

Dispute management in Islamic financial services and products: A *maqāṣid*-based analysis

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Abstract: The increasing expansion of the Islamic financial services industry beyond its original frontiers has not only come with success stories but has also been affected by the growing preference for litigation as the mode of dispute resolution. Exorbitant legal fees and cost of sustaining protracted litigation are two major challenges that require the attention of major stakeholders in the industry. This paper examines these challenges through a *Maqāṣid al-Sharī'ah* focused prism considering the importance of the sustainable dispute management framework in Islamic financial services and products. While singling out the important higher objective (*maqṣad*) of *ḥifẓ al-māl*, this study argues that preservation of wealth and financial resources requires effective means of resolving increasingly diverse disputes in the Islamic financial services industry. It is further argued that an effective dispute management framework will consider the original value proposition of Islamic financial intermediation which promotes *maṣlahah* (benefits) and prevents *mafsadah* (hardship) and *ḍarar* (financial harm). This makes a case for the affirmative relevance, potential adoption, and systemic modernisation of Islamic dispute management mechanisms such as *ṣulḥ*, *taḥkīm*, and *muḥtasib* in order to fulfil the overarching objective of protection and preservation of wealth and financial resources as one of the core objectives of *Sharī'ah*.

Keywords: Dispute management; Islamic dispute resolution; Islamic finance; litigation; preservation of property.

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Abstrak: Perkembangan yang pesat dalam kalangan industri perkhidmatan kewangan Islam menjangkau perbatasannya yang asal bukan sahaja untuk mencapai kejayaan malah telah memberikan kesan melalui pertumbuhan minat terhadap tindakan undang-undang sebagai satu kaedah untuk menyelesaikan pertikaian. Yuran perundangan yang tinggi dan kos pembayaran tindakan undang-undang merupakan dua cabaran utama yang memerlukan perhatian pemegang amanah utama dalam industri. Kertas kerja ini mengkaji cabaran-cabaran melalui *Maqāsid al-Sharī'ah* dengan menumpukan terhadap kepentingan rangka bentuk pengurusan, pertikaian yang berterusan dalam perkhidmatan dan produk kewangan Islam. Sementara itu dengan mengambil hanya tujuan utama (*maqṣad*) *ḥifẓ al-māl*, kajian ini membincangkan bahawa pemeliharaan kekayaan dan sumber kewangan memerlukan cara yang berkesan dalam menangani pertikaian yang meningkat dalam industri perkhidmatan kewangan Islam. Ia juga turut membincangkan bahawa rangka bentuk pengurusan pertikaian yang berkesan akan mengambil kira nilai asal cadangan perantaraan kewangan Islam yang mempromosikan *maṣlahah* (manfaat) dan menghalang *mafsadah* (kesusahan) dan *ḍarar* (bahaya kewangan). Ini membuatnya satu kes yang diperlukan secara positif, bakal diterima pakai, dan sebagai pemodenan sistemik mekanisme pengurusan pertikaian Islam, contohnya *ṣulh*, *taḥkīm*, dan *muḥtasib* demi untuk memenuhi objektif perlindungan yang menyeluruh dan bagi pemeliharaan kekayaan serta sumber kewangan sebagai satu daripada objektif utama *Sharī'ah*.

Kata Kunci: Pertikaian pengurusan; penyelesaian pertikaian Islam; kewangan Islam tindakan undang-undang; pemeliharaan harta benda.

While the global Islamic financial services industry is gradually reaching a record high of USD 2 trillion *Sharī'ah*-compliant products and services, it is faced with emerging challenges which have some unpronounced connections with the underlying philosophy of the industry. One such challenge is the increasing rate of disputes. Disputes are inevitable in commercial transactions, particularly in a complex and dynamic financial environment with multiple regulatory frameworks. From the perspective of Islamic banks, the most preferred mode of resolving disputes is through the courts, often called "litigation. Though litigation has its benefits, the risks associated with it do not favour core principles of Islamic jurisprudence applicable to commercial transactions (Zakaria, 2013). The *2015 Litigation Trends Annual Survey* revealed that litigating banking and finance disputes is more common than any other sector, and globally, litigations relating to contracts are the most common type of disputes in the courts (Norton Rose Fullbright,

2015, pp. 8-9). The recent decision of the English court in *Standard Bank Plc v EFAD Real Estate Company WLL & Ors* [2014] EWHC 1834 (Comm) involving *murābahah* financing presents both legal and *Sharī'ah* challenges associated with the recovery of funds advanced under a *Sharī'ah*-compliant financing facility.

One of the key triggers for disputes in the financial sector is when there are new regulatory reforms. More often than not, parties seek to understand their rights and obligations when such reforms are introduced. It is therefore pertinent to note that the Islamic financial services industries in different jurisdictions across the world have undergone – or are currently undergoing – significant reforms since the turn of this decade. This is a potential trigger for litigation in the industry, particularly in more advanced jurisdictions such as Malaysia, United Arab Emirates, and the United Kingdom (Hasan & Asutay, 2011). For instance, in the Federal Court decision in *CIMB Bank Bhd v Maybank Trustees Bhd* [2014] MLJU 117, one of the issues raised is compliance with a new ruling of the *Sharī'ah* Advisory Council (SAC) of the Central Bank of Malaysia relating to late payment penalty (*ta'wīd*), which has been codified in the Rules of Court 2012. While the Court of Appeal awarded pre-judgment interest contrary to express clauses of the Trust Deed, the Federal Court overturned the decision and held *inter alia* that such pre-judgment interest (*ribā*) is contrary to Islamic commercial law principles.

