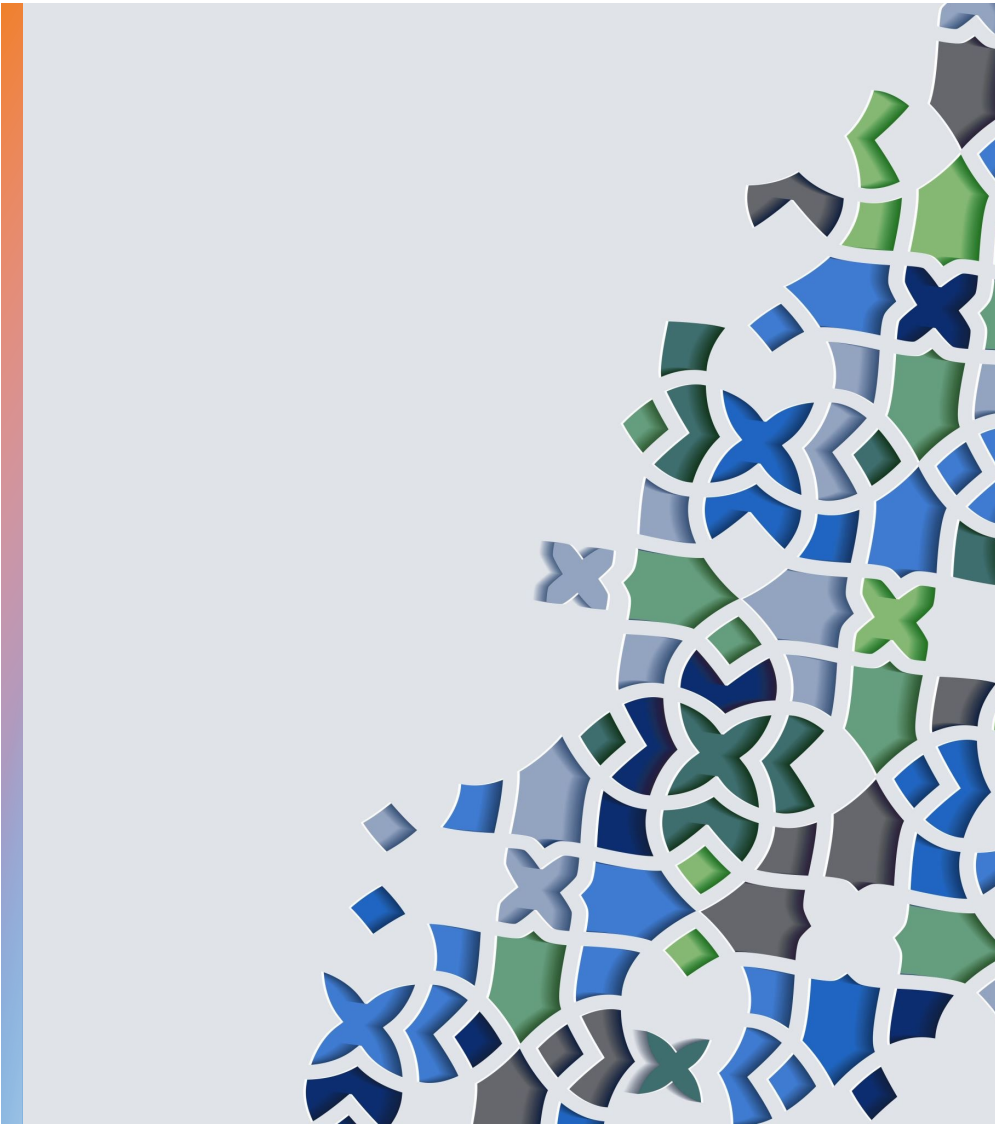




Fundamental Principles of Islamic Finance

zulkiflihasan.com



Content

Islamic Economic and
Maqasid al-Shariah

Elements of Islamic Finance

- **Blameworthy:**
 - Riba
 - Gharar
 - Maisir
- **Praiseworthy**
 - Risk
 - Values and Ethics

Fundamental of Islamic Economic



Maqasid al-Shariah

Two dimensional utility

Allah is the absolute ownership

Sources-Quran and Sunnah, Qiyas and Ijma'

