailing currency is like the generic Thaman and it has taken the place of generic Thaman ,so point of view demands that ,verdicts of should be implemented on currency and Zakat should be paid up with this currency, in addition to this currency should be considered as rausul maal too but should not be considered as musalmmih or subject matter in the transaction of Salam, so if this point of view was taken then execution of Salam would be illegitimate In the views of all authentic jurist which we have already mentioned earlier, this point of view has gotten the acceptance in the conference of AAOFI ,and almost all the Arab jurists are acting upon this point of view.
Third point of view is based on the opinion of IMAM MUHAMMAD (may Allah bless him) and this point of view has gotten the acceptance of sheikh ul-Islam, Mufti Taqi Usmani. Conclusion regarding to this point of view is that prevailed currency is in the verdict of Thaman e urfi or Thaman e istalahi which means that currency has become the Thaman or consideration due to the custom or convention of the people due to the treatment of the government it as Thaman. Therefore, every country’s currency is considered as one single genus, subsequently Zakat should be allowed to pay with the currency and considering this currency as rausul maal should be allowed too, furthermore if the genesis were different then execution of Salam in currency would be legitimate too, however danger of considering currency as the mean of Riba as the condition of exchanging the currencies on market rate isn’t there in this point of view therefore Sheikh ul-Islam mufti Taqi Usmani has included this condition in the execution Salam and in the exchanging of currencies. So it will not be sold unless on market rate.  

The result of the contradiction among the modern jurists is that execution of Salam in the currency is illegitimate with reference to first point of view because in that situation it is in the verdict of sale of sarf due to treating it as genetic al-Thaman therefore its sale purchase is illegitimate too no matter they are homogenous or inhomogeneous, that is the reason why modern Arab jurist don’t allow the execution of Salam against one another in currencies.

Whereas with reference to the third point of view fatwa is on the opinion of Imam Muhammad (may Allah bless him ) consequently if currency of one genus is sold against the currency of another genus then execution of this sale will be legitimate because it’s not sale of Sarf ,furthermore taking possession on one of the genesis or the counter values should be prerequisite however in Salam rausulmaal is taken under the possession on the spot so the execution of sale Salam will be legitimate ,but to refrain from the Riba exchange rates of currencies should be subject to the market rate . This is the opinion of sheikh ul-Islam Mufti Taqi Usmani. Meezan Bank was the first bank who came up with this newly design model of exchanging of currencies in Pakistan and following Meezan’s Footstep State Bank of Pakistan also adopted this currency model.

4. Salam based Model

In this model sale of Salam is executed in currency, after shipping goods as per the L/C contract terms ,exporters do not wish to wait for the proceeds , that are expected as future date , in order to generate liquidity exporters bring bill of exchange to the Islamic bank counter and get the bill against it discounted using the mechanism of currency based Salam, under this mechanism Islamic bank purchases the foreign currency on the market rate from the exporter to be delivered on the future date against the immediate payment in local currency on market rate, mostly in Pakistan its PKR. Exporter takes the local currency (rausul mal) in his possession immediately and it becomes mandatory in his liability to pay the foreign currency (muslamfihi) on the agreed future date, when he receives that on the he instantly reimburse the foreign currency to the bank.
Treasury department of the bank plays a very significant role in the execution of sale of Salam. It gathers the liquid cash from the market and from the deposit of the bank then executes this deal. Islamic bank normally doesn’t take the profit more than the profit of conventional bank, however, the main difference is that in conventional banks the profit is haram as it consists of the debt sale or Riba whereas in Islamic bank its halal profit base on the sale purchase of a currency.

In short if we observe closely the contraction between the modern jurists and the sheikh ul-Islam Mufti Taqi Usmani we conclude the result in the end that Mufti Taqi Usmani’s view is substantial after observing the situation in the market, because in other alternatives like Murabaha customer or exporter doesn’t need the required commodity to be purchased but he needs money in cash, and alternative Murabaha basically depends upon on the required commodity, so the need of required is created for the sake of the execution of Murabaha sometimes but in Salam his need can be full filled with the amount of cash he received from the as rasulmaal.

4.1 Process flow

Exporter comes to the bank and a final approval for bai Salam will be sought as per the standard credit approval policy of the bank. After the approval, master agreement for the overall facility will be signed between the customer and the bank. Whenever customer has the need of the PKR, he will bring his export LC bills to the bank. The banks treasury based on the market price of the day, will set a range for the spot this rate will be used for conversion (purchase) rate negation between the bank and the customer. After finalization of the deal bank purchases the foreign currency to be delivered at future known specific date (due date) and pay the price in PKR as per agreed rate. To extend the facility the Islamic bank may ask the exporter to assign its receivable under this L.C to the bank, it may also ask the exporter to furnish the other securities to protect itself in case if exporter defaults. The customer will deliver the foreign currency on the due date to the bank but will not be contingent to the arrival of the L.C proceeds, in case if L.C doesn’t arrive on due time the customer will have to arrange foreign currency from his own sources and ensure payment on the due date and transaction will be concluded.
Increasing Population and Housing Deficit in Nigeria: The Application of Islamic Finance as a Moderating Instrument

By
Ibrahim Mohammed Lawal

Abstract

The paper seeks to examine the role of Islamic finance as a mediating instrument in a case of an increasing population and housing deficit. The paper adopted a content review analysis and a modified revenue function approach in analyzing the potentials of the instruments of Islamic finance. The study focused on zakat, sadaqah and sukuk as tools of Islamic financing. E-Sadaqah was analyzed based on the number of active Telecoms line subscribers in Nigeria, and if N20 is paid weekly at a 5% level of cash collection error rate coupled with an admin expenses of 15%. The study revealed that zakat has the potentials of generating about USD8M-USD21M while sadaqah could generate N154 billion annually. If combined they can be used to improve the welfare or needs of the growing population. The study further revealed that sukuk if issued to the tune of N1,002 billion which can be utilized to build about 330,820 housing estate across the six (6) geopolitical zone of the country. The study concluded that Islamic finance can contribute significantly in addressing these economic ills of increasing population and housing deficit. The study recommends that efforts should be made on public awareness in order to enlightened the Nigerian populace about benefits of zakat, sadaqah, sukuk via local media like TV, radio in local dialects, magazines, articles, legal framework such as Zakat Act is required and deployment of IT infrastructure.

Keywords: Population, Islamic Finance, Housing deficit, Shariah, Sukuk

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1.0 Introduction

Globally, the human population is estimated to about 7.7 billion (Worldometers, 2019). This trajectory in the population can be marked out to the 18th century which was when the population grew from 1 billion in 1804 to about 7 billion in 2011 within 207 years as against 0.2 to 1 billion within 1803 years. Regions that accounted for this figures (7.7 billion) are Asia (4.6 billion), Africa (1.3 billion), Europe (747 million), Latin America and the Caribbean (653 million), Northern America (368 million) and Oceania (42 million). More so, countries that are considered as top 10 (ten) with the highest population count are; China (1.4 billion), India (1.3 billion), United State of America (327 million), Indonesia (267 million), Brazil (211 million), Pakistan (202 million), Nigeria (197 million), Bangladesh (166 million), Russia (143 million) and Mexico (131 million).

However, Nigeria is ranked as the 7th Top populated countries in the world and which it was estimated that by 2050, the world population and that Nigeria is projected to be at 9.7 billion and 410 million respectively (World meter, 2019). With the rapidly increasing population of Nigerians and couple with the alarming reports that over 50% of the proportion of Nigerians are multidimensionally poor over the past decades which implies that it has increased from 86 million to 98 million (United Nations Development Programme, 2019). This figure is in tandem to both national and international poverty line of about $1.25 per day. More so, this has signaled that the country is over populated owing to the fact that its population is growing geometrically while food or output is growing arithmetically which further implies that the latter cannot cater for the former.

Consequently, this has raised concerns among Government and Non-Governmental Organization (NGO’s) that the earth may not be able to sustain the present or larger numbers of its inhabitants. This is due to the fact that it is associated with many environmental problems such as rising levels of atmospheric carbon dioxide, global warming and pollution etc, economic problems such unemployment problem, fall in per capita income, balance of payment problems, increase in price level, pressure on social services, increased demand for resources such as fresh water and food, starvation and malnutrition, consumption of natural resources.

Therefore, an overriding question arising from this increasing population is that are they adequate housing to accommodate this population? Juxtaposing this question to the Nigeria context, there exist huge gaps because the available housing is not enough to accommodate the rising population. Reports available indicates that the country is having a housing deficit of about 22 million housing units (Federal Mortgage Bank of Nigeria, 2018). This has further revealed the state of the country’s infrastructural condition. In order to cater for this deficit it requires an investment of about N60 billion dollars every year (BBC Report, 2019). Taking into consideration the available government resources, rising debt, it is too little to fill the financing gap, hence the need to seek for an alternative source of financing. This necessitates the need for the adoption of Islamic finance instruments. It is against this background that this paper was carried out.
2.0 Literature Review

2.1 Conceptual Review

2.1.1 Housing Deficit

Housing deficit can be seen as the number of shelters which do not have adequate conditions to be habitable, plus the number of housing units that need to be built to shelter all families who currently lack one and as a result, share a shelter with another household in overcrowded conditions (Carols, 2012). This condition is mostly attributable to households who live below the poverty line and their income is very limited for them to obtain affordable housing.

2.1.2 Population

Population refers to the total number of persons or inhabitants living in a particular geographical area. A population of an area can be said to be overpopulated or under populated. It is under populated if the total number of persons is less that the output/resources and vice versa when it is said to be over populated. The population of Nigeria is estimated to be at about 204 Million which is equivalent to 2.64% of the world total population (Worldometer,2020).

2.1.3 Islamic Finance

Tabash and Dhankar, (2014) sees Islamic finance as the structuring financial instruments and financial transactions to satisfy traditional Muslim structures against the payment of interest and engaging in gambling. it can also be defined as the provision of financial services in accordance with the Shariah (Kamar, et al, 2015) which is also known as Fiqh Al-Mu'amalat (Jurisprudence of Commercial transaction). Islamic finance is made up of different components which includes Islamic banking, Islamic insurance (takaful), Islamic funds and Sukuk (Islamic Bond). More so, this source of finance has its own third sector called Islamic social finance (It refers to the provision of financial services to the vulnerable members of the society to achieve socio-economic welfare). Its tools such are zakat, sadaqah and waqf etc.

2.2 Empirical Review

Farid and Awad (2017) examined population growth and economic development in an Islamic perspective. The study concluded that Muslim nations should not take an inert attitude towards technological improvements; strive at making an efficient use of their endowed resources by acquiring the most developed science and technology base. More so, they should exercise fear of Allah, exercise high level of faith as this will guarantee a sustained positive relationship between population growth and economic development.

Similarly, Dasgubta (1995) based on David Ricardo (1815) deductions of the Malthus theory, who formulate the now popular adverse relationship between population growth and economic development. Ricardo’s viewed that population growth will put upward pressures on food prices, which eventually leads to higher real wages and greater economic rent to landlords.
More so, Funmilayo and Adetokunbo (2013) examine housing delivery in Nigeria: Repackaging for Sustainable Development which they concluded that Nigeria cannot copy models from other nations but rather develop feasible models based on our socio-cultural background to address the huge housing shortage in Nigeria.

Owuike Iheme et al (2015) assessed the effect of government policy on housing delivery in Nigeria. Their study shows that insufficient fund is closely related to other finance related factors identified as barriers to the accessibility of public housing by the low income group who are non-public servants. Such factors as high interest rate, low per capita income, lack of security of income, lack of collateral and high cost of public houses.

