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Application of *Sharī'ah* contracts in contemporary Islamic finance: A *maqāṣid* perspective

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Abstract: This research exposes the underlying *maqāṣid* embedded in *Sharī'ah* contracts as applied in Islamic banking and finance. It addresses the problem of not observing *maqāṣid* in nominated and combined *Sharī'ah* contracts as well as the problem of not sufficiently imbuing *maqāṣid* in products developed by Islamic financial institutions. As a benchmark of the *maqāṣid* of wealth, the research adopts Ibn 'Āshūr's classification of *maqāṣid* to evaluate the conformity of *Sharī'ah* contracts to *Maqāṣid al-Sharī'ah* namely, justice, circulation, transparency, and firmness. The study focuses on three markets related to the application of *Sharī'ah* contracts, namely, banking, Islamic capital market, and *takāful*. The study concludes that, by and large, the application of *Sharī'ah* contracts has observed *Maqāṣid al-Sharī'ah* during its development and initial application stages of Islamic finance products; however, offering such products in the market has raised economic questions as to their viability and economic values. In addition, the malpractice of some *Sharī'ah* contracts has long raised concerns as to the *maqāṣid* compliance of such products. The research recommends a de-sophistication of Islamic financial engineering to minimise the possibility of convergence with conventional finance. The research also emphasises product differentiation based on less complicated combined *Sharī'ah* contracts.

Keywords: Islamic capital market; Islamic finance; *Maqāṣid al-Sharī'ah, Sharī'ah* contracts; *takāful*.

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Abstrak: Kajian ini mendedahkan asas *Maqāṣid* dalam kontrak *Sharī'ah* seperti yang dilaksanakan dalam kewangan dan perbankan Islam. Ia menjurus kepada permasalahan terhadap mereka yang tidak melaksanakan *Maqāṣid* dalam penamaan dan pergabungan kontrak *Sharī'ah* selain daripada masalah yang tidak mendalami *Maqāṣid* dalam produk yang dihasilkan oleh institusi-institusi kewangan Islam. Sebagai tanda aras kekayaan *Maqāṣid*, kajian ini menggunakan klasifikasi Ibn 'Āshūr bagi *Maqāṣid* dalam menilai keputusan kontrak *Sharī'ah* kepada *Maqāṣid al-Sharī'ah,* contohnya, keadilan, penyebaran, tranparensi dan keutuhan. Kajian ini memfokuskan terhadap tiga pasaran yang berkaitan dengan aplikasi kontrak *Sharī'ah,* iaitu perbankan, pasaran modal Islam dan *takāful.* Kajian ini merumuskan bahawa pada keseluruhannya kontrak *Sharī'ah* telah menggunakan *Maqāṣid al-Sharī'ah* semasa perkembangannya dan pada peringkat awal penggunaanya dalam produk kewangan Islam. Walau bagaimanapun produk-produk yang diberikan dalam pasaran telah menerima persoalan ekonomi sebagai daya maju dan nilai ekonomi. Tambahan pula penyelewengan dalam beberapa kontrak *Sharī'ah* telah lama mendapat tumpuan dalam pematuhan *Maqāṣid* produk tersebut. Kajian ini mencadangkan ketidakcanggihan kejuruteraan kewangan Islam bagi mengurangkan kemungkinan untuk bersatu dengan kewangan konvensional. Selain daripada itu, ia juga turut menekankan pembezaan produk berdasarkan kontrak *Sharī'ah* yang kurang rumit.

Kata Kunci: Pasaran modal Islam; kewangan Islam; *Maqāṣid al-Sharī'ah*; kontrak *Sharī'ah; takāful*.

Islamic finance has attracted enough attention to justify its introduction as a robust financial system with a unique value proposition. Aiming to establish a real economy, Islamic finance endeavours to trade in real assets and have returns that commensurate with risks. Islamic finance prohibits usury, gambling, uncertainty, and trading in unlawful goods. It also establishes a financial system that enhances justice and welfare for all stakeholders at macro and micro levels. This value proposition hinges upon many requirements, especially the observance of *Maqāṣid al-Sharī'ah* that permeates the very essence of Islamic finance. Since the latter is entirely based on *Sharī'ah* contracts, this research aims to unveil the *maqāsid* dimension underlying them as well as evaluating the extent to which *Sharī'ah* contracts preserve their objectives when applied in contemporary Islamic finance.

This research exposes the *maqāṣid* of *Sharī'ah* contracts in Islamic finance via a review of classical literature and the contemporary

practices of *Sharī'ah* contracts by Islamic financial institutions. All classical scholars maintained that the proper formation of a contract would achieve its objective by default (al-Shāfi'ī, 1990; al-Qarāfī, n.d; *Majallah*, 2005). This refers to the transfer of value and counter value between the contracting parties as the legal effect of concluding a contract. Imam al-Qarāfī spoke of the binding force of a contract that would entail the protection of the rights of the contracting parties and the removal of hardship (al-Qarāfī, n.d), which is in itself a *Sharī'ah* objective. On the other hand, the form of a contract as opposed to its substance, has been questioned by many scholars including Ibn Taymiyyah and Ibn Qayyim al-Jawziyyah. The latter devoted an entire section on *ḥiyal* (legal stratagems) in contracts whereby he dismissed certain contracts as usurious in nature such as '*īnah* and *tawarruq* (Ibn Qayyim, 1955). Furthermore, the Mālikīs dismissed as illegitimate the *murābaḥah* to the purchase orderer (MPO) arguing that it is as a sale of a good not owned by the seller (Ibn Rushd, 1988).