Vicegerent and Trusteeship

Islam esteems wealth and wealthy

Social Mutual Solidarity- Brotherhood

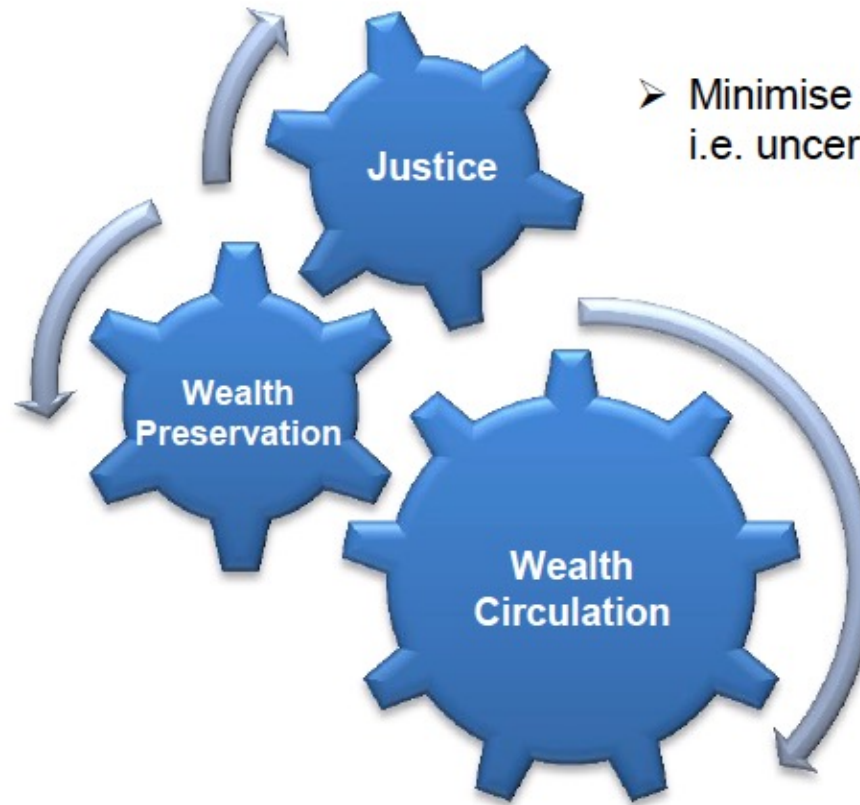
The Prohibition of usury, gharar and gambling

Risk and Ethics

Ummatic (broad) ownership of natural resources

Maqasid al-Shariah

- Recognise private ownership
- Prohibit transgression of rights of others
- Ensure valid transfer of ownership



- Minimise unjust elements
i.e. uncertainty, exploitation

- Equitable wealth distribution
- Prohibit wealth hoarding
- Encourage income generation
- Channeling wealth to productive sector



Riba

During the civilization of the Pharaohs in Egypt, the Sumerian, Babylonian and Assyrian civilizations in Iraq, and the Jewish and Hebrew civilizations, usury was a disease of the people's economy. It is written in the Old Testament that it is forbidden for Jews to take usury from Jews, but it is permissible for Jews to take usury from non-Jews. The Jews introduced usury to the Arabs on the Arabian peninsula, particularly in Taif and Yathrib.

Riba

فَإِنْ لَّمْ تَفْعَلُوا فَأْذَنُوا بِحَرْبٍ مِّنَ اللَّهِ
وَرَسُولِهِ وَإِنْ تُبْتُمْ فَلَكُمْ رُءُوسُ
أَمْوَالِكُمْ لَا تَظْلِمُونَ وَلَا تُظْلَمُونَ

<https://www.youtube.com/watch?v=40Edc5qfKas>

First: In Mecca
Quran Al Rum 30:
39 Riba deprived
wealth of Allah's
blessing, charity
raised it manifoldly

Second: In Medina
1st H Quran Al
Nisa: 161: Severely
disapproved or
riba

Third: 2nd H. Al
Imran: 130-131.
Enjoining muslim
to keep away from
riba.

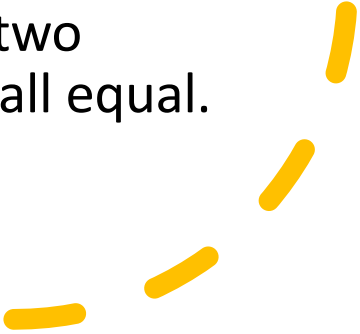
Final: 9 days
before the demise
of the prophet. 2:
275-281.

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

- 275. Those who eat Rib (usury) will not stand (on the Day of Resurrection) except like the standing of a person beaten by Shaitan (Satan) leading him to insanity. That is because they say: "Trading is only like Riba (usury)," whereas Allah has permitted trading and forbidden Riba (usury). So whosoever receives an admonition from his Lord and stops eating Riba (usury) shall not be punished for the past; his case is for Allah (to judge); but whoever returns [to Riba (usury)], such are the dwellers of the Fire - they will abide therein.
- 276. Allâh will destroy Riba (usury) and will give increase for Sadaqat (deeds of charity, alms, etc.) And Allah likes not the disbelievers, sinners.
- 277. Truly those who believe, and do deeds of righteousness, and perform As-Salat (Iqamat-as-Salat), and give Zakat, they will have their reward with their Lord. On them shall be no fear, nor shall they grieve.
- 278. O ye who believe! Fear Allah, and give up what remains of your demand for usury, if ye are Indeed believers.
- 279. If ye do not, take notice of war from Allah and His Messenger: but if ye turn back, ye shall have your capital sums; Deal not unjustly, and ye shall not be dealt with unjustly.