Iwedi Marshal and Onuegbu Onyekachi (2014) examine Housing Deficit Funding in Nigeria: A Review of the Efforts, Challenges and the Way Forward. The study concluded that adequate funding via appropriation or international aids, viable mortgage system and policy implementation are indispensable tools for bridging the housing deficit in this sector of the Nigeria Economy and recommended among others that government should collaborate with the private sector and international donors for provision of funds for effective housing delivery for Nigerians. From these reviewed studies, most of it focused on the use of conventional approach in addressing housing deficit and the population growth while little or no studies have tried to show the nexus between increasing population and housing deficit whereas adopting Islamic finance as a moderating instrument in addressing these economic conditions.

3.0 Methodology
This study adopted a content review method. This method was adopted taking to cognizance the theme so as to make inferences about the antecedents, uniqueness and outcome on the previous studies. However, the information was obtained from Quran, Hadiths, Bible, different articles, text books, reports and other sources available on theme. The study further adopted a modified revenue function approach in analyzing the potentials of the instruments of Islamic finance.

4.0 Results and Discussions
4.1 Population Growth and Islamic Finance
Nigeria’s increasing population over the years has attracted concern as it has seen as gradually converging to the views of main stream economist especially the theory of Malthus which emphasize that as world population is increasing according to a geometric series, the growth of food production follows a numeric series as a result of decreasing returns to lands which consequently will end up with massive famines and wars on food.

Source: Worldometer, 2020
Despite this trajectory in the population growth, Islamic economist viewed it from a different perspective which contradicts the position of Malthus. In Islam, population growth should not be considered as an issue to be discussed not to think of having polices like birth control because Allah (SWT), has guaranteed sustenance and forbade any means of preventing reproduction on plea of need as He says in The Quran: “Kill not your children for fear of want: We shall provide, sustenance for them as well as for you verily the killing of them is a great sin” (Al-Israa, verse 31).

However, there is little exemption to accepting birth control especially when pregnancy endangers mother or child's health, or lead to some family related problems. Allah the Al-Mighty has given the right to individual families to decide on this matter according to their own reasoning, for which they are held accountable in the Day of Judgment. Consequently, Islamic finance has an inbuilt mechanism that can address issues relating to an increasing population. These mechanism is enshrined in its Islamic social finance that have its tools like Zakah, Sadaqah, Waqf, Micro finance, Qard ul Hassan etc. For convenience, this paper will lay emphasis on the following; zakat and sadaqah

4.1.1 Zakat

Zakah or alms tax can be defined as that portion of a man’s wealth which is designated for the poor. This is permissible in both Islam and Christianity (see Deu 14:28, Gen 14:19-20, Lev 27:30-34 etc). The Quran has specify the beneficiaries of zakah in (Q9:60) that: “As-Sadaqah (Zakah) are only for the Fuqara’(poor), and Al-Masakeen (the needy), and those employed to collect (the Zakah), and to attract the hearts of those who have been inclined towards Islam, and to free captives, and for those in debt, and for Allah’s cause (i.e. for those fighting in holy battles), and for the wayfarer (a traveller who is cut off from everything); a duty imposed by Allah. Allah is All-Knower, All-Wise.”

More so, according to the IDB’s research institute, global Zakat collections alone are estimated to come up to a total of at least US$500 billion a year. This is about 20 times more than total global humanitarian aid (GlobalSadaqa Beta,2018). Despite the fact that there are no reliable data currently to depict accurately how much zakat is being paid by Muslims around the world and how much is spent. Therefore, in Nigeria, the potentials of zakat in 2013 is estimated to be between 0.86-2.08 of GDP or USD 8,776.5-USD 21,160.99 million (IRTI-Islamic Social Finance Report, 2015; Aliyu Dahiru et al, 2018). Juxtaposing, the estimated zakat potentials and poverty level or housing deficit associated with an increasing population, it will go a long way to provide succor to these individuals or country at large facing such problem.

4.1.2 Sadaqah or Infaq Fi Sabilillah

Sadaqah linguistically is derived from the root verb sadq or sidq which means to speak the truth, to be sincere. Sadaqah is a term applicable to the concept gift offered to someone from ones rightfully owned holding without remorse or regret or without any ulterior motives in secret for the pleasure of Allah. Sadaqah can also be a contributory tool in addressing the issues of an increasing population. Though, despite its status as
voluntary and not a compulsory act, it’s still vital. This can be in physical cash or through other platforms like E-Sadaqah funds which are deducted from their bank account or via mobile by sending coded SMS to a designated sever number ordering for deduction from his or her airtime. This is considered as the easiest means for the public to perform sadaqah. However, for the purpose of this study, we shall demonstrate its potentials monetarily. To buttress this argument of cash or e- sadaqah potentials, a projected cash flow is further conducted. A simple revenue function (P*Q) is adopted and modified. (i.e., Price X Quantity) as thus;

\[ T = S_A \times \text{Pop.} \]  

Where \( T \): Total cash generated, \( S_A \): Sadaqah amount voluntarily contributed per individual active lines; \( \text{Pop.} \): Total Population of active lines in Nigeria. This estimation is done under the following assumptions:

i. It will consider only population of active line users in Nigeria.

ii. Every user voluntarily in respective of religion contributes a minimum of N20 per week.

iii. Payment can be spread with the week for individual lines with sufficient airtime

iv. No carryover of payment to another week

v. 5% level of cash collection error rate (i.e. some remain uncollected, some did not pay in full, some lines went inactive or dormant and some paid above N20 etc) is considered

vi. Use of existing structure and facilities of government/mobile operators

vii. Sadaqah funds are to be managed by prudent and efficient trustees.

viii. Provision for lump sum payment (i.e, one off on per monthly).

ix. All active lines will be considered on case by case basis.

x. 10-15% income should be considered as administrative expenses.

**Table 1. Projected Cash Inflows (Active Lines)**

<table>
<thead>
<tr>
<th>Total Active Lines (Muslims &amp; Non Muslims)</th>
<th>Cash Sadaqah per week (NGN)</th>
<th>Total Cash realised per Month (NGN)</th>
<th>Total Cash per annum (NGN)</th>
</tr>
</thead>
<tbody>
<tr>
<td>N20 @184,426,187</td>
<td>3,688,523,740</td>
<td>14,754,094,960</td>
<td>191,803,234,480</td>
</tr>
</tbody>
</table>

Assume if 5% error rate (NGN)

Gross Cash Collected

3,504,097,553

14,016,390,212

182,213,072,756

Less: Admin Exp (15%)

525,614,633

2,102,458,532

27,331,960,913

Net Cash Sadaqah Collected

2,978,482,920

11,913,931,680

154,881,111,843

Source: Authors Computation, (2020)-For Research Purpose; NCC (2020).
From table 1, it depicts that if N20 as deducted from every mobile active user in the country, it will generate about N3.5 Billion and N14 Billion on weekly and monthly basis respectively which could be used to take care of the welfare of the increasing population and as well as empowering them to be self reliance. This will go a long way to reduce issues related to population explosion in the country.

4.2 Housing Deficit and Islamic Finance

With the rising population, it has further revealed the housing problem bedeviling the country as its gap currently stood at 22 Million housing units that is required. Islamic finance could serve as a mediating tool in addressing these issues. In so doing, there exist numerous instruments in Islamic financing which can be adopted but for the sake of this study, emphasis will be placed on sukuk.

4.2.1 Sukuk

*Sukuk* (Islamic bond) is a certificate of investment of same value of shares representing the ownership of tangible asset of the firm (AAOIFI, 2008). It is equivalent to bonds but since fixed income, interest bearing bonds are not permissible in Islam, it is structured in such a way to comply with the Islamic shariah. Sukuk can be issued under different structures to accommodate the dynamics of different transactions. Some of these structures include:— *Salam*-Deferred Sale, *Ijarah* -Rent or Lease, *Mudaraba*-Part financing, *Musharakah* –Partnership, *Murabahah* -Sales Contract, *Istisna* Sukuk, Hybrid Sukuk.

Several studies have explored the potentials of *sukuk* in addressing infrastructure which housing is not an exemption. Among such studies are the works of Hamza (2006), Kammer et al., (2015), Said and Grassa, (2013), Diaw, Bacha and Lahsasna (2014). Under this arrangement to fill the housing deficit the *sukuk* will be addressed as “Housing Sukuk” More so, we shall demonstrate how the issuance of *sukuk* can assist in filling the housing deficit in Nigeria. This is based on the following assumptions:-

i. 2- Bedroom Housing units will be built.

ii. The cost of 2-Bedroom Housing unit is N3,029,400 (Rumourjiuce, 2020)

iii. The Housing unit will be spread among six (6) geopolitical zones.

iv. 330,820 Housing unit will be built within the first *sukuk* issuance.

v. The Housing unit will be solely for federal Civil servants

vi. The total beneficiaries is 330,820 employees of 486 MDAs enrolled on Integrated Personnel and Payroll system as at June,2018 (Federal Ministry of Information & Communication, 2018)

vii. Federal Civil servants will pay based on installments-Owner Occupiers basis.
viii. One household per 2-bedroom housing unit.

ix. Outright purchase of the housing unit by individual civil servants is permitted.

x. In case of death, retirement or dismissal, the staff entitlements will be used to offset the outstanding sum.

xi. Housing units will be insured with Federal Government interest noted as “First loss payee”

xii. Lower Cadre Civil servant will be given priority in the distribution.

xiii. *Sukuk* holders will be paid rentals quarterly

xiv. *Sukuk* price will be anchored based on Nigerian Interbank Offer Rate (NIBOR)

xv. Investors can be locally and Internationally

Consequently based on the above assumptions, the total *sukuk* issuance will be as thus

\[ = N3,029,400 \times 330,820 = 1,002,186,108.00 \]

**Table 2: Summary of *Sukuk* to be issued (FGN Ministry of Housing *Sukuk*)**

<table>
<thead>
<tr>
<th>Issuer</th>
<th>FGN Ministry of Housing <em>Sukuk</em> Company Plc</th>
</tr>
</thead>
<tbody>
<tr>
<td>Issue Size</td>
<td>NGN1,002,186,108.00</td>
</tr>
<tr>
<td>Sector</td>
<td>Housing</td>
</tr>
<tr>
<td>Tenure</td>
<td>10-20years</td>
</tr>
<tr>
<td>Structure</td>
<td>Ijarah</td>
</tr>
<tr>
<td>Governing Law</td>
<td>Nigerian Law</td>
</tr>
<tr>
<td>Purpose of Issuance’</td>
<td>Proceeds will be used for the construction of 330,820 Housing units in the six (6) geopolitical Zone of Nigeria.</td>
</tr>
<tr>
<td>Unit of Issuance</td>
<td>N500 per unit</td>
</tr>
<tr>
<td>Minimum Subscription</td>
<td>Minimum of N5,000 (10 units @ N500 per unit)</td>
</tr>
<tr>
<td>Redemption</td>
<td>Bullet payment at maturity</td>
</tr>
<tr>
<td>Paying Agent</td>
<td>Central Bank of Nigeria</td>
</tr>
<tr>
<td>Security</td>
<td>Supported by the full trust &amp; Credit of the Federal Government of Nigeria</td>
</tr>
</tbody>
</table>

*Source: Authors Computation (2020)-Research purpose only.*

Therefore, continuous tranche of *sukuk* can be issued subsequently with different maturity period so as to bridge the housing deficit in the future. However, the *Ijarah sukuk* can be presented in the flow chart below
Figure 1: Diagram showing to indicate Process Flow of Ijarah Sukuk

Source: Modified by Author from the work of Umar (2019).