As the regulatory environment becomes increasingly tough, the platform for potential litigations is provided. One may argue that the way litigation proceedings are carried out under the common and civil law does not represent the traditional court adjudication (*qaḍā'*) in Islamic law. Regulatory reforms in the Islamic financial services industry should consider the unique nature of Islamic financial transactions and the traditional processes of dispute resolution in Islamic law. As argued in previous studies, the concept of *qaḍā'* goes beyond court litigation. It is a hybrid process of dispute resolution which encompasses the coercive dispute resolution processes such as court adjudication and the less formal processes such as mediation and arbitration (Oseni, 2015). Therefore, this study hypothesises that it is a complete misfit to exclusively subject disputes arising from Islamic financial products and services to litigation under rules and procedures that are foreign to such transactions. The psychological and financial hardships associated with

litigation in the English courts necessitate a re-examination of Islamic finance litigation from the *maqāṣid* perspective with a view to revisiting the original value proposition of Islamic financial intermediation.

This study therefore examines current trends in dispute management in Islamic financial services and products from a rather different perspective when one considers previous studies on this area of research such as Abdullah & Yaacob (2012), White (2012), and Yaacob (2011). The *maqāṣid* perspective of dispute management makes a case for effective mechanisms of dispute avoidance and resolution that will promote *maṣlahah* (benefit) and prevent *mafsadah* (hardship) and *ḍarar* (financial harm) for an end-to-end *Sharī'ah* compliance of the products and services. Following the popular classification of *Maqāṣid al-Sharī'ah*, the majority of the Muslim jurists identify the following five major higher objectives of Islamic law: *ḥifẓ al-dīn* (preservation of religion), *ḥifẓ al-naḥs* (preservation of life), *ḥifẓ al-nasl* (preservation of family lineage or progeny), *ḥifẓ al-'aql* (preservation of the intellect), and *ḥifẓ al-māl* (preservation of wealth) (al-Ghazālī, 1937; al-Raysūnī, 2006; al-Shāṭibī, 2003; Ibn 'Āshūr, 2001; Zaydān, 1998). One unique thing about Islamic financial services and products is that they all seek to fulfil the higher objectives of Islamic law. There is an element of *ḥifẓ al-māl* in every mode of finance recognised under the *Sharī'ah* (Hussein, 2010). The concept of *ḥifẓ al-māl* has significant bearing for dispute management in Islamic financial services and products.

Preservation of wealth and the original value proposition of Islamic finance

It is pertinent to observe that preservation of wealth as a major higher objective of Islamic law has been discussed comprehensively in the works of early Muslim jurists (Hallaq, 1999). The jurists have adopted different hermeneutic tools to analyse legal texts (*nuṣūṣ*) relating to wealth and the significance of its protection and preservation through lawful means ('Urābī, 1987). Property is essential to life and its preservation is required for the sustainability of mankind. The Islamic law acknowledges this fact and provides extensively for the acquisition, preservation, protection, development, and sustainability (*ri'āyat al-maqāṣid*) of this essential necessity of life. This is part of the natural instinct (*fiṭrah*) of mankind: "Beautified for men is the love of things they covet; women, children, much of gold and silver (wealth), branded

beautiful horses, cattle and well-tilled land. This is the pleasure of the present world's life; but Allah has the excellent return (Paradise with flowing rivers, etc.) with Him" (Qur'ān, 3:14) [Emphasis added].

Through a background discussion, this section examines some of these textual evidences as analysed by Muslim jurists and identifies the inextricable nexus between such textual analyses and the original value proposition of Islamic financial intermediation. Therefore, in contextualising the five higher objectives of the *Sharī'ah* and their roles in promoting social welfare, Imām al-Ghazālī (1937) contends that anything that seeks to safeguard the five objectives ultimately serves public interest (*maṣlahah*) and as such is desirable. On the contrary, whatever negatively affects, diminishes, destroys, or dissipates the five essentials is antithetical to public interest and is undesirable in the eyes of the law (Abū Zahrah, 1958). This analogy is generally based on the literal definition of *maṣlahah* which emphasises seeking benefits and warding off harms as directed by the Lawgiver (*jalb al-manfa'ah wa daf' al-maḍarrah*) through the preservation of the ultimate ends of the *Sharī'ah* (Nyazee, 2006, pp. 195-196). All measures must therefore be put in place to avoid squandering of financial resources particularly if such resources are being held or invested on behalf of others.