Sharī'ah scholars have attempted to highlight the objectives of *Sharī'ah* contracts in contemporary Islamic financial practice. Abū Ghuddah highlighted the general *maqāṣid* of contracts as being, "justice for exchange contracts, intactness for options (*khiyārāt*), fairness and integration for partnership contracts (*mushārakat*), benevolence (*iḥsān*) for donation contracts, and *security* for surety instruments" (Abū Ghuddah, 1997, p. 5). Despite the importance of these objectives, they seem to be drawn from a *fiqh* perspective. *Al-Mawsū'ah al-Fiqhiy*yah referred to *riḍā* (satisfaction) as one of the objectives of a *Sharī'ah* contract (*al-Mawsū'ah*, 2007). But *riḍā* if not regulated can circumvent the prohibition of many contracts.

Mundhir Qahf delineated the principles of a *Sharī'ah* contract, namely satisfaction, equitable rights, ethical dimension, and transacting in real business activities (Qahf, 2011). However, these principles themselves are interrelated with the objectives of *Sharī'ah* contracts; an interrelation that may blur the difference between principles and objectives (*maqāṣid*). It is also unclear which of these principles mentioned by Qahf apply to equity contracts and debt contracts. Sāmī al-Suwaylim is an ardent defendant of the "substance over form" in Islamic finance. He categorically rejected the contract of the sale of debt for a debt (*bay' al-kāli' bi-al-kāli'*) as being against the objective of *rawāj* (wealth circulation) (Suwaylim, 2009). In the same vain, he

would consider *'īnah* and organised *tawarruq* as tricks to circumvent the prohibition of *ribā,* despite the validity of the combined contract when applied separately (Suwaylim, 2009).

This is an approach that Nazīh Ḥammād does not subscribe to as long as the asset in *tawarruq* does not return to the original seller (Nazīh, 2007). Highlighting the divergence of views in Islamic finance, the Accounting and Auditing Organisation for Islamic financial organisation (AAOIFI) has validated *al-ijārah al-muntahiyah bi-al-tamlīk* (Islamic hire-purchase) based on the binding promise (*wa'd)*, which Sheikh Ibn Biyyah considers against *Maqāṣid al-Sharī'ah* (Ibn Biyyah, 2010). AAOIFI has also validated *murābaḥah* to the purchase ordered. Rafīq al-Miṣrī, however, considers it invalid as it would ultimately amount to a loan with interest, hence undermining *Maqāṣid Sharī'ah* in financing (al-Miṣrī, 2007). In *murābaḥah* to the purchase ordered, Sheikh Muṣṭafā al-Zarqā considers the agency agreement between the Islamic bank and the customer to procure the asset from the supplier a mere formalism (*ṣūriyyah*) that renders the contract close to conventional financing (al-Zarqā, 2012). This point was also observed by AAOIFI (2009), which reluctantly allowed such an agency. On *sukūk* products, the *sukūk* structure embodied several amalgamated contracts that continue to raise many concerns.

Among the staunch critics of *sukūk* is Sheikh Taqī 'Uthmānī whose corrective measures for the *sukūk* in 2008 unveiled the superfluous structures of certain *sukūk* that made them similar to conventional bonds, hence undermining the *Maqāṣid Sharī'ah* in *sukūk* ('Uthmānī, 2011). Unquestionably, the most distinguished reference linking *Sharī'ah* contracts to *Maqāṣid al-Sharī'ah* is Sheikh al-Ṭāhir Ibn 'Āshūr in his seminal work, *Maqāṣid al-Sharī'ah*. He articulated a formidable theoretical framework of *maqāṣid* with a special emphasis on the *maqāṣid* of wealth, i.e. justice, wealth circulation, firmness of contracts, and transparency (Ibn 'Āshūr, 2006). Ibn Zughaybah (2001) expanded the theory of wealth protection propounded by Ibn 'Āshūr with greater articulation of the classical examples, but with little reference to Islamic banking and finance practices.

From the literature review above, it is clear that none of the previous studies have evaluated the observance of the objectives of *Sharī'ah* in *Sharī'ah* contracts in Islamic finance based on a definite and comprehensive benchmark of *maqāṣid*. Besides, two things are eminent.

First, there are different opinions on what exactly is a *maqāṣid*-based contract. Second, the *maqāṣid* itself has been debated in such a way that it has created more confusion in the marketplace. This paper addresses these two issues in view of the current practices of *Sharī'ah* contracts in Islamic finance.

Maqāṣid al-Sharī'ah in Islamic finance and the thrust of *ijtihād*

Islamic finance is a system that adheres to the Islamic principles in fund mobilisation, provision of finance and investment. The *maqāṣid* underlying this system comprise explicit *maqāṣid* that are stated in the revealed texts, and formulated ones that are traced from a number of particular rulings and jurisprudential principles through the process of induction (*istiqrā'*). Both categories must be observed when establishing a new Islamic legal ruling or issuing a fatwa. Ibn 'Āshūr emphasises the necessity of observing *Maqāṣid al-Sharī'ah* in *ijtihād.* He put it:

> In sum, we can say that we are certain that all the *Sharī'ah* commands embody the lawgiver's purposes, which consists of underlying reasons, benefits, and interests. It is, therefore the duty of the scholars of the *Sharī'ah* to search for the reasons and objectives of legislation, both the overt and the covert (Ibn 'Āshūr, 2006, p. 64).