A large orange shape on the left side of the slide, consisting of a vertical rectangle on the left and a quarter-circle on the right. The word "Hadith" is written in white text inside the rectangle.

Hadith

- "Hakim relates on the authority of Ibn Mas'ud that the Prophet said, '*Riba* is of seventy three kinds, the lightest in seriousness of which is as bad as one's marrying his own mother; for the Muslim who practices *riba* goes mad.' " (Related by Ibn Majah)
 - Jabir reported: Allah's Messenger (pbuh) cursed the accepter of interest and its payer, and one who records it, and the two witnesses, and he said: They are all equal. (Muslim)
- 
- A yellow decorative shape in the bottom right corner, consisting of several short, curved lines that form a partial arc.

The Fall of the Ottoman Empire

Ottoman Empire :
1299-1922

High Interest Loan
with British and
France 1854: £3M
interest 6%,

1855, £5M interest
4%,

1858, £5M interest
6% and £8M
interest 6%.

It achieved
£200M.

6th Oct 1875-
Default

*'a Council of the
Debt'* - to recover
the debt.

Interest in Banking

Ebusuud Efendi, the Mufti of Istanbul: Ebusuud defended the act of interest-taking, as a practical matter of necessity.

Sheikh-al-Azhar Muhammad Sayyid Tantawi and the Azhar Islamic Research Institute (IRI) (Majma al-Buhuth al-Islamiyyah) 1989: Interest in Bank is not riba.

Syeikh Yusuf al-Qaradhawi refuted Syeikh Tantawi 1990 in *Fawa'id al Bunuk Hiya al-Riba al-Haram*.

The first Islamic Economic International Conference in Mecca 1977: Bank interest is unlawful.

January 2003, *Majma al-Fiqh al-Islam*: Reject the Islamic legitimacy of all forms of bank interest.

Riba

Excess, expansion, increase,
addition or growth

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

Riba on Loan Contract

Riba alduyun / al-jaliyy / al Quran / al-Jahiliyyah/ al-Nasiah:
An increase for the repayment deferment/postponement in
contract of loan

Riba al duyun- occurs in lending and borrowing.

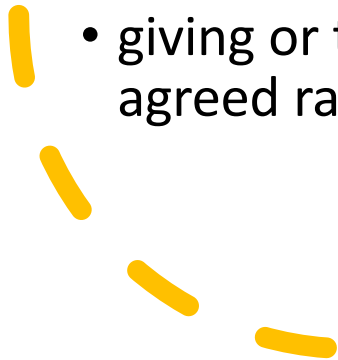
Riba al nasiah (to delay): excess due to delay in payment

Any unjustified increment in borrowing or lending money
whether in kind or cash over and above the principal amount
as a condition stipulated or agreed btm the parties.




Riba al Nasiah or Riba al Jahiliya

- *“that kind of loan where specified repayment period and an amount in excess of capital is predetermined”*(Imam Abu Bakr Jassas Razi)
- *all loans that draw interest is riba*”(Hadith quoted by Ali ibn Talib)
- real and primary form of riba: premium paid to the lender in return for his waiting
- giving or taking of every excess amount in exchange of a loan at an agreed rate irrespective of whether it is low or high






Riba in Exchange Contracts



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

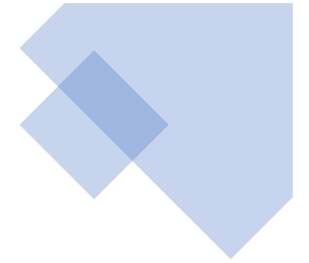
Riba al-Fadl: Inequality of quantity between the (ribawi) counter values

Riba al-Nasiah: Deferment of one of the (ribawi) counter values which share the common illah



Riba al Buyu

- Ubadah b Samit that the Prophet said: Gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates and salt for salt, like for like, equal for equal and hand to hand, if the commodities differ, then you may sell as you wish provided that the exchange is hand to hand (Sahih Muslim)
- 1. It must be a spot transaction: If one of the commodities are delayed, riba al buyu occurs
- 2. It must be equal counter-value. 2kg of wheat with 2 kg of wheat.
- 1. Medium of exchange: gold and silver and currency
- 2. Food stuff: Barley, dates and salt.
- Shafie: Edible
- Hanafi: saleable by the measurement of weight or capacity
- Maliki: staple foodstuffs and preservable



Hadith Ubadah

If gold for gold: Equality and spot delivery

If wheat for wheat: E and S.