Ibn 'Āshūr (2001) contends that preservation of property or wealth entails every measure taken to protect the wealth of the community from being plundered or usurped without adequate compensation (Jahīsh, 2002). This restates the position of the *Sharī'ah* on right to ownership of property and the preservation and protection of such rights through clear-cut legal provisions (Muqrin, 1999). Such legal provisions have been well articulated by earlier jurists such as al-Juwaynī and al-Ghazālī who make references to the legal texts in the Qur'ān and Sunnah regarding the punishment prescribed for theft which is obviously meant to protect property ownership (Al-Ghazālī, 1985; al-Raysūnī, 2006). In a similar vein, al-Shāṭibī's (2003) conceptualisation of preservation of property or wealth relates to measures taken to protect individual rights to property ownership. He contends that the concept of *ḥifẓ al-māl* includes prohibition against any form of economic or proprietary injustice, corruption, and embezzlement of public funds, short measures and weight, deprivation of orphans of their inherited property, and wastefulness and extravagance even in personal property.

While the law strives to ensure adequate distribution and circulation of wealth in the society, it also guarantees individuals the right to ownership and takes reasonable steps to protect such right (Al-Alwani, 1990). Equitable distribution of wealth is essential to the development of a society and tends to promote mutual benefits in a convivial atmosphere. In achieving equitable distribution of resources in the modern society through the application of the *ḥifẓ al-māl* concept, Chapra (2008) suggests that redistributive mechanisms such as *zakāh*, *ṣadaqah*, and *awqāf* will play a significant role. He further argues that in order to strengthen the economic development of the state, some strategies have to be adopted to increase national income and these include: human resource development, proper monetary and fiscal policies, financial inclusion through access to capital, employment opportunities, and self-employment initiatives. In addition to his suggestions, one may add that such initiatives should include blocking any means (*sadd al-dharī'ah*) that will negatively impact both the wealth of the company and the shares of investors, as well as the property of the bank customer. This is where the waste of huge financial resources on protracted litigation involving Islamic finance transactions might be regarded as being antithetical to the general concept of *ḥifẓ al-māl*.

Two affirmative legal texts are related to the way disputes are managed in financial transactions and the requirements to preserve and protect individual ownership of wealth (Kamali, 1991). Brief exegeses of these two verses in the Qur'ān, 2:188 and 4:29, re-emphasise the significance of the *ḥifẓ al-māl* concept which can be usefully applied to Islamic finance and in its original value proposition. The first legal text provides:

And eat up not one another's property unjustly (in any illegal way e.g. stealing, robbing, deceiving, etc.), nor give bribery to the rulers (judges before presenting your cases) that you may knowingly eat up a part of the property of others sinfully [Qur'ān, 2:188].

This verse expressly prohibits bribery in very strong terms, particularly in relation to the administration of justice while determining cases involving commercial transactions. In *Tafsīr Ibn Kathīr*, it is revealed that 'Alī ibn Abī Ṭalḥah reported that Ibn 'Abbās commented on the above verse: "This is about the indebted person when there is no evidence of the loan. So he denies taking the loan and the case goes to

the authorities, even though he knows that it is not his money and that he is a sinner, consuming what is not allowed for him” (Ibn Kathīr, 2000, p. 247). The central theme of the verse is the need to avoid disputing when one knows he or she is being unjust to the other. Unfortunately, disputes that are fraught with unnecessary legal and juristic controversies are transforming into court cases involving Islamic finance products and services. To this end, Sajoo (2014) argues, “legalism shorn of fairness violates the essential principles (*maqāṣid*) that undergird the sharia itself”. This classical notion of justice is captured in a prophetic saying which is based on a legal precedent established during the early days of Islam. Umm Salamah narrated that Prophet Muhammad (S.A.W.) said:

I am only a human being, and opponents come to me (to settle their problems); maybe someone amongst you can present his case more eloquently than the other, whereby I may consider him true and give a verdict in his favour. So, if I give the right of a Muslim to another by mistake, then it is only a portion of (Hell) Fire, he has the option to take or give up (before the Day of Resurrection) (al-Bukhārī, 46:2458).

Ibn Kathīr (2000, p. 247) further cited a relevant saying of Qatādah which relates to this issue of adjudication of rights by a judge.

O son of Adam! Know that the judge’s ruling does not allow you what is prohibited or prohibit you from what is allowed. The judge only rules according to his best judgment and according to the testimony of the witnesses. The judge is only human and is bound to make mistakes. Know that if the judge erroneously rules in someone’s favour, then that person will still encounter the dispute when the disputing parties meet Allah on the Day of Resurrection. Then, the unjust person will be judged swiftly and precisely with that which will surpass whatever he acquired by the erroneous judgment he received in the life of this world.

This spiritual dimension to litigation is not in any way emphasised in matters involving Islamic finance transactions. The current trend in many cases involving default in payment in Islamic finance facilities granted by banks is the general defence from the bank customers commonly known as the “*Sharī‘ah* defence” as emphasised by the English court in *Shamil Bank of Bahrain v Beximco Pharmaceuticals Limited and others* [2003] EWHC 2118 (Comm), *The Investment DAR Company*

K.S.C.C. v Blom Development Banmk S.A.L [2009] EWHC 3545 (Ch), and in the following Malaysian cases: *Tahan Steel Corp Sdn Bhd v Bank Islam Malaysia Bhd* [2004] 6 MLJ 1, *Bank Islam Malaysia Bhd v. Rhea Zadani Corp Sdn Bhd and Ors* [2012] 10 MLJ 484. The courts have consistently considered such a defence as merely “a lawyer’s construct” which holds not water in the determination of the case. In practice, such unnecessary juristic issues raised in the court have sparked further legal dust-off during the litigation process leading to protracted proceedings which invariably depletes the financial resources, including profits, of the financial institutions.