Explanation

i. The sukuk holder buys the issue from the SPV at various units which certificate will be issued to them as certified holders of the asset in the company.

ii. The SPV receives the proceeds of sukuk and buys the asset from FGN-Ministry of Housing (Originator).

iii. Upon payment for the asset, FGN transfer the rights of the land & asset where the Housing unit will be situated to the SPV-MOH Sukuk Company under with the lease agreement and undertakings will be executed.

iv. The SPV-MOH Sukuk Company can now lease the asset to the lessee (Federal Civil servants) and receives rent after which the net amount will be distributed to the sukuk holders as fixed income.

v. Upon maturity, the asset is sold back to the originator (Lease and Buy arrangement) who normally promised to buy back the asset at a given price at maturity or default.

vi. The proceeds from the sales of the asset will now be distributed to the sukuk holders as repayment of their investment.

Conclusion

Islamic finance has gradually come to stay in the Nigeria as an alternative form of financing despite the mixed feelings that welcomed it. It’s adoption has further deepened the space of the Nigeria financial system and it is gradually gaining patronage from both the Muslims and non Muslims. Therefore, based on the findings from this study, it is crystal clear that Islamic finance can serve as a veritable tool in moderating a double edge
phenomena like increasing population and Housing deficit. i.e., it is considered as an agent in restoring or resolving the problems associated with increasing population via its inbuilt social mechanism.. These tool of Islamic social finance has the potentials of generating about USD8M-USD21M and N154 billion for zakat and sadaqah respectively. These funds can be used to improve the welfare of the growing population. More so, in addressing the housing deficit, sukuk is considered as it can generate about N1,002 billion which can be used to build about 330,820 housing estate. Thus, making each federal civil servant to have access to 2-bedroom housing estate

**Recommendations**

The study recommends as thus

i. Since these tools are permissible in the major religions, there is need to intensify effort on public awareness in order to enlightened the Nigerian populace about benefits of zakat, sadaqah, sukuk via local media like TV, radio in local dialects, magazines, articles etc as this will go along way to address some of the misconceptions about some of this tools

ii. Need to have a legal framework such as Zakat Act or creation of a ministry as this will ensure transparency as its record will be subject to public scrutiny.

iii. Establishment of Zakat Advisory Board so as to moderate its financing activities in ensuring that the government expenditure to be financed should not be vague and non shariah compliance.

iv. There is need to improve the welfare of the staff involved so as to mitigate against corrupt practices.

v. There is to deploy IT infrastructure, e-zakat or sadaqah portals so as to make payment easy and convenience

vi. There is need to adopt a mix of financing tools so as to take care of the peculiarities that may exist

vii. Organizing Training, refresher training and organizing development program for officers involved in the entire administration of zakat

viii. Contracts for provision of Housing units or other welfare packages should be awarded to the host communities so that they know who to look up to incase whether the job is abandoned or done haphazardly.

ix. There is need to amend the land use act so as to reflect the current reality in terms of land ownership acquisition etc.

**References**


Cryptocurrency for Commodity Futures Trade in Indonesia: Perspective of Islamic Law

By

Teddy Kusuma*

Abstract

Cryptocurrency is a virtual money that does not have a physical form or concrete form in cyberspace. One of the few types of crypto money is bitcoin. The use of bitcoin as a means of payment in e-commerce lately has become increasingly widespread and unstoppable, even though the Government has banned the practice. In early 2019, the Government of Indonesia issued regulations regarding the legalization of bitcoin (crypto assets) in Commodity Futures Trading. The dual function of bitcoin as a commodity and exchange tool raises the pros and cons of scholars and economists. This study aims to obtain answers about bitcoin and cryptocurrencies, its usage in commodity futures trading according to the perspective of Islamic law and bitcoin’s chance as sharia commodity in Indonesia. The theory applied is theory of legitimate and vanity business transactions in Islam. This research is a literature study and is qualitative in nature. The data analysis technique used is descriptive analytical with normative juridical Islamic law approach. From this research, the results show that cryptocurrency can be traded in Islamic commodity exchanges, provided that the State issues or create their own cryptocurrencies whose price depends on gold or the country’s currency. Bitcoin cannot be used as a commodity in Sharia Derivative Contracts in Indonesia, because it contains a lot of speculation, maysir and is vulnerable to use for illegal activities. Bitcoin is haram lighairihi or haram because of external factors, so it should be avoided.

Keywords: Cryptocurrency; Bitcoin; Commodity Futures Trading; Sharia Derivative Contracts.

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Introduction

Human economic activities are now increasingly dominated by online activities. The internet has been transformed into a popular choice with all the conveniences and speeds provided. The era of digital economics 4.0 is an era marked by the rise of the use of the internet as a medium of communication, transactions and collaboration. Trading through cyberspace is known as e-commerce.

Digital or electronic money is a means of payment or exchange that is used in e-commerce financial transactions. This money cannot be touched because of its digital form. One of the new money that has digital characteristics is cryptocurrency. Bitcoin is one of the few cryptocurrencies that uses peer-to-peer cryptographic technology and is decentralized or without a central authority, and then all of its mechanisms go through the blockchain system. Bitcoin is used based on freedom and idealism that the government that controls it only works for the sake of corrupt subjective benefits and favours mere tycoons (Darmawan, 2018).

The emergence of bitcoin as a cryptocurrency has become world-famous and has a high selling value also in Indonesia, leaving the pros and cons related to its use as a means of payment lately. The experts agree that bitcoin still does not meet the elements and criteria as a legal currency used in Indonesia (Diasti, 2018). As stipulated in Law number 7 of 2011 concerning Currency Article 1 paragraph 1 which states that:

"Currency is money issued by the Unitary State of the Republic of Indonesia, hereinafter referred to as Rupiah."

On the other hand, in February 2019, the Commodity Futures Trading Regulatory Agency (BAPPEBTI) has issued official rules regarding cryptocurrency as a commodity in commodity futures trading (PBK) in Indonesia. This rule is considered to have provided a breath of fresh air and an opportunity for the first step to the digital financial market. The Government of Indonesia through BAPPEBTI and the Minister of Trade Regulation (PERMENDAG) has officially set the crypto asset to be subject to Futures, Sharia Derivative Contracts and other Derivative Contracts traded on the Commodity Futures Exchange (CNBC, 2018).

The country of Indonesia is a country with a majority Muslim population. In daily life, a Muslim must not be separated from the guidelines and norms of the prevailing Islamic religion. A devout Muslim must do every economic activity by existing sharia law and must avoid the elements that are prohibited/forbidden by Allah SWT and His Messenger. The National Sharia Council-Indonesian Ulema Council (DSN-MUI) is an institution that handles financial activity issues and responds to issues related to the economic problems of Muslim communities in Indonesia.

Cryptocurrency, bitcoin and commodity futures trading are new things that are popular in economic activities in Indonesia today. This research is present and invites the reader to examine more closely related cryptocurrency (cryptocurrency) in this case bitcoin in commodity futures trading taken from the perspective of Islamic law. The researcher hopes that this research can contribute in determining the attitude of the
reader, DSN-MUI Institute (fatwa decision) and related parties to make it a basic reference for Islamic business ethics in daily life and to make a basis for consideration to bring benefits and problems to current economic practices.

**LITERATURE REVIEW**

This study refers to several previous studies, including:

Khoirul Anwar (2016) Masters in Islamic Law from Sunan Kalijaga University in Yogyakarta, researching and analyzing the currency of bitcoin as a transaction tool in the perspective of Islamic law. The results of his research indicate bitcoin has the nature of *gharar* and *maysir*. *Gharar* because the object is not visible if traded and how to obtain it if traded. Bitcoin is *maysir* because there is speculation and gambling in it, namely in the practice of buying and selling bitcoin.

Muhammad Hafidz (2016) A Lecturer at STAIN Pekalongan examines Commodity Futures Trading: Fiqh and Economic Aspects. The results of this study are Commodity Futures Trading (PBK) which has hedged as the main objective. But for some 'illicit investors', PBK was used to make blind speculations that divert and change the existence of PBK. In the perspective of Islamic economics, PBK also remains a problem related to the legal basis that can be used to justify its implementation in the contemporary economy.

In general, the difference between this thesis and previous studies is that this research focuses on the position of cryptocurrency as a commodity in futures trading in Indonesia. Previous research has focused more on both positive law and the bitcoin Islamic normative approach as a currency and payment tool in general. There exists an absence of an Islamic perspective on the position of bitcoin as a trade commodity that has been legalized in Indonesia. Researchers draw the common thread using Islamic sharia glasses through Saddu Adz-dzarai "approach and the theory of" Legitimate and Legal Business Transactions "taken from the view of world scholars and credible Islamic authorities. This is what researchers use to conclude the final results of the research.

**CRYPTOCURRENCY(VIRTUAL MONEY)**

From ancient times until now, money has undergone many changes in the form of dates, salt, seashells, gold coins, copper, silver, precious stones and now paper and metal are used as government efforts to reduce production costs even though the nominal value written is much more compared to its intrinsic value. The development of technology was welcomed by the evolution of money which was no longer in paper form, but in an invisible digital form, only in the form of numbers written in a computing system. Satoshi Nakamoto is an anonymous designation from a person or group of people who developed cryptocurrency in 2008. Then bitcoin was officially released and began operating in the community. Bitcoin works uniquely peer to peer through a sophisticated cryptographic network in a decentralized blockchain without being bound by any authority (Kelly, 2018).

The increasing prestige of bitcoin in the eyes of the world has an impact on the high supply and the birth of other currencies. There are dozens of cryptocurrencies
currently circulating in the community, such as Ripple, Libre, NameCoin, LiteCoin, Ethereum, Cardano and others. Even the Coinye currency is taken from one of the names of the famous singer Kanye West (Khameswara, 2014).

### HISTORY OF BITCOIN

Bitcoin is virtual money and was included as the initial electronic money made by Satoshi Nakamoto in 2009. The name Satoshi Nakamoto is associated with open source software that is designed and also uses peer to peer (P2P) networks that connect everything. Long before the appearance of bitcoin, e-payment was created to facilitate online transactions. The transaction is done by transferring money to the facility provider, then an amount of money equivalent to the amount of the transfer will appear in the 'virtual wallet' and can be used for transactions (Khameswara, 2014).

In 2009, Satoshi Nakamoto released bitcoin software with certain infrastructure, anyone can 'mine' bitcoin. The concept of 'mining' for money itself immediately absorbs the attention, of cyber citizens to meet their needs. Bitcoin as cryptocurrency has several excellent features, such as 1) Instant transfers from peer to peer, 2) Transfers anywhere, without fees, 3) Transactions are irreversible, meaning once transferred cannot be cancelled, 4) Bitcoin transactions are anonymous, 5) Bitcoin is not controlled by any institution or government (Kelly, 2018).