If gold for silver: Spot delivery

If wheat for dates: Spot delivery

If gold for wheat: Willing seller willing buyer



Islamic Finance:

The prohibition of **Riba**, Gharar and Haraam

Currency transaction

Type	Shari'ah requirements
Same currency (EUR for EUR)	<ul style="list-style-type: none">• Spot transaction• Equal amount
Different currencies (USD for EUR)	<ul style="list-style-type: none">• Spot transaction

Commodity (food) transaction

Type	Shari'ah requirements
Same food (wheat for wheat)	<ul style="list-style-type: none">• Spot transaction• Equal amount
Different food item (sugar for wheat)	<ul style="list-style-type: none">• Spot transaction



Illustration for currency

RM100 and RM100 + on the spot =No riba

RM100 and RM100 + delay=Riba

RM100 and RM150 + excess=Riba

RM380 and USD100 + on the spot=No riba

RM380 and USD100 + delay=Riba

Money is not a commodity. Money is a medium of exchange, store and measure of value.

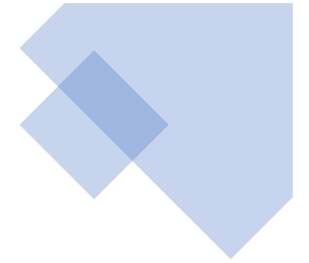


Illustration for Food

10kg Rice and 10 kg rice + on the spot=No riba

10kg rice and 10 kg rice + delay=riba

10kg rice and 15 kg rice + on the spot=Riba

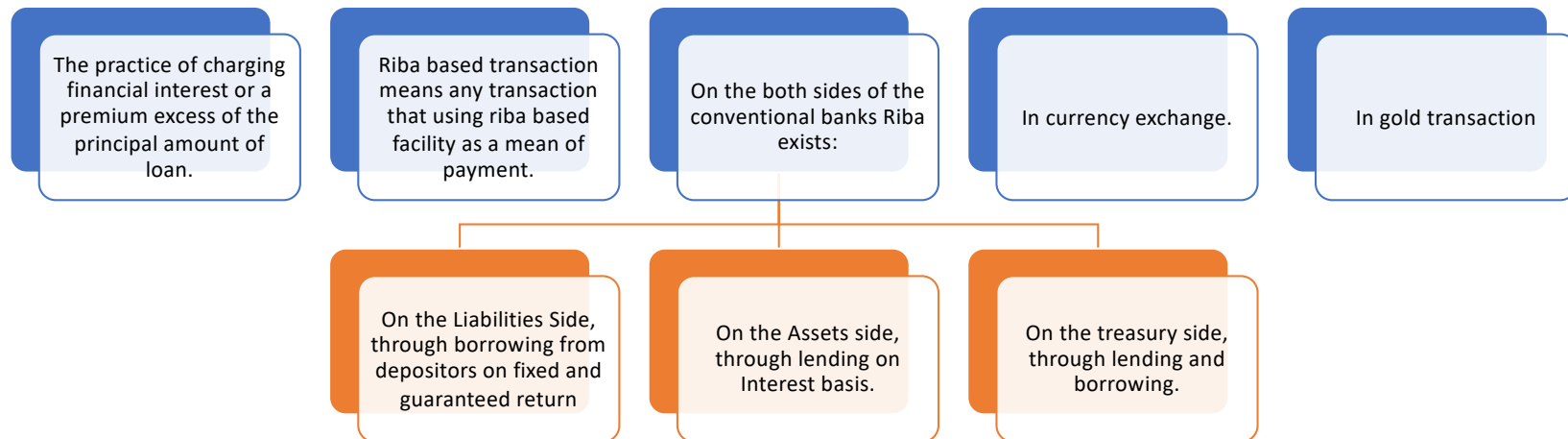
10kg rice and 15 kg wheat + spot=No riba

10kg rice and 15kg wheat + delay=riba





Riba in Banking



Reason or Rationale

1. Barter system is not so favourable from the Shariah point of view.

2. The impact of riba is on the society at large: It violates the equity aspect of economic organization.

2. The inflexibility of an interest-based system in a loss situation can lead to a bankruptcies in loss of productive potential and unemployment.

4. Money is considered as commodity in an interest-based system and subject to the law of demand and supply (Allowing speculation on money).

5. Discourage innovation.

6. **Security oriented vs growth oriented.** Wealth creation and transfer: Riba activities do not create a new stock of wealth.