The second significant legal text from the Qur’ān with significant implications on the enormous financial resources expended on litigation and unlawful enrichment through somewhat twisted legal arguments, provides:

O you who believe! Eat not up your property among yourselves unjustly except it is a trade amongst you, by mutual consent. And do not kill yourselves (nor kill one another). Surely, Allah is Most Merciful to you. [Qur’ān, 4: 29]

While the first verse establishes the nexus between property ownership and administration of justice, this second verse focuses on property ownership and the need to promote *consensus ad idem* in commercial transactions. It begins with the prohibition of corruption, usurpation, and forceful acquisition of the properties of others and provides a benign exception to the foregoing restrictions to property acquisition. The exception is commercial trade which is highly encouraged for earning one’s means of livelihood. According to Ibn al-‘Arabī (1972), Qur’ān 4: 29 provides a legal prohibition and codifies the express forbidding of unlawful enrichment through usurpation of other’s property and devouring other person’s property unjustly. This includes deliberate negligence to allow other people’s properties kept in one’s custody to be subject to depletion and extinction. Ibn al-‘Arabī (1972) emphasised that instances that could fall under the category mentioned in the verse include *ribā* (interest), *gharar* (speculative risk), *rashwah* (bribery), *ihtikār* (monopoly or hoarding), *maysir* or *qimār* (game of chance or gambling), *akl māl al-yatīm bi al-bāṭil* (devouring the wealth of orphans wrongfully), *ghaṣb* (usurpation), and any other prohibited element in civil and commercial transactions that is connected with property with

the same or similar features of the aforementioned practices. Thus, the prohibition of unlawfully earned money through dishonest means entails a wide range of prohibitive or forbidden elements in commercial transactions.

One may recall that a fundamental difference between the Islamic and the conventional banking industry is the nature of financial intermediation. Islamic banks carry out their banking businesses through *Sharī'ah*-compliant commercial transactions which include engaging in lawful businesses which may be in partnership with customers (Lee & Oseni, 2015). On the other hand, conventional banks are generally prohibited from engaging in trade transactions with customers, as they are merely considered as lending institutions subject to specific statutory exceptions as regulated by the Central Bank (Cetorelli, Mandel, & Mollineaux, 2012; Huck, 1966). For instance, under Malaysia's Financial Services Act 2013 (Act 758) which regulates the conventional banking industry in the country, Section 2 defines what constitutes "banking business" as:

- a. the business of—
 - i. accepting deposits on current account, deposit account, savings account or other similar account;
 - ii. paying or collecting cheques drawn by or paid in by customers; and
 - iii. provision of finance; and
- b. such other business as prescribed under section 3.

Section 3 is the exception which allows the Minister of Finance on the recommendation of the Central Bank to expand the definition of "banking business", "investment banking business", "financial intermediation activities", "factoring business", and "leasing business".

Having analysed the concept of *ḥifẓ al-māl* and some essential features identified by Muslim jurists, it is apposite to establish the nexus with the original value proposition of Islamic financial intermediation. The modern Islamic financial services industry is premised on the broader Islamic economic paradigm which seeks to bring benefit (*maṣlahah* or *manfa'ah*) to the people and ward off all sorts of harm (*ḍarar*) in civil dealings among human beings. The Islamic economic theory is built on the *ḥifẓ al-māl* concept as a key objective of the law.

Hence, apart from the requirement of just distribution of resources in the society, everybody has a right of acquisition of property and right to ownership. And once such property is legally acquired, it is jealously protected by the law. Any violation of such right is punishable under the law. Such modes of property acquisition have crystallised over the centuries and have been developed into complex modes of financing through the process of financial engineering. These modes of financing and their modernisation to suit the needs of the highly competitive financial environment are the building blocks of the modern framework of Islamic financial intermediation.

Between Islamic banks and customers: Litigation and dispute resolution choice

In an editorial which appeared in *The Metropolitan Corporate Counsel*, the impact of litigation on a company was clearly revealed. "Litigation costs have a major impact on any company's bottom line. Yet management may not realise the immensity of these costs" (Editorial, 1999). Millions of dollars have gone down the drain in the course of litigation. The Islamic banks are not spared from this increasing practice. While litigation seems to be the easiest way to recover their debts from defaulting customers, the amount of financial resources usually expended on such endeavour might not be worth the result. Even though the bank earns more in the process of recovering the debts and can get the court to compel the defendant to pay for the costs associated with the court proceedings, the psychological havoc and financial loss caused to the customer might require a rethink of the dispute resolution choice.

One of the main elements of consumer protection is the institutionalisation of cost-effective dispute resolution mechanisms. This is part of the wider enforcement mechanisms when it comes to consumer rights, including Islamic finance consumers. In a recent IMF Working Paper, the perils of litigation and its tendency to shut the doors to access to justice are identified. "The cost of litigation could be prohibitive to consumers relative to the values that may be in dispute, thus consumers may fail to seek redress in instances of unfair treatment. In the event of a dispute, resolution processes that are simple and cost-effective are critical to ensuring that consumers are given fair treatment" (Lukonga, 2015, pp. 6-7).