The knowledge of *maqāṣid* is an important condition of *ijtihād* as maintained by al-Shāṭibī (1997). In the field of contemporary Islamic finance, *ijtihād* has adopted adaptive (*takyīf fiqhī*) and innovative (*ibtikār*) approaches. The former adapts existing conventional financial products and instruments to relevant Islamic principles and is hence a simulative approach, while the latter innovates new instruments that combine nominated contracts (*'uqūd musammāt)*, which are embedded with instruments of surety (*ḍamān*) and agency to achieve the objectives of financing and investment. Both approaches employ *Maqāṣid al-Sharī'ah* and both seek to maintain *Sharī'ah* compliance and economic viability.

Sharī'ah contracts and the realisation of *Maqāṣid al-Sharī'ah* of wealth

In its specific sense, a contract is a voluntary and binding agreement between two or more persons to create enforceable rights and duties. Al-Jurjānī defines it as an agreement that, "binds the contracting parties with offer and acceptance" (al-Jurjānī, n.d., vol. 1, p. 153). The Ḥanafīs

define it as, "the correspondence of the offer of any of the contracting parties with the acceptance of the other" (*Kamāl al-Dīn*, n.d., vol. 3, p. 187). The Shāfi'īs define a contract as a forceful link between the offer and acceptance (al-Zarkashī, n.d). As for the Ḥanbalīs, they emphasise the specific meaning of a contract as an agreement between two or more promises to initiate or transfer obligations (Zayn al-Dīn, n.d.). These definitions have not explicitly highlighted the objectives of a contract as they emphasised contracts initiating obligations and rights. Imam al-Qarāfī from the Mālikī School shed light on what is deemed to be the *Maqāṣid al-Sharī'ah* of contracts. In his seminal work *al-Furūq he* reiterated that a contract, in principle, is binding as it is promulgated to achieve the legitimate objective of the contracting party and to remove hardship.

The binding feature, according to al-Qarāfī is to remove hardship and to achieve the objectives of a bilateral contract, whereas the objectives of unilateral contracts are achieved without any binding element (al-Qarāfī, n.d.). To emphasise the legal effects of a contract, the *Majallah* (n.d, p. 29) defines a contract as "the commitment of the contracting parties to undertake a matter. It is the link between the offer and acceptance." Al-Qarāfī's view on the removal of hardship and the *Majallah's* referral to the legal effect sum's up the objectives of a *Sharī'ah* contract as the realisation of *maslaḥah* and the removal of *mafsadah*. The latter is the ultimate goal of all *Sharī'ah* rulings including those of Islamic financial transactions. The *Maqāṣid al-Sharī'ah* in contracts are traceable in three areas in Islamic jurisprudence: specific objectives of wealth, the principle of intention in contracts, and the pillars and conditions of contracts.

The specific objectives of wealth according to Ibn 'Āshūr are five: "circulation (*rawāj)*, clarity (*wuḍūḥ*), protection (*ḥifẓ*), firmness (*thabāt*), and justice ('*adl*)" (Ibn 'Āshūr, 2001, p. 464). We shall analyse the relationship between these *maqāṣid* and *Sharī'ah* on the one hand, and contracts and principles in their capacity as means (*wasā'il*) on the other. This is addressed on the premise that the means hold the same ruling as *maqāṣid* as maintained by al-Qarāfī, al-'Izz (1991), and many other Muslim scholars. Abū Ghuddah highlighted the general *maqāṣid* of contracts as being, "justice for exchange contracts, intactness for options (*khiyārāt*), fairness and integration for partnership contracts (*mushārakāt*), benevolence (*iḥsān*) for donation contracts, and security for surety instruments" (Abū Ghuddah, 1997, p. 5).

The principle of intention in contracts is manifested in the integration of *Maqāṣid Sharī'ah* of wealth with the intention of the contracting parties. In the course of engaging in any financial activity, the contracting parties must align their intentions with *Maqāṣid Sharī'ah*. Al-Shāṭibī (2003) ascertains that, "the objective of the lawgiver is to make the intentions of the person (*mukallaf*) in full conformity with the objectives of *Sharī'ah* … the person [thus] should not aim [something] not intended by *Sharī'ah*" (al-Shāṭibī, 2003, vol. 3, pp. 23-24). Muslim jurists have long emphasised the importance of linking *Sharī'ah* contracts to their legitimate objectives. Their debates revolved around the principle of form vs. substance when concluding a contract. The issue is well summed up in the Islamic legal maxim "contracts are judged by the intentions and meanings and not by the words and forms". Ibn Qayyim says, "intention is the spirit of a deed as well as its essence. The deed's legitimacy or illegitimacy depends squarely on the intention, " (Ibn Qayyim, 1955, vol. 3, p. 123). As for the pillars of a *Sharī'ah* contract, it will be highlighted in the next point which will extensively analyse the relationship between *Maqāṣid al-Sharī'ah* and *Sharī'ah* contracts and evaluate their level of convergence or divergence in contemporary Islamic banking and finance.