7. Riba is a sure gain without any possibility of loss, hence all the risk is taken by the borrower, rather than sharing the risk and the profits with both parties.

From Riba to **Sale and Equity Based Transaction**

Islamic finance goes beyond Riba. Eg Sale not loan

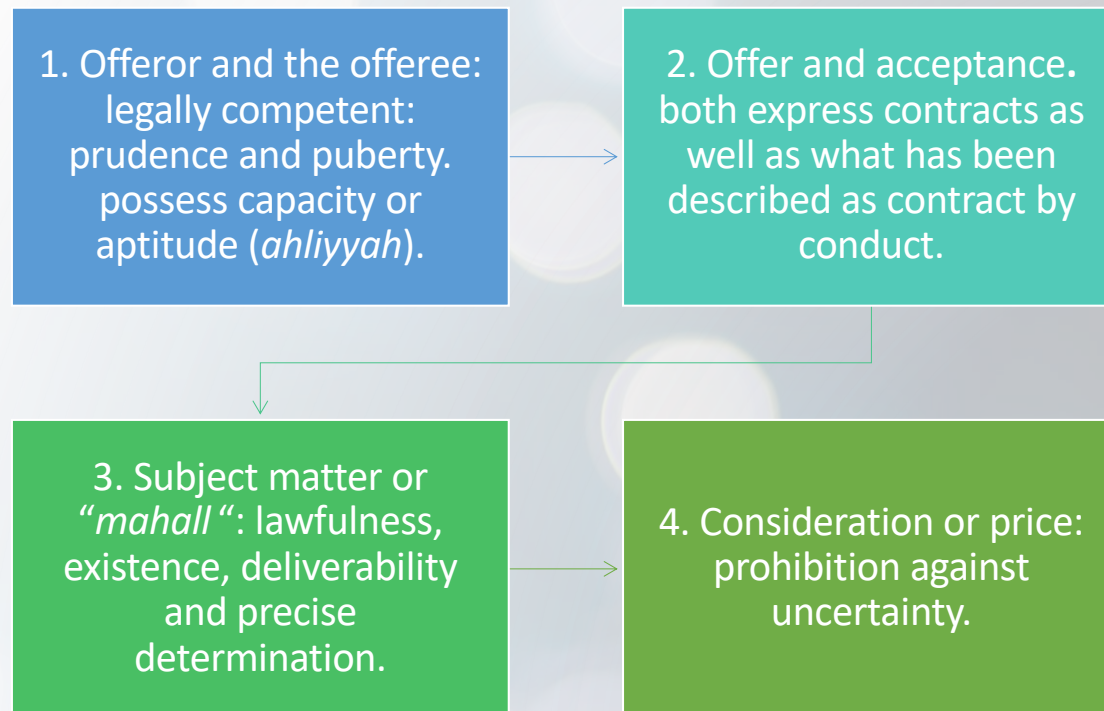
Conventional banks do not involve themselves in trade and business

Sale is conducted under the principles of Shariah binding its rules and regulations and abides by all the objectives of Shariah.

Sale must be concluded by selling of property not trading money.

Gharar is more relevant in sale transactions.

Elements of Sale



Equity Based Transaction



Mudarabah is a partnership where one party provides the capital while the other provides labor and both share in the profits. The party providing the capital is called the rabb-ul-mal ("silent partner", "financier"), and the party providing labor is called the mudarib ("working partner").



[Musharakah](#) is a profit and loss sharing contract whereby two or parties or more pool and invest their capital (cash, in kind, etc) and share in the outcome of their venture, whether profit or loss.



Elements (i) Wording/ [sighat al-aqd](#) (offer/ [ijab](#) and acceptance/ [qabool](#)). (ii) Contracting parties (the partners). (iii) Subject matter of the contract or agreement: funding and work. Funding may include [cash](#), [tangible](#) and [intangible assets](#) (examples of intangible assets are [goodwill](#), [patents](#), [rights](#), etc.). In-kind funding (tangible and intangible assets) is valued at [cash equivalent value \(CEV\)](#) as agreed by the partner at inception.

Gharar

Surah al Nisa:29 “ O you who believe? Eat not your property among yourselves unjustly by falsehood and deception, except it be a trade amongst you by mutual consent”.

The world *batil* unjustly include all categories of illegal and defective elements in commercial contracts, including that of a gharar.