Previous studies reveal the tendency of banks, including Islamic banks, to prefer litigation to any other form of dispute resolution. From the perspective of such banks, this helps to mitigate credit risks associated with the debt-based products they offer. In *Malaysia Debt Ventures Bhd v MK Construction & Communication Sdn Bhd & Ors* [2012] MLJU 308, Zawawi Salleh, J. (as he then was), articulated the purpose of summary judgment which is often used by Islamic banks for the recovery of debts from defaulting customers. He observed that:

[The purpose of applying for Summary Judgment in cases involving default in payment is] to prevent a plaintiff being frustrated by a defendant who has bogus defence and who has entered appearance solely for the purpose of delay. The aim of the procedure is to save the parties and the Court the time and expense associated with unmeritorious claims and defence.

Summary judgment is an efficient means of avoiding the costs of a trial. It is a procedure in which a court based on straightforward evidence (which is not subject to fact finding) makes a ruling. Though one may not dispute this position, it is quite obvious that court proceedings often lead to other risks such as *Sharī'ah* non-compliant risk, reputation risk and legal risk. On top of that, financial resources are wasted to hire lawyers and pay for filing fees which could have been channelled to other productive means. This often occurs when *Sharī'ah* issues are raised during the proceedings such as the *Sharī'ah* non-compliance of *bay' bi-thaman ājil* (BBA) facility raised in *CIMB Islamic Bank Bhd v LCL Corp Bhd & Anor* [2012] 3 MLJ 869, therefore creating more controversies and casting doubts in the minds of potential Islamic finance customers. This ultimately defeats the *maqāṣid* underlying such transactions (Markom & Yaakub, 2012). Therefore, rather than basking in the euphoria of superfluous litigations, devising more effective and relationship building mechanisms for dispute resolution might be the way forward. One might not disregard the reasons why Islamic banks specifically might only prefer litigation (Yaacob, 2011). As identified in another study, the former Chief Justice of Malaysia, Tun Abdul Hamid identified four major reasons why the Islamic banks would prefer litigation over any other type of dispute resolution process:

First, most litigated cases involve payment defaults of which time is of essence. Most Islamic banks will not want to

explore arbitration before litigation since the former has not proved to be cheaper than the latter in the real sense of it. Second, most Islamic financing products involve a charged asset. An order for the sale of a charged asset in the event of a default can only be made by the High Court. Third, parties in arbitration are under the assumption that the arbitrators are learned in *Sharī'ah*, law and finance, so they might not want to pay the arbitrator to refer a *Sharī'ah* issue to the *Sharī'ah* advisory Council (SAC). And fourth, it is generally claimed civil court judges are not learned in *Sharī'ah* and Islamic finance issues, but it is also difficult to find arbitrators that are learned in Islamic finance and *Sharī'ah* and have practical experience in legal practice (Oseni, Adeyemi, & Mohd Zain, 2015, p. 4).

Even though arbitration from the strict Islamic legal perspective is preferable in Islamic finance disputes due to its binding nature and enforceability when properly designed to reflect the Islamic legal principles relating to *tahkīm* (Islamic law of arbitration) (Nadar, 2009), the conventional arbitration process seems to mirror a normal litigation process due to the skyrocketing costs involved and the procedural technicalities associated with it (Rashid, 2008). Furthermore, the dispute resolution processes in Islamic law are not limited to arbitration alone (Oseni & Kadouf, 2012). There are other relevant processes which are more relevant to financial and commercial transactions which could be structured for the normal banker-customer disputes (Oseni, 2012).

It thus appears that Islamic banks are faced with two key challenges: profit maximisation and *Sharī'ah* compliance. The banks seek to recover their debts through all available legal means by all costs while they also seek to ensure that their transactions and processes are *Sharī'ah*-compliant. At the end of the day, financial expediencies and the need to maximise profit often take precedence in most cases. An end-to-end *Sharī'ah* compliance requires that the dispute resolution process, which is at the tail end of the transaction continuum, to be *Sharī'ah* compliant. This is where the preservation of wealth and financial resources as one cardinal objective of Islamic law needs to be reiterated. Dispute avoidance and dispute resolution are key features of dispute management. As part of the framework for the preservation of wealth in Islamic law, a number of mechanisms have been introduced to confer on, protect, and secure the rights of individuals when it comes

to wealth and financial resources. Foremost among these mechanisms is the requirement for legal documentation in all debt-based transactions.