As for the conditions (*shurūṭ*) of a contract, the *Sharī'ah* upholds any condition that does not contravene the established rulings and principles of Islamic commercial law. Imam al-Shāṭibī links between *shurūṭ* and *Maqāṣid al-Sharī'ah*. He is of the view that a condition *vis-à-vis* the contracts have three scenarios: first is a condition that complements the objective of the contract such as stipulating collaterals in loans; thus, such a condition is permissible. Second is a condition that contravenes the objective of a contract such as stipulating that the buyer of an asset should not make use of it; such a condition is void. Third is a condition that is vague as to its conformity with the objectives of a contract (al-Shāṭibī, 1997). However, Abū Zahrah accentuated the fact that schools of jurisprudence have disagreed as to the application of these general principles (Abū Zahrah, 1996).

The objective of justice ('*adālah*)

Justice in Islamic finance is of paramount importance. It will not be achieved without the provision of financing itself which "refers to money that makes it possible to acquire existing wealth for consumption

and/or as inputs in the production process" (Siddiqi, 2004, p. 30). It entails the equal preservation of the right of the contracting parties, the realisation of the legal effect of the contract such as the transfer of a property after a payment is fully or partially made, and the prohibition of usury, gambling, and uncertainty. Ibn ʻĀshūr (2001, p. 477) held that justice in wealth entails, "its acquisition in a non-oppressive way through labour, exchange with its owner, donation, or inheritance." Siddiqi reiterated that, "what is sought in the financial system is justice and equity [*iḥsān*]. Islamic history is rich in examples of how to realise justice and equity in economic life in general and finance in particular. Prohibition of *ribā*/interest is part of Islamic guidance designed to play a key role in ensuring a just and equitable financial system" (Siddiqi, 2004, p. 34). To achieve justice in Islamic contracts, the *Sharīʻah* looks at contracts in terms of its structure and type.

Structure

The structure emphasises the validity of the contract's pillars, terms, and conditions, as well as the validity of supporting contracts such as guarantee and pledge. As for the pillars, the unequivocal nature of the offer and acceptance, the legal capacity of the contracting parties, as well as the validity of the subject matter would have ensured *Sharīʻah* compliance of the contract with both parties' rights protected and not infringed. The pillars and conditions of a contract are reflective of many objectives that conform to *Maqāṣid al-Sharīʻah*. Muslim jurists pursued both literal and contextual approaches in tackling this topic. As for the offer and acceptance, the majority of scholars are more literal in considering the offer to extend only from the seller or the lessor while the acceptance is to come from the buyer or the lessee (Ibn Qudāmah, n.d.). The Ḥanafīs held a different approach by considering the offer initiated by either party, be it the seller or the buyer, while the acceptance must come only from the second party (al-Kamāl, n.d.). The offer and acceptance is to attain a level of satisfaction for the contracting parties precluding any possibility of dispute over the price, type of goods and service offered, or mode of delivery (*al-Mawsūʻah*, 2007). Satisfaction (*riḍā*) is thus an objective of a *Sharīʻah* contract.

While pursuing justice in *Sharīʻah* contracts, contemporary Islamic finance has reinvented the classical debate on the "form versus substance" in financial transactions. The debate is triggered

by the offer and acceptance *vis-à-vis* the underlying intention. In the classical theory of *Sharī'ah* contracts, the Ḥanafīs adhered strictly to the principle of "substance over the form" when the offer and acceptance are exchanged, considering *wafā'* contract such as a guarantee rather than a sale. The Mālikīs reiterated the significance of the meaning of a contract as a parameter of its validity allowing, for example, *bay'al-mu'āṭāt* (sale by conduct) and any business activity deemed by people as a sale (al-Qarāfī, n.d.). Although the Shāfi'īs are more inclined to consider the form over the intention of the contracting parties when such an intention is not obvious, they do not subscribe to the ultimate supremacy of intention over form in the absence of a signifier (al-Qarāfī) (*al-Mawsū'āh*, 2007). Imam Nawawī held, "from the obvious statements of the Malikis, they agreed with us that Islamic legal rulings should not be predicated primarily on *maqāṣid* but rather on the apparent forms…thus if the predication of rulings on *maqāṣid* is not permissible then it would be a matter of priority to consider the forms of Shariah contracts," (Nawawi, *Majmu'*, vol. 1, p. 155). He further reiterated that " '*īnah* is not among the prohibited contracts...this is the authentic view of *aṣḥāb* (Shāfi'ī scholars)," (al-Nawawī, vol. 3, p. 419). Thus, a *hibah* (gift) with a condition of exchange (*hibat al-thawāb*) is deemed as a sale given its meaning but is deemed as an actual gift given its form. Similarly, a guarantee with the right of recourse is deemed as a loan given its meaning but is deemed an actual *kafālah* given its form. The '*īnah* transaction is valid according to Shāfī'īs given the form that precludes any prior agreement to circumvent the prohibition of *ribā*, but Shāfi'ī himself considers '*īnah*, "reprehensible if the contracting parties have an overt intention that invalidates the sale contract" (al-Shāfi'ī, 1990, vol. 3, p. 75). The majority of jurists prohibit '*īnah* as they consider it a usurious loan in disguise (*al-Mawsū'ah*, 2007). According to the Islamic Fiqh Academy and AAOIFI, this transaction is prohibited by clear texts and its contradiction to *Maqāṣid al-Sharī'ah*. This also applies to organised *tawarruq*.