At present, according to Coin ATM Radar, 1,960 bitcoin ATMs have been recorded in the United States. Canada is the second-largest country that has a bitcoin ATM, followed by the Czech Republic which has 46 ATMs spread across the country. Noted there are already more than 3,150 bitcoin ATMs spread across 70 countries in the world, one of them in Indonesia. This bitcoin ATM is available in 3 places, including:

1. Bitcoin ATM in Kuta, Bali. (Information Center, Legian Kaja Street)
2. Bitcoin ATMs in Ubud, Bali. (Hubud, Jl. Monkey Forest, Gianyar)

3. Bitcoin ATMs in Jakarta. (LTC Glodok, Ground Floor, Block B2 No. 2)

**MONEY CONCEPTS IN ISLAMIC ECONOMY**

Islam views money only as a medium of exchange, not as a commodity (commodity). Therefore, the motive for the demand for money is to meet transaction needs (money demand for transactions), not for speculation (Arifin, 2002). Islam also strongly advocates the use of money in exchange, as in the Hadith narrated by Ata bin Yasar, Abu Said and Abu Hurairah and Abu Said Al-Khudri explained that it turned out that the Prophet Muhammad did not approve transactions with the barter system. He seems to forbid such an exchange because there is an element of usury in it.

Explained in Al-Qur'an Surah Al-Kahfi (18) verse 19 as follows:

"Then send one of you to go to the city with your silver coins and let him see which is the best food, so he should bring the food for you and he should behave gently and do not ever tell your thing to anyone."

In the Islamic concept, there is no known money demand for speculation, because speculation is not allowed. Contrary to the conventional system of giving interest on the property, Islam makes the property the object of zakat. Money is the property of the community so hoarding it under a pillow (not productive) is prohibited because it reduces the amount of money circulating in the community.

Roman and Persian civilizations were two dynasties or superpowers that had a profound impact on civilization in Islamic history, especially in terms of the economy and the use of money in it. The Qur'an and the Hadith explain textually that the dinar and dirham are the currencies used as a medium of exchange in the time of the Prophet, a measure of the value of stored wealth, not as a commodity. Dinars are made of gold, while dirhams are made of silver. But in the Qur'an and the Hadith, it is not explicitly ordered to apply the dinar and dirham as currency.

It is written in the word of Allah SWT in the QS. At-Taubah verse: 34:

"O you who have believed, indeed many of the scholars and the monks devour the wealth of people unjustly and avert [them] from the way of Allah. And those who hoard gold and silver and spend it not in the way of Allah - give them tidings of a painful punishment".

The verse describes people in those days who liked to hoard gold and silver without being offered or used in the way of Allah SWT. It can be concluded that gold and silver are assets that can be stored and used as a symbol of one's wealth. So gold and silver have functioned as medium of exchange, store of value, unit of account and standard payment on future (Karim, 2004).

In a hadith of the Prophet's Muslim history narrated by Abu Sa'id Al Khudri it can be seen that in Islam, dinar and dirham coins (gold and silver) are not the only means of exchange used in ancient times. Dates, wheat and salt also functioned as money, which is
why there are no special privileges that require only dinars and dirhams to be used as currency. The reason the Prophet (SAS) gave freedom to choose this medium of exchange was because money was part of the economic activities agreed upon by a country and generally regulated with the same provisions.

**COMMODITY FUTURE TRADE (CFT)**

Human economic activities always develop along with the times, from simple market to market, where sellers and buyers are directly met to a complex mechanism. Such evolution has taken place in Islamic banking, Islamic capital markets, Islamic insurance and Islamic stock exchanges (Yusuf, 2008). Meanwhile, since the 2000s Indonesia has also run a commodity futures exchange called the Jakarta Futures Exchange or the Jakarta Future Exchange (JFX) which began officially running on December 15, 2000.

Definition of Futures Exchange is a business entity that organizes and provides facilities and or systems for the sale and purchase of commodities based on futures contracts, sharia derivative contracts and or other derivative contracts. The meeting place between supply and demand for commodities and their derivatives is called commodity exchanges. Commodities can be interpreted in several definitions, including first, an object or tangible object that can be traded relatively easily, can be delivered in form, can be exchanged for other products of the same type and can be stored for a certain period, which can usually be sold or purchased by investors through the futures exchange. Second, in general, a commodity is a product that can be traded, including foreign currency (forex), indexes and financial instruments.

Commodities have a price characteristic determined by market demand and supply, not based on the count of the dealer or seller. Then the price is concluded based on the calculation of the price of each (purchasing power) commodity. Examples of commodity subjects are agricultural products, such as cocoa, sugar, rice, crude palm oil, CPO, corn and others. In the case of agricultural products or mining, coal, minerals and gold are traded as commodities (Nurlaela, 2014).

**TYPES OF COMMODITY FUTURES TRADE**

Commodity Futures Trade has several types. Commodity futures markets are divided into two types namely Over the Counter (OTC) and futures exchanges. OTC is a bilateral contract futures market. Whereas the futures market is a multilateral contract system futures market. OTC commodity is often also called the Commodity Market. While the futures exchange is often called the Commodity Exchange (Samsul, 2010).

Commodity Market is divided into several types of contracts, namely Forward and Swap Contracts. Commodity Exchange (futures exchange) according to Law Number 10 of 2011 concerning Commodity futures trading has four types of contracts namely Futures Contracts, Derivative Contracts, Sharia Derivative Contracts and Options Contracts.
RESEARCH METHODS

This research is library research (library research) and has a descriptive-analytical nature, namely research with the presentation of facts and then analyze them systematically until easily concluded and understood. The method used is a normative juridical approach, namely the analysis of the implementation of transactions using bitcoin in online trading and trading of commodity futures based on the provisions of Islamic law taken from various opinions of scholars, experts and fatwas of Islamic institutions and organizations in various countries.

Data analysis techniques used by researchers are inductive and deductive. The inductive method is used to analyze the concept and context of money in general and according to the Islamic view as a medium of exchange, then deepen the aspects of implementing online trading using bitcoin payment instruments. While deductive analysis is used to analyze the law of bitcoin in its position as a commodity in futures trading in Indonesia. Both are presented then analyzed using the perspective of normative Islamic law.

The author uses grand theory techniques, middle-range theory and applied theory in concluding (ITB, 2018).

The grand theory used to complete this research is the 'Al-Mashalah al-Mu’tabarah' theory of the ulama agreement. The middle theory used to bridge the grand theory of this research is the theory of 'legitimate and vanity business transactions' from the ulama agreement (jumhur) developed by Zaidan in Al-Wajiz fi-l Usul Fiqh's book (Zaidan, 2006). Applied Theory used is normative Islamic law using the theory in usul ul fiqh: Saddu ad-Dzari’ah, which stipulates a prohibition on certain acts which are basically allowed to prevent other acts that are prohibited. It can be said in Saddu adz-Dzari’ah, the stipulation of the law always emphasizes the primacy of benefits and avoids disputes. This is to anticipate the attitude of life that is not commendable in the community (Manzhur, 1999).

DISCUSSION

The Exchange has a global vision to improve the welfare of the nation and achieve a good level of economic growth. Its mission is to realize the determination of appropriate prices and can be a reference for world commodity prices. With an increase in demand for commodities, this will have a significant impact on rising prices of commodity products or goods themselves in line with the inflation rate. Through the Futures Exchange, market participants can protect commodity prices against inflation (BKDI, 2014).

ANALYSIS OF COMMODITY FUTURES TRADING CONTRACT (PBK) USING BITCOIN IN INDONESIA

Referring to the explanation about sharia commodities above, the researcher can conclude that bitcoin in commodity futures trading in Indonesia can be implemented using taukil, murabahah and tawarruq contracts. The underlying proposition is as follows:
Permission for wakalah is permitted, either in return or without compensation. Because the Prophet (PBUH) once represented to Unais to apply punishment and to Urwah to buy a goat and to Abu Rafi 'to perform a marriage qabul (all) without giving a reward. The Prophet also sent his employees to collect alms (zakat) and he gave them rewards. "(Ibn Qudamah, 2004).

Al-Ma’ayir As-Syar’iyyah, (2010):

Generally speaking, Tawarruq is not one of the investment or financing schemes. Tawarruq is allowed because of the needs of the conditions that are met. Tawarruq can only be used to cover liquidity shortages, avoid and minimize losses.

The opinion of Kuwait Islamic Jurisprudence Encyclopedia Drafting Team:

Wakalah with ujroh (rewards) the law is the same as the law of ijarah. The representative has the right to get wages by giving up something that is represented to the representative if the object is transferable, then he has the right to receive wages.

Bitcoin in commodity futures trading in Indonesia can be carried out using murabaha contracts when consumers buy bitcoin from trading participants. The bargaining agreement is used by trading participants to trade bitcoin with asset traders. Taikil contract is a contract that applies when a trading participant represents a consumer to buy bitcoin to an asset trader.
ANALYSIS OF THE LEGAL ASPECTS OF BITCOIN ACCORDING TO THE VIEWS OF SCHOLARS AND EXPERTS

Permission (halal) buying and selling online according to the agreement of scholars, can affect economic progress along with technological developments. The use of digital (fiat rupiah) money can be reflected this time for crypto currencies and fulfilment of criteria as a legal currency and / or payment instrument. The most famous type of cryptocurrency today is bitcoin. In general, Islamic scholars and experts have two different opinions. First, some scholars argue that cryptocurrency is haram, meaning that it is forbidden by sharia. Other groups are of the view that cryptocurrency is in principle halal, meaning that it is permitted.

1. Egyptian Grand Mufti Shaykh Shawki Allam (2018) has stated that bitcoin and cryptocurrency are haram. The Shaykh cites these reasons in his statement, including Bitcoin is easy to use for illegal activities; Bitcoin is intangible and allows for money laundering and fraud (alaraby.co.uk).

2. The Turkish government's religious authority also states that bitcoin is prohibited because it is open to excessive speculation (gharar and maysir) (Abu Bakr, 2018).

3. The Fatwa Center of Palestine also issued unfavourable fatwas related to bitcoin and cryptocurrency, because the issuer of bitcoin is unknown and includes gambling.

4. Shaykh Haitam from England. British-based Muslim scholar Shaykh Haitam wrote a paper in Arabic, he stated that bitcoin and other cryptocurrency are prohibited and not compatible with sharia.

5. Abdullah bin Muhammad bin Abdul Wahab Al'Aqil (2017). A Doctor of the Shariah Faculty at the Islamic University of Madinah, Saudi Arabia stated the ban on bitcoin because it contained a large element of usury.

6. Fatwa of the Government of Saudi Arabia. Saudi Arabian cleric Sheikh Assim Al-Hakeem gave a fatwa that the digital currency 'bitcoin' is forbidden in Islamic law. He stated that bitcoin is an open gateway for money laundering, buying and selling drugs and smuggling (bitcointalk, 2018).

7. The Indian Muslim Personal Law Council (AIMPLB) refers to bitcoin as un-Islamic. Therefore, the Muslim Institution called on the Muslim community to avoid using the cryptocurrency.

Experts and some other scholars are of the view that bitcoin is permitted in principle. This view can be analyzed based on previous exposure concerning the criteria and definitions of money and buying and selling. The famous jurisprudence rules explained by legal experts, namely:

"الأصل في المعاملة الإباحة إلا أن يَدْعُو الدَّعْيِ على تَحْرِيبِهَا."

This means that the rules of origin are permitted in financial and business transactions (Ibrahim, 1999). In other words, everything is permitted unless an argument is found that is contrary to Islamic principles. Some other famous quotes in Islamic economic ethics, namely a brief phrase from Ibn Taymiyyah:
"The basis of the contract is the pleasure of both parties."

In the book 'Ilaamul Muwaqqit, Ibn al-Qayyim said:

"Fatwas can change with changing times, places, customs and conditions. And all that comes from God. Wabillahittaufiq."