In Islamic law, there are numerous processes of dispute management scattered in many classical *fiqh* books. The processes may be summarised as: *naṣīḥah* (counselling), *ṣulḥ* (good faith negotiation, mediation/ conciliation, compromise of action), *mushāwarah* (consensus building though deliberation), *taḥkīm* (arbitration), Med-Arb (hybridised mediation and arbitration), *muḥtasib* (ombudsman), *maẓālim* (special tribunals for redress), *fatwā al-muḥtāḥ* (expert determination or non-binding evaluative assessment), and *qaḍā'* (court adjudication) (al-Dūrī, 2002; al-Jabali, 2006; al-Khassaf, 1978; Haidar, 1925; Rashid, 2004; Sambo & Kadouf, 2014). The processes of dispute management have been further reclassified into three main categories:

The three categories are: *Preventive measures* [*naṣīḥah* and *fatwā al-muḥtāḥ*], *facilitative processes* [*ṣulḥ*, Med-Arb, *muḥtasib*], and *binding processes* [*taḥkīm* *maẓālim*, and *qaḍā'*]. It is important to observe that the practical reality of a sustainable dispute resolution framework would often involve some form of hybridization of a number of processes as described below. In addition, some of the processes such as *muḥtasib* and *maẓālim* oscillate between facilitative and binding processes depending on the way they are structured and the purpose for which they are put in place (Oseni, 2012, p. 5).

It is therefore clear that amicable dispute resolution in Islamic law goes beyond mere theoretical abstraction. There are standard processes that have been utilised in the early days of Islam and are still in use in the modern era (Rashid, 2004; White, 2012). However, proper identification of the relevant processes in Islamic finance is essential to a successful paradigm of dispute management within the modern context.

Dispute management and the *maqāṣid* paradigm

The interrelationship between *Maqāṣid al-Sharī'ah* in Islamic jurisprudence cannot be over-emphasised in the process of independent legal reasoning (*ijtihād*) by Muslim jurists. Factoring these elements into the dispute management framework in Islamic financial services and products presents a different paradigm as opposed to prevailing practices of Islamic finance litigation. From the perspective of dispute

management, there is a need for a sustained relationship through consensus-building initiatives to promote Islamic finance. Therefore, the original philosophy of commercial transactions as enunciated in the Qur'ān, *'an tarāḍin minkum*, requires mutual satisfaction on both sides of the coin. That is, the parties in a particular transaction, such as the relationship in the banker-customer scenario, must endeavour to promote practices that will benefit both without necessarily introducing anything that will cause harm to the other. This overarching objective which the Qur'ānic concept of commercial transactions seeks to achieve requires the exploration of effective dispute management processes. Therefore, as part of the overall strategy to ensure an end-to-end *Sharī'ah* compliance of Islamic banking products and services, banks and regulators might need to introduce measures to modernise the Islamic dispute management mechanisms such as *ṣulḥ*, *tahkīm*, and *muhtasib* in order to fulfil the overarching objective of protection and preservation of wealth and financial resources as one of the core objectives of the *Sharī'ah* (Othman, 2007).

It is in the light of this that the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) issued a *Sharī'ah* Standard No. 32 on *Tahkīm* (Arbitration) on 12 September, 2007 (AAOIFI, 2008). This is meant to introduce effective dispute management in Islamic financial transactions where the process as well as the outcome will be *Sharī'ah*-compliant. Arbitration is well established in Islamic legal sources and there are many legal precedents of arbitration in Islamic history even though there are a number of juristic issues involving the legality of an arbitration clause and other related procedural matters beyond the scope of this study. Clause 1 of the AAOIFI Standard on Arbitration clearly stipulates the purpose of the standard and the relevance of arbitration to Islamic financial institutions. It provides that: "This standard discusses arbitration as practiced in financial transactions and other activities and relationships which take place among [financial] institutions, or between [financial] institutions and their clients or employees or other parties; whether inside or outside the host country of the institution" (AAOIFI, 2008, p. 555). This objective of arbitration is as broad as the provision of the 15 clauses contained in the Arbitration Standard. Though the standard is meant to be a general reference on the permissibility of the arbitration in Islamic financial transactions, there is a need to further develop relevant *Sharī'ah*-compliant procedural rules

on arbitration for disputes involving Islamic financial transactions. The Kuala Lumpur Regional Centre for Arbitration (KLRCA) has issued the KLRCA i-Arbitration Rules 2012 (revised in 2013) specifically meant for dispute arising from *Shari'ah*-compliant commercial transactions whether domestic or international.

Though the KLRCA i-Arbitration Rules is generally said to be *Shari'ah*-complaint and largely satisfies the need of the *hifz al-māl* concept, a closer look and in-depth study of the rules and the relevant fees involved lead to two important observations. First, Rule 12 (8) (b) of the rules empowers the arbitral tribunal to award “interest” (*ribā*) which goes against the very essence of commercial transactions in Islamic law (Lee & Oseni, 2015). Second, one of the major disadvantages of litigation which goes against the *hifz al-māl* concept in commercial transactions is the costs involved in resolving a dispute. It appears that such costs may be more in arbitration considering the relevant fees parties have to pay for both arbitrators’ fees and administrative fees. This is not unique to the KLRCA i-Arbitration Rules, as the fees contained in the rules are merely based on international standards. This is a general concern of stakeholders in international dispute settlement (Strong, 2014) and by extension, the Islamic financial services industry. Thus, Islamic banks are reluctant to use arbitration, as they do not consider it more cost-effective.