The Islamic banking industry does not generally practice *'īnah* except in Malaysia which relies heavily on the Shāfi'ī view on the issue. However, in 2012 the *Sharī'ah* Council of Malaysia's Central Bank released a resolution obliging all Islamic banks to remove the inter-conditionality clause binding the two legs of the *'īnah* contract (Bank Negara Malaysia, 2012). This has purified the practice of *'īnah*

to a great deal and is a corrective measure rather than a new resolution. Contemporary scholars such as al-Miṣrī (2007), Najatullāh Ṣiddīqī (2004), al-Suwaylim (2009), Taqī ʻUthmānī (Osmani, 2007), and many others have called for a critical review of Islamic banking practices so that justice would be upheld among the contracting parties. To them, the current practices of Islamic finance are more about form than substance given the way contracts are being amalgamated to serve the same purpose as conventional loans. The articulation of this debate is beyond the scope of this research.

The structure of a contract is also supported by contracts such as *kafālah* (guarantee) and *rahn* (pledge) to secure payment and reduce events of defaults that may impair capital. This is in line with the protection of wealth as a universal objective of *Sharīʻah*. Furthermore, the removal of the element of *ribā* in Islamic contracts aims at establishing justice by blocking the transfer of risks from the lender to the borrower. In this transfer, the lender would have earned unfairly since he neither acts as a partner nor as a trader, absolving himself from taking risks.

In modern capital market products, the debt financial market creates a liability on the part of the issuers widening the gap between the real economy (Davis, 2015) based on real assets, and the financial economy that raises the debt ratios through money lending and speculation, although regulated. The control of central banks may prove defective when securitisation of debts goes viral. It may create bubbles leading to acute financial crises similar to the 2008 sub-prime crisis in the USA. We shall see later how the profit and loss sharing feature in equity-based contracts is more than risk sharing and promotion of real economy.

The structure of *Sharīʻah* contracts must also be free from *gharar* (uncertainty) to protect the right of the buyer. Selling a good without identifying its type, price, or mode of delivery would amount to *gharar* that affects either the buyer or the investor. Exchanging an insurance policy with a premium in order to cover a defined loss in an insurance contract involves a *gharar* that may run counter to the rights of the insured (OIC, 2013). The cover will be provided in case risk occurs, otherwise no cover is provided. In contemporary Islamic finance, contracts are used in combination (*ʻuqūd murāqabah*) to serve certain objectives such as cash and liquidity management, risk management,

reduction of cost and obligation, and exit from prohibited transactions (Shahrul, 2014). However, AAOIFI has regulated the practice by stipulating parameters including the combination should not lead to a usurious activity, the combination should not be a trick to circumvent the prohibition of *ribā*, and that two contradicting contracts should not lend the *muḍārabah* capital to the *muḍārib* (AAOIFI, 2009.).

Type

Mundhir Qahf summarised the main principles upon which all *Sharī'ah* contracts are built as satisfaction, equitable rights, ethical dimension, and transacting in real business activities (Qahf, 2011). All types of *Sharī'ah* contracts guarantee the rights of the contracting parties to ensure the prevalence of justice. Apart from a typical sale contract whereby the value and the counter value are exchanged on the spot, debt-based and equity-based contracts also promote justice. For example, the *murābaḥah* contract (cost plus profit) which developed into *murābaḥah* to the purchase ordered (MPO), is structured in such a way that the *maqāṣid* of *murābaḥah* are achieved. In this transaction, justice is observed in many ways including in the deferred payment facility, which benefits the purchase order and is compensated by the increment of the price, which would benefit the seller. "Time has value" is a principle approved for such increment, however, the opportunity cost should be discarded.

The agency agreement in *murābaḥah* in which the Islamic financial institution appoints the purchase ordered to purchase the good from the supplier, is meant to facilitate the transaction and ensure a speedy and convenient financing mechanism. However, AAOIFI confined this agency only to situations where there is a pressing need and to hold the Islamic bank fully responsible for the purchase of the good and ascertain the true acquisition of the asset. The binding nature of the *wa'd* in MPO ensures that the purchase ordered would not revoke his *wa'd* so that the Islamic financing institution would not incur losses after buying the asset from the supplier. Al-Miṣrī (2003) and others have categorically objected to the binding force of the *wa'd* in Islamic banking declaring the structure as mere *ḥīla* (legal stratagem) aiming to circumvent the prohibition of *ribā*. Nazīh Ḥammād would consider MPO as a *makhraj shar'ī* (legal exist from a hardship) rather than *ḥīla* as the intention of the contracting parties is to get rid of hardship and prohibited elements

(Nazīh Ḥammād, 2007). Majma‘ Fiqhī and AAOIFI have ruled on the permissibility of the MPO structure with conditions that include the prohibition of having reciprocal binding *wa‘d* (*muwā‘adah*) from both the bank and client to rid the MPO from the exchange feature at the stage of *wa‘d*.