Gharar

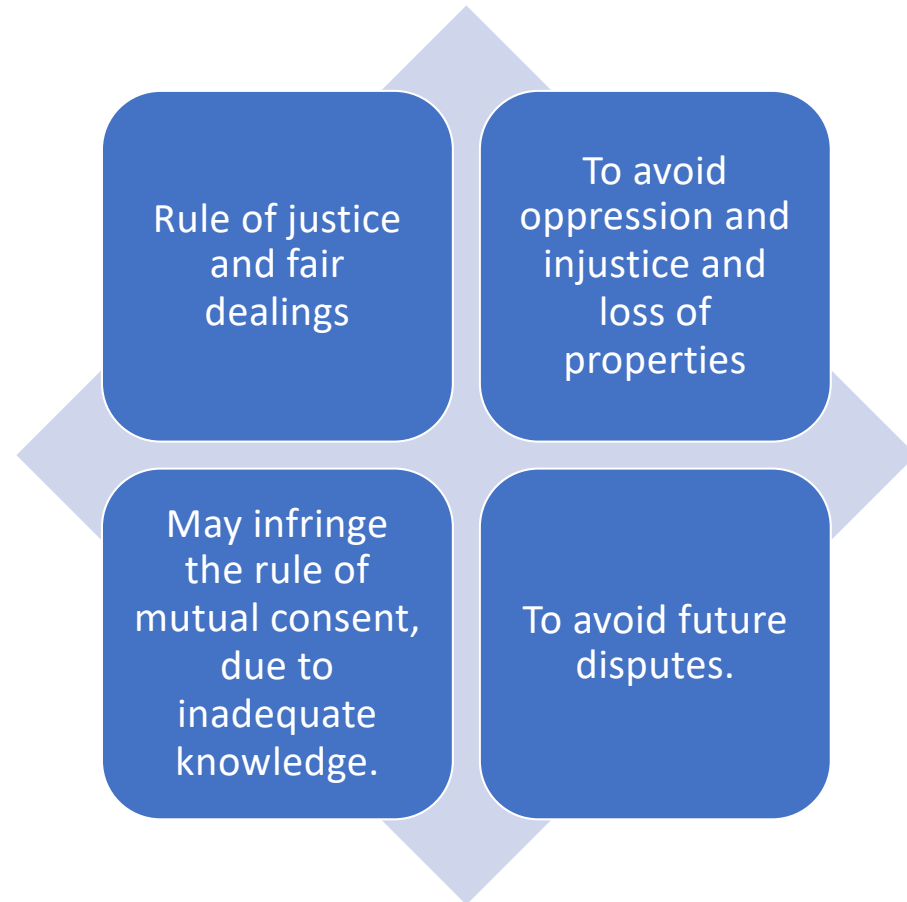
<https://www.youtube.com/watch?v=L7Iy4SPhRxs>

Risk, uncertainty, doubtfulness, ignorance, and hazard

Ibn Qayyim: as a sale in which the vendor is not in position to hand over the SM to the buyer whether the SM is in existence or not.

WZ: Contract which contains a risk to any of the parties which could lead to his loss of properties.

Rationale



Types of Gharar

Non-existence of the exchanged counter-values or the control of the parties over the SM to be exchanged.

Inadequacy or inaccuracy of information: Non disclosure. Eg characteristics of the exchanged counter value, its species, quantities, data of future delivery,.

Undue complexity of the contracts. Eg two sales in one.



Degree of Gharar

Gharar yasir: Minor gharar: unavoidable gharar due to the nature of the subject matter without causing considerable damage to one of the parties will not affect the validity of the contract.

Gharar fahish: Major gharar: Important and material information. Contract is void.



Maysir

﴿يَسْأَلُونَكَ عَنِ الْخَمْرِ وَالْمَيْسِرِ ۖ قُلْ فِيهِمَا إِثْمٌ كَبِيرٌ وَمَنْفَعٌ لِلنَّاسِ وَإِثْمُهُمَا أَكْبَرُ مِنْ نَفْعِهِمَا﴾

They ask thee concerning wine and gambling.

Say: In them is a great sin and some benefit for men. The sin is greater than the benefit. (2:219)

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

Maysir or Qimar

<https://www.youtube.com/watch?v=qGuTSwT-Ess>

“Yusrun” which denotes wishing something valuable with ease and without paying any equivalent compensation for it, or without working for it, or without undertaking any liability against it, or by way of a game of chance.

Involves betting whereby the winner will take the entire bet and the loser will lose his bet.

Games of pure chance where any party might gain at the expense of the loss of the party.

Short Quiz

Who Wants To Be A Millionaire.