Muhammad Mushthafa Az-Zuhaily in the book Al Qawaid al Fikhiyyah explains the rules as follows:

"Sometimes some Sharia laws are based on human habits and customs. So if the custom has changed from the custom in the previous era, the technical and legal changes will also change, while the Shari'a laws whose origin is not based on human customs and habits will not change."

Based on the above argument, all digital/virtual or cryptocurrency that meets the requirements can be accepted as money. The South Africa Islamic Seminar Fatwa Center, Darul Uloom Zakariyya, has taken the position that bitcoin meets the requirements as money, therefore bitcoin is allowed to trade. However, they note that to qualify as a currency, the money must be approved by the relevant government authorities (Abu Bakr, 2018).

Bitcoin transactions have also been opened in several Muslim countries. The first country in the Middle East to open was the United Arab Emirates (UAE) with BitOasis: a new cryptocurrency, which was converted to gold. Islamic banking requires banking activities to always follow Islamic law. The Shariah Review Bureau (SRB), an Islamic advisory firm licensed by Bahrain's central bank, provides certification for Stellar: a provider of blockchain platforms from California, USA. This halal certification is not only for the Stellar blockchain system but also for their cryptocurrency, namely Lumens (XLM), the Lumens capitalization is valued at 5 billion USD or around 75 trillion and can be estimated even higher (Source: CNBCIndonesia).

In Malaysia, HelloGold launched GOLDX as a cryptocurrency supported based on the gold price and was approved by the Islamic Ulema Authorities at Amanie Advisors based in Kuala Lumpur. This Islamic coin transaction occurs within a specified period.
and makes it less volatile (price fluctuations are not too extreme) and can overcome the problem of price ambiguity. (Source: Aljazeera)

The Indonesian government has formalized the use of cryptocurrency as a commodity in Futures Trading, but to date has not yet issued official regulations/provisions concerning the prohibition or sanctions for people who still conduct online trading transactions using bitcoin.

Referring to the exposure of the view to the prohibition of bitcoin above, the researcher can conclude that most scholars (Jumhur) and State authorities agree that it will not be allowed (haram) bitcoin in its function as a substitute tool for legal money. They have the same view that bitcoin is too much speculation, intangible, lacks official government regulation (legal umbrella) and can be easily used for illegal activities.

Relying on the reasons that countries allow and Islamic authorities which justify crypto money, apart from bitcoin which has several advantages and positive sides such as controlling inflation, security, transaction efficiency and decentralization. Researchers can conclude that the cryptocurrency allowed is the currency issued or authorized by their respective countries, not bitcoin. Due to the protection of pricing and provisions that are based on the intrinsic value of gold or from the country's currency.

**ANALYSIS OF BITCOIN’S OPPORTUNITY AS A COMMODITY IN SHARIA DERIVATIVE CONTRACTS (SHARIA COMMODITIES) IN INDONESIA**

Sharia Derivative Contract is a commodity trading derivative contract by sharia principles. The Sharia Business Unit and the Jakarta Futures Exchange Sharia Financial Institution (BBJ) have been formed to provide a system and accommodate the needs of the financial industry for a commodity transaction instrument that meets sharia principles. The legal basis used by the DSN-MUI Fatwa Number 82 of 2011 concerning Sharia Commodity Trading.

The author concludes that technically and practically, the crypto asset used as a commodity in futures trading in Indonesia has reached the Islamic elements. Strict regulations, implementing the principle of Know Your Customer (KYC) well, the screening process for illegal practices, money laundering and terrorism and reporting official documents that must be approved by the centre and customer protection by the Indonesian government, in this case, BAPPEBTI, has been able to strengthen security guarantees the public in business on commodity futures exchanges. In accordance with the principles of fiqh stating that the Government is obliged to protect and regulate all matters relating to the lives of its people and to always prioritize the benefits of the people as a whole.

"The actions or policies of the Imam [the authority holder] towards the people must be oriented to the mashlahat." (As-Suyuti, 2004)
The minimum standard provisions for capital/assets of the manager or Provider of credit assets, in this case, bitcoin, are the Government of Indonesia's efforts to maintain managerial liquidity so that they are always on the green belt or can be said to be controlled / safe. If there is a dispute or a criminal act that violates the rules, it can be settled by consensus or law at the Commodity Futures Trading Arbitration Agency (CFTAA) or the District Court (Pengadilan Negeri/PN) in Indonesia.

According to some previous scholars' views, bitcoin also has a negative side in its position as a currency, as a medium of exchange or a means of payment as well as a commodity in futures trading. Based on the rules of fiqh proposal which reads:

\[

dur adh mafsada mukaddar \text{ on } ghan im almsalab
\]

The above principle means that it is better to avoid mafsah (ugliness/damage) rather than taking advantage. This implies that researchers in commodity trading in Indonesia bitcoin are still unable to avoid some traits that are prohibited in buying and selling according to Islamic law, one of which is speculation.

Money laundering, embezzlement of funds and other illegal activities are elements that are difficult to avoid in the use of bitcoin commodities. The money used for investing in bitcoin assets comes from illegitimate money that is deliberately removed so as not to be tracked by local authorities. The majority of scholars agree that it will be forbidden if proven to lead to immoral acts. There is a (potential) element of usury. Due to the highly volatile nature of bitcoin every day, bitcoin consumers/owners prefer to buy bitcoin when the price goes down, then sell it immediately when the price goes up, it is feared the price will drop the next day.

The *maysir* / gambling level of bitcoin commodity trading is fairly high, considering that shortly bitcoin will soon run out. When 21 million units have been circulating in the market, no one can guarantee that bitcoin has a higher price because of its scarcity like gold which is guaranteed of its underlying assets. On the contrary, the prediction of bitcoin can also be a ‘bubble’ which is worthless while other cryptocurrencies, such as ethereum, altcoins, ripple, digicoin, libre are more and more hunted.

The phenomenon of soaring bitcoin prices, is caused by a large market demand and the limited number of offers. Bad possibilities could occur, such as the rise of expensive bacan stone rings during booms. Love waves (anthurium plants), louhan fish and lovebird birds were also expensive at that time.

All transactions that contain elements of gambling (*maysir*), obscurity (*gharar*), fraud (*tadlis*) and *rasuah* are vanity forbidden and *haram lighairihi* the law. This virtual currency is considered to have elements of *maysir* in it, because the bitcoin business is like betting. Thus, it can be concluded that the use of bitcoin virtual money as a commodity in sharia derivative contracts is *haram lighairihi* or *haram* because there are other factors outside the substance.
CONCLUSIONS

From the results of the research that the researchers have explained in the previous chapters, in this last chapter the researcher can conclude several things, namely:

Bitcoin is a virtual currency that can be used for online transactions both buying and selling and trading commodities, but bitcoin is not a legal and official currency for buying and selling in Indonesia.

Ulema agrees that bitcoin is not permitted in its function as a substitute for money, because there are too many disadvantages compared to its mashlahah, although bitcoin has several positive aspects such as controlling inflation, security, transaction efficiency and decentralization. Cryptocurrencies allowed are currencies issued or authorized by their respective countries, not bitcoin. Example: Lumens (Bahrain / Middle East), HelloGold / GoldX (Malaysia) and BitOasis / OneGram / ZayedCoin (UAE). Due to the protection of pricing and provisions based on the intrinsic value of gold or the value of the country's currency.

Bitcoin in its position as a commodity in PBK still contains elements of maysir because in it there is high speculation and is chancy. That is heavier than foreign exchange trading. Thus, the use of bitcoin as an instrument in sharia derivative contracts is lighairihi, or illegitimate due to external factors (speculation / maysir, usury, vulnerable to illegal practices: money laundering).

SUGGESTIONS

After discussing the problem and concluding, the writer will give the following advice:

The author hopes that DSN-MUI as the official authority in determining legal fatwa is an issue for the majority of Muslims in Indonesia to issue fatwa related to whether there is an element of usury to bitcoin or whether it is used in online trading transactions and commodity futures trade.
The government should issue official and specific virtual currencies for Indonesia / ASEAN, in addition to bitcoin which has a less volatile nature and guarantees a good price determination in accordance with the current rupiah or gold prices.

This qualitative writing still does not explain the concepts and mechanisms of mining in detail and has not revealed the blockchain system as a whole. The analysis of this research can be a basic reference for further research in order to examine quantitatively the effect of cryptocurrency on a macro scale, factors causing price fluctuations and so forth.

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Shari’ah-Compliant Stock Screening: A Financial Perspective

By
Abdessamad Raghibi*
Lahsen OUBDI

Abstract

Stock markets have always provided countries with a practical and flexible way to finance their economies. Hence, Islamic finance has embraced the stock market since the early 90s adopting the same framework as an ethical investment. Accordingly, Islamic investors in emerging countries shall have a range of choices when constructing a financial portfolio. However, existing screening methodologies lack flexibility as they are mainly based on rigid ratios and irrelevant thresholds. Consequently, these methodologies lead to an inefficient stock index as they completely ignore the features of each stock market along with the specificities of each industry. Thus, our study will try to propose a new screening methodology based on the optimal financial structure of each industry. The main objective of our study is to propose a methodology that will overcome different loopholes addressed in the literature. The present paper is an explanatory study which needs an empirical confirmation of the proposed methodology in order to measure its performance and efficiency against existing shari’ah-compliant indices. Hence, the main preliminary finding of our research is to enrich the academic debate on shari’ah-compliant screening methodologies through appealing to conventional corporate finance framework to enhance current methodologies.

Keywords: Screening methodology, stock markets, Stock Index.

Introduction

It is hard to imagine a world with no capital markets, banks or financial institutions as they have become crucial players in the modern economic life. The innovative and dynamic structure of capital markets especially stock markets has released great

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opportunities, and to the same extent has increased the risk for all players involved in the market. A stock exchange is an organized marketplace, licensed by a relevant regulatory body where ownership stakes (shares) in companies are listed and traded. The definition clearly shows how stock markets play an important role in providing financing and, therefore, triggering dynamics all along the business chain. Also, the financial stock market facilitates higher investments and the allocation of capital, and indirectly fosters economic growth.

Hence, the existence of an efficient stock market promotes economic prosperity. Indeed, an efficient stock market contributes to attracting more investments by financing productive projects that lead to economic growth, mobilize domestic savings, allocate capital proficiency, reduce risk by diversifying, and facilitate exchange of goods and services.

The main pillar of Islamic investing philosophy is risk taking as the sole justification for any lucrative compensation. Therefore, a suitable environment for Muslim investors must be secured in order to provide relevant investing instruments that comply with shari’ah principles. This situation pushes researchers and policy makers to look for a market where risk taking, information efficiency and tough regulation would co-exist to relatively comply with shari’ah’s ruling. In addition to that, there is an increasing demand for Shari’ah-Compliant Investment products which provide stability and lower risk due to the growing Muslim population which represents almost 20% of the world population. This reality has attracted more listed companies to opt for shari’ah-Compliant status through the screening process of inclusion-exclusion exercise.

Indeed, stock exchange provides an answer to the Muslim demand for an equity market that can be adapted and regulated by shari’ah law. Therefore, the introduction of Islamic principles and values within the stock market would have a significant impact in restructuring the stock market so that it can comply with shari’ah’s ruling. The existence of Islamic values will mainly target the screening of permissible business activities conducted in accordance with shari’ah principles. For that, shari’ah screening methodology will significantly influence the development of Islamic capital market.