However, the over reliance on *murābaḥah* in Islamic banking has irked many scholars as they believe it has derailed Islamic finance from equity to debt, undermining the very objectives of *Sharī‘ah* of wealth. Due to its low risk profile to the Islamic bank (Kumar, 2009). MPO has become the norm of Islamic finance. According to Asutay (2007, p. 168), this has developed as an approach whereby he explained that, " Islamic Banking and finance does not support nor is it supported by the normative assumptions of Islamic economics. Consequently, the pragmatic approach adopted by IBF plays an important role in the internationalisation of capitalism throughout the Muslim world". Siddiqi (2003) on the other hand noted that MPO has many negative aspects such as its risk free nature and the lack of flexibility Sāmī Al-Suwaylim, though did not refer specifically to MPO, highlighted that the repercussion of debt such as the borrowing syndrome undermines the borrower's appetite for long term investment and bearing risks to justify earnings (al-Suwaylim, 2009). This debate, as mentioned before, is beyond the scope of this research.

While the collateral is meant to compensate the bank in case of the customer's default, the security deposit (*hāmish jidiyyah*) is meant to seize the commitment of the purchase ordered so that the banks' efforts to provide financing would not go in vein. Justice is also observed when *Sharī‘ah* stipulates that *hāmish jiddiyyah* can be fortified in proportion of the actual expenses incurred as result of the revocation of the *wa‘d* by the customer. Equally important is the fact that *murābaḥah* promotes "trust" as both cost and profit is disclosed to the contracting parties. The Fiqh Encyclopaedia of Kuwait made a reference to the *ḥājah* (need) of people to know the cost and profit in *murābaḥah*, especially the inexperienced businessmen who may be fouled in the market (*al-Mawsū‘ah*, 2007). Muṣṭafā al-Zarqā reiterates that as far as *murābaḥah* is concerned, "failure to disclose the capital or any information that impacts the price is an act of betrayal" (al-Zarqā, 2012, p. 89). Further, all debt based contracts such as *murābaḥah, istiṣnā‘, ijārah,* and *salam* are structured in a risk transfer model of banking and thus tend to be

similar to conventional loans in form, but not in the substance. This arbitrary similarity may create confusion among stakeholders who may ultimately revert to conventional banks as a result. The fact is that *Sharī'ah* is against risk transfer in loans with interest but is not against risk transfer in trade. That marks the clear distinction between usury and trade emphasised by the Holy Qur'ān in (2:275).

Equity based contracts such as *mushārakah* and *muḍārabah* manifest a great deal of justice as an objective of *Sharī'ah*. In *mushārakah*, whether capital is in cash or in kind, both partners share profits and losses in proportion to their capital. Both of them have an interest in the business and are both responsible for the success or failure of the venture. Thus, it is not permissible for one partner to stipulate a lump sum payment at the end of the venture as it amounts to capital guarantee, a stipulation that defeats the profit and loss aspect of *mushārakah*. Guarantee, however, is applicable upon negligence of either party and is determined by the terms and conditions of the contract as well as commercial custom. The same is applied to *muḍārabah* where profit is shared based on a pre-agreed ratio, but pecuniary losses are borne solely by the capital provider and the entrepreneur would have lost his efforts and time invested in the venture. The *muḍārabah* contract serves the bigger objective of fund mobilisation. Muslim economist Salmān held that, "the resource mobilisation made possible by *muḍārabah* contracts in Muslim lands during 7th, 8th, and 9th centuries" (Salmān, 2014, p. 30).

The objective of wealth circulation (*rawāj*)

Ibn 'Āshūr defines *rawāj* as, "fair circulation of wealth in the hands of as many people as possible in a rightful way" (Ibn 'Āshūr, 2001, p. 464). Wealth circulation is an important cycle in a society aiming to be economically stable. The means to achieve the *maqṣad* of *rawāj*, *Sūrat al-Baqarah* verses 275 and 282 clearly calls for trade as a means of wealth creation. *Sūrat al-Muzammil* verse 20 elevates traders to higher positions in the eye of God. ʿUmar ibn al-Khaṭṭāb urged the guardians of orphans to invest their wealth so that it is not impaired as a result of the yearly zakat payment. *Sharī'ah* shuns wealth concentration and encourages distribution through a myriad of channels. *Surat al-Ḥashr* verse 7 states that wealth should not be concentrated in the hands of the rich. This provides an additional justification for the prohibition of *ribā,* as it leads to the concentration of wealth in the hands of the lenders.

Rawāj is achieved via investments contracts and contacts of exchange. *Murābaḥah* and *mushārakah* investment contracts are typically the most important vehicles towards a productive society. In *muḍārabah*, funds are channelled towards the production of goods that create balance between saving and investment (Lahsasna, 2013). It invites entrepreneurs with various risk appetites to grow their wealth and not leave it idle. In venturing into *muḍārabah*, high returns are expected as a result of the rigor with which the entrepreneur runs the *muḍārabah* venture. This means a more sophisticated investment infrastructure is established that would employ sound business strategies, financial engineering, and hedging mechanisms that protect capital but should not in any way culminate in capital guarantee. As a result, more competent investors and fund managers are bred in the market who would eventually realise the level of trust capital providers are looking for, particularly in volatile markets that threaten the erosion of capital.

Mushārakah has the same objectives as *muḍārabah* but its application is much wider and sophisticated. In retail banking, *mushārakah* is applied in home financing using *mushārakah mutanāqiṣah (*diminishing *mushārakah)*, however, its real objectives are well observed in Islamic capital market where funds are moved from surplus units to deficit units. Whether the new public listed companies aim to attract capital or to grow their share capital, the Islamic capital market facilitates the flow of liquidity needed. The equity market, which is based on *mushārakah* injects more capital every day. *Sharī'ah* compliant indices and unit trusts such as REITS and ETFs motivate investors to take more risks to justify high returns. This guarantees greater wealth circulation *(rawāj)*.