Therefore, the major stakeholders in the Islamic financial services industry, particularly the legal experts and *Shari'ah* scholars, might need to return to the drawing board to come up with effective and sustainable processes of dispute management in the industry. Emphasis should be placed on disputes arising from normal banker-customer relationships. Such a framework must be cost-effective, fast, consensus-building, and relationship-sustaining in the overall interest of the industry. It is an anomaly to utilise a foreign procedure such as the English-styled court procedures for disputes arising from banker-customer relationship in Islamic financial transactions even if there is a procedure for reference to the *Shari'ah* Advisory Council as practiced in Malaysia. The limitation of such a procedure is often felt when most contractual and other transactional matters, which are not necessarily considered as *Shari'ah* issues, are subject to the overriding laws applicable in the country. This is based on the nature and character of most legal systems which still give preference to their colonially inherited laws. Though there are a

series of reforms ongoing in most developing countries to ensure legal acculturation of their laws, their trust with destiny with the colonial baggage still has much influence on the existing laws. This has led to situations where Islamic finance transactions have been subjected to the overarching laws of the country as evidenced in Singapore, Indonesia, and the United Kingdom.

At the international level, one must acknowledge the efforts of the International Islamic Centre for Reconciliation and Arbitration (IICRA) in Dubai. Just like the KLRCA, it has its unique rules for arbitration in Islamic finance. The IICRA was established in 2005 by the joint efforts of the Government of United Arab Emirates, Islamic Development Bank and, the General Council of Islamic Banks and Financial Institutions. It effectually began its activities in January 2007. Though IICRA has not handled as many Islamic finance cases compared to the courts, it is on record that three of its awards have been recognised and enforced in Dubai, Abu Dhabi, and Sharjah courts respectively. For instance, its arbitral award in a case involving *ijārah muntahiyah bi al-tamlīk* (lease contract ending with ownership or financial lease) between an Islamic bank and an individual foundation based in Sharjah was recognised and enforced by a Sharjah Court in its judgment No. 953/2013 on 16th March 2014. The total value of the subject matter of the dispute was AED 5,620,224. The proceedings took 165 days and related fees did not exceed 1.90% of the value of the dispute. It is thus clear that the cost element as well as the time factor is considered in the resolution of dispute through arbitration in IICRA (IICRA, 2014). Nevertheless, this issue of cost of arbitration proceedings remains a major challenge that should be addressed by major stakeholders in the industry.

There are several mechanisms inherent in the principles of Islamic jurisprudence to prevent all kinds of harms, hardship, or risks associated with the normal financial transactions. Within the modern context and organisation of Islamic financial institutions, one may argue that as part of the general framework of dispute management and prevention of hardship on the part of the bank and customer, there are a number of measures that should be put in place. These measures include proper *Shari'ah* governance framework, a robust legal and regulatory framework, codification of prohibited business conduct, and effective dispute management mechanisms. These measures are geared towards fulfilling the original objective of protection, perseverance,

and development of wealth and financial resources for the benefit of the parties involved as well as those who are not directly involved but who might have derivative rights such as family relations, the needy, wayfarer, etc. This comprehensive communal social security is what the law seeks to promote in every commercial and financial transaction. Such efforts in eliminating all sorts of harms include risk management measures undertaken by the financial institutions since the institutions are corporate entities. The rights of the shareholders, and in some situations, the creditors of such financial institutions need to be adequately secured and protected in accordance with the *hiḏ al-māl* concept. Even though the principle of a separate legal entity applies, which considers the corporate entity distinct from the shareholders, an Islamic bank may need to introduce prudential measures for credit risk management to avoid unnecessary legal tussles in the courtroom. The shareholders have the right to maximise their returns on investment. Unnecessary litigation might ultimately deplete the profits made by the bank which in turn will adversely impact shareholders' equity.

Learning from recent reforms in Malaysia

In conceptualising the dynamics of dispute management in Islamic financial services and products within the framework of the modern financial systems, it is instructive to briefly examine a case study from one of the most progressive jurisdictions for Islamic financial services. Malaysia is gradually putting together the necessary building blocks to become a global hub for Islamic financial services and products. With a new comprehensive law that is second to none in terms of scope and details, the Islamic Financial Services Act 2013 (IFSA 2013), and other relevant guidelines and standards issued by the Central Bank of Malaysia has repositioned the Islamic financial services industry in Malaysia. The reforms introduced are worth exploring in order to derive meaningful lessons for other emerging jurisdictions. Any measure taken by a particular jurisdiction to introduce Islamic financial services must definitely take into consideration the dispute management framework. From the *maqāṣid* perspective, and in line with the central hypothesis of this study, an effective dispute management framework must be built into the entire process of the transaction in the delivery of Islamic financial services and products. Therefore, from the pre-contract up to the post-contract stage, there should be an in-house mechanism for dispute management. Though the dispute management processes for

each stage might be different, a sustainable transaction requires such an inbuilt mechanism.

The basis of the dispute management framework for Islamic financial services and products in Malaysia is found in Section 135 of IFSA 2013 which provides:

1. The Bank may specify standards on business conduct to a financial service provider for the purposes of ensuring that a financial service provider is fair, responsible and professional when dealing with financial consumers.
2. Without limiting the generality of subsection (1), standards specified under that subsection may include standards relating to— (e) complaints and dispute resolution mechanisms.