The implementation of screening methodologies follows the classic process of any shari’ah ruling (Qur’an, Sunnah, Ijma’, Qiyas and Ijtihad). However, one should not blindly be bound by a mechanic application of shari’ah ruling (Ahkam) and ignore the core philosophy of Islam. This philosophy can be summarized in the objectives of

1 Shari’ah refers to the Islamic canonical law based on the teachings of the Qur’an and the traditions of the Prophet (Hadith and Sunnah), prescribing both religious and secular duties and sometimes retributive penalties for lawbreaking.
2 Ijma’, (Arabic: “consensus”) in Islamic law, the universal and infallible agreement of either the Muslim community as a whole or Muslim scholars in particular.
3 Qiyas is the principle of analogy applied in the interpretation of points of Islamic law not clearly covered in the Qur’an or sunnah: analogical inference or deduction.
4 Ijtihad, (Arabic: “effort”) in Islamic law, the independent or original interpretation of problems not precisely covered by the Qur’an, Hadith (traditions concerning the Prophet Muhammad’s life and utterances), and ijma’.
shari’ah (Maqasid al-shari’ah), which Al-Ghazali\textsuperscript{5} identifies as promoting human beings’ welfare through the protection of their five basic interests (maṣāliḥ) which are: religion, life, reason, progeny and property.

The importance of a rigorous screening methodology becomes obvious when we realise that when owing a stock, Muslim investors need to take into account not only the structure of the transaction but also the nature of the counter party. The investor turns into a part-owner of the company, and become responsible for its internal structuring as well. Consequently, the screening methodology should take into consideration both quantitative and qualitative criteria in order to match as much as possible shari’ah’s requirements.

The following sections will include details on the main screening methodologies. However, for the sake of initiating our problematic, the most common feature of the existing screening methodologies is their rigidity. This fact comes as a result of the fixed ratios and thresholds adapted by each service provider. These thresholds do not take into account the specificities of each sub-sector of the stock exchange. Hence, the index may suffer some over/under evaluation when a common ratio is adapted apart from the requirements of each sector.

The most problematic ratio is the debt/equity ratio with an average threshold varying from (33%-50%). Nevertheless, it is argued that the tolerable level of conventional debt should be based on the unavoidable level of debt such as working capital, and that the currently applied tolerance level seems to be too liberal, since a concession is made about the actual level of conventional debt that is supposed to be zero (Khatkhatay & Nisar, 2006).

Accordingly, this paper aims to propose a flexible shari’ah screening methodology that takes into consideration the optimal financial structure of each sector in order to come up eventually with an optimal shari’ah-compliant stock portfolio. Thus, the first section will present a literature overview on past research on stock screening. In the second section, we will expose different screening methodologies offered by service providers along with the main problematic issues. Finally, the third section will propose a new framework for shari’ah-compliant stock screening.

I. Literature Review:

Researchers have put much effort to detail the methodologies adopted by different financial services across the globe. Kasi & Muhammad (2016) have conducted a comparative study of the screening methodology between Asian countries (Malaysia, Indonesia, Honk Kong and Singapore) with the screening methodology of the USA illustrated by the famous Down Jones approach. According to these authors, the United

\textsuperscript{5} Al-ghazali (1058-1111) was a Muslim theologian, jurist, philosopher, and a mystic descending from the Persians.
States is the only pioneering nation, by far, to have introduced, undertaken and retained the current Shari’ah screening methodologies, namely industry screens and financial ratio screens for the past 15 years. Also, USA is known to adopt the most rigorous shari’ah screening methodology namely the Down Jones screening methodology.

Norlita Zainudin and Surianom Miskam (2014) have presented a critical review on the existing screening methodologies. They have pointed at the issue of the variety of screening methods which may imperil the long term growth of Islamic finance. Therefore, there is a need for Muslim scholars to standardize their screening methodologies effectively in the international market. They have also highlighted the Malaysian approach to calculate the level of mixed contributions from permissible and non-permissible activities towards group turnover and group profit before tax of the companies. This approach makes Malaysia a unique case in tolerating mixed contribution from non-permissible activities which do not constitute the core business of a company under the justification of offering a diversified shari’ah-compliant index.

On this same issue, Yaquby (2000) explored different justifications among contemporary scholars on trading joint stock companies (mixed contribution to the company’s income), and suggested that arguments cited by the advocates of permissibility are more convincing than those of its detractors. Moreover, Rehman & Masood (2013) argued that since it is almost impossible to find a company which is purely Shari’ah-compliant, Muslim scholars have agreed to approve of any company where 95 per cent of its earnings are derived from halal activities. Hence, the remaining 5% would be tolerable due to current business practices.

According to the same authors, the relevance of some screening ration is still subject to scientific debate especially the cash/total asset ratio. They have explained that money in itself is not a permissible asset in accordance with the Islamic Shari’ah principles. The level of liquid assets which may include cash and cash equivalents, short term investments and accounts receivables should be kept to a minimum in Islamic finance.

Khatkhatay & Nisar (2006) mentioned three main accounting ratio that need to be determined for a company to be listed as shari’ah-complaint: indebtedness of the enterprise, interest and other suspicious earnings, as well as the extent of cash and receivables of the company.

Derigs and Marzban (2008) raised the issue of fixing thresholds among shari’ah scholars. They have affirmed that there is no set of thresholds for the financial structure fixed in the Quranic teachings and it is instead mainly based on Ijtihad. Interpretations on the minimum acceptable ratios or threshold values from 5 to 50 percent tend to differ between different Shari’ah boards resulting in differing standards acceptable by various Shari’ah boards all over the world (Rehman & Masood, 2013).
When going through the screening methodologies, the most common thresholds are (30-33%) level of conventional debt, (30 - 33%) for interest-based investment/deposit, (33% - 50%) liquidity and (5% - 25%) of impure income. Hence, the legal maxim used to justify these ratios can be cited as follow: “the majority deserves to be treated as the whole of a thing” (Mahfooz & Ahmed, 2014). That implies that if securities represent composite assets, the rule of the dominating asset (having more that 50 percent) will apply to the security. It is argued that the threshold range of between 33% and 49% is deduced from this Shari’ah maxim whereby the majority can be classified as a ‘simple majority’ in the case of more than 50% and a ‘super majority’ in the case of more than 67% (Usmani, 2005).

In their detailed article, Khatkhatay & and Nisar(2007) presents complete assessment of the current screening practices. They begin on commenting on the compliance of stock investment, they state that the compliance of such investment comes from the structuring of the transaction itself as equities which do not confer any assured benefits on the holder. In fact, shareholder could stand to lose his entire capital in the event the company in which he has invested suffers massive losses. Also, the authors comment on the relevance of the cash/asset ratio, they affirm that if inventories are valued at market prices, the investors would end up with a residual value for the cash and debts of the company which can deviate largely their par values. As a result, it would be unacceptable Shari’ah-wise to be involved in the trading of such scrips.

However, Wilson (2004) argues that imposing fixed ceilings on cash and liquidity holdings does not seem practical, since the level of holdings of cash and liquidity vary according to the business cycle.

Concerning the debt/asset ratio that relates to our research, Khatkhatay & and Nisar(2007) affirm that companies differ in their capital structuring, depending on the sector in which they operate. There may be a case for setting differential ratios for the debt: total assets ratio depending on the industry segment of the company. If this is not feasible, debt: total assets ratio of <20% or 25% appears a realistic tolerance limit to be set. However, the Malaysian SAC adopts another extreme position not placing any restriction on the level of debt or level of interest bearing securities at all. They argue that the judgment should be based on the usage of the money, rather than its source, since the debt of the company has occurred in the past (Dar Al Istithmar, 2009).

II. Shari’ah-compliant Screening methodologies:

The principle of Islamic finance consists in retaining only the companies that obey, or at least are, closest to the principles explained in the introductory chapter. For this reason, auditing standards have been set by the Accounting and Audit Organization for Islamic Financial Institutions (www.aaoifi.com). Nevertheless, a variety of other financial service providers propose other methodologies with slight differences like Dow Jones, FTSE, Morgan Stanly and others. Table 2 presents the geographical coverage of the Morgan Stanly Islamic index around the world.
Table 1. Geographical coverage of the MSCI Islamic Index

<table>
<thead>
<tr>
<th>Covered areas</th>
<th>Number of countries</th>
<th>Large caps</th>
<th>Mid-caps</th>
<th>Small caps</th>
</tr>
</thead>
<tbody>
<tr>
<td>Developed markets</td>
<td>23</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Emerging Markets</td>
<td>23</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Gulf States</td>
<td>6</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Other markets</td>
<td>17</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
</tbody>
</table>

Source: MSCI (2011)

The following figures sums up the main screening methodologies in terms of their respective service providers:

<table>
<thead>
<tr>
<th></th>
<th>Malaysia SAC</th>
<th>DJII</th>
<th>AAOIFI</th>
<th>FTSE shari’ah global equity index</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debt Ratio</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest Ratio</td>
<td>N/A</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Liquidity Ratio</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income Ratio</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: The Authors

These indices, which were initially launched as trend indicators for shari’ah-compliant stocks, have become benchmark portfolios, paving the way for the creation of mutual funds and the development of index products and structured Islamic products. In general, investors wishing to invest in accordance with the principles of Islamic law seek the diversification of their portfolios through investment funds and financial products whose underlying assets are securities included in the index. Among the screening methods for the securities that are part of a stock market index in Islamic finance, the most commonly accepted criteria in the sense of El Gamal (2006), are those retained by the Sharia Committee of the Dow Jones Islamic Market Index (DJIMI).

The current methodology underlying global shari’ah-compliant stocks is based on a two-tier process. First, a qualitative filtering that we will call "extra-financial screening". Second, a quantitative filtering called "financial filtering" (Cekici, 2009).

These criteria consist of filtering in two steps: choosing companies whose sectors of activity are authorized by the shari’ah, and select only companies that respect the following thresholds:
- Debts / market capitalization = Less than 33%;
- Current assets / market capitalization = Less than 49%;
- Interest-generating assets / market capitalization = Less than 33%.

We choose to present hereafter ratios published on the Standard & Poor's Shari’ah Indices guideline as they represent a relative consensus among Muslim jurists.

Our analysis will focus on the debt and cash component as they raise many questions on the relevance of the measure and threshold adopted.

II. The Proposed Methodology:

When going through existing screening methodologies, we can realize that the level of the tolerance thresholds of debt, liquidity, interest-bearing securities and impermissible income ranges are (33.33% - 30%), (33% - 50%), (33.33% - 30%) and (5% - 25%) respectively. Thus, we can deduce that these thresholds appear to be set arbitrarily, since they are based on *ijtihad* of scholars to deal with contemporary finance issues, rather than being explicitly linked to the Qur’ān or Sunnah (Derigs and Marzban, 2008).

Indeed, in the case of debt to asset ratio, Obaidullah (2005) reports that shari’ah scholars built their conclusion on a certain instance about which the Prophet was reported to have said: “one-third and one-third is too much” on the issue of *Wassiyah* (Will). The prophetic citation clearly relates to heritage matters rather than financial transactions.

Concerning the 49% threshold, the maxim of majority in Islamic Law is used which states that “the majority deserves to be treated as the whole of a thing”. This implies that if securities represent composite assets, the rule of the dominating asset (having more that 50 percent) will be applied to the security (Mahfooz & Ahmed, 2014).