Guessing of 'Sado' Cow

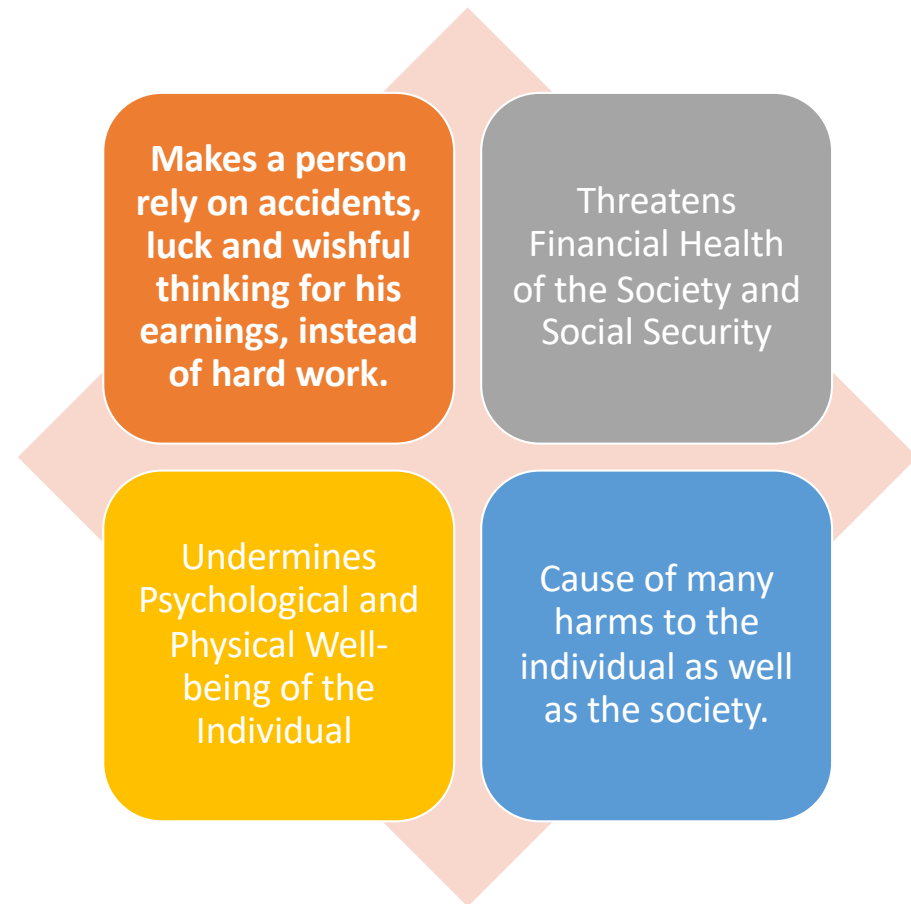
Fishing Competition

Roda Impian

'Gores dan Menang'

'Cabutan SSP BSN'

Rationale



Risk (Khatar)

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

Rationale

Majallah al Ahkam Al Adliyah in 1876.

Article 85: the benefit of a thing is a return for the liability for loss arising from that thing.

Art 87: The detriment is as a return for the benefit.

Arti 88: the burden is in proportion to the benefit and the benefit in proportion to the burden.

Al ghunmu bil ghurmi
(no risk, no gain).

Al kharaj bidhaman: the right to the return is justifiable by assuming the risk of loss.




Types of Risks (Fiqh)

1. Entrepreneurial risk which might occur as part of the normal course of business: Praiseworthy

2. Risk due to possibility of the occurrence of natural disasters and calamities: Allowed if by way of cooperative.

3. Unnecessary risk. Arise from game of chance. Prohibited.



Types of Risks

Credit Risk

Equity Investment Risk

Market Risk

Liquidity Risk

Rate of Return Risk

Operational Risk

Shari'ah Non-compliance Risk

Legal Risk

Reputational Risk

Values and Ethics

Tenet bound

- **Fundamental tenets are derived from Shariah**
- Absence of interest-based transactions
- Avoidance of economic activity involving speculation
- Prohibition on production of goods and services which contradict the values of Islam

Principles based

- **Concept is grounded in ethics and values**
- Principles akin to ethical investing
- Emphasis on risk-sharing and partnership contracts
- Credit and debt products are not encouraged

Real economy linked

- **Islamic finance offers an alternative financing paradigm**
- Asset-backed transactions with investments in real, durable assets
- Stability from linking financial services to the productive, real economy
- Restrains consumer indebtedness as credit is linked to real assets

Communal Prosperity

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

Value-Based Intermediation

- VBI promotes a more holistic observation of Shariah, **beyond Shariah compliance**, i.e. ensuring Islamic banking offerings and practices not only comply with Shariah requirements but also achieve the intended outcomes of Shariah. Intended outcomes of Shariah focus on enhancement of well-being of the people through preservation of wealth, faith, lives, posterity and intellect.
- VBI aims to create focus on **value and impact creation**, regardless of any business modality (credit or investment intermediation) adopted by industry players.
- VBI intends to focus on ensuring application of the established concepts is in line with Shariah; and **emphasising Shariah values** or principles that are yet optimally propagated such as entrepreneurship and community empowerment. (BNM, 2018)





What's next for the Malaysian Islamic financial industry?