Contracts of exchange are equally important in realising *rawāj* in modern Islamic banking and finance. These contracts enhance the relationship between production and financing, as the latter is not possible without the former. A typical *murābaḥah* contract would stimulate production of finished goods to fulfil the needs of customers, which would make the *maqṣad* of the *mukallaf* (customer) in conformity with the *maqṣad* of *Sharī'ah*; an important concomitant requirement stipulated by the decrees of *maqāṣid*. An *istiṣnā'* contract stimulates manufacturing of goods and is particularly ideal for the construction of infrastructure facilities with Build, Operate and Transfer BOTs structures. It encourages labour and takes into account the customers' wants to buy manufactured products according to certain specifications.

Salam contract would provide working capital to producers so that production is not hindered by lack of capital. *Ijārah* recognises the sale of usufruct with the retention of the legal title by the lessor.

Its modern application is similar to hire-purchase whereby the lessee would own the leased asset at the end of the lease period by way of sale or automatic transfer of property depending on the prevailing jurisdiction. All these contracts with their modern structures fulfil the short, medium, and long term needs of customers who do not have enough capital to purchase the goods or services they need. Conversely, some traders do not have enough working capital to start production. All these are forms of *maqāṣid* (objectives) of traders fully endorsed by *Maqāṣid al-Sharī'ah*. These contracts provide convenience by meeting the needs of customers and hence convenience is a *maqṣad* of *Sharī'ah* by itself. In the same vein, *Sharī'ah* promulgated many contracts called *'uqūd musāmmāt* (nominated contracts) to facilitate the creation, accumulation, and circulation of wealth. New contracts are also formed but should adhere to the purport of the Lawgiver as enshrined in the revealed texts. The new contracts are generally a combination of two or more contracts supported by contracts embedded to realise the objectives of financing or investment.

To widen the scope of *rawāj*, the *Sharī'ah* allows the incorporation of *shurūṭ ja'liyyah* (man-made conditions) to secure more rights to the contracting parties and hence provide more confidence and trust in markets marred by stiff competition and uncertainties; factors that sometimes drive away investors and cause capital to remain idle. Equally important in creating confidence in trade and finance are the legitimatisation of a set of options (*khiyārāt*) that protect the rights of the buyer in the asset purchased. Option of *sharṭ* (grace period of normally 3 days) for instance, would grant the buyer the right to confirm the contract or rescind it within an agreed period (Ibn Rushd, 1988), with both value and counter value returned.

There are issues on whether modern Islamic finance has helped achieve wealth circulation when it is actually involved in a risky debt creation via debt financing. On the one hand, Islamic finance operates on risk transfer model as most of its products are based on deferred sales with higher prices compared to lower prices paid on spot. On the other hand, debt based contracts contribute to GDP, stimulate production, and

reduce unemployment rates. This point is still controversial, as many researchers such as Rafīq al-Miṣrī, Mabad Jarhī, ʻAbd al-Raḥmān Sātī, Sāmī al-Suwaylim, and ʿAbdul ʿAẓīm Abū Zayd tend to hold that Islamic and conventional finance converge rather than diverge and that all polemics on the unique value proposition of Islamic finance is merely a theoretical abstraction that lacks practicality and feasibility in an interest-based financial environment. However, debt could be channelled to stimulate the economy via investment. Ibn ʻĀshūr maintained that, "credit is one of the modes of the expansion of Islamic financial transactions as the skilful investor may need to borrow capital to show his skills in business, manufacturing and agriculture" (Ibn ʻĀshūr, 1984, vol. 3, p. 99).

The objective of transparency (*wuḍūḥ*)

The renowned scholar Ibn Biyyah (2010, p. 77) asserts in his seminal work on *maqāṣid* of Islamic financial transactions that, "*wuḍūḥ* in the contemporary context means transparency". Accordingly, Islamic contracts are formed to reflect the utmost rights of the contracting parties. The terms and conditions of those contracts are supposed to be as transparent as possible to avoid disputes and prevent fraud, cheating, and misrepresentation. Offer and acceptance must use explicit expressions whether written or verbal. The contracting parties must have full legal capacity of execution (*ahliyyat al-adā' al-kāmilah*) to conclude a contract so that they could clearly understand the legal effects of the concluded contract. The subject matter must be clearly identified, segregated, and delivered without any encumbrance.

The price must be fixed and agreeable to the contracting parties during the contract session. However, issues pertaining to conventional benchmarks such as LIBOR to determine profit rates in debt-based *Sharīʻah* contracts should not cast doubt on the legitimacy of such pricing, even though an Islamic benchmark is always sought and recommended. Linking the rental rate in *ijārah* to the performance of indices in subsequent lease periods has also been approved by *Sharīʻah* authorities to consider the prevailing rate by the time the new lease contract is signed. Taqī ʻUthmānī holds, "it is thus clear that the use of the rate of interest merely as a benchmark does not render the contract invalid as an interest–based transaction" (Osmani, 2007,

p. 118). This is to provide the market price and market rental rate to ensure market stability, which is undoubtedly one of the *Maqāṣid al-Sharī'ah*.