The provision empowers the Central Bank to specify standards relating to complaints and dispute resolution mechanisms. This is in line with the *ṣulḥ* concept in Islamic law which is the preferable way of resolving complaints and disputes. In line with the *ḥifẓ al-māl* concept, this helps in preserving huge wealth and investments of the bank, their creditors, shareholders, and the customers. This is eloquently captured in Othman's (2007) study:

This focus on the judge and adjudication has obscured another, perhaps even more important, method for resolving disputes in Islamic law. Jurists state that *ṣulḥ*, or amicable settlement, is the ethically and religiously superior way for disputants faced with conflict. What is rarely noted is the fact that *ṣulḥ* is a legal instrument intended not only for the purpose of private conciliation among individuals and groups in lieu of litigation; it is also the procedural option that could be resorted to by a *qāḍī* within the context of his courtroom, for judges can defer disputants to mediation before trying their case or at any stage of trial (Othman, 2007, p. 65).

This dispute management mechanism introduced in the new law in Malaysia is better defined in sections 133 and 138 of IFSA 2013. Section 138 introduces the Financial Ombudsman Scheme (FOS) and defines the new dispute management mechanism for Islamic financial services as “a scheme for the resolution of disputes between an eligible complainant and a financial service provider in respect of financial services or products.” While specific rules relating to FOS are provided

in section 138, the Concept Paper on Financial Ombudsman Scheme released by the Central Bank on 29 August 2014 details the operation of the FOS. It is from the Concept Paper one realises that FOS goes beyond just dispute resolution and provides a comprehensive process of dispute management in Islamic financial services and products which supports the *ḥifẓ al-māl* concept. This is reflected in the following underlying principles of FOS: independence, fairness and impartiality, accessibility, accountability, transparency, and effectiveness (Lee & Oseni, 2015).

Apart from the FOS process which has its jurisdictional limit and subject matter limitations, parties may explore other avenues such as the Small Debt Resolution Scheme (SDRC) also introduced by the Central Bank of Malaysia through the issuance of the Enhancement of the Policy and Guidelines of the Small Debt Resolution Scheme (SDRS) that came into effect on 9 July 2014. The SDRS is introduced to facilitate rescheduling or restructuring of financing facilities for viable small and medium enterprises (SMEs) that are facing difficulties. Thus, financial institutions are made to play the facilitating role in the rehabilitation of such SMEs (Promwichit, Mohamad, & Hassan, 2013). With reference to *Sharī'ah*-complaint SMEs, Islamic banks established under IFSA 2013 play the effective role in facilitating their rehabilitation in line with the concept of *maṣlahah* under the supervision of the Small Debt Resolution Committee (SDRC) established by the Central Bank.

Conclusion and policy recommendations

In fulfilling the original value proposition of Islamic financial intermediation, a proper framework for dispute management which is premised on the *Maqāṣid al-Sharī'ah* could help to shift financial resources away from litigation to focus on funding of research that will promote research and development through innovative financial solutions that are not only *Sharī'ah*-compliant but also conventionally viable and competitive. Such funds may also be channelled to noble social causes such as poverty alleviation. Though Islamic financial institutions are not necessarily charitable organisations, their basis remains the *Sharī'ah*. Therefore, in enforcing their rights and seeking recovery of overdue debts or payments from their customers, they should be conscious of the hardship associated with litigation and the consequential effect to the customers. The *Sharī'ah* encourages

mutual benefit in all transactions, hence, less rancorous procedures should be adopted in recovering overdue debts from customers to avoid unnecessary hardship. The legal maxim *dar' al-mafāsīd awlā min jalb al-maṣāliḥ* which prioritises the prevention of harm and hardship over any means of seeking benefit should be the guiding principle in dispute management in Islamic financial services and products (Kamali, 2006; Zakariyah, 2012). According to 'Izz al-Dīn ibn 'Abd al-Salām, the entire Islamic law serves this dual purpose of seeking benefits or interests and eliminating harm or hardship ('Abd al-Salām, 1999). Therefore, dispute management in Islamic financial services and products should be built into every contract through proper legal documentation (Ahmad, 2014; Lahsasna, 2014).

Finally, legal and policy reforms are required to introduce the *maqāṣīd* spirit into the dispute management framework in Islamic financial transactions. Considering the nature of the Islamic financial services industry and its potentials for further expansion into new markets, it is proper to consider the possibility of some macro-prudential policy reforms to cater for systemic risks associated with the nature of Islamic finance disputes as well as micro-prudential regulation at individual financial institution level. At the macro level, introducing relevant laws and policies that would compel Islamic financial institutions to manage claims, complaints, and disputes effectively will go a long way in promoting best practices in the industry. At the micro level, the financial institutions will be able to effectively manage risks associated with disputes such as legal and reputational risks. Having a good dispute management framework at the bank level is as good as having an effective marketing strategy. These reforms will ensure that unnecessary financial resources are not expended on protracted and expensive litigations which will in turn boost the profit of the financial institutions as well as shield the investment of the shareholders from avoidable risks in line with the *ḥifẓ al-māl* concept.

Acknowledgement

This study was carried out under the Fundamental Research Grant Scheme (FRGS) with the ID No.: FRGS13-003-0244 awarded by the Ministry of Education (MOE), Malaysia. The author acknowledges

MOE and the International Islamic University Malaysia for their immense financial supports.

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