What is Value-based Intermediation?

An intermediation function that aims to deliver the intended outcomes of Shariah through practices, conduct and offerings that generate positive and sustainable impact to the economy, community and environment, without compromising the financial returns to shareholders



How does Value-based Intermediation benefit us?



Financial Industry

Greater innovation, enhanced efficiency and effective ecosystem



Customer/Community

Improved standard of living, fair and transparent treatment



Government

Realignment of business focus with national agenda



Regulator

Strengthened financial stability

Diagram 2.2: What do value-based banking practices look like?

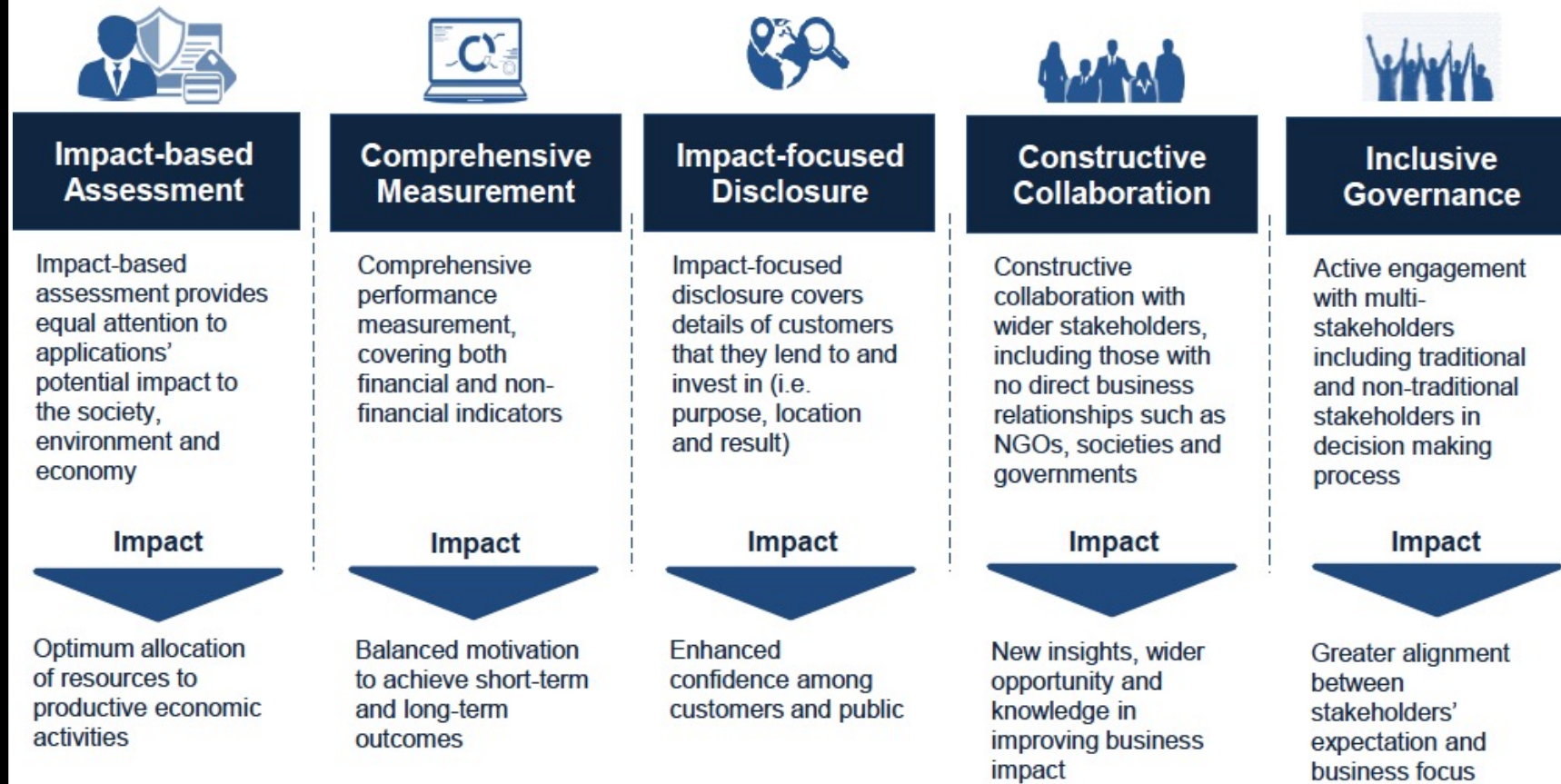


Diagram 4.5: Value-based intermediation network