Consequently, divergences occur depending on the thresholds and the methodology adapted. These divergences persist because they have not been approved by a credible, independent and universal shari’ah authority such as the International Islamic Fiqh Academy which includes all Muslim countries. Concerning the AAOIFI’s methodology, although it is recognized as a major actor in Islamic finance standardization, it is not responsible for shari’ah rulings and it does not represent all Muslim countries.

That is why we will try through this paper to propose a new methodology based on financial theory concerning capital structure theories and optimal cash holdings theories for both Debt to Asset and Cash to Asset ratio. Germaine to other screening ratios, we shall use AAOIFI’s guideline as it offers a relative consensus with regards to its representation and credibility Muslim countries.

The literature on shari’ah stock screen has extensively examined different loopholes within the existing screening methodologies (Habib & Ahmed, 2017; Ho, 2015; Pok, 2012; Khatkhatay & Nizar, 2007; Zainudin, Miskam & Sulaiman, 2014). Nevertheless, no alternative methodology has been proposed to integrate all the critics.
and modifications to the existing methodologies. That is why the present work aims mainly to propose a new methodology based on financial criteria which will take into consideration the specificities of each company and each portfolio in order to provide Muslim investors with the most efficient shari’ah-compliant portfolio.

The firm’s optimal debt-to-equity ratio might depend on the industry in which the firm operates or the historical levels of debt-to-equity. In this study, the aim is to estimate the optimal debt ratio for listed companies on the Moroccan stock market. In fact, the question of how much debt or cash a company can hold still goes under academic scrutiny whether an optimal level exists or not. The following table presents a worldwide overview of the level of debts which clearly points to the fact that debt holding is no arbitrary thresholds.

<table>
<thead>
<tr>
<th>Country</th>
<th>Total Debts to Total Assets (Book Value)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Developed Countries</strong></td>
<td></td>
</tr>
<tr>
<td>USA</td>
<td>58%</td>
</tr>
<tr>
<td>Canada</td>
<td>56%</td>
</tr>
<tr>
<td>Japan</td>
<td>69%</td>
</tr>
<tr>
<td>UK</td>
<td>54%</td>
</tr>
<tr>
<td>Germany</td>
<td>78%</td>
</tr>
<tr>
<td>Italy</td>
<td>70%</td>
</tr>
<tr>
<td>France</td>
<td>71%</td>
</tr>
<tr>
<td><strong>Developing Countries</strong></td>
<td></td>
</tr>
<tr>
<td>Pakistan</td>
<td>66%</td>
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<td>Jordan</td>
<td>47%</td>
</tr>
<tr>
<td>India</td>
<td>67%</td>
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Source: Adapted from Wet (2011)

The relative trend to have a close level of debt to assets around similar countries may suggest the existence of a targeted intention for a certain level of debt among countries with similar geographic or economic features.
Indeed, various factors have been cited in the literature such as the firm size and industry features to explain the empirical deviation of capital structure initial framework. A vast empirical study has been conducted by Both and Al. (2001: 106) where they elaborated a common world model for capital structure determinants. Their model includes such variables as the average tax rate, business risk, profitability, firm size and market-to-book ratios among others. Their results show that this model supports the conventional country models. Nevertheless, the regression coefficients differ from a country to another which may stipulate the existence of other institutional determinants.

The firm’s size is often cited as a main determinant for capital structure decisions. In fact, small companies have higher capital raising costs than big companies, so they prefer short-term borrowing, and hence the firm size has a negative relation with the short-term borrowing ratio (Tsai et al., 2011). Also, the business activity constitutes a major determinant in the capital structure as different companies have different business cycles, regulatory framework and assets categories. Indeed, Baxter (1963) confirms that companies within the same industry have more similar capital structures than companies from different industries.

In addition to that, Oraluck & Mohamed (2004) conducted a study on the Australian market to explore the relevance of the concept of optimal capital structure. They adopted the industry median as a benchmark for the optimal capital structure. Their findings indicated that the market reacts positively to announcements of financing events that lead to the firm’s capital structure moving closer to their relative industry median debt-equity ratio.

Consequently, the use of a fixed threshold for the Debt to Equity ratio becomes irrelevant taking into consideration the determinants of debt levels. Accordingly, the proposed methodology will replace the fixed thresholds with the optimal levels as they reflect both the features of each company and the stock market.

Concerning cash levels thresholds, they are set arbitrary following the same reasoning as debt levels. The reason for using such screening ratio is to avoid investing in companies whose assets would be mostly represented by cash, which would consequently amount to buying not a stock but cash directly.

In fact, corporate cash holding has been at the center of academic debate in the recent years regarding its determinants and relation with the firm’s value. Empirical studies have been conducted in different geographic areas on corporate cash holding since the late 1990s. One of the first studies conducted on this issue was by Opler & al. (1999) on US publicly listed firms. They have found that having strong growth opportunities, higher business risk along with firms of smaller size, hold more cash than other firms. The predominance of the size variable in determining cash holding levels can be explained from a perspective of the managers’ influence over the firm. Anabestani & Shourvazi (2014) suggest that larger corporations are assumed to hold more cash since
their managers have more authority and liberty. On the other, they expect smaller firms to hold more cash as well. The absence of capital markets’ supervision may push managers to have more freedom.

In addition to that, the volatility of future cash-flows accounts for cash holding level as reported by Bates, Kahle and Stulz (2009). They affirm that the average cash-asset ratio of industrial companies in the United States between 1980 and 2006 was more than doubled due to the increasing uncertainty over future cash-flows. Hu & Jiang (2005) came to the same conclusion on linking firm’s size, cash-flow volatility and cash holding. They have found that a positive correlation exists between cash holding and firm’s size. Their justification relates to the fact that the large companies generally have achieved significant success, so their cash flows are much more abundant.

On the existence of an optimal cash level, Martínez-Sola, García-Teruel and Martínez-Solano (2008) confirm the existence of an optimal level at 14% of whole assets and conclude that deviations from this optimal level reduce the firm’s value. Accordingly, screening methodologies must respect the empirical evidence on the relative levels of cash depending on the abovementioned determinants. That is why incorporating optimal levels instead of fixed thresholds seems more relevant and solid.

To sum up, maqasid al-shari’ah aim to bring maslahah (public interest) to Muslims through their daily life practices including fi nancial transactions. Thus, we have shown that adopting fixed thresholds would undermine Muslim investors’ ability to constitute an efficient stock portfolio. The solution would be to incorporate optimal financial theory on capital structure and cash holding within existing screening methodologies in order to address the issues surrounding current methodologies.

**Conclusion**

The Islamic economic and finance system main added-value to the economic doctrine is to eliminate ribah, gharar, maysir and impermissible activities. Hence, shari’ah’s screening processes on stock markets emphasize sector and financial screening criteria to ensure the permissibility of the investment from a shari’ah point of view. The existing screening methodologies are mainly based rigid thresholds which do not take into consideration the features of each stock market.

Academic literature has separately addressed some issues on screening methodologies such as the use of market cap instead of total assets. However, a distinctive points has been addressed by Nizar & Khatkhatay (2006) where they have suggested a system requiring compliant companies in industries such as hotels, shipping to regularly report their results and activities to the screening organization for a fee. This suggestion shall largely develop the range of shari’ah-complaint listed companies and, therefore, provide investors with diversified choices.
Accordingly, the second section presented a global insight on existing screening methodologies for shari’ah-compliant stock screening. It showed a global consensus over the two-tier methodology i.e. qualitative and quantitative filters. In addition, the chapter addressed the loopholes in these methodologies mainly the question of debt and cash ratio. Indeed, the thresholds adopted by most of SB i.e. 33% and 49% would penalize companies just because they belong into a specific industry.

Regarding the literature’s approach to these two ratios, the debt ratio’s threshold is seen to be liberal and should be bought under the level of 33%. The cash ratio is seen to be unjustified by Nizar & Khatkhatay (2006). Indeed, the level of the market price of a share is not due to a corresponding value for the company’s cash hoard or receivables and payables. Thus, the use of such a screen does not serve any purpose.

The last section highlighted a first overview of our main objective to propose a new screening methodology based on an optimal financial structure. Indeed, our methodology will take into consideration each industry’s feature and eventually, the thresholds will be
References


Country Model: Indonesia

Introduction

Indonesia, the world fourth most populous country and 16th largest area wise, is located in Southeast Asia and composed of some 17,500 islands, of which more than 7,000 are uninhabited. Indonesia is reported to have an impressive economic growth, which is projected to grow at 5.2 percent in 2019. The country’s GDP per capita stood at US $3,932 in 2018. Regardless of being home to largest Muslim population in the world, the establishment of Islamic banking in Indonesia is considered late compared to other Muslim majority countries. Islamic banking began in Indonesia with the establishment of Bank Muamalat Indonesia (BMI) in 1992. Islamic banking constitutes 6 percent share of domestic banking assets and 1.9 percent share at global level in 2018. Indonesia is a prominent figure in global sukuk market.

Islamic Banking and Finance

The idea of Islamic banking in Indonesia was discussed theoretically until 1960 when Indonesian banks were operating on the basis of interest under banking Law No 14 of 1967. In 1968, a non-governmental Islamic organization named (Muhammadiyah) tried to establish banking institutions in accordance with Islamic rules. However, lack of commitment from Muslim community and governments delayed the establishment of Islamic banking in Indonesia. Later in 1980’s, the Indonesian Muslim intellectuals and Ulama re-visited the idea of setting up of Islamic banking in the country. In October 1988, the Indonesian government issued a policy package (PAKTO) which stated that, banking can be established at zero percent interest rate. This policy paved the way for the establishment of Islamic banking in the country. Enforcement of Banking Act No. 7 by Bank Indonesia-the central bank, in 1992, allowed the setting up of Islamic banks in the country. In the same year on May 1, 1992 Bank Muamalat Indonesia (BMI), the first Indonesian Islamic bank, was inaugurated. According to the Otoritas Jasa Keuangan (OJK)-Financial Services Authority, there are now 14 full-fledged Islamic banks, 34 Islamic banking business units/windows and 196 Shariah rural banks with an asset base of IDR 481.174 billion (end July, 2019). Moreover, Islamic microfinance banks in the

* Source: State Bank of Pakistan, Quarterly Islamic Banking Bulletin July-Sept 2019
form of micro Wqaf banks under Act No.21 of 2011 of OJK, are operative in the country. The aim of this innovation is to increase financial inclusion among micro and small enterprises (MSEs) through Islamic boarding schools. Currently there are 33 Micro Waqf banks operating in the country.

**Regulatory Environment**

Bank Indonesia, in 1992, allowed the establishment of Islamic banking through enforcement of Banking Act No.7 while in 1993, Indonesian Council of Ulama set up an arbitration forum (Badan Arbitrase Muamalat Indonesia) to resolve Islamic finance disputes. Subsequently, a number of legislative changes were made to lay sound legal foundations for Islamic finance industry in the country. In 1999 Bank Indonesia permitted to utilize Shariah compliant instruments as part of the monetary policy. After 1999, the Islamic finance structure in Indonesia started to take shape; the Indonesian Council of Ulama set up the National Shariah Board, an independent body authorized to issue rulings on Shariah products. In 2001, Bank Indonesia created the Islamic Banking Bureau to regulate, supervise and issue license for Islamic banks.