Transparency is very much present in the terms and conditions of each *Sharī'ah* contract. In *murābaḥah*, both cost and mark up must be disclosed. In *salam* (forward sale), the price, quantity, and quality as well as the mode and time of delivery of the produced good must be clearly identified. In *istiṣnā'*, the manufactured asset must be specified in advance, and the mode of delivery must be free from any ambiguity. In modern Islamic finance, disclosure of financial statements of listed companies in the stock market is essential for investors to make informed investment decisions. The turbulences of financial crises have urged the adoption of robust *Sharī'ah* corporate governance that advocates transparency as a pre-requisite of good governance. *Sharī'ah* audit that checks the activities of an Islamic financial institution and provides an adequate scrutiny of what is going on behind the scenes. Violation of processes and procedures, non-compliance to *Sharī'ah* and local regulations, mismatch between assets and liabilities, the lack of check and balances and money laundering, to mention but a few, can ensue if audits are not conducted with transparency.

Further, transparency is apparent in the legal documentation of *Sharī'ah* contracts so that the terms and conditions can be enforced in a court of law. According to *Sūrat al-Baqarah* verse 282, this is called *kitābah*. The verse urges both creditor and debtor to document the debt-based transaction in writing. Ibn 'Āshūr further noticed that the verse actually refers to both creditor and debtor, but is more relevant to the debtor who is urged to satisfy his creditor (Ibn 'Āshūr, 1984). Transparency as one of the *Maqāṣid al-Sharī'ah* of wealth is further enhanced by the principles of collateral (*rahn*) and *kafālah* (guarantee). Being a typical requirement in modern Islamic banking practices in deferred sales (*al-buyū' al-ājilah*), the collateral is needed to safeguard the rights of the seller in the payment in the events of default. The collateral is liquidated as per the terms and conditions of the *rahn* contract. *Kafālah* from a third party would not only safeguard the right of the creditor in the payment, but also creates confidence in the market and encourages financiers to provide financing to customers with adequate guarantors.

The objective of firmness (*thabāt*)

This *maqṣad* refers to the right of ownership of both value and counter value after a contract has been concluded. The seller's right in the price is permanently secured, and the buyer's right in the purchased asset is permanently secured. To that effect, both value and counter value must be present, deliverable, and not legally encumbered. The purchaser should not be bankrupt and the collateral must not be charged to another financing that would make it legally impossible to liquidate.

The firmness of the *Sharī'ah* contract is realised through the bindingness (*luzūm*) of contracts after they are concluded. According to the theory of Islamic law, a contract is deemed binding as soon as "offer and acceptance" are exchanged, which is the view of the Imam Mālik and Imam Abū Ḥanīfah who denied the option of the contract session (*khiyār al-majlis*) (al-Qarāfī, n.d.). A more flexible view was adopted by Imam al-Shāfi'ī and Aḥmad who maintained that a contract is not binding so long as the contracting parties have not separated (Ibn Qudāmah, n.d.). Accordingly, the parties can exchange the offer and acceptance during the contract session and rescind it at their discretion, but once they make the offer and acceptance then separate, the contract becomes binding and the legal effect of the contract would ensue. This binding force of the contract, however, is not applicable in certain contracts such as *wakālah* (agency), *muḍārabah*, *mushārakah* (partnership), *wadī'ah* (deposit taking), and *ju'ālah* (promise of commission) as long as work has not commenced because no liabilities have been created and the rescinding of the contract after work has commenced would not lead to dispute or incur any financial loss.

One modern example would be the issuance of *sukūk mushārakah*. The current practice is that capital is raised through *sukūk* issuance which represents an undivided ownership of the capital raised after the closure of subscription. Once the venture has commenced and the raised capital has been injected, the *sukūk* program agreement becomes binding and thereafter *sukūk* could be traded in the secondary market at market value. In case the *sukūk* program is rescinded, the *sukūk* holders would redeem their capital at par and not at market value as the *sukūk* have not been listed and traded.

Conclusion

The research has attempted to decipher *Sharī'ah* business contracts and expose the *Maqāṣid al-Sharī'ah* imbued therein. The emphasis was on the level of adaptation and variation needed to apply those contracts in contemporary finance. The paper concludes that *maqāṣid* are championed by all stakeholders and observed in most of the products via their underlying contracts, but some are marred by malpractices causing more harm to customers, and creating a reputation risk to Islamic finance. One of the main conclusions is that Islamic finance is subservient to the dictates of globalisation and the contemporary financial landscape. This situation necessitates the observance of economic reality. Since Islamic finance is still in its infancy and has yet to reach the economy of scale, let alone the level of independence that allows her to operate freely, the pure realisation of *Maqāṣid al-Sharī'ah* both at macro and micro levels in a way that grounds itself as an alternative financial model, is a far reaching objective.

There is a need to discard the idea that only an Islamic commercial bank can realise *Maqāṣid al-Sharī'ah*. It is high time to confine debt-based products operating on the risk transfer model to Islamic commercial banks only, and move towards establishing Islamic investment banks that operate on the profit and loss sharing model. Product development should pursue a less complex process to combine *Sharī'ah* contracts in order to emphasise the true sale/investment feature of Islamic financial operations. Pursuing sophistication through Islamic financial engineering would not always produce pure and acceptable *Sharī'ah* compliant products, and sometimes the same sophistication would lead Islamic finance to converge with conventional finance.

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