In 2002, Bank Indonesia issued a strategic plan; ‘The Blueprint for Islamic Banking Development’, detailing clear priorities to create a sound Shariah banking system in the country. The year 2008 is considered to be a groundbreaking year, when Law 21 of 2008, the authoritative law on Islamic finance, was passed in Indonesia. The law covers; company formation, permissible and prohibited form of Islamic transactions, corporate governance and dispute resolution. In 2018, the Financial Services Authority, OJK, also announced various new regulations, including asset management, fintech, sukuk and takaful. Moreover, the government of Indonesia recently launched Shariah Economy Master Plan (MEKSI) 2019-24 and a roadmap aims at strengthening Halal products, Shariah Finance, Micro, Small and Medium Enterprises (MSMEs) and optimizing the digital economy. The Indonesian National Islamic Finance Committee is also drafting a development roadmap for Islamic microfinance institutions, expected to be launched this year.

**Sukuk**

Indonesia is the key player in the global sukuk market. The sukuk issuance in Indonesia began with the first series of Surat Berharga Syariah Negara (SBSN) with the total issuance of IDR 7.51 billion in 2008. Since this initiation, varieties of sukuk have been available in the market making Indonesia as one of the key players in the global sukuk market. Currently, sukuk market of Indonesia consists of Retail Sukuk (SR), Indonesian Global Sukuk (SNI), Pilgrimage Sukuk, Treasury Sukuk (SPN-S), Project Based Sukuk and Saving Sukuk. Indonesia is also the pioneer of first ever-sovereign green sukuk worth US$ 1.25 billion, issued in 2018.

In August 2019, the ministry amended its regulation on the issuance and sale of state sukuk in foreign exchanges in the international primary market to boost the participation of local banks in its sovereign sukuk market. Under this new regulation, domestic financial institutions have been allowed to be joint lead managers of state sukuk even if they only have domestic operations. It is expected that this will assist in enhancing the contribution of Indonesia towards sukuk market.
Future Outlook

With growing significance and focus on Islamic banking and finance industry, and having Muslim population of more than 87 percent in Indonesia, there are ample opportunities for the industry to grow in the country. The concerned authorities are also working for creating a conducive environment for Islamic banking and finance through introducing legal amendments. The Islamic banking network is also expected to undergo changes over the next few years, as conventional banks will be required to convert their Islamic windows into separate stand-alone units by 2023. According to Islamic Finance News (October 2019) Islamic finance assets are projected to reach US$ 3.81 billion in 2023 in Indonesia.

Sources of Information

- Islamic finance news {www.islamicfinancenews.com}
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- Otoritas Jasa Keuangan {https://ojk.go.id/id/}
- Global Islamic Finance Report {http://www.gifr.net/gifr}
- Central Intelligence Agency The Fact Book {https://www.cia.gov/the-world-factook/}
- International Islamic Financial Market {http://www.iifm.net}
Book Review

The Art of Islamic Banking and Finance (2014) by Dr. Yahia Abdul-Rahman

By Camille Paldi*

This book is a fascinating account of the journey of Dr. Yahia Abdul-Rahman and his family in their journey to America from Egypt in 1968 in his pursuit of several MA degrees and a PHD and a glimpse into his rich professional life, which includes the pioneering of no interest banking in the United States through his highly successful venture LARIBA and Whittier Bank in Southern California, USA. The LARIBA system and Bank of Whittier serves all 50 states in America and services a portfolio of no-interest financing that is worth approximately USD $400 million. In 2001 and 2002, Fannie Mae and Fannie Mac approved the LARIBA financing system.

Dr. Rahman asks the reader, ‘What is the first thing when one thinks of when one hears the term Islamic Banking?’ The most common answer was ‘vast amounts of oil money from the Gulf countries, which are waiting to find investment opportunities.’ However, Dr. Rahman goes on to explain the rich philosophical roots embedded in Christianity, Judaism, and Islam behind the no interest finance principle and shows with real-life examples how the majority of people and the economy become more financially sound and stable under a system where money is not rented, but where the bank acts as a finance house that invests in people, productive trade, and promotes economic growth and expansion. Americans are definitely curious about this new brand of banking as the author reveals that between 2000 and 2009, the LARIBA site attracted more than 1 million unique visitors whom were exploring the topic of interest-free banking. In fact, LARIBA has been showcased on ABC Nightly News, The Los Angeles Times, USA Today, the Dallas Morning News, the Wall Street Journal, the Washington Post, the Houston Chronicle, the Chicago Tribune, and the Detroit Free Press to name a few. When concerns about anything ‘Islamic’ arose in society after September 11, 2001, Dr. Rahman became involved in inter-faith activism and obtained a historic announcement from the Fuller Theological Seminary in Pasadena, CA that the Christian God and the Muslim God was in fact the same God and this pronouncement was published in the Los Angeles Times on December 3, 2006. In fact, the Bible is rich in language which condemns excessive interest and usury as this creates hardship for the normal person and turns people into slaves of the money-lenders. In fact, one can recall that in the Bible, Jesus went to the marketplace to crush the money-lenders stalls. Jesus Christ stated that one of his goals is to drive the money changers out of the Temple (John 2:15-15; Matthew 21:12-13; Mark 11:15-18). A story about community controversy in Nehemiah 5 concerns oppressive lending: It may refer to charging interest or to other tough actions,

* Author: Camille Paldi, CEO of the Franco-American Alliance for Islamic Finance (FAAIF) Ltd, Durham DH1 3DE; tel: +44 (0)7742 433998 E-mail: paldi16@gmail.com. Biography at http://www.linkedin.com/in/camillepaldi and website at http://ilovethuae.com
such as foreclosing on personal properties. It alludes to two reasons for debt: crop failure and imperial taxation. The story makes clear the results of default. One may forfeit fields, orchards, and houses, and/or one may end up in slavery. Rahman says that his brand of no-interest banking is in fact a manifestation of Christian, Jewish, and Islamic values particularly in concern to usury or renting money for profit, which is prohibited in all of the Holy Books. Basically, no interest finance helps one to live within one’s means, avoid exorbitant debt, enables one to have more cash to invest in his/her business, children, homes, cars, and education, promotes cash flow throughout the economy, promoting economic stimulation and growth as well as induces the optimal health of the individual, family, society, and world at large. S.C. Mooney an author and Protestant opponent to interest finance states, “What is being argued here is not a new idea or a new interpretation of Scripture. It is the historic position. This is not a call to strike out in a new direction; it is a call to return to faithfulness to God.”

Throughout the book, the author explains the modes of no-interest finance compared to interest finance and the two foundations of the no-interest banking system, (1) Commodity Indexation and (2) Marking to Market. The no-interest discipline clearly states that fiat (paper) money can be used, and the U.S. dollar may continue to be the reserve currency of the world along with maybe the euro, but gold or a basket of commodities may be used to calibrate the real value of the currency. President John F. Kennedy and James Baker III (1987) have both approved and proposed these concepts previously in US history and monetary policy. John F. Kennedy attempted to introduce silver certificates with Executive Order 11110. In fact, at one time in history, the US dollar was backed by gold. Under the rule of the British Empire, the British pound sterling and the gold standard were adopted around the world. In 1913, the gold cover for Federal Reserve notes was set by 1913 law to be 40%. In 1945, the gold reserves against Federal Reserve notes were reduced to 25%, and to continue the inflation spiral, this figure (25%) had to be reduced to zero. Toward the end of WWII, the US dollar and gold became the principal international reserve assets under the Bretton Woods Agreement. The US dollar became the world reserve currency, and it was treated as if it were gold because the agreement defined its value to be $35 per ounce of gold. On August 15, 1971, President Richard Nixon ordered the gold window closed, ending the international currency’s link to gold. In fact, the US Constitution says that each state shall issue currency in gold and silver. Some speculate that the authors of the US Constitution may have extracted this principle from the Qu’ran. Thomas Jefferson indeed did have his own Qu’ran collection and often studied these books for various principles of social justice, commercial dealings, fiscal and monetary policy, and treatise’s on government.

This no-interest discipline is implemented in order to price things fairly in the market while detecting any overpricing ‘bubble.’ In fact, it is interesting to note that Dr. Rahman through his LARIBA system detected the 2008 bubble as early as 2005 using this Commodity Indexation Discipline. In fact, this system helps to fairly define prices and to standardize and stabilize markets, allowing the efficient working of the market forces of supply and demand. It lays the foundation of fair pricing for products and services, based on real market values within an open and free market operation. Thus, we can see that the no-interest banking brand is not based on renting money at a rental price (interest), but on the actual measured fair market rent of properties, businesses, and services. This system is also the main reason for the superior portfolio performance of LARIBA since 1988.

Dr. Rahman gives the following example of how the no-interest discipline may be used to buy a house. The buyer who wants to obtain no-interest finance and the no-
interest bank should mark the house to market. The best way of doing this is to find out how much a similar house in the same neighborhood and with similar specifications would rent/lease for in terms of U.S. dollars per square foot (or euros/square meter). This mutually agreed-upon live market lease rate is used to calculate the rate of return on investment of the proposed purchase and no interest transaction, looking at it as a no-interest investment. If the rate of return on investment makes economic sense, the no-interest bank proceeds to finance (invest in) the property. In addition, the no-interest bank does its best to make the monthly payments in the no-interest mode of finance competitive with those offered by conventional banks. Basically, the author summarizes that the no-interest banking and finance discipline, in an effort to neutralize the effects of the prevailing fiat currency in the local markets, requires that the financier first apply the Commodity Indexation Discipline to check, in a macroeconomic way, on the existence of a bubble in the business/asset that is being considered for finance. This process is followed by the Mark-to-Market Discipline and approach, evaluating the economic prudence by calculating the real return on investing in this item, using its actual real market rental value. In this way, it is affirmed that money is not rented with interest and that the rent is that of the market rent of the facility in the marketplace.

Through using the no-interest discipline, Dr. Rahman states that we may enter into a new era where:

1. We normalize prices expressed in fiat money in order to be expressed in the real no-interest value of that currency in terms of staple food and other commodities that are in the economy. (2) Apply the Commodity Indexation Discipline for the early detection of local or international economic bubbles by using the no-interest currency to measure prices and disengage price fluctuations due to normal supply-and-demand factors from major change due to speculation using regular banknote fiat paper currencies. (3) and Devise a fair and intelligent tax policy that will enhance the vibrancy of the economy and create new job opportunities and prosperity leading to peace, happiness, and more production, leading to world peace among all nations.

In addition, in the subsequent chapters of the book, the author explains the concept of money, the money creation process, the fractional reserve banking system, the financial crisis, spells out US banking regulations and the supervision process, details the US banking system (state, national, federal reserve), discusses conventional and no-interest banking products, and shows how the no-interest model fits into the US banking and legal system without having to change the laws of the USA. Dr. Rahman consistently backs up theory with real-life examples and case-studies, giving a firm impression and understanding of how the no-interest finance models work in the real banking world and the real results. In addition, Dr. Rahman has placed a series of review questions at the end of each chapter to solidify the reader’s understanding of the core banking concepts, which he presents to the reader in a clear, logical, and efficient fashion.

Dr. Rahman articulates how the most historic moment for the LARIBA no-interest finance model came in 2001, when Freddie Mae approved LARIBA. In, 2002, Fannie Mae followed suit. The support of Freddie and Fannie helped the growth of no-interest home mortgage financing in America. With the support of Freddie and Fannie, LARIBA went from financing 2-3 to 50 homes per month for US citizens. Dr. Rahman describes another first in the history of the United States financial event when LARIBA and FANNIE MAE joined forces to issue no-interest mortgage backed securities. This book is definitely worth reading for anyone curious about no-interest finance and its benefits and success rates as compared to the conventional banking system.
Note to contributors